

Telefónica Emisiones, S.A. (Sole-Shareholder Company)

Independent auditor's report,
Annual Accounts and Management report
For the year ended 31 December 2017



This version of our report is a free translation of the original, which was prepared in Spanish. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of our report takes precedence over this translation.

Independent auditor's report on the annual accounts

To the Sole Shareholder of Telefónica Emisiones, S.A. (Sole-Shareholder Company)

Report on the annual accounts

Opinion

We have audited the annual accounts of Telefónica Emisiones, S.A. (the Company), which comprise the balance sheet as at 31 December 2017, and the income statement, statement of changes in equity, cash flow statement and related notes for the year then ended.

In our opinion, the accompanying annual accounts present fairly, in all material respects, the equity and financial position of the Company as at 31 December 2017, as well as its financial performance and cash flows for the year then ended, in accordance with the applicable financial reporting framework (as identified in Note 2 of the notes to the annual accounts), and, in particular, with the accounting principles and criteria included therein.

Basis for opinion

We conducted our audit in accordance with legislation governing the audit practice in Spain. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the annual accounts* section of our report.

We are independent of the Company in accordance with the ethical requirements, including those relating to independence, that are relevant to our audit of the annual accounts in Spain, in accordance with legislation governing the audit practice. In this regard, we have not rendered services other than those relating to the audit of the accounts, and situations or circumstances have not arisen that, in accordance with the provisions of the aforementioned legislation, have affected our necessary independence such that it has been compromised.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the annual accounts of the current period. These matters were addressed in the context of our audit of the annual accounts as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.



Cuestiones clave de la auditoría

Modo en el que se han tratado en la auditoría

Inter-company loans valuation

The main activity of the Company consists on the issuance of bonds, which are then used to finance Grupo Telefónica operations through loans to the Sole Shareholder of the Company, Telefónica S.A.

The total amount of short-term and long-term credits to group companies, as disclosed in note 6 of the annual accounts, represents around 99% of total assets of the Company. These credits are valued at amortized cost as described in note 4.4 of the annual accounts, and their value would be adjusted if management identifies objective evidence of actual impairment. The analysis of the valuation of these credits is key for our audit given their relevance and the implicit judgement element in their valuation.

We have conducted audit procedures over the valuation of the short and long-term credits to group companies, specifically including:

- Examination of contracts with the Sole Shareholder and recalculation of amortized costs of the loans, in accordance with said contracts.
- Confirmation of balances at the end of the year with Telefónica, S.A.
- Evaluation of the analysis performed by management over the Sole Shareholder payment capacity, based on available treasury forecasts.

Based on the procedures performed, we have not identified any relevant aspect affecting management conclusions over the valuation of credits to group companies.

Verification of initial accounting record of bonds issuances occurred during the year

As disclosed in note 8, the Company has issued long-term bonds during the current year, guaranteed by its Sole Shareholder, Telefónica, S.A. through 9 issuances, which are valued at amortized cost as described in note 4.2 of the annual accounts.

Said issuances represent almost the totality of the Company's activity during the year and therefore, the work performed in this area is relevant to our audit in relation to the evaluation of the risk of material misstatement in the initial accounting record.

We have conducted audit procedures over the initial accounting record of the issuances of bonds during the year, specifically including:

- Understanding of the control environment, evaluating and testing performance of relevant controls over the contract process and initial registration of the bonds issued.
- Examination of contracts of the bonds issued during the year to analyze the issuance conditions and initial accounting record.

Based on the procedures performed, we consider that we have obtained sufficient and adequate evidence around the initial accounting record of the issuances of bonds during year ending 2017.



Other matters

The annual accounts of the Company for the year ended 31 December 2016 were audited by another auditor who expressed an unmodified opinion on those annual accounts on 21 February 2017.

Other information: Management report

Other information comprises only the management report for the 2017 financial year, the formulation of which is the responsibility of the Company's directors, and does not form an integral part of the annual accounts.

