



Capital Structure Strategy and New IFRS for 2018

Telefónica Group
23 March 2018



Finance and Accounting session

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Key Objectives

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Key Objectives

Capital Structure Strategy

Guarantee Solvency and Liquidity

Interest rates and FX volatility management

Cost optimization across capital structure

New IFRS for 2018

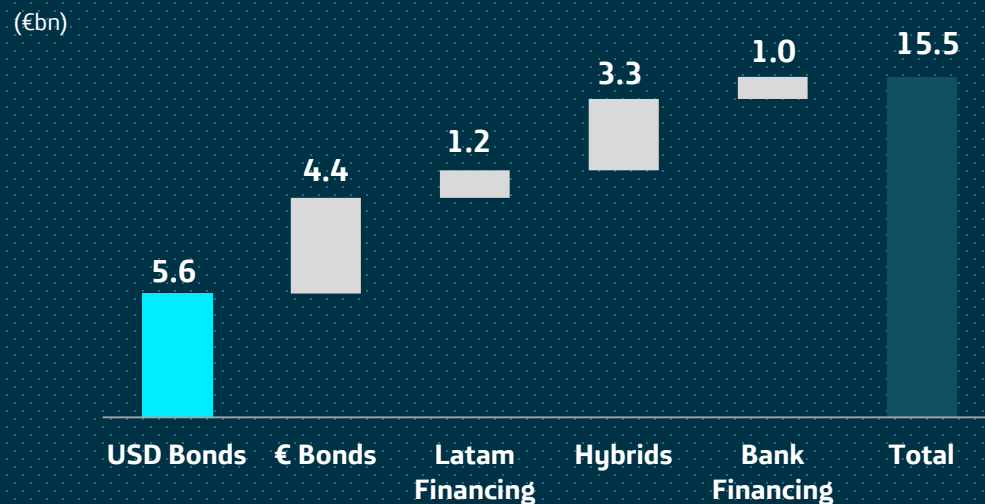
Implications and main changes of new accounting standards

Capital Structure Strategy

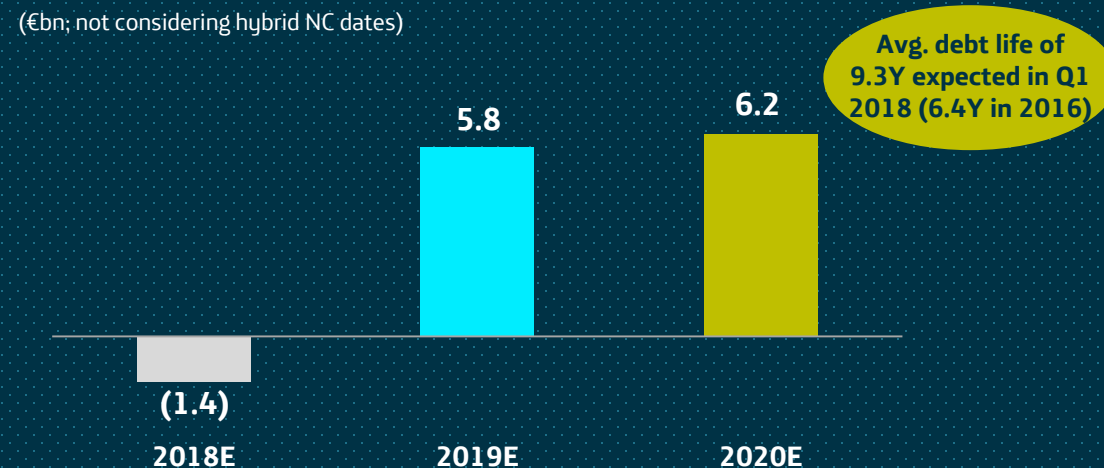
Jesús Romero
Deputy Chief Financial Officer

Long term financing strengthened our balance sheet in 2017 and YTD

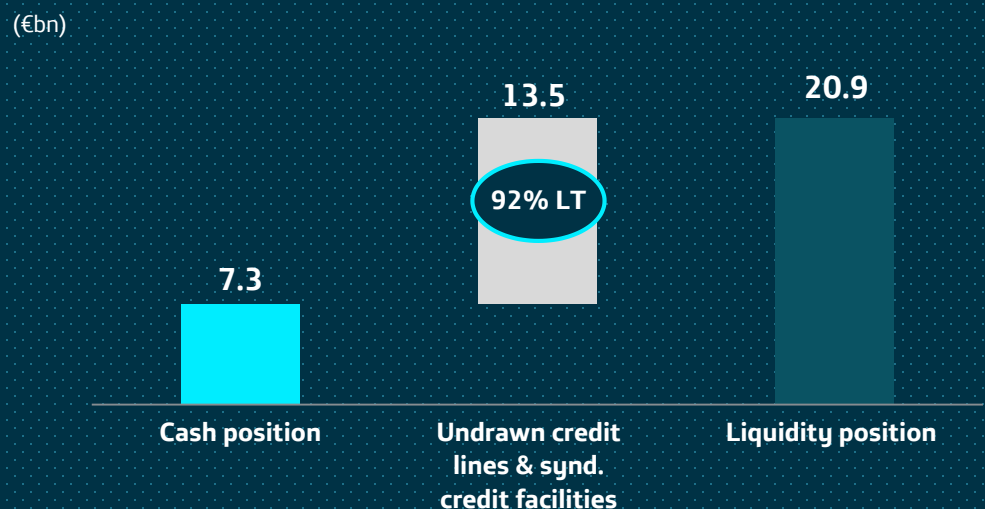
Sources of long-term financing (FY 17 & 2018 YTD)



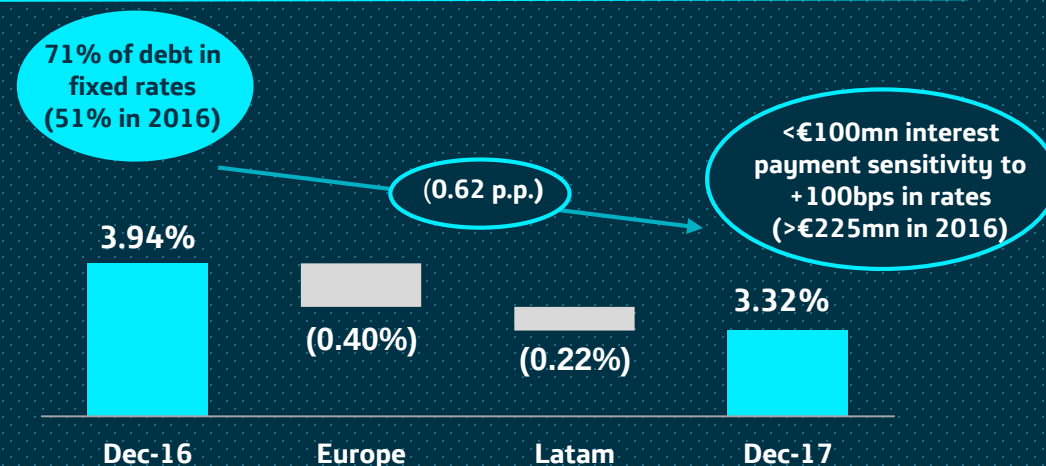
Net Debt maturities (March 2018 PF with 2018 YTD issues)



Liquidity position (Dec-17)



Interest payments cost (Dec-17)



