

NOTA DE PRENSA

PRESS RELEASE

Madrid, 27th July 2017

TELEFÓNICA'S NET PROFIT INCREASES 28.9% AND REACHES 1,600 MILLION EUROS IN THE FIRST HALF OF THE YEAR

Highlights:

- The Company upgrades guidance and reiterates the dividend announcement for 2017.
- The second quarter of 2017 shows a general acceleration in growth in main financials and operational terms.
- Revenues reached €12,960m in the quarter (+1.9% vs. 2Q16, +3.1% in organic terms), thanks to improved trends in all segments. Both service revenues and terminal sales accelerated year-on-year organic growth (+2.9% and +5.2%, respectively).
- OIBDA amounted to €4.158m in April-June (+6.1% vs. 2Q16, +7.2% organic vs. 1.3% in the first quarter). The OIBDA margin stood at 32.1% and recorded a year-on-year expansion of +1.3 pp (+1.2 pp organic).
- Free cash flow reached €1,620m in the January-June period, double than in the same period a year earlier.
- Net profit for the quarter was €821m (18.4% vs. 2Q16) and net profit per share stood at €0.15 (+16.3%).
- Debt totaled €48,487m in June, with a year-on-year reduction of €3,706m, or a €4,981m reduction including the sale of Telxius. Net debt was €279M lower than at the end of March.

José María Álvarez-Pallete, Executive Chairman of Telefónica:

"During the second quarter of the year we have accelerated organic growth through the execution of our structural quality-based strategy, which was reflected in the strong competitive positioning in our main markets. Moreover, we continued to make progress in our transformation towards becoming a platform Company, with CapEx devoted to UBB networks, underpinning E2E digitalization and cognitive intelligence, with a differential value proposition for customers. All this, with a stronger balance sheet, after doubling Free Cash Flow in the last twelve months and reducing net debt by 5 billion euros, when considering the sale of the stake in Telxius.

The strength and better business trends in the first half of the year, as well as being well-positioned to continue capturing sustainable growth in the coming quarters, allow us to upgrade our guidance for 2017".

Financial results _ January-June 2017:

Telefónica today announced its results for the first half of the year, a period characterized by growth across the board and by good progress in the transformation process of the company and in the reduction of the group's financial debt. The second quarter of the year shows the acceleration of this growth, in both financial and operational metrics.

The Company upgrades guidance and reiterates the dividend announced for 2017.

- Revenue guidance upgraded to growth >1.5% (vs. stable previously), despite the negative impact from regulation (approximately 1.2 p.p.).
- OIBDA margin guidance (y-o-y expansion up to 1 p.p.) and CapEx/Sales excluding spectrum (around 16%) reiterated.

TELEFÓNICA GUIDANCE 2017

2016 Base		Original Operative 2017 Guidance (Feb-2017)	Upgraded Operative 2017 Guidance (Jul-2017)	2017 Jan - Jun
51,734	Revenues (% Chg YoY)	Stable (in spite of regulation: ~-1.2 p.p.)	Growth >1.5% (in spite of regulation: ~-1.2 p.p.)	2.3%
31.8%	OIBDA margin (Chg YoY)	Expansion up to 1 p.p.	Expansion up to 1 p.p.	0.6 p.p.
16.5%	CapEx / Sales	Around 16%	Around 16%	13.4%

- **Organic criteria:** Assumes constant exchange rates as of 2016 (average FX in 2016), excludes the impact from hyperinflation in Venezuela in both years and considers constant perimeter of consolidation. In OIBDA and OI terms, excludes write-downs, capital gains/losses from the sale of companies, tower sales, material non-recurring impacts and restructuring costs. CapEx also excludes investment in spectrum.

2016 adjusted base excludes:

- The results of the companies sold in 2016 (Telefó, T. Personalizadas and Vocem) from 1 January, 2016 to the date of exiting the perimeter of consolidation.
- OIBDA excludes additionally write-downs, capital gains/losses from the sale of companies, tower sales, material non-recurring impacts and restructuring costs.
- CapEx excludes additionally spectrum acquisition.