Our audit opinion on the annual accounts does not cover the management report. Our responsibility regarding the management report, in accordance with legislation governing the audit practice, is to evaluate and report on the consistency between the management report and the annual accounts as a result of our knowledge of the Company obtained during the audit of the aforementioned financial statements, and does not include information different to that obtained as evidence during our audit. Likewise, our responsibility is to evaluate and report on whether the content and presentation of the management report is in accordance with applicable regulations. If, based on the work we have performed, we conclude that material misstatements exist, we are required to report that fact.

On the basis of the work performed, as described in the previous paragraph, the information contained in the management report is consistent with that contained in the annual accounts for the 2017 financial year, and its content and presentation are in accordance with the applicable regulations.

Responsibility of the directors and the audit and control committee for the annual accounts

The Company's directors are responsible for the preparation of the accompanying annual accounts, such that they fairly present the equity, financial position and financial performance of the Company, in accordance with the financial reporting framework applicable to the entity in Spain, and for such internal control as the directors determine is necessary to enable the preparation of annual accounts that are free from material misstatement, whether due to fraud or error.

In preparing the annual accounts, the Company's directors are responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

The audit and control committee of the Sole Shareholder (Telefónica S.A.) is responsible for overseeing the process of preparation and presentation of the annual accounts.



Auditor's responsibilities for the audit of the annual accounts

Our objectives are to obtain reasonable assurance about whether the annual accounts as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with legislation governing the audit practice in Spain will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these annual accounts.

As part of an audit in accordance with legislation governing the audit practice in Spain, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the annual accounts, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Company's directors.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the annual accounts or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the annual accounts, including the disclosures, and whether the annual accounts represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the Company's audit and control committee of the Sole Shareholder regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the Company's audit and control committee of the Sole Shareholder with a statement that we have complied with relevant ethical requirements, including those relating to independence, and we communicate to said committee those matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the audit and control committee of the Sole Shareholder, we determine those matters that were of most significance in the audit of the annual accounts of the current period and are therefore the key audit matters.

We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter.



Telefónica Emisiones S.A. (Sole-Shareholder Company)

Report on other legal and regulatory requirements

Report to the audit and control committee

The opinion expressed in this report is consistent with the content of our additional report to the audit and control committee of the Sole Shareholder dated 20 February 2018.

Appointment period

The Company's Sole Shareholder, through its decision on 25 May 2017, appointed us as auditors for a period of 3 years, as from the year ended 31 December 2017.

Services provided

Services provided to the Company for services other than the audit of the accounts are disclosed in note 12.1 of the annual accounts.

PricewaterhouseCoopers Auditores, S.L. (S0242)

(Original signed in Spanish)

Fernando Torres (22224)

20 February 2018

Telefónica

Elegimos todo

TELEFÓNICA EMISIONES, S.A.

(Sole-Shareholder Company)

Annual Accounts and Management Report
for the year ended 31 December 2017



2017

CONTENTS

| | Page |
|---|------|
| ➤ Balance sheet at 31 December..... | 2 |
| ➤ Profit and Loss Statement for the year ended 31 December..... | 3 |
| ➤ Statement of changes in equity for the year ended 31 December..... | 4 |
| ➤ Cash flow statement for the year ended 31 December..... | 5 |
| ➤ Notes to the annual accounts for the year ended 31 December 2017..... | 6 |
| ➤ Management Report..... | 27 |
| ➤ Signature validation | 30 |

TELEFÓNICA EMISIONES, S.A. (Sole-Shareholder Company)
Balance sheet at 31 December

(Expressed in thousands of euros)