Key Finance objectives – guarantee solvency and liquidity

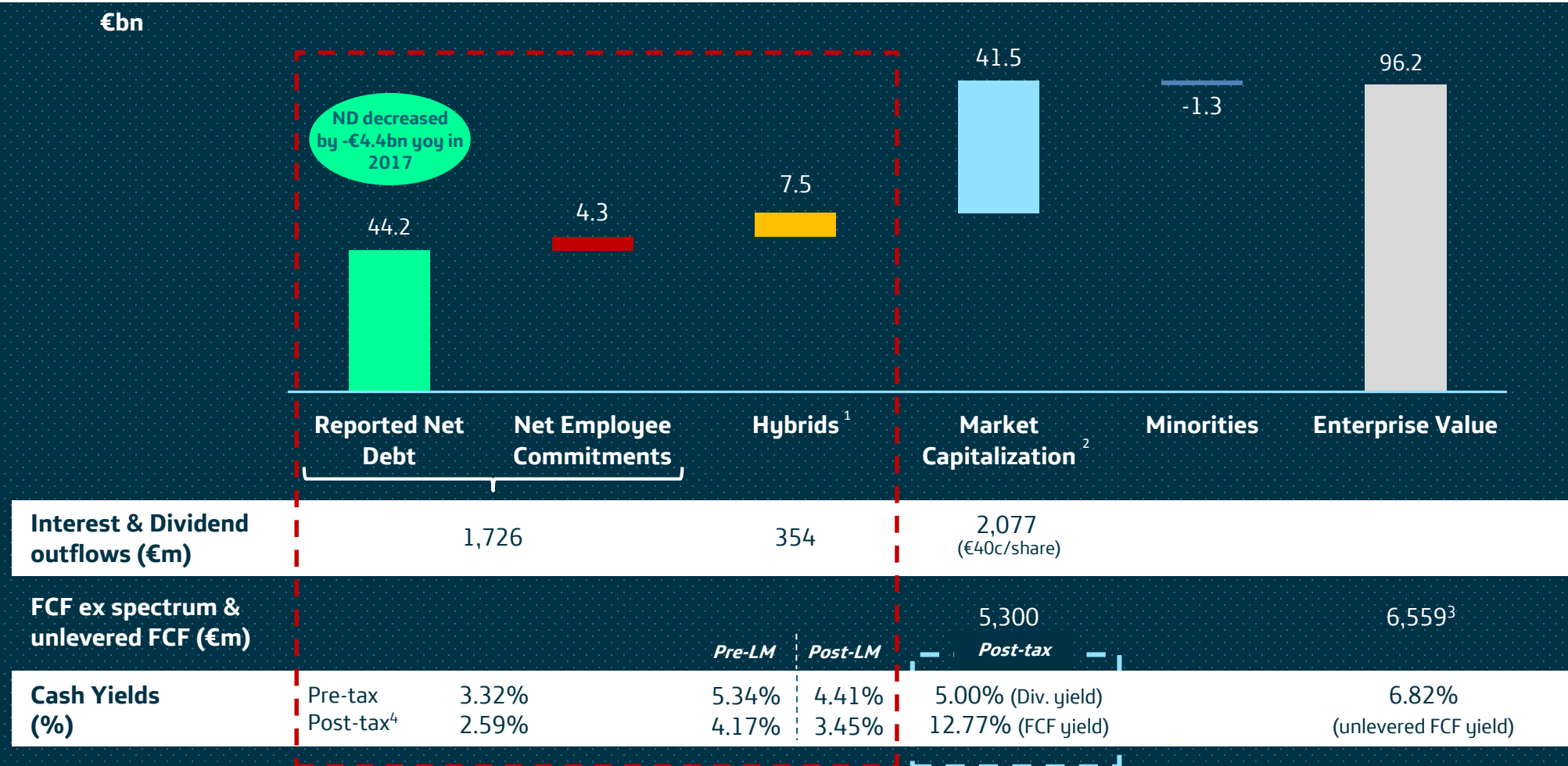
1. Fully committed to a solid investment grade credit rating (BBB/Baa2)

2. Current liquidity covers debt maturities in excess of two years

3. Manage and hedge main risks – focus on interest rates and FX

Meet key objectives while optimizing costs across our capital structure

Capital structure breakdown and pricing of debt vs. equity



In six quarters, TEF refinanced €19bn at historically low rates and long tenors, equivalent to 34% of total debt plus hybrids and 20% of enterprise value

