

Interview with the Chairman & CEO



José María Álvarez-Pallete
Chairman & CEO

What is your assessment after your first year as Chairman & CEO of Telefónica?

I am proud to say that, in 2016, we managed to keep our promises: the Company's results consolidated a change in trends and Telefónica has now embarked on a cycle of sustainable growth.

In 2016, main financial metrics grew organically. Revenue increased by 1.3%, driven by customer growth, now at 350 million accesses, and a higher average revenue per access. This proves that we are relevant to our customers who place their trust in Telefónica every day thanks to our convincing value proposition. OIBDA also grew, up by 4.7% year-on-year in organic terms, and OIBDA margin increased to 31.5%, exceeding our profitability targets.

With regards to our main challenge, namely free cash-flow generation, we have been able to grow for the first time in 5 years, up by 24% year-on-year, to almost 4.4 billion euros. We achieved this in a context of record levels of investment, totalling almost 9 billion euros, which leverages our almost 13,000 suppliers.

Beyond the financial figures, we met our goals with a sustainable business model, generating a positive impact in all our markets. We are one of the main drivers for economic progress. In

2016, we increased our contribution to GDP up to 0.6% in the countries in which we are present, generating over a million jobs, while at the same time boosting the proportion of renewable energy consumption, already reaching close to 44%.

Our drive towards digitalisation has placed us in a leading position in the deployment of fixed ultra-broadband in Europe and Latin America. Likewise, LTE technology was extended across all geographies. We are building one of the most powerful and advanced digital infrastructures in the world so that our customers can enjoy a differential experience.

In parallel, and always with customers at the heart of everything we do, we have accelerated end-to-end digitalisation. The digitalisation process goes far beyond creating an application, a solid distribution channel and an online customer service or digital billing. The true challenge lies in simplifying the complexity of the analogue world and digitalising processes so that all the information can be obtained in real time and we can apply Cognitive Systems. This enables us to better understand what our customers want.

We have also successfully completed financial initiatives, such as the recent partial sale of

Telxius and our outstanding financing activities in the markets. And we have taken difficult decisions, such as reviewing the shareholder remuneration policy to set a cash dividend of 0.40 euros per share for 2017. This allows for an attractive remuneration for our over 1.3 million shareholders and offers a dividend yield consistent with the market and represents a sustainable pay-out.

All this, together with organic deleveraging, enabled us to strengthen the Company's financial position. I am satisfied as we now depend on ourselves rather than on external factors to achieve our targets.

The enormous effort and strong commitment shown by the whole Telefónica team has received significant external recognition from indices such as the Dow Jones Sustainability Index (takes into account companies' economic, social and environmental progress), or the Carbon Disclosure Project (assesses how companies are handling climate change), as well as from Fortune magazine (selected Telefónica as the most admired telecommunications operator in Europe).

At the same time, the benefits of the profound transformation initiated a few years ago and the achievements in 2016 have contributed to the revaluation of Telefónica's shares by 16%



over the last twelve months to the end of April, far above the European Telco index (7.2%), and positioned us among the top 10 companies in the sector worldwide by market capitalization.

Overall, thanks to the commitment, talent and enthusiasm of the 127,000 professionals at Telefónica, 2016 has been a very positive year for the Company. For me, it is a source of pride and a great responsibility to be working with all of them every day.

What targets have been set for 2017 and the years ahead?

Our priorities have not changed. Our main goal is to continue to build the company we all want for the future: a business that enjoys sound short-term results while being able to turn the long-term challenges into huge opportunities.

Our ability to anticipate milestones has written our history. We have never been afraid of change, and now we are facing a context of constant profound change. Globalization, demographic shifts, the scarcity of resources, the stock market crisis and technological disruption are changing everything.

And digitalisation lies at the centre of this revolution in which we aim to be a key player. We don't have all the answers. But we do have the commitment and skills to drive progress and society forward.

Digitalisation is having a positive impact and will have very beneficial consequences in terms of growth. We want to keep on leading the development of the new digital society in those countries where we are present, through a customer-centred team with solid foundations based on integrity, transparency and commitment.