| ASSETS | Notes* | 2017 | 2016 |
|--|----------------------|-------------------|-------------------|
| NON-CURRENT ASSETS | | 29,438,640 | 27,473,206 |
| Long-term investments in group companies and associates | 6 and 11.2 | 29,438,640 | 27,377,145 |
| Credits to companies | | 29,438,640 | 27,377,145 |
| Long-term tax receivable for deferred taxes | 9 | - | 96,061 |
| Long-term tax receivable for deferred taxes | | - | 96,061 |
| CURRENT ASSETS | | 4,255,762 | 5,903,441 |
| Trade and other receivables | | 751 | 2,243 |
| Prepayments to suppliers | | 428 | - |
| Trade receivables | | 100 | 19 |
| Other receivables | | 178 | 178 |
| Other receivables from public administrations | | 45 | 2,046 |
| Short-term investments in group companies and associates | 6 and 11.2 | 4,250,581 | 5,898,022 |
| Credits to companies | | 4,248,937 | 5,898,022 |
| Accounts receivables from Group companies for consolidated taxation | | 1,644 | - |
| Cash and cash equivalents | 11.2 | 4,430 | 3,176 |
| TOTAL ASSETS | | 33,694,402 | 33,376,647 |
| EQUITY AND LIABILITIES | Notes* | 2017 | 2016 |
| EQUITY | | 11,435 | 9,833 |
| CAPITAL AND RESERVES | 7 | 11,435 | 9,833 |
| Share capital | | 62 | 62 |
| Issued capital | | 62 | 62 |
| Reserves | | 9,771 | 7,771 |
| Legal and by-law reserves | | 12 | 12 |
| Other reserves | | 9,759 | 7,759 |
| Profit for the year | | 1,602 | 2,000 |
| NON-CURRENT LIABILITIES | | 29,434,837 | 27,470,113 |
| Long-term debts | 8 | 29,434,837 | 27,374,052 |
| Debentures and other marketable debt securities | | 29,434,837 | 27,374,052 |
| Long-term debt with Group companies for consolidated taxation | 8 | - | 96,061 |
| Long-term debt with Group companies for consolidated taxation | | - | 96,061 |
| CURRENT LIABILITIES | | 4,248,130 | 5,896,701 |
| Short-term debts | 8 | 4,247,443 | 5,896,033 |
| Debentures and other marketable debt securities | | 4,247,443 | 5,896,033 |
| Short-term debts with group companies and associates | 8, 9 and 11.2 | - | 453 |
| Trade and other payables | | 687 | 212 |
| Other payables | 8 | 239 | 210 |
| Suppliers, group companies and associates | 8 and 11.2 | 448 | 2 |
| Current income tax payable | | - | 3 |
| TOTAL EQUITY AND LIABILITIES | | 33,694,402 | 33,376,647 |

* Notes 1 to 15 are an integral part of the Annual Accounts.

TELEFÓNICA EMISIONES, S.A. (Sole-Shareholder Company)
Profit and Loss Statement for the year ended 31 December

(Expressed in thousands of euros)

| | Notes* | 2017 | 2016 |
|---|--------|--------------------|--------------------|
| Other operating expenses | | (1,804) | (1,173) |
| External services | 10.1 | (1,801) | (1,169) |
| Taxes other than income tax | | (3) | (4) |
| OPERATING PROFIT | | (1,804) | (1,173) |
| Financial revenues | 10.2 | 1,334,792 | 1,336,929 |
| In group companies and associates | | 1,334,792 | 1,336,929 |
| Financial expenses | 10.3 | (1,330,537) | (1,332,832) |
| Debts with group companies and associates | | - | (7) |
| Debts with third parties | | (1,330,537) | (1,332,825) |
| Exchange rate differences | 10.4 | (315) | 65 |
| FINANCIAL RESULTS | | 3,940 | 4,162 |
| PROFIT BEFORE TAXES | | 2,136 | 2,989 |
| Income tax | 9 | (534) | (989) |
| PROFIT FOR THE YEAR FROM CONTINUING OPERATIONS | | 1,602 | 2,000 |
| PROFIT FOR THE YEAR | | 1,602 | 2,000 |

* Notes 1 to 15 are an integral part of the Annual Accounts.

TELEFÓNICA EMISIONES, S.A. (Sole-Shareholder Company)
Statement of changes in equity for the year ended 31 December

A. Statement of recognised revenues and expenses for the year ended 31 December.

(Expressed in thousands of euros)

| | 2017 | 2016 |
|--|-------|-------|
| PROFIT AND LOSS STATEMENT RESULT | 1,602 | 2,000 |
| TOTAL RECOGNISED INCOME AND EXPENSE | 1,602 | 2,000 |

Note: Notes 1 to 15 are an integral part of the Annual Accounts.