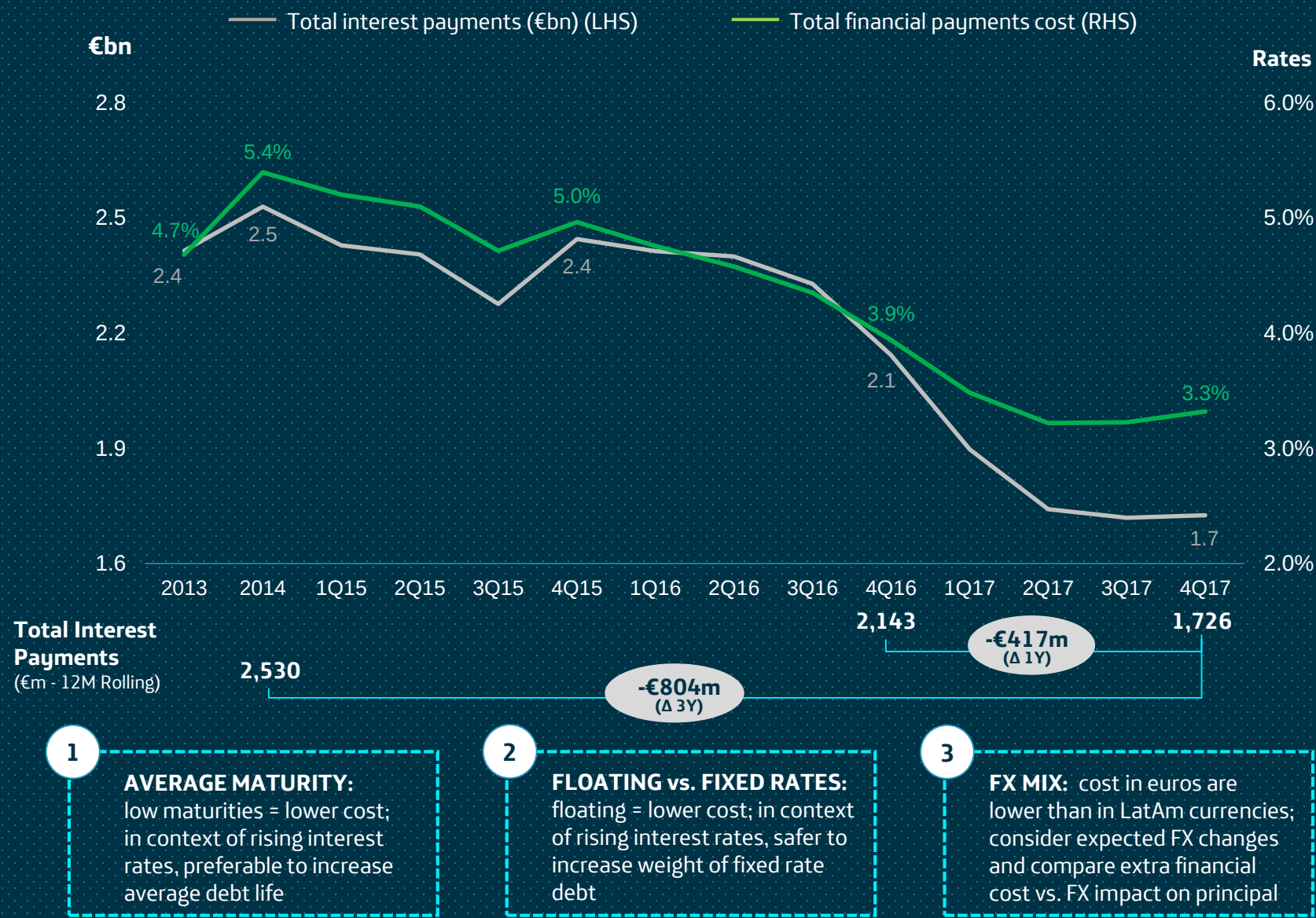
1. Hybrids valued at issuance date

2. Data as of 20/03/2018. Source: Bloomberg

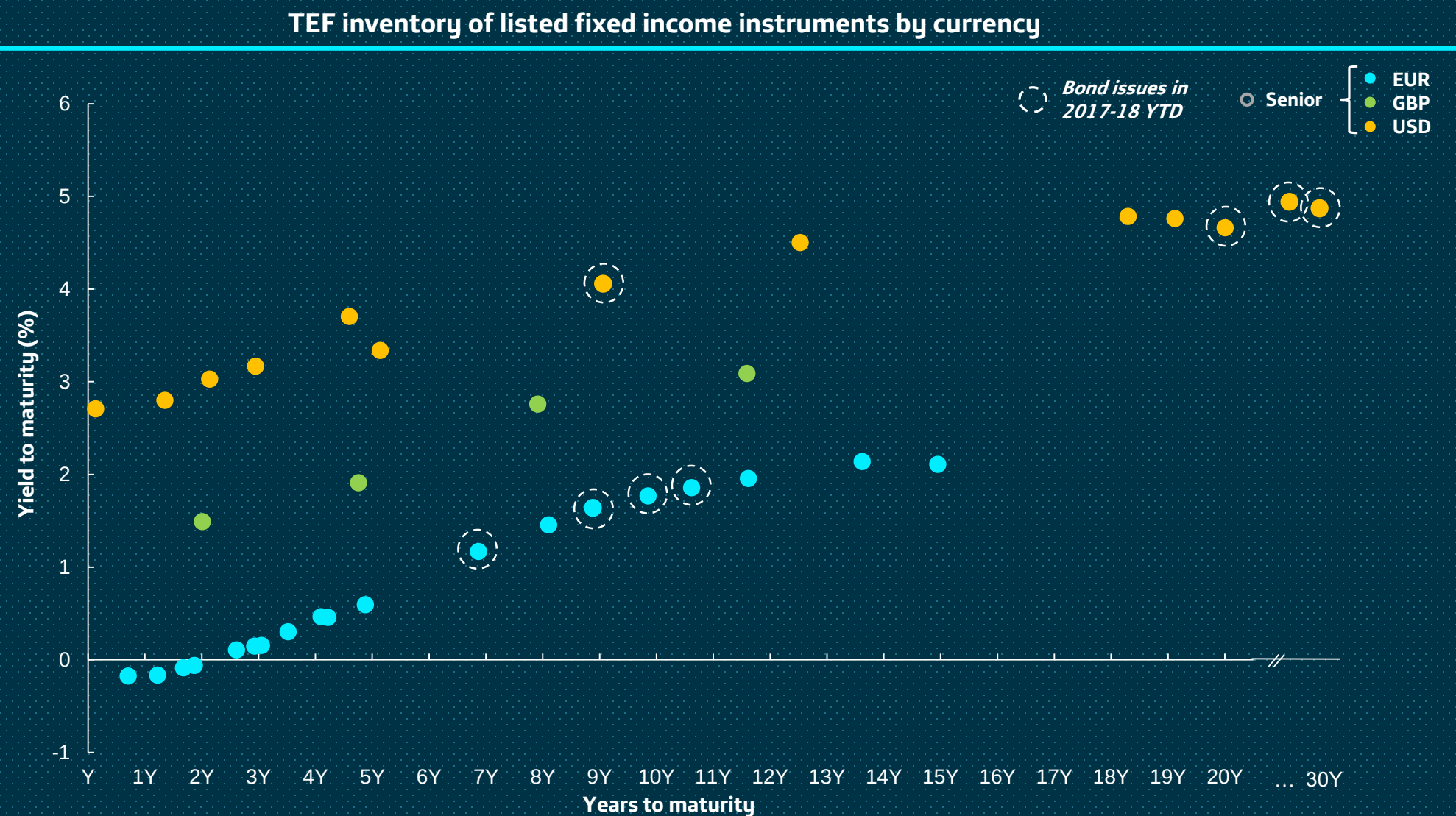
3. FCF ex spectrum plus financial payments net of taxes and adjusted for minorities

4. Assuming TEF's effective cash tax rate of 21.9%

Historical trend in financial payments and key trade-offs in costs



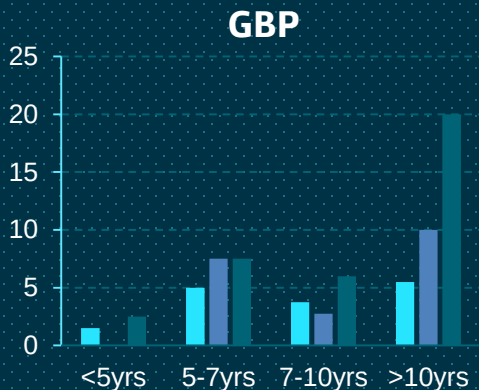
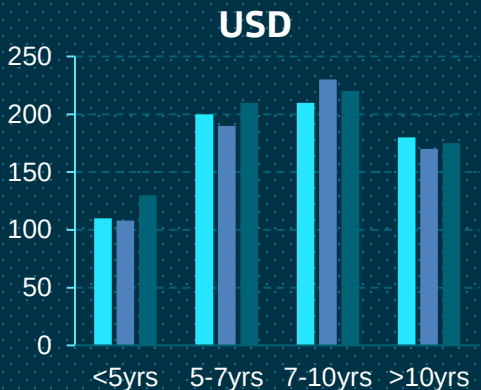
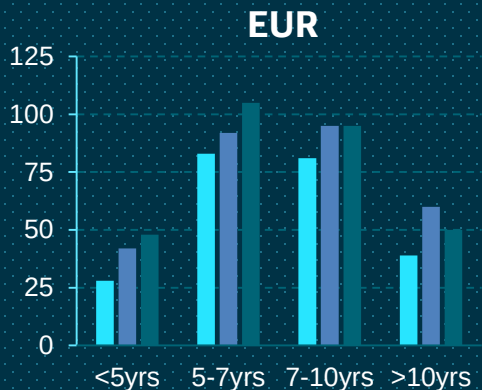
Current market value of senior bonds - €39bn vs. notional €37bn



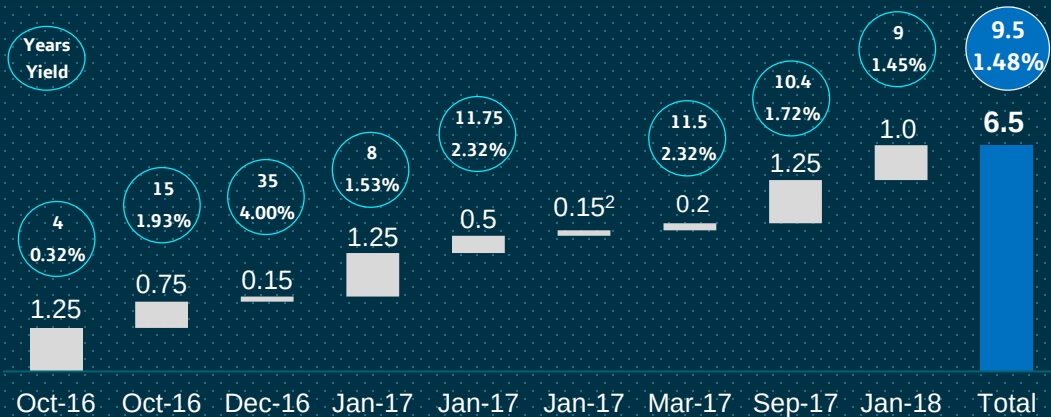
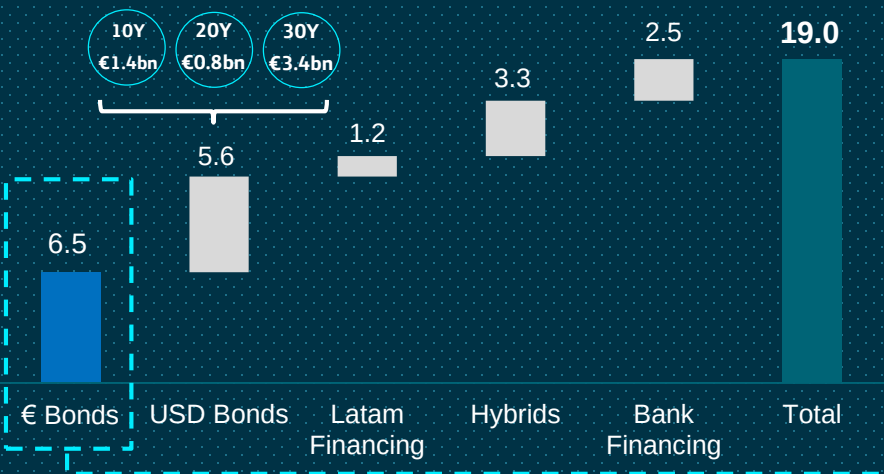
Credit market depth is critical, specially in long tenors

Total Corporate IG issuance¹ in 2017 – 300bn in EUR, 728bn in USD and 36bn in GBP