At Telefónica, we are convinced that life is digital. Technology is emerging as the driver for democratization in all areas of society, as it enables individuals to face social and environmental challenges, and helps improve people's quality of life.

That's why we have chosen to create, protect and encourage connections in life, so that everybody can access a world of infinite possibilities through technology.

We have started 2017 with confidence. This is going to be a year of sustainable growth based on the solid foundations we have consolidated. Our strategic priorities are very clear. To reach them, we need to advance with our own technological and cultural transformation by leveraging our geographic diversification.

We already have the best team to achieve this and we are going to strengthen it with even more diversity, digital profiles and new ways of working; we will improve both our Customer Promise and aspects such as privacy

and security, as well as helping users make a positive, responsible use of technology.

We aim to grow in all the main profit and loss statement metrics and in cash generation, increasing our margins. We will continue moving forward on our transformation path towards a platform company by driving end-to-end digitalisation and Cognitive Intelligence with investments focusing on fixed Ultra-Broadband and 4G connectivity.

Our ambition is to increase the universality, availability and energy efficiency of our network, progressing towards our 2030 commitment of 100% of energy consumed coming from renewable sources. And we will continue to simplify our procurement process in order to become more agile and build more sustainable relationships with our suppliers.

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We will manage our portfolio based on strategic criteria, adopting a transversal asset view to accelerate organic deleveraging and strengthen our balance sheet. At the same time, we will be offering attractive shareholder remuneration.

How is Telefónica positioned vis-à-vis the global challenges?

The dimension of what we are experiencing nowadays is unparalleled. We are an extremely fortunate generation of human beings, because no other generation in the history of humankind has lived-through such a wave of technological disruption as the one we are experiencing.

All these changes have led us to strengthen our commitment to sustainability as the main lever for social development. Technology opens the door to improvements in prosperity and wellbeing but, at the same time, it creates uncertainties and risks that need to be faced.

Reaching our goals is as important as how we achieve them. We are convinced that a responsible business model capable of generating trust among our customers, investors, employees, shareholders and throughout society, is the future.

We face the future with optimism and with well-defined principles that must guide us when taking decisions. We must ask ourselves



where we want to take society or how we want to share wealth in this new economy. To do so, we need values to build a better, fairer society that does not leave anyone behind in terms of participating in the new Digital Society, and to allow for a more balanced distribution of wealth.

In today's hyper-connected world, not everything is acceptable. We are responsible for shaping a society that will enable us, and the generations to follow, to live with freedom and privacy.

In this sense, our strategy as a responsible company includes major global challenges with a long-term perspective. I have already mentioned some examples of what we are already doing, such as network management systems for energy efficiency and reducing CO2 emissions driven by greater use of renewable sources to slow down climate change. Or how, in response to customer uncertainty about data privacy, we at Telefónica are not only transparent about what we do with our customers' data but also strive to help them preserve their digital empowerment.

Another challenge is the transformation of the labour environment as a result of the impact of the new technological paradigm. At Telefónica, we are seeking to transform our

way of working to maximise the talent of a team that has to be increasingly diverse.

I would like to highlight the essential role of connectivity in meeting the United Nations' Sustainable Development Goals. Our core business has a very positive impact on the industry, innovation and infrastructures goal. Although our strategy as a responsible company and our projects aimed at driving sustainability enable us to contribute to the rest of the goals, with a more direct influence on those related to economic growth. In fact, several years ago now, we signed the UN Global Compact.

We feel especially proud of the various initiatives we are encouraging in the realm of education and, in particular, about the ProFuturo Foundation launched by the Telefónica Foundation and 'La Caixa' Banking Foundation. The mission of ProFuturo is to reduce the educational divide by providing high-quality digital education to children in vulnerable settings in Sub-Saharan Africa, Latin America and South-East Asia. It is a very ambitious goal: we want to transform the education of 10 million boys and girls by 2020, through technologies, educational contents and teaching methodologies for both teachers and students.

Thinking about technological advances, which one do you think will have the greatest impact on Telefónica and its customers?

Technology is key to be closer to our customers through the new service experience we want to create for them.