B. Total statement of changes in equity for the year ended 31 December.

(Expressed in thousands of euros)

| | Issued capital | Reserves | Profit for the year | TOTAL |
|---|----------------|----------|---------------------|--------|
| BALANCE AT 1 JANUARY 2016 | 62 | 6,135 | 1,636 | 7,833 |
| Total recognised income and expense | - | - | 2,000 | 2,000 |
| Transactions with shareholders and owners | - | - | - | - |
| Other changes in equity | - | 1,636 | (1,636) | - |
| BALANCE AT 31 DECEMBER 2016 | 62 | 7,771 | 2,000 | 9,833 |
| Total recognised income and expense | - | - | 1,602 | 1,602 |
| Transactions with shareholders and owners | - | - | - | - |
| Other changes in equity | - | 2,000 | (2,000) | - |
| BALANCE AT 31 DECEMBER 2017 | 62 | 9,771 | 1,602 | 11,435 |

Note: Notes 1 to 15 are an integral part of the Annual Accounts

TELEFÓNICA EMISIONES, S.A. (Sole-Shareholder Company)
Cash flow statement for the year ended 31 December

(Expressed in thousands of euros)

| | Notes* | 2017 | 2016 |
|---|--------|--------------------|--------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | | |
| Profit before tax | | 2,136 | 2,989 |
| Adjustments to profit | | (3,940) | (4,163) |
| Financial revenues | | (1,334,792) | (1,336,929) |
| Financial expenses | | 1,330,537 | 1,332,831 |
| Exchange rate differences | | 315 | (65) |
| Change in working capital | | 1,964 | (2,373) |
| Accounts receivable | | 1,492 | (1,643) |
| Accounts payable | | 475 | (733) |
| Other current liabilities | | (3) | 3 |
| Other cash flows from operating activities | | (906) | (2,011) |
| Interest paid | | (1,368,743) | (1,496,107) |
| Interest received | | 1,371,940 | 1,495,257 |
| Income tax payments | | (616) | (3,032) |
| Other receipts | | (3,487) | 1,871 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | (746) | (5,558) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | |
| Payments on investments | 6 | (7,324,009) | (4,900,000) |
| Group companies and associates | 6 | (7,324,009) | (4,900,000) |
| Proceeds from divestments | 6 | 5,232,326 | 6,539,976 |
| Group companies and associates | 6 | 5,232,326 | 6,539,976 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | (2,091,683) | 1,639,976 |
| CASH FLOWS FROM FINANCING ACTIVITIES | | | |
| Proceeds from and payments of financial liabilities | | 2,094,068 | (1,635,541) |
| Issuances | | | |
| Debentures and other marketable debt securities | 8 | 7,323,758 | 4,900,000 |
| Repayment and redemption of | | | |
| Debentures and other marketable debt securities | 8 | (5,229,690) | (6,535,541) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | 2,094,068 | (1,635,541) |
| NET FOREIGN EXCHANGE DIFFERENCE | | (385) | (9) |
| NET INCREASE/DECREASE IN CASH & CASH EQUIVALENTS | | 1,254 | (1,132) |
| Cash and cash equivalents at January 1 | | 3,176 | 4,308 |
| Cash and cash equivalents at December 31 | | 4,430 | 3,176 |

* Notes 1 to 15 are an integral part of the Annual Accounts.

TELEFÓNICA EMISIONES, S.A. (Sole-Shareholder Company)
Notes to the Annual Accounts for the year ended 31 December 2017

1. ACTIVITY

Telefónica Emisiones, S.A. (Sole-Shareholder Company), hereinafter referred to as the "Company" or "Telefónica Emisiones, S.A.U.", was incorporated as a Sole-Shareholder Company in Spain for an indefinite period on 29 November 2004 as "Telefónica Emisiones, S.A.U."

Telefónica Emisiones, S.A.U. is a company 100% directly held by Telefónica, S.A. The corporate purpose of Telefónica Emisiones, S.A.U. entails the issuance of preferential shares and/or other financial debt instruments.

The registered address of Telefónica Emisiones, S.A.U. is Calle Gran Vía, 28 – 28013 Madrid.

2. BASIS OF PRESENTATION OF THE ANNUAL ACCOUNTS

The annual accounts were drawn up according to the Chart of Accounts approved by Royal Decree 1514/2007 of 16 November, last amended by Royal Decree 602/2016 of 2 December, and the pertinent legislation currently in force on the date these annual accounts were drawn up.