Maturity breakdown

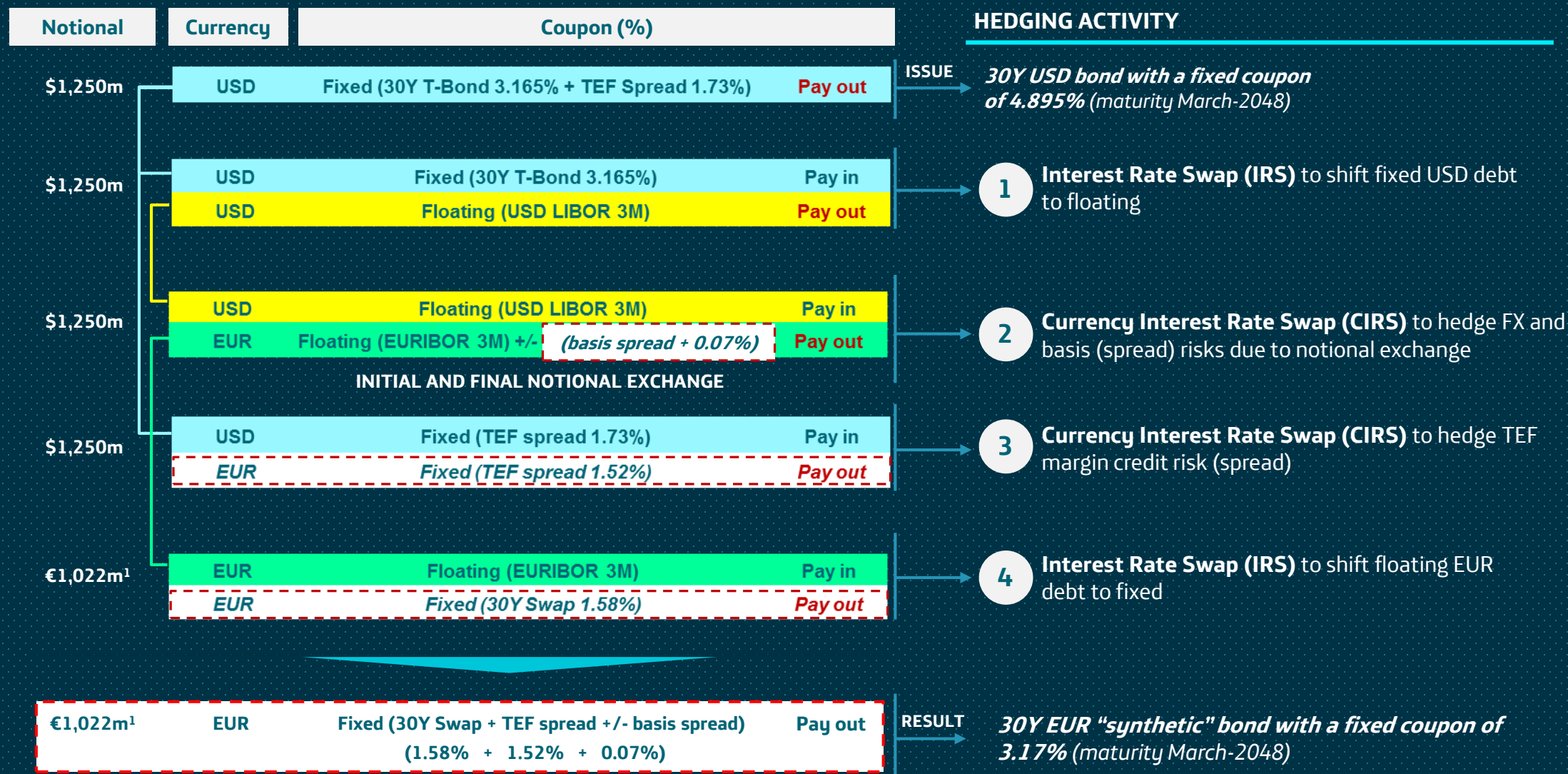


TEF: clear focus of long-term financing in last six quarters (between October 16 to March 18 in €bn)



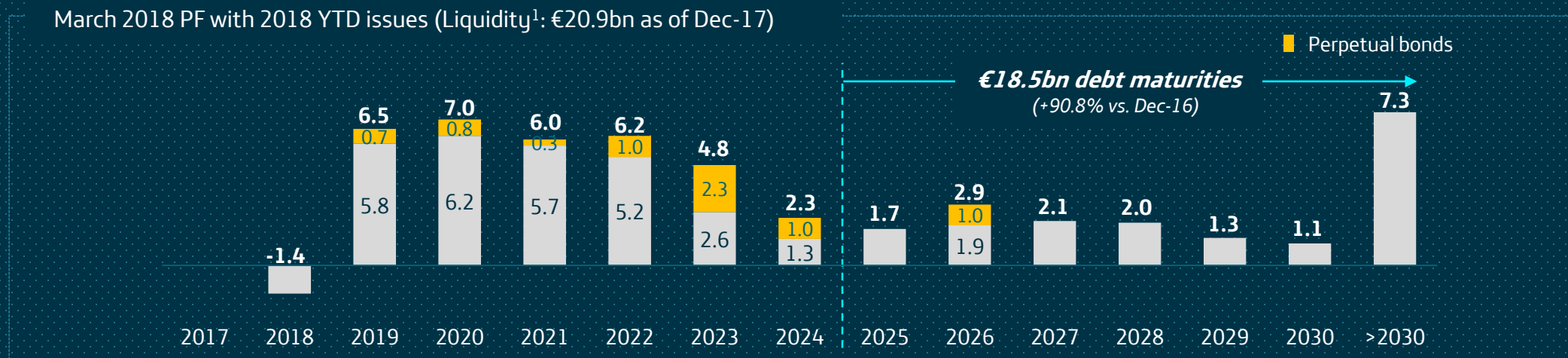
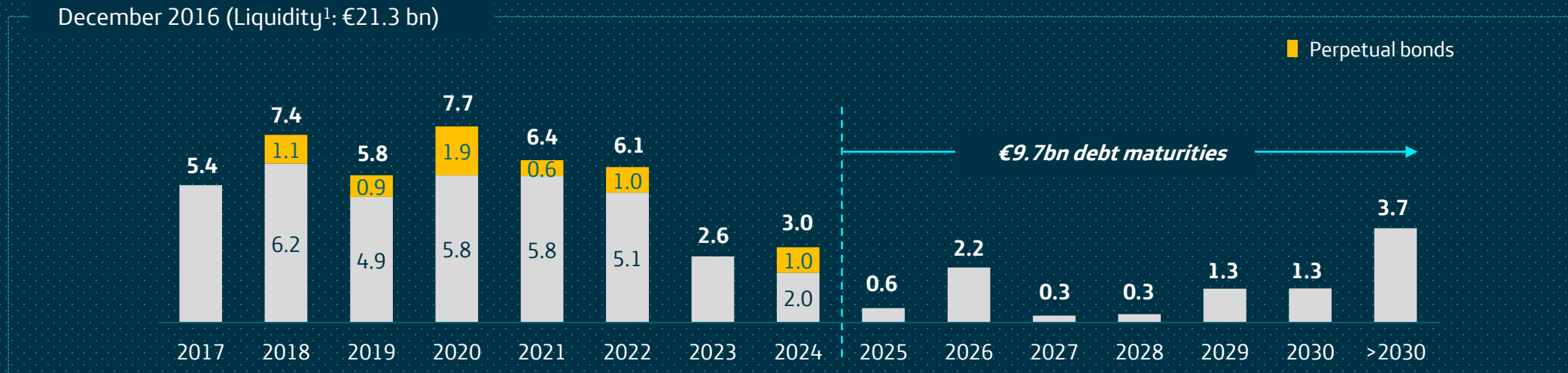
Derivatives – turn a 30Y USD coupon of 4.895% into 3.17% in €

Same steps used to turn 20Y USD bond with a fixed coupon of 4.665% into a 20Y EUR "synthetic" bond with a fixed coupon of 2.87%



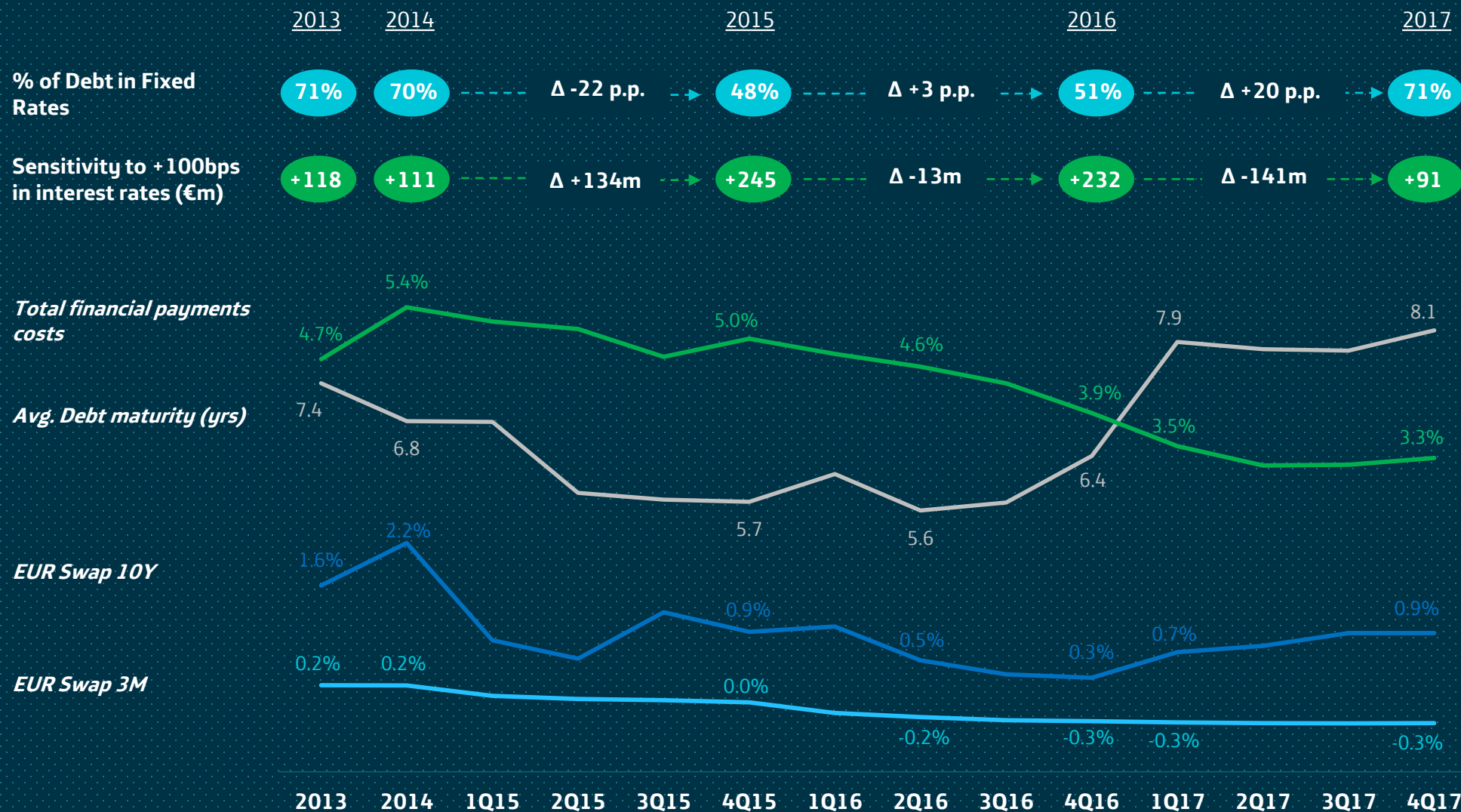
Trade offs (1) – increased average debt life (6.4Y to 9.3Y in 5Qs)