Growth across the board

The Company remained focused on increasing the weight of higher-value service so quality of the Telefónica Group's customer base continued improving, as reflected by average revenue per customer increase (+3.1% y-o-y in organic terms) and churn reduction (-0.2 p.p. vs. the first quarter). Total accesses stood at 346.2m at June and showed y-o-y growth in LTE (1.6x y-o-y); in mobile contract accesses (+5% y-o-y); in smartphones (+19%), achieving a 61% penetration. FTTx and cable customers (10m) grew 19% vs. June 2016 and accounted for 47% of the total fixed broadband accesses, reaching a coverage of 41.2m premises passed (+14% y-o-y). Pay TV accesses improved sequentially and returned to post positive net additions in the quarter (+56k) for the first time since the second quarter of 2016.

In the second quarter, **revenues** (€12,960m) increased 1.9% y-o-y and accelerated growth to 3.1% in organic terms thanks to improved trends across the board. Also, growth accelerated in service revenues (+2.9% y-o-y organic) and handset sales (+5.2%). Mobile data revenues continued to be a key growth driver and improved their pace of growth in the second quarter to 17.8% y-o-y in organic terms, increasing their weight over mobile service revenues by 6 p.p. to 60%. Revenues reached €26,091m in the first half (+3.4% y-o-y; +2.3% y-o-y organic).

Operating expenses (€9,048m in April-June; -0.2% y-o-y) grew 1.2% y-o-y in organic terms due to higher network and system costs and increased personnel expenses.

Operating income before depreciation and amortisation (**OIBDA**) totalled €4,158m in the second quarter, growing 6.1% vs. April-June 2016 (+7.2% y-o-y organic), while OIBDA margin stood at 32.1% in the second quarter, reflecting a y-o-y expansion of +1.3 p.p. reported (+1.2 p.p. organic). OIBDA totalled €8,179m in the first half of the year (+5.5% y-o-y; +4.3% organic) and the margin reached 31.3% (+0.6 p.p. reported; +0.6 p.p. organic).

As a result, **net profit** in the quarter (€821m) increased 18.4% y-o-y. In January-June, it reached €1,600m (+28.9% y-o-y). Basic earnings per share stood at €0.15 in the second quarter (+16.3%) and reached €0.29 (+30.3%) in January-June.

Solid investment commitment and deployment of infrastructure

The transformation process of the Company continued its progress in the quarter, as evidenced by the high investment commitment of the group and the deployment of infrastructure in the different geographies. In this way, Telefónica registers at June 30, 41.2 m premises passed with FTTx and cable (+14% y-o-y) and an LTE coverage of 68% (89% in Europe). **CapEx** in the first half (€3,507m) was focused on 4G and fibre optic network expansion, and the simplification and digitalisation of processes and systems, and its y-o-y performance (-4.0% reported; -5.7% organic) reflected integration synergies, consolidation and network optimisation ("big data"). **Operating cash flow** (OIBDA-CapEx) reached €4,672m in January-June and grew at double digit rates (+13.9% y-o-y in reported terms; +13.0% organic), reflecting business performance and lower CapEx intensity. Y-o-y growth accelerated sequentially in the second quarter 8.6 p.p. up to 17.5% in organic terms (+16.0% reported).

TELEFÓNICA
CONSOLIDATED INCOME STATEMENT
Unaudited figures (Euros in millions)