The figures shown in these annual accounts are presented in thousands of euros unless otherwise indicated.

2.1 True and fair view

The present annual accounts were obtained on the basis of the Company's accounting records and were formulated following the generally accepted accounting principles in Spain as per the pertinent legislation currently in force.

These annual accounts offer a true and fair image of the equity, financial situation and financial results of the Company. The cash flow statement has been prepared to present fairly the origin and usage of monetary assets such as cash and cash equivalents.

These annual accounts were prepared on 20 February 2018 by the joint directors of the Company, and are expected to be approved without modification by the Sole-Shareholder.

2.2 Comparison of information

According to the commercial legislation, figures for the previous year are presented, for the purposes of comparison, together with the figures for 2017, with each one of the items of the Balance Sheet, Profit and Loss Statement, statement of changes in equity and statement of cash flows. The notes also include quantitative information from the previous year, unless when an accounting standard establishes that it is unnecessary.

2.3 Critical issues concerning the assessment of uncertainty

As of the closing date of the year, there are no key cases regarding the future or further relevant data regarding estimation of uncertainties associated with an important risk entailing significant changes in the value of assets and liabilities in the next year.

The Company pertains to the Tax Group, whose parent company is Telefónica, S.A. The Group estimates the likelihood of recovering the deferred tax assets based on estimates of future earnings. Such recovery depends on the Group's ability to generate taxable earnings over the period for which the deferred tax assets remain deductible. Actual income tax receipts and payments could differ from the estimates made by the Group as a result of changes in tax legislation or unforeseen transactions that could affect tax balances.

3. APPROPRIATION OF PROFIT

The Joint Directors will submit the following proposed distribution of 2017 profit for approval of the company's sole-shareholder:

| (Expressed in thousands of euros) | 2017 |
|---|--------------|
| Proposed appropriation | |
| Balance of the Profit and Loss Statement (profit) | 1,602 |
| | 1,602 |
| Appropriation to: | |
| Voluntary reserves (other reserves) | 1,602 |
| | 1,602 |

4. RECOGNITION AND MEASUREMENT ACCOUNTING POLICIES

The main recognition and measurement accounting policies applied by the Company in the preparation of these annual accounts are the following:

4.1 Financial assets

Classification and measurement

Loans and receivables

Granted loans are classified based on maturities, i.e., short-term loans as loans with a maturity of less than twelve months and long-term loans as having maturities greater than that period.

These items are measured initially at fair value in the balance sheet, which, unless there is evidence to the contrary, is the transaction price, which is equivalent to the fair value of the consideration transferred plus directly attributable transaction costs. After initial recognition, these financial assets are measured at amortised cost using the effective interest rate method.

Impairment of financial assets

The Company adjusts the carrying amount of financial assets against the profit and loss statement when there is objective evidence of actual impairment.

To determine impairment loss, the Company assesses the potential loss of individual assets as well as groups of assets with similar risk characteristics.

Cancellation

Financial assets are fully or partially derecognised when the contractual rights to related cash flows have expired or when the Company has assigned the rights to receive the effective flows of the asset to the third party, transferring nearly all risks and rewards associated with the asset.

Interest

Interests are recognised as earnings in the Profit and Loss statement. Interests must be recognised using the effective interest rate method from the moment of the referred concession of the credits.

For this purpose, attending to the maturity and separately, the amount of the explicit interest accrued and unpaid is recorded as current assets.

Explicit interests are the interests obtained when applying the contractual interest rate of the financial instrument.

4.2 Financial liabilities

Classification and measurement

Trade and other payables

They include financial liabilities created by issuing obligations, and are classified based on maturities, i.e., short-term debts as debts with a maturity of less than twelve months and long-term debts as having maturities greater than that period.

They are measured initially at fair value in the balance sheet, which, unless there is evidence to the contrary, is the transaction price, which is equivalent to the fair value of the consideration transferred plus directly attributable transaction costs. After initial recognition, these financial liabilities are measured at amortised cost using the effective interest rate method.

Cancellation

The Company derecognises a financial liability when the corresponding obligation is settled, cancelled or matures.