Avg. Debt maturity was 6.4Y (Dec-16) vs. current 9.3Y (Mar-18 PF with 2018 YTD issues) - €bn



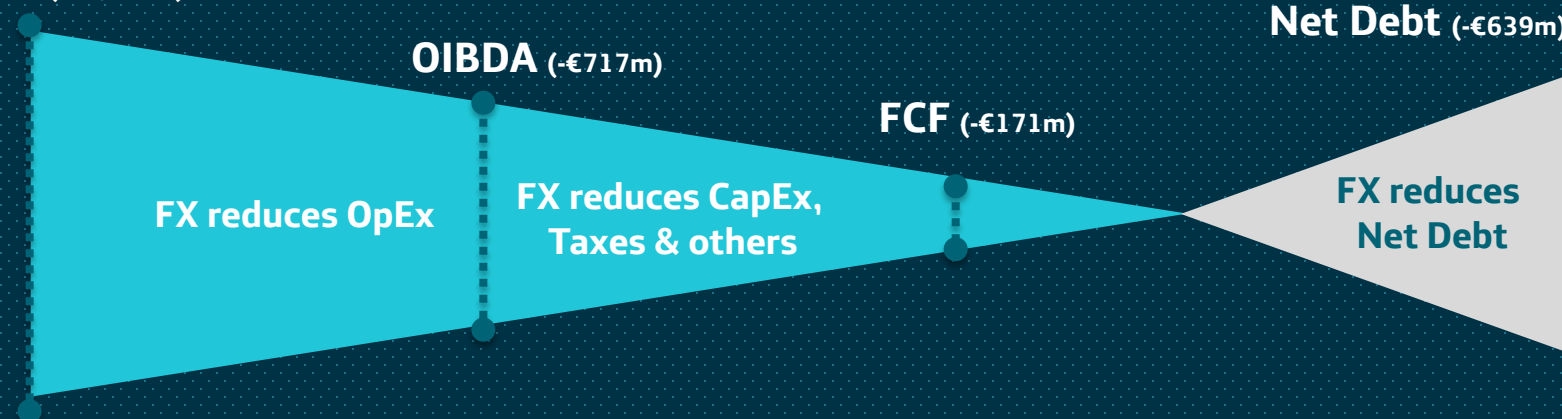
1. Includes Cash position and undrawn credit lines & syndicated credit facilities

Trade offs (2) – increased fixed vs. floating rate debt

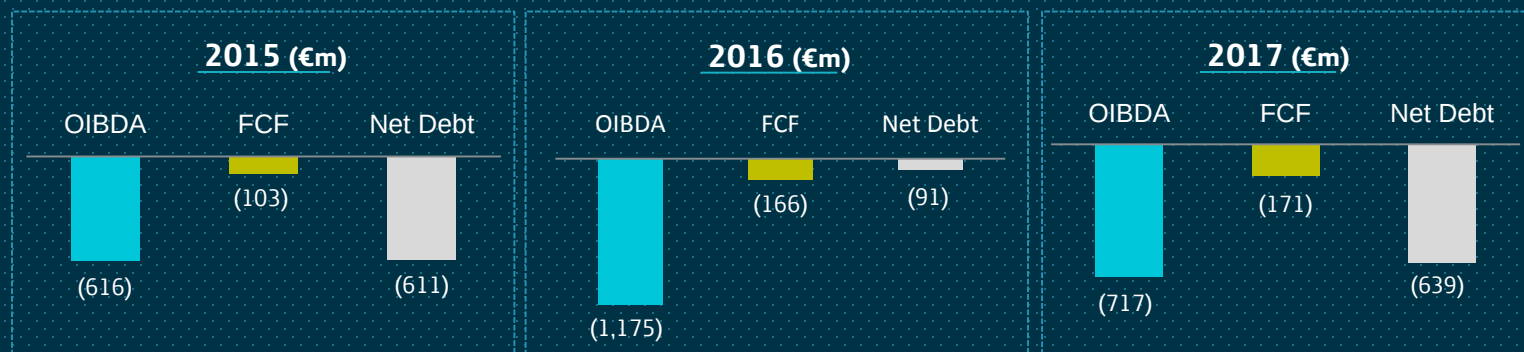


Trade offs (3) – FX hedging strategy produced positive results

Revenues (-€1,653m)

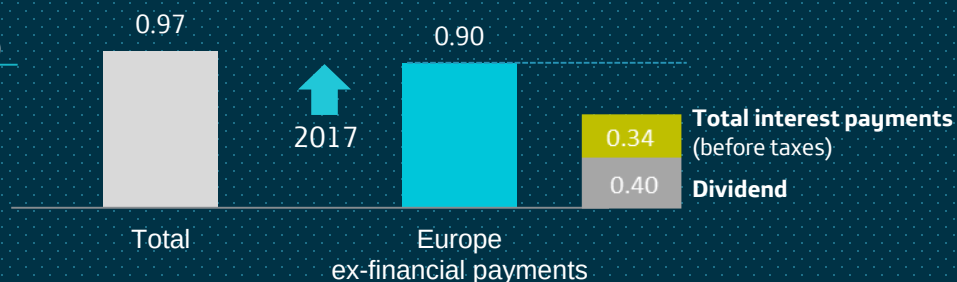


FX impact in FCF is mitigated, "natural hedge"



Debt structure more than offsets FCF impact

FCFS 2017 (€)