	January - June		% Chg		April - June		% Chg	
	2017	2016	Reported	Organic	2017	2016	Reported	Organic
Revenues	26,091	25,235	3.4	2.3	12,960	12,723	1.9	3.1
Internal exp. capitalized in fixed assets	430	428	0.5	(1.2)	222	214	3.4	2.7
Operating expenses	(18,396)	(18,010)	2.1	1.1	(9,048)	(9,067)	(0.2)	1.2
Supplies	(7,362)	(7,423)	(0.8)	(1.2)	(3,632)	(3,748)	(3.1)	(2.2)
Personnel expenses	(3,493)	(3,436)	1.7	1.7	(1,675)	(1,687)	(0.7)	4.3
Other operating expenses	(7,541)	(7,152)	5.4	3.2	(3,741)	(3,632)	3.0	3.3
Other net income (expense)	28	98	(71.8)	(55.8)	(1)	49	c.s.	(68.3)
Gain (loss) on sale of fixed assets	18	8	n.m.	n.m.	10	2	n.m.	n.m.
Impairment of goodwill and other assets	9	(2)	c.s.	c.s.	16	(3)	c.s.	c.s.
Underlying operating income before D&A (OIBDA)	8,292	7,824	6.0		4,183	3,964	5.5	
Operating income before D&A (OIBDA)	8,179	7,756	5.5	4.3	4,158	3,918	6.1	7.2
OIBDA Margin	31.3%	30.7%	0.6 p.p.	0.6 p.p.	32.1%	30.8%	1.3 p.p.	1.2 p.p.
Depreciation and amortization	(4,809)	(4,673)	2.9	(1.1)	(2,358)	(2,351)	0.3	(0.9)
Operating income (OI)	3,370	3,083	9.3	12.2	1,800	1,567	14.9	19.0
Share of profit (loss) of investments accounted for by the equity method	3	(3)	c.s.		1	0	n.m.	
Net financial income (expense)	(1,197)	(1,320)	(9.3)		(748)	(660)	13.3	
Profit before taxes	2,176	1,760	23.7		1,053	907	16.1	
Corporate income tax	(520)	(549)	(5.2)		(206)	(251)	(17.8)	
Profit for the period	1,656	1,211	36.7		847	656	29.1	
Attributable to equity holders of the Parent	1,600	1,241	28.9		821	693	18.4	
Attributable to non-controlling interests	56	(30)	c.s.		26	(37)	c.s.	
Weighted average number of ordinary shares outstanding during the period (millions)	5,094	5,066	0.6		5,123	5,053	1.4	
Basic and diluted earnings per share attributable to equity holders of the Parent (euros)	0.29	0.22	30.3		0.15	0.13	16.3	
Underlying basic and diluted earnings per share attributable to equity holders of the Parent (euros)	0.38	0.28	32.3		0.20	0.16	21.9	

Notes:

- After considering Venezuela as a hyperinflationary country, P&L and CapEx from the operations in the country are to be accounted at the closing exchange rate Bolivar Fuerte/Euro. For the January-June 2017 period Telefónica has adopted a synthetic exchange rate of 3,547 Venezuelan bolivars fuertes per dollar at June 2017 (please see Note 3 of the Condensed Consolidated Interim Financial Statements for the six-month period ended June 30, 2017).

- Basic and diluted earnings per share ratio is calculated dividing Profit for the period Attributable to equity holders of the Parent, adjusted for the net coupon corresponding to "Other equity instruments" (€68m in April-June 17; €136m in January-June 17), by the weighted average number of ordinary shares outstanding during the period.

- 2016 and 2017 reported figures include hyperinflationary adjustments in Venezuela in both years.

In addition, Telefónica continues to advance its **deleveraging strategy**. Net debt stood at 48,487 million euros at the end of June and experienced a **reduction of 3,706 million euros y-o-y, or a 4,981 million euros reduction considering the closing of the sale of Telxius**. In the quarter, debt reduction is of 279 million euros compared to March, thanks to free cash flow generation (€1,021m) and the lower value in euros of the net debt in foreign currencies (€648m). In January-June 2017, **free cash flow** totalled €1,620m, doubling y-o-y, despite the seasonality associated with working capital.

During the first half of 2017, **Telefónica's financing activity** amounted to approximately €6,884m equivalent and continue focused on strengthening the liquidity position, and refinancing and extending debt maturities (in an environment of very low rates). Therefore, as of the end of June, the Group maintained a comfortable liquidity position, covering debt maturities for around the next 2 years. The average debt life stood at 7.82 years.

Definitions: *Organic Growth: Assumes constant exchange rates from 2016, excludes the impact of hyperinflationary adjustments in Venezuela in both years and considers a constant perimeter of consolidation. In OIBDA and OI terms, excludes write-downs, capital gains/losses from the sale of companies, sale of towers, restructuring costs and material non-recurring impacts. CapEx also excludes investment in spectrum. Underlying Growth: Reported figures excluding the impact of write-downs, capital gains/losses from the sale of companies, tower sales, restructuring costs and material non-recurring impacts, as well as depreciation and amortisation charges from purchase price allocation processes.*

Separately, given the absence of official exchange rates representative of the economic situation in Venezuela, the Company has considered the need to estimate a synthetic exchange rate that matches the progression of inflation to reflect the economic and financial position of the Group's subsidiaries in Venezuela in a more accurate way. This rate has been fixed at 3,547 VEF/USD at the end of June 2017, affecting the January-June 2017 results reported by the Company. This new exchange rate reversed the positive contribution of exchange rates in the first quarter, which became negative in the second quarter, detracting 0.8 p.p. and 1.3 p.p. to the y-o-y growth of revenues and OIBDA respectively. Excluding Venezuela, the contribution would have been positive (+1.5 p.p. in revenues and +1.8 p.p. in OIBDA in the quarter) on the back of the appreciation of most Latin American currencies vs. the euro, particularly the Brazilian real.