When there is an exchange of debt instruments, so long as they have substantially different conditions, the original financial liability is derecognised and the arising new financial liability is recognised. Likewise, a substantial modification in the current conditions of a financial liability is recorded.

The difference between carrying value of the financial liability or the derecognised part thereof, and the consideration paid, including the attributable transaction costs, and including any asset assigned other than the assumed cash or liability, is recognised in the Profit and Loss Statement for the year in which it takes place.

When there is an exchange of debt instruments that have no substantially different conditions, the original financial liability is not derecognised from the balance sheet, recording the amount of commissions paid as an adjustment of its carrying amount. The new amortised cost of the financial liability is determined by applying the effective interest rate, which is equal to the carrying amount of the financial liability on the modification date with the cash flows payable according to the new conditions.

In this regard, contractual conditions are considered to be substantially different when the lender has also granted the initial loan and the current value of the cash flows of the new financial liability, including net commissions, differs by at least 10% of the current value of the cash flows pending payment of the original financial liability, after updating both to the effective interest rate of the initial liability.

Interest

Interests are recognised as expenses in the Profit and Loss statement. Interests must be recognised using the effective interest rate method from the issue date of the referred liability.

For this purpose, attending to the maturity and separately, the amount of the explicit interest accrued and unpaid is recorded as current liability.

Explicit interests are the interests obtained when applying the contractual interest rate of the financial instrument.

4.3 Cash and cash equivalents

This heading includes the floating balance of the account maintained with Group company Telfisa Global, B.V. in local and foreign currencies that meets all the following requirements:

- They are readily convertible to cash.
- At the time of its acquisition, its maturity did not exceed three months.
- The risk of change in value is insignificant.
- They are part of the Company's standard cash management strategy.

4.4 Income tax

The Company is subject to consolidated taxation in the Corporate Tax with its Sole-Shareholder.

Income tax expense for the year is calculated as the sum of current tax resulting from applying the corresponding tax rate to taxable profit for the year, less any applicable rebates and tax credits, taking into account changes during the year in recognised deferred tax assets and liabilities. The corresponding tax expense is recognised in the profit and loss statement, except when it relates to transactions recognised directly in equity, in which case the corresponding tax expense is likewise recognised in equity and in business combinations in which it is recorded with a charge or credit to goodwill.

Deferred income tax is recognised on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts. The tax base of an asset or liability is the amount attributed to it for tax purposes.

The tax effect of temporary differences is included in “Deferred tax assets” or “Deferred tax liabilities” on the balance sheet, as applicable.

Deferred tax liabilities are recognised for all temporary differences, except where disallowed by prevailing tax legislation.

The Company recognises deferred tax assets for all deductible temporary differences, unused tax credits and unused tax loss carryforwards, to the extent that it is probable that the Tax Group will have future taxable profit available against which these assets may be utilised, except where disallowed by prevailing tax legislation.

At each financial year end, the Company assesses the deferred tax assets recognised and those that have not yet been recognised. Based on this analysis, the Company derecognises the asset recognised previously if it is no longer probable that it will be recovered, or it recognises any deferred tax asset that had not been recognised previously, provided that it is probable that the Tax Group will have future taxable profit available against which these assets may be utilised.

Deferred tax assets and liabilities are measured at the tax rate expected to be applied to the period in which they reverse, as required by enacted tax laws and in the manner in which it reasonably expects to recover the asset’s carrying value or settle the liability.

Deferred tax assets and liabilities are not discounted and are classified as non-current assets or non-current liabilities.

4.5 Revenues and expenses

Earnings and expenses are registered on an accruals basis.

4.6 Transactions in foreign currency

The Company’s functional and presentation currency is the euro. The conversion of credits and debits expressed in foreign currencies into the national currency applies the exchange rates prevailing on the transaction date, and are adjusted at year end to the exchange rates then prevailing.

Monetary assets and liabilities in foreign currencies are translated at the exchange rate prevailing at the balance sheet date. All exchange rate differences (whether gains or losses) arising from translation as well as those resulting on settlement of balance sheet items are recognised in the profit and loss statement in the period in which they occur.