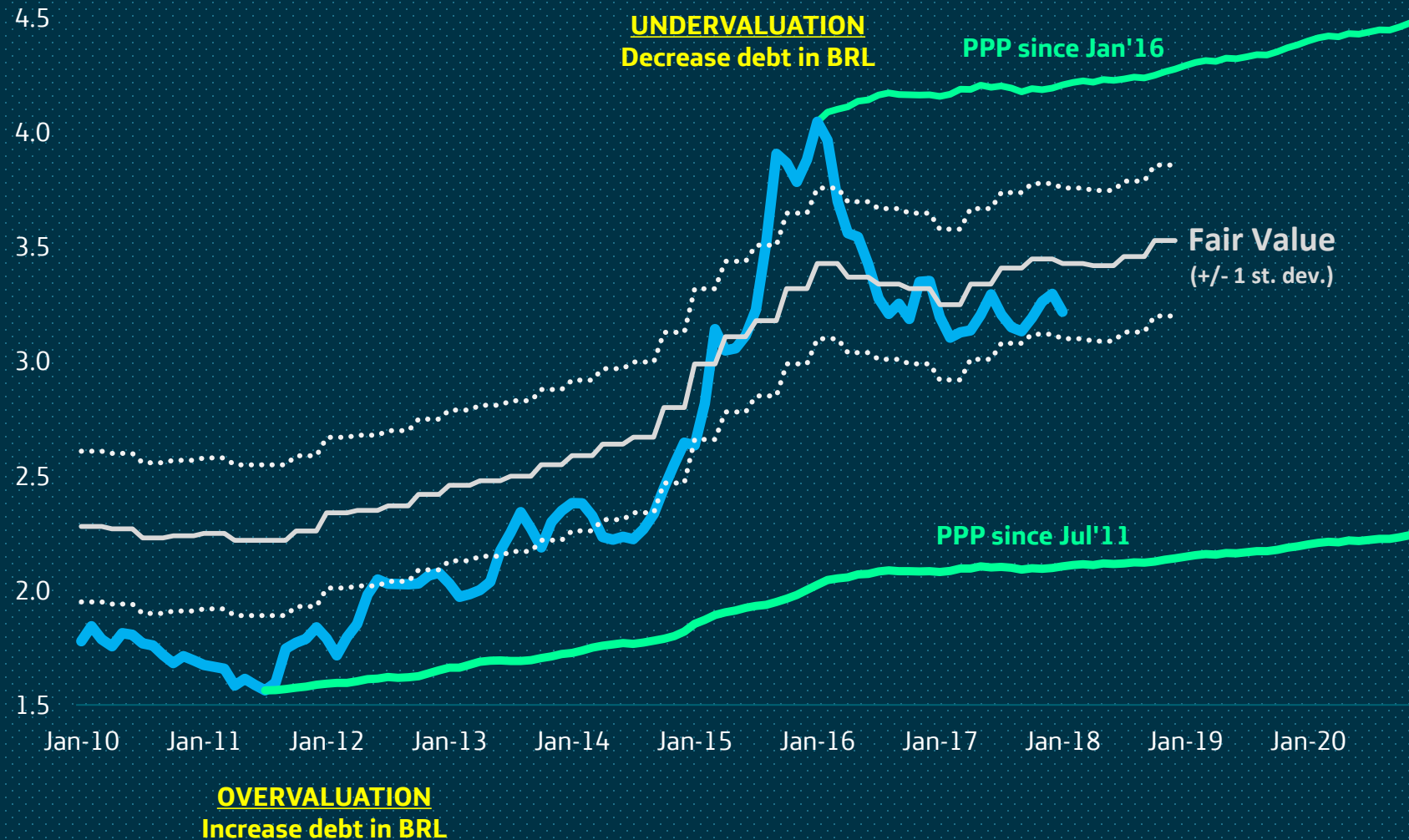
European FCF significantly...

...exceeds dividends and interest payments...

...LatAm is all upside

Levels of FX debt constantly monitored relative to FX fair value views

Illustrative case study: BRL/USD spot rates relative to equilibrium levels



FX hedging in 2016 – decision making based on economic profit analysis



Executed 1st large EU hybrid liability management; annual savings >€60m

Hybrids Pre-LM

1 st Call Date (currency)	NOTIONAL (€m)	Years to Call	COUPON (%)
Sep-18 (EUR)	1,125	0.49	6.50%
Dec-19 (EUR)	850	1.70	4.20%
Mar-20 (EUR)	750	2.02	5.00%
Nov-20 (GBP) ¹	685	2.68	6.75%
Sep-21 (EUR)	625	3.49	7.625%
Mar-22 (EUR)	1,000	3.98	3.75%
Jun-23 (EUR)	1,000	5.21	2.625%
Mar-24 (EUR)	1,000	6.03	5.875%
TOTAL TEF Holding	7,035	3.23	5.16%
Mar-20 ² (USD)	417	1.94	8.5%
TOTAL TEF Group	7,452	3.16	5.34%

Hybrids Post-LM

1 st Call Date (currency)	NOTIONAL (€m)	Years to Call	COUPON (%)
Sep-18 ³ (EUR)	0	0.49	0
Dec-19 (EUR)	705	1.70	4.20%
Mar-20 (EUR)	592	2.02	5.00%
Nov-20 (GBP) ¹	196	2.68	6.75%
Sep-21 (EUR)	293	3.49	7.625%
Mar-22 (EUR)	1,000	3.98	3.75%
Sep-23 (EUR)	2,250	5.21	2.833%
Mar-24 (EUR)	1,000	6.03	5.875%
Sep-26 (EUR)	1,000	8.51	3.88%
TOTAL TEF Holding	7,035	4.86	4.17%
Mar-20 ² (USD)	417	1.94	8.5%
TOTAL TEF Group	7,452	4.70	4.41%

1. FX: 0.88 GBP/EUR

2. COLTEL Hybrid (FX: 1.20 USD/EUR)

3. €473m outstanding; assumes exercise at first call date (Sept 18)

Implied costs of equity component of recently issued hybrid bonds

A Hybrid Dec-17 (5.5Y)

	NOTIONAL	COUPON (%)	COST (€m)
Hybrid	1,000	2.625%	26.3
EUR senior	500	0.40%	2.0
Equity	500	4.85%	24.3
Implied cost of Equity (post tax ¹)		3.79%	

B Hybrid Mar-18 (5.7Y)

	NOTIONAL	COUPON (%)	COST (€m)
Hybrid	1,250	3.0%	37.5
EUR senior	625	0.95%	5.9
Equity	625	5.05%	31.6
Implied cost of Equity (post tax ¹)		3.95%	

C Hybrid Mar-18 (8.5Y)

	NOTIONAL	COUPON (%)	COST (€m)
Hybrid	1,000	3.875%	38.8
EUR senior	500	1.64%	8.2
Equity	500	6.11%	30.6
Implied cost of Equity (post tax ¹)		4.77%	

Consider hybrids as attractive long term components of our capital structure

Main takeaways

Objectives – guarantee solvency and liquidity; solid investment grade credit rating (BBB/Baa2)

Hedge interest rate and FX risks while optimizing capital structure costs

In 2017 we strengthened our balance sheet ahead of potentially higher interest rates

Refinanced €19bn since Oct 2016, equivalent to 34% of total debt and 20% of enterprise value

Q1 2018: issued €3bn in senior bonds, executed €2.25bn hybrid LM and refinanced €5.5bn RCF

Stronger balance sheet and solid track record of risk management

New IFRS for 2018

Marta Soto

Head of Accounting Policies

Overview

IFRS 15: The new revenue standard

Major changes and implications of the new standard

Replacing various different standards on revenue recognition. IFRS 15 delivers a unified accounting model across industries ensuring...



Higher comparability
Higher consistency



IMPACTS (*):
Opening pre-tax equity 2018:
€+1.0 Bn

Estimated P&L impact based on FY17:

- Revenue: €-60 Mill
- OIBDA: €-80 Mill

(*) Unaudited figures

EFFECTIVE DATE...

- ... January 1st 2018
- ... Partial Retrospective approach adopted by Telefónica

CORE OF THE STANDARD...

... Revenue recognition is **based on the contract with the customer** and is not necessarily aligned with billing

CHANGES IN REVENUE RECOGNITION...

- ... New revenue mix
- ... Variations in timing of revenue recognition

AND IN SOME COST RECOGNITION...

... Certain costs of customer acquisition have to be capitalized



IFRS 9: Financial Instruments

Main changes

Classification & Measurement

- Financial Assets Classification based on:
 - Business model
 - Contractual Cash Flow Characteristics
- Financial Assets Measurement:
 - Fair Value through profit and loss (FVtPL)
 - Fair Value through other comprehensive income (FVtOCI)
 - Amortised Cost (AC)

Impairment

- We move from an incurred loss model to a new impairment model based on **EXPECTED CREDIT LOSSES**
- Objective: To reflect the pattern of deterioration or its improvement