5G will radically transform connectivity. We are talking about a 1,000 times greater mobile data transport capacity, speeds that will multiply by 10 to 100 times, a significant reduction in latency, more powerful devices with more efficient batteries, ... All this will make the explosion of the Internet of Things possible, with self-driving cars, remote surgical operations in real time, distance digital education or holographic communication, to mention just a few examples. It is already possible to glimpse the boom in Virtual Reality and Augmented Reality, and there is a new and more powerful technological wave advancing in the form of Cognitive Intelligence.

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This technological disruption facilitates a new world of information and knowledge; it enables us to be increasingly connected. We are talking here of unstoppable exponential growth.

The potential provided by the information generated in all these connected devices is enormous. By applying an intelligent use to all these data through Artificial Intelligence and Cognitive Systems, we will be capable of solving problems in health-care, education, energy and transport, with a positive impact on the lives of individuals and on society as a whole.

In a company like Telefónica, technology has always been and will always remain at the core. In addition, nowadays, when there is more technology available than ever before, we are working to place innovation and digital disruption at the service of our customers in an efficient and sustainable manner.

We are doing so by building a platform-based Telefónica. We have invested 48 billion euros since 2012, mostly to strengthen the first platform (our physical assets), followed by the second platform (our systems), and the third platform (products and services).

Furthermore, we have prepared the Company to continue pioneering in the field of Cognitive Intelligence, driving our fourth platform



(cognitive power) to be able to establish a new relationship with our customers, interacting with them in a simpler, more natural way.

We aspire to broaden the relationship with our customers aiming at increasing their satisfaction and providing new opportunities to enrich their digital life with us under the principles of transparency, security and control over their data. Our priority is to foster the trust of our customers every day.

I am convinced that the impact of the Cognitive Intelligence, embedded in our fourth platform, will be comparable in the near future to the impact of mobile telephony or broadband.

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What is the role of Telefónica on this road to innovation?

Innovation is part of Telefónica's DNA. The continuous transformation of Telefónica, over its almost 100 years of history, is pure innovation and reflects a mindset of anticipation and vision of any entrepreneur.

We are committed to technological innovation as a fundamental tool to help create a more sustainable world, while achieving a competitive advantage and differentiating products.

On the one hand, our strategy promotes our internal capabilities for R&D+I. Our in-house innovation model that enables us to stay at the forefront of the sector. In 2016, we invested almost 6.6 billion euros in R&D+I, positioning us as the fourth Telco in the world for R&D. We have 9 innovation centres and a portfolio of 577 patents.

On the other hand, the traditional sources of innovation are not enough and we are fostering open ecosystems through Open Future, an integrated programme that accompanies entrepreneurs through every stage of their growth cycle. Telefónica Open Future has already accelerated over 1,500 businesses and invested in over 700 start-ups.

Regarding Corporate Governance, what measures have been taken to enhance best practices?

Advancing in compliance with the recommendations and best practices of Good Corporate Governance is one of my top priorities and in the last two years the Company has made solid progress in this direction.

At the next General Shareholders' Meeting the following will be submitted for approval: the ratification and appointment of two new independent directors, Carmen García de Andrés and Francisco José Riberas Mera and the reduction of the number of members on the Board of Directors to seventeen, in accordance with the recommendations on Good Governance and international trends.

These new additions, together with the four in 2016, further strengthen the Company's highest management body, increasing its independence and diversity. Independent directors thus represent 53% of the total, and the proportion of female directors increases to 18%.

In parallel, the incorporation of Carmen García de Andrés as a member of the Audit and Control Committee and of José Javier Echenique and Luiz Fernando Furlán to the Appointments, Remuneration and Good Governance Committee, all of them



independent directors, strengthens our compliance with the Good Governance recommendations regarding the composition of the Board's Committees.

We are very fortunate to have a deeply committed Board that protects the future and the sustainability of the Company, a Board that works to ensure that Telefónica will continue to be more relevant than ever in society over the decades ahead with a responsible business model.

I would like to take this opportunity to thank César Alierta, Pablo Isla and Gonzalo Hinojosa for their dedication, commitment and great contribution during their many years of work on Telefónica's Board.