4.7 Classification of current and non-current assets and liabilities

Assets and liabilities are classified in the balance sheet as current and non-current. For this purpose, assets and liabilities are classified as current when they are linked to the normal operating cycle of the Company, and are expected to be sold, consumed, made or settled in the course thereof; they differ from the previous ones and their maturity, disposal or execution is expected to take place within one year; they are kept for the purpose of trading or as cash and equivalent, whose use is not restricted to a period over one year.

4.8 Related party transactions

Related-party transactions are measured as described in the recognition and measurement accounting policies described above.

4.9 Measurement standards under the International Financial Reporting Standards (IFRS)

The Company has issued securities admitted for trading in a regulated market by an EU Member State and only publishes individual annual accounts. If the International Financial Reporting Standards adopted by the European Union were applied, there would have been no significant differences in either the Equity or Profit and Loss Statement.

5. MAIN RISKS ASSOCIATED WITH THE ACTIVITY AND RISK MANAGEMENT POLICY

(i) Concentration of revenue, liquidity and other financial risks

Nearly all the Company's revenue presently comes from the same customer (Telefónica, S.A.). Therefore, the Company's ability to honour its obligations with third parties is closely related to the financial situation of Telefónica S.A. and its ability to honour the loan contracts signed with the Company.

The terms and conditions of the financial investments maintained with Telefónica, S.A., which represent virtually all the financial assets of the Company, are similar to the terms and conditions of the financial liabilities (mainly issued debentures) subscribed by the Company. Therefore, interest rate, exchange rate and liquidity risks are substantially mitigated. For this reason, the Company presently holds no financial derivatives.

(ii) Credit risk from investing in debentures and other marketable securities issued by the Company

All debentures issued by the Company that are currently in circulation have an unconditional and irrevocable guarantee from Telefónica, S.A. and the credit risk for investing in debentures issued by the Company is therefore similar to investing directly in Telefónica, S.A.

(iii) Worsening of the financial markets

The current conditions or worsening of the financial markets could limit the Company's finance capacity and, as a result, the Company's ability to continue its activities, i.e., securing financing in capital markets to subsequently loan them to the Telefónica Group.

Likewise, financing may become complex and costly when facing a significant deterioration in the conditions of international or local financial markets because of monetary policies fixed by central banks because of not only possible interest rate hikes but also balance reductions, oil price instability or possible impaired solvency or operational behaviour of the Telefónica Group.

The occurrence of any of the aforementioned risks could limit the Company's capacity (whereby increasing the financial cost) to secure financing to furnish the Telefónica Group. This in turn could adversely affect the businesses, financial situation, profit or cash generating capacity of the Company and the Telefónica Group.

6. FINANCIAL ASSETS

The breakdown of financial assets at 31 December 2017 and 2016 is as follows:

| (Expressed in thousands of euros) | 2017 | 2016 |
|---|-------------------|-------------------|
| Non-current financial assets | 29,438,640 | 27,473,206 |
| Credits to Group companies (Note 6.1) | 29,438,640 | 27,377,145 |
| Long-term tax receivable for deferred taxes | - | 96,061 |
| Current financial assets | 4,250,581 | 5,898,022 |
| Credits to Group companies (Note 6.1) | 4,248,937 | 5,898,022 |
| Accounts receivables from Group companies for consolidated taxation | 1,644 | 5,898,022 |

During 2017, the Company conferred new funding to Telefónica, S.A. amounting to €7,324,009 thousand (loans in euros and US dollars), and received funds from debt cancellation (of the same debtor) of €5,232,326 thousand.

6.1 Credits to companies

The balance of this heading corresponds to credits conferred to Telefónica, S.A. from 2006 to 2017, broken down as follows:

(Expressed in thousands of euros)