Opening pre-tax equity impact 2018: €-200 Mill

No relevant impact expected in P&L FY18

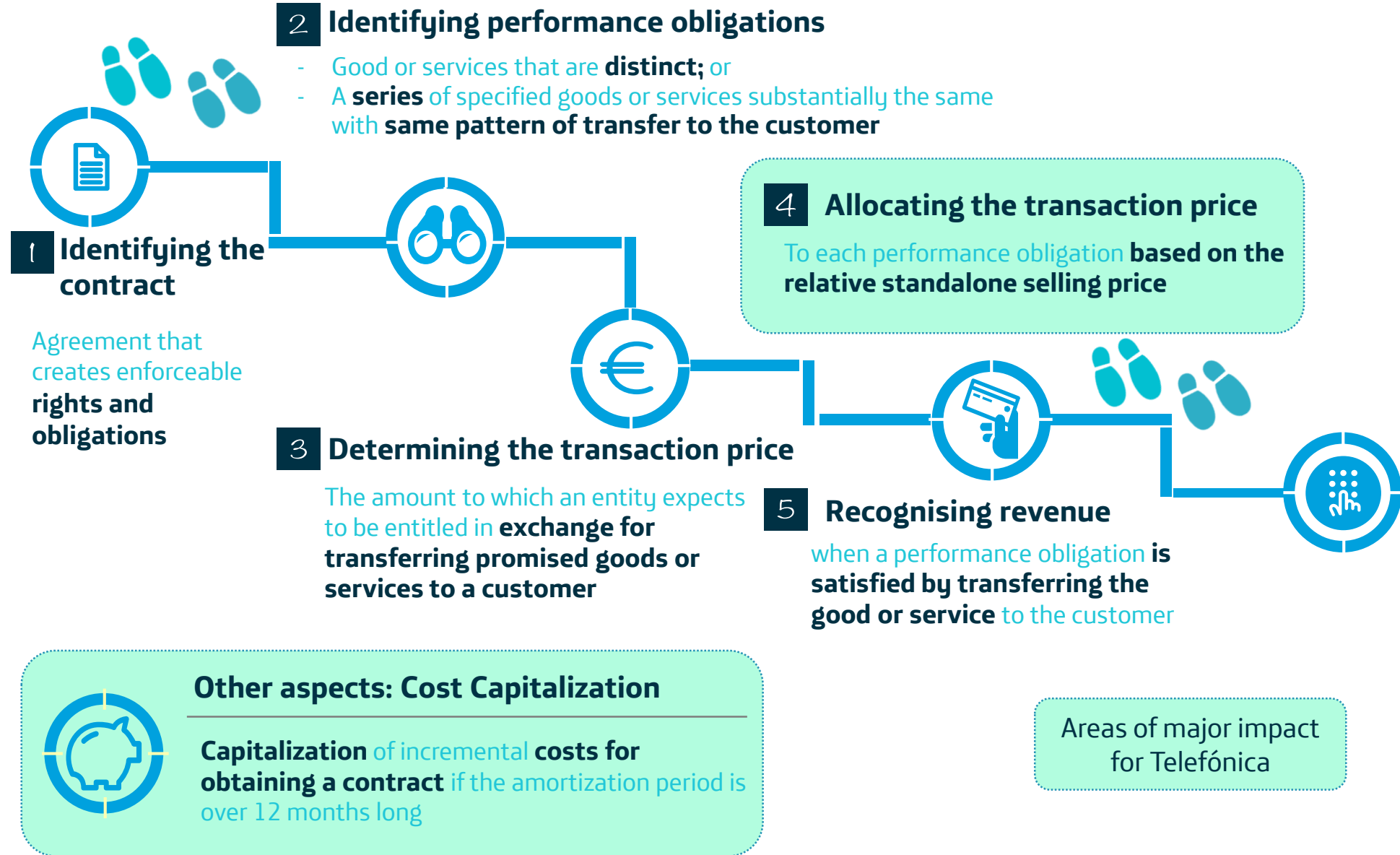
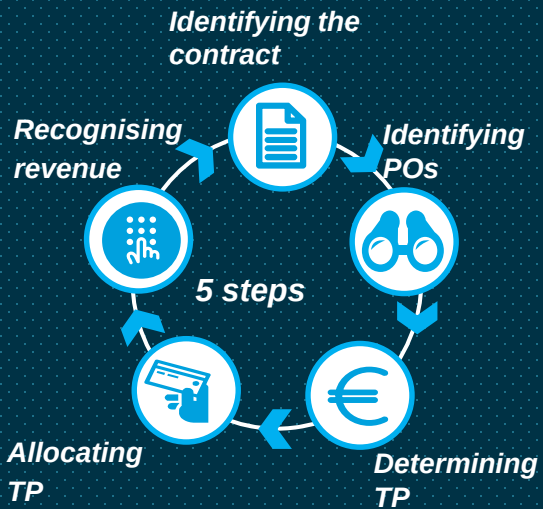
Hedge Accounting

- Simplification of IAS 39 requirements but higher volume of information about the activities carried out by the Entity regarding risk management
- Objective: To align hedge accounting with risk management

IFRS 15 in detail

IFRS 15: The model

Applying a 5 Step Model to determine **when and how to recognise revenue**



IFRS 15: Basic Adjustment

Step 4 implications through an example...

... affecting those offers with a discount on the handset or the service, or both

Tipo de contrato: **Línea Nueva**
Con Plan vuelo 4G S/150

> Samsung Galaxy J7	S./150 per month
> Precio del equipo: S/200	during 18 months
> Cargo fijo: S/150 al mes por 18 meses	Total = S./2,700

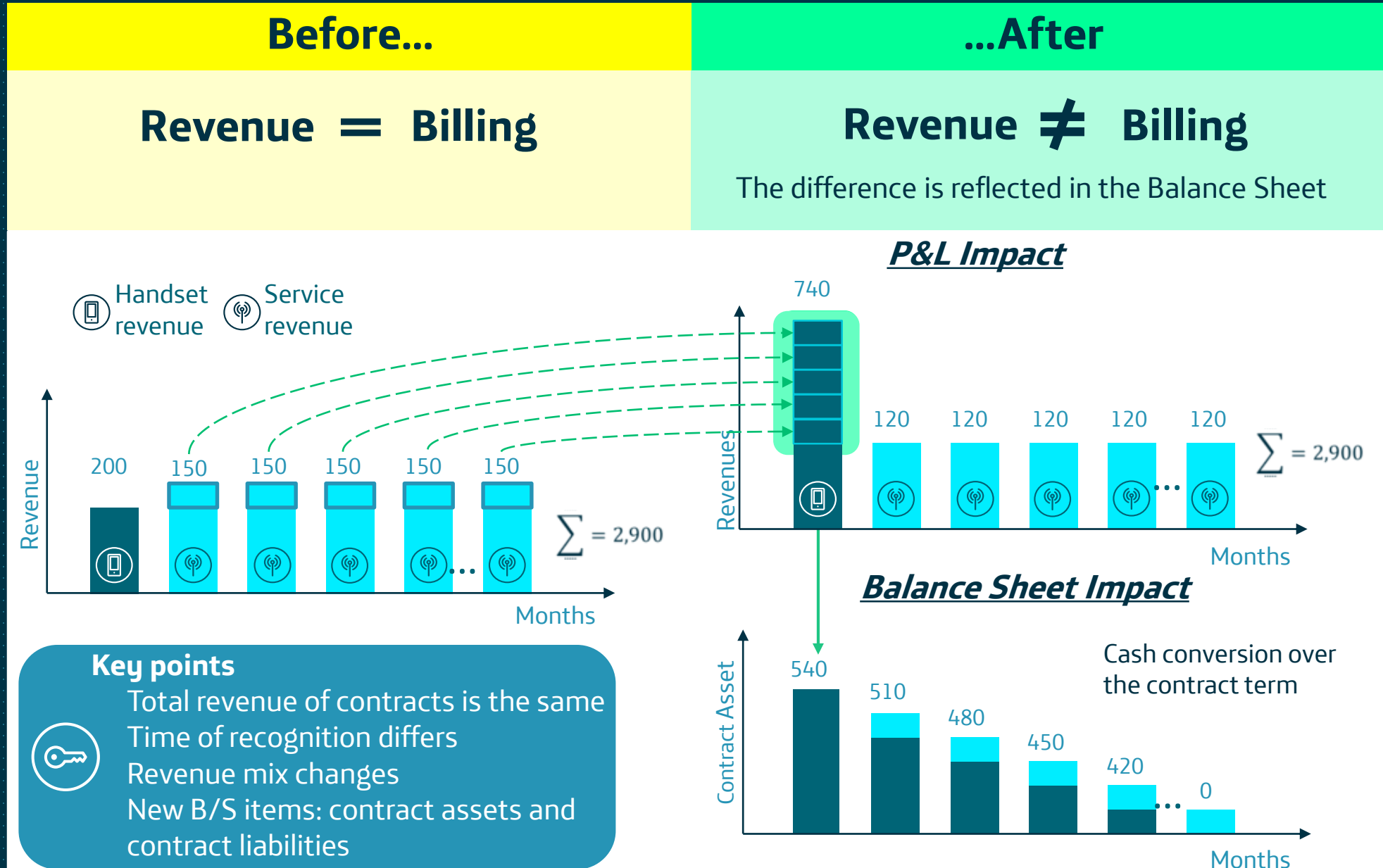
S./150 per month during 18 months
Total = S./2,700