Results by geographies: (y-o-y changes in organic terms)

Spain. In the second quarter of 2017 T. España's results showed a sequential improvement in revenue performance. This evolution was driven by higher commercial activity, with churn reduction in virtually all services, which reflects the sustainability of the Company's value strategy. Quarterly service revenues improved their year-on-year performance compared with the previous quarter and decreased by 0.8%; this growth would have been positive (+0.2%) if the impact of the lower revenues from wholesale TV rights of "La Liga" were excluded; an impact that will be neutralised from August.

Revenues in the second quarter reached to €3,160m (Q2: -1.9% year-on-year; Q1: -2.6%) and improved compared with the previous quarter (+0.6 p.p.), thanks to the better service revenue performance (Q2: -0.8%; Q1:-1.5%; +0.8 percentage points compared with the first quarter) and despite a higher decline in handset sales (-31.8%, -1.9 p.p.). Total revenues (€6,226m) and service revenues (€6,062m) in the semester declined 2.3% and 1.1% respectively.

OIBDA in April-June rose to €1,282m, which is 1.5% less than the same period a year ago (Q2:-2.4%), driving a sequential improvement of 0.9 percentage points explained by the better revenue performance and cost containment. The OIBDA margin stood at 40.6% (+0.8 p.p. q-o-q, +0.2 p.p. y-o-y). In the first half of the year, OIBDA stood at €2,425m with a 1.9% year-on-year reduction. CapEx in the semester rose to €704m (-20.6% y-o-y) and operating cash flow grew soundly to €1,720m (+8.0% y-o-y).

Telefonica Deutschland. In a dynamic market increasingly focused on larger data buckets, Telefonica Deutschland maintained solid momentum in the second quarter, leveraging on "O2 Free" and the 15 year anniversary promotions of the O2 brand.

In the second quarter, revenues reached €1,771m and improved their y-o-y trend to -3.4% (-4.1% to €3,542m in the first half). OIBDA reached €461m and its y-o-y growth rate accelerated to 3.8% in the quarter (€861m in January-June; +2.7% y-o-y) as incremental synergies of €40m offset the negative effect from regulation as well as continued investments into the positioning of the O2 brand. OIBDA margin was 26.1% and expanded 1.9 p.p. y-o-y.

In the first half of 2017 CapEx totalled €435m (+1.3% y-o-y), benefitting from incremental synergy related savings of €20m while Telefónica Deutschland pushed ahead with network integration and further rollout of the LTE network. Operating cash flow (OIBDA-CapEx) totalled €426m in January-June 2017; up 4% y-o-y.

Telefonica UK. Telefónica UK delivered a robust financial performance in a competitive market, demonstrating the success of its customer-led, mobile-first strategy, with yet another quarter of revenue and OIBDA growth built on its market-leading customer loyalty.

Revenues continued to grow this quarter, up 2.6% y-o-y to €1,607m (+2.3% in the first half, €3,208m), building on the 2.1% growth seen in the first quarter, on better trends in both mobile service and other revenues. The robust revenue and expenses performance resulted in OIBDA growing by 3.9% y-o-y to €433m in April-June (vs. +0.6% in the first quarter; €849m, +2.2% in January-June), while OIBDA margin stood at 27.0% in the quarter, up 0.3 p.p. y-o-y, and was flat y-o-y in the six months to June (26.5%).

CapEx amounted to €434m in January-June, up 15.4% y-o-y, as Telefónica UK continued to invest in the rollout of LTE. Thus, operating cash flow (OIBDA-CapEx) decreased by 8.7% y-o-y to reach €415m in the first half.

Telefonica Brasil. In the second quarter of 2017, Telefónica Brasil continued to show an acceleration in revenue growth that, coupled with a reduction in operating expenses for the sixth consecutive quarter, allowed to maintain solid growth in OIBDA and operating cash flow, in a context of expanding margins. This performance was achieved in spite of the regulatory impacts (-45.6% in mobile interconnection rates, -17.7% in fixed-mobile retail, -35.3% in fixed local and -50.9% in fixed inter-urban, since 25 February 2017).