Handset Price with service(*) S./200

Total Contract = S./2,900

SSPR = S./740

(*) SSP = S./925



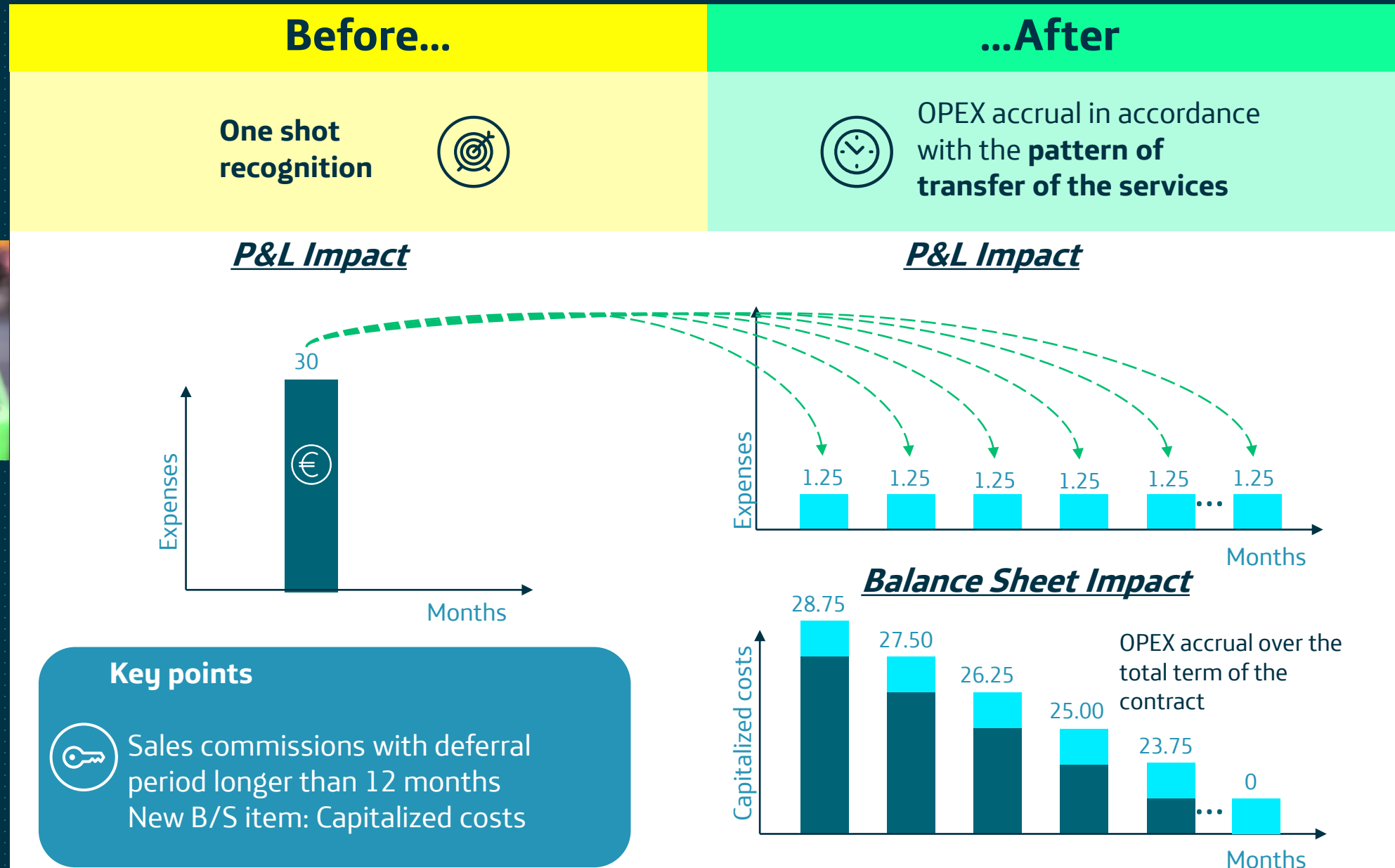
IFRS 15: Cost Capitalisation

Incremental costs have to be capitalised if the entity expects to recover those costs



Let's see an example...

A dealer is paid a commission of 30 € for a new contract with a customer. The total duration of the contract is 24 months



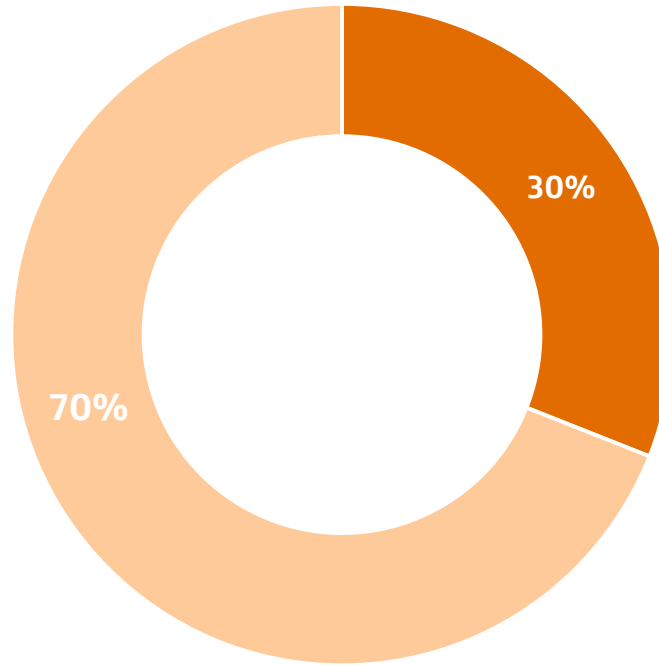
IFRS 15: Opening equity impact 2018

The following charts represent the estimated equity impact on a pre-tax basis of €+1.0 Bn distributed by areas of impact and segments



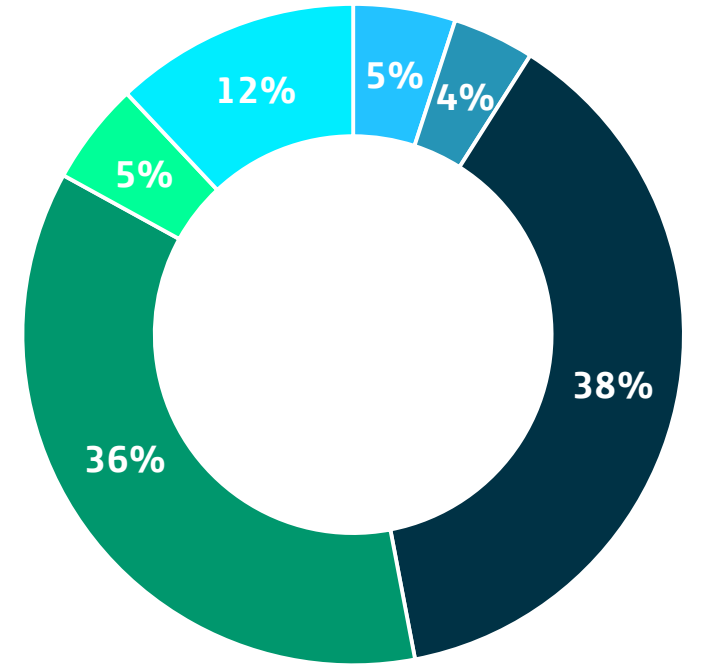
Unaudited figures

Areas of impact



- Contract Assets & Contract Liabilities
- Capitalised costs

Segment Distribution



- Spain
- Brazil
- Germany
- UK
- North Hispam
- South Hispam

IFRS 15: Estimated contribution per region

Non-relevant
impacts in any
segment

Estimated P&L impact
based on FY17

Unaudited figures

	Revenue					OIBDA				
 Spain										
 Brazil										
 Germany										
 UK										
 North HISPAM ¹										
 South HISPAM ²										
 Total Group	Revenue: € -60 Mill -0.1% over Revenue					OIBDA: € -80 Mill -0.5% over OIBDA				

¹ North HISPAM: Colombia, Mexico, Costa Rica, El Salvador, Guatemala, Nicaragua, Panama, Ecuador and Venezuela

² South HISPAM: Argentina, Peru, Chile and Uruguay

Key Takeaways

Laura Abasolo
Chief Financial and Control Officer

Key Takeaways

Capital Structure Strategy

Impressive refinancing exercise: €19bn

Solid risk management track record

Healthier Balance Sheet

New IFRS for 2018

No material impacts expected
-0.1% Revenues and -0.5% OIBDA (estimated impact based on FY17)

Guidance not affected under new standards

Q&A Session

Laura Abasolo

Jesús Romero

Marta Soto

Pablo Eguirón

Appendix



IFRS 15: Practical Expedients

The Standard contains certain **practical expedients** for the adoption of revenue recognition



TRANSITION

Telefónica Group will adopt the **cumulative transitional approach**, recognizing the cumulative effect of the initial application of the Standard as an adjustment in equity in 2018



PORTFOLIO APPROACH

Telefónica Group will **use portfolios as a method** of clustering similar contracts, wherever possible



FINANCIAL COMPONENT

Telefónica Group will **not require the calculation of the financing arrangement** for those commercial offers where the customer pays for the good or service in **one year or less**



COSTS

Telefónica Group will **not capitalize incremental costs**, that would create an asset with an amortization period of **one year or less** and recognize the costs as expenses directly upon incurrence



MODIFIED CONTRACTS

For modified contracts, Telefónica Group will **not evaluate** separately the effects of the **contract modifications before January 1st 2018**



COMPLETED CONTRACTS

Contracts with customers completed before the effective date of January 1st 2018 do not create adjustments to the financial statements and will therefore **not have any effect** for the Telefónica Group

Telefónica

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