Revenues in the second quarter (€3,028m) grew 1.8% y-o-y (+1.7% in the half year) despite the regulatory effects (impact of -1.8 p.p. in y-o-y change for the second quarter; -2.0 p.p. for January-June) and lower handset sales (-0.4 p.p. in y-o-y change for the quarter and for the half year). Thus, OIBDA totalled €1,034m in the second quarter (+7.0% y-o-y; +7.2% in the half year) and OIBDA margin stood at 34.1% in the quarter and at 34.5% in the first six months (+1.7 p.p. and +1.8 p.p. y-o-y respectively).

CapEx for January-June 2017 (€915m; -3.6% y-o-y) was primarily allocated to the expansion of the 4G and fibre networks. As a result, operating cash flow (OIBDA-CapEx) amounted to €1,223m in the first half (+17.0% compared to January-June 2016). In the first half of the year, synergies due to the purchase of GVT had a positive impact in operating cash flow of €286m (€833m in the last two years).

Telefonica Hispanoamérica. In the second quarter of the year, Telefónica Hispanoamérica recorded strong year-on-year growth in revenue, OIBDA and operating cash flow both in organic and reported terms, despite the change in the Venezuelan exchange rate to a synthetic conversion rate of 3.547 bolivars fuertes per US dollar.

Revenues in the second quarter (€3,134m) were up 15.5% y-o-y (+12.3% in January-June), posting robust acceleration (+9.2% in the first quarter), with a positive contribution from mobile service revenues (+18.2% y-o-y; +10.6% y-o-y in January-March) and fixed (+5.7%; +4.1% y-o-y in the first quarter). In reported terms, revenues increased by 5.9% (+6.7% in January-June). OIBDA reached €892m in the quarter and accelerated its y-o-y growth up to 20.9% (+6.2% in the first quarter; +13.5% in the first half) with the notable positive contributions from Argentina, Mexico and Colombia. In reported terms, OIBDA increased

6.9% (+5.7% in the first six months of the year to €1,796m). Thus, OIBDA margin stood at 28.5% for the six-month period (+1.3 p.p. y-o-y) and 28.0% in the half year (+0.3 p.p. y-o-y).

CapEx amounted to €923m in January-June, decreasing by 6.2% y-o-y, and was mainly aimed at improving the network, with the deployment of 4G and fibre optic networks, as well as the simplification and digitalisation of processes and systems. Thus, operating cash flow (OIBDA-CapEx) amounted to €873m in the first six months with a year-on-year growth of 43.2% (+28.2% in the reported terms).

TELEFÓNICA
SELECTED FINANCIAL DATA
Unaudited figures (Euros in millions)

	January - June		% Chg		April - June		% Chg	
	2017	Reported	Organic		2017	Reported	Organic	
Revenues	26,091	3.4	2.3		12,960	1.9	3.1	
Telefónica España	6,226	(2.3)	(2.3)		3,160	(2.0)	(1.9)	
Telefónica Deutschland	3,542	(4.1)	(4.1)		1,771	(3.4)	(3.4)	
Telefónica UK	3,208	(7.4)	2.3		1,607	(6.2)	2.6	
Telefónica Brasil	6,193	21.8	1.7		3,028	14.1	1.8	
Telefónica Hispanoamerica	6,419	6.7	12.3		3,134	5.9	15.5	
Other companies & eliminations	504	(16.9)	(8.5)		259	(23.5)	(12.9)	
Telxius	370	27.1	8.3		182	18.7	11.4	
OIBDA	8,179	5.5	4.3		4,158	6.1	7.2	
Telefónica España	2,425	(5.0)	(1.9)		1,282	(1.6)	(1.5)	
Telefónica Deutschland	861	2.1	2.7		461	2.2	3.8	
Telefónica UK	849	(7.4)	2.2		433	(5.0)	3.9	
Telefónica Brasil	2,138	30.1	7.2		1,034	23.3	7.0	
Telefónica Hispanoamerica	1,796	5.7	13.5		892	6.9	20.9	
Other companies & eliminations	110	10.2	(7.7)		56	55.4	108.5	
Telxius	179	78.0	11.1		87	17.8	7.9	