| Loan number | Signing date | Maturity date | Annual interest rate | Payment frequency | 2017 Non-current assets | 2017 Current assets | 2016 Non-current assets | 2016 Current assets |
|-------------|--------------|---------------|----------------------|-------------------|-------------------------|---------------------|-------------------------|---------------------|
| 3 | 02/02/2006 | 02/02/2018 | 5.375% | Annual | - | 886,219 | 876,215 | 42,884 |
| 4 | 02/02/2006 | 02/02/2026 | 5.375% | Annual | 561,902 | 27,543 | 582,965 | 28,590 |
| 9 | 20/06/2006 | 20/06/2036 | 7.045% | Half-yearly | 1,659,480 | 3,749 | 1,887,535 | 4,244 |
| 13 | 31/01/2007 | 30/12/2021 | Euribor 6m + 0.830% | Half-yearly | 54,984 | 2 | 54,980 | 1 |
| 14 | 31/01/2007 | 31/01/2018 | Euribor 3m + 0.700% | Quarterly | - | 24,015 | 24,000 | 16 |
| 22 | 02/07/2007 | 03/07/2017 | 6.221% | Half-yearly | - | - | - | 684,770 |
| 29 | 06/07/2009 | 15/07/2019 | 5.877% | Half-yearly | 833,176 | 22,594 | 947,662 | 25,711 |
| 30 | 10/11/2009 | 11/11/2019 | 4.693% | Annual | 1,748,570 | 11,250 | 1,747,949 | 11,250 |
| 31 | 10/12/2009 | 09/12/2022 | 5.289% | Annual | 731,482 | 2,335 | 758,847 | 2,423 |
| 36 | 26/04/2010 | 27/04/2020 | 5.134% | Half-yearly | 1,165,716 | 10,765 | 1,325,916 | 12,235 |
| 37 | 16/09/2010 | 18/09/2017 | 3.661% | Annual | - | - | - | 1,009,969 |
| 38 | 08/10/2010 | 08/10/2029 | 5.445% | Annual | 449,376 | 5,648 | 466,226 | 5,861 |
| 39 | 07/02/2011 | 07/02/2017 | 4.75% | Annual | - | - | - | 1,250,873 |
| 41 | 16/02/2011 | 16/02/2021 | 5.462% | Half-yearly | 1,248,336 | 25,644 | 1,419,988 | 29,178 |
| 42 | 21/03/2011 | 07/02/2017 | 4.688% | Annual | - | - | - | 104,281 |
| 45 | 07/02/2012 | 07/02/2017 | 4.75% | Annual | - | - | - | 125,050 |
| 46 | 21/02/2012 | 21/02/2018 | 4.797% | Annual | - | 1,561,363 | 1,498,739 | 61,764 |
| 47 | 12/03/2012 | 12/03/2020 | 5.597% | Annual | 787,574 | 35,557 | 816,909 | 36,898 |
| 48 | 30/03/2012 | 30/03/2017 | 3.934% | Annual | - | - | - | 47,622 |
| 49 | 11/07/2012 | 11/07/2018 | 4.25% | Half-yearly | - | 75,560 | 81,030 | 1,632 |
| 50 | 19/09/2012 | 05/09/2017 | 5.811% | Annual | - | - | - | 1,019,185 |
| 51 | 19/10/2012 | 20/01/2020 | 4.71% | Annual | 1,198,503 | 53,423 | 1,197,879 | 53,423 |
| 52 | 14/12/2012 | 14/12/2018 | 2.718% | Annual | - | 213,800 | 232,531 | 300 |
| 53 | 14/12/2012 | 14/12/2022 | 3.45% | Annual | 127,888 | 209 | 139,304 | 228 |
| 54 | 22/01/2013 | 23/01/2023 | 3.987% | Annual | 1,496,662 | 56,036 | 1,496,126 | 56,037 |
| 55 | 27/03/2013 | 26/03/2021 | 3.961% | Annual | 982,509 | 30,386 | 977,663 | 30,386 |

Continued on the next page

| Loan number | Signing date | Maturity date | Annual interest rate | Payment frequency | 2017 Non-current assets | 2017 Current assets | 2016 Non-current assets | 2016 Current assets |
|-------------|--------------|---------------|----------------------|-------------------|-------------------------|---------------------|-------------------------|---------------------|
| 56 | 29/04/2013 | 27/04/2018 | 3.192% | Half-yearly | - | 1,047,867 | 1,184,789 | 6,730 |
| 57 | 29/04/2013 | 27/04/2023 | 4.57% | Half-yearly | 623,574 | 5,080 | 709,293 | 5,781 |
| 58 | 29/05/2013 | 29/05/2019 | 2.736% | Annual | 749,372 | 12,143 | 748,988 | 12,143 |
| 59 | 23/10/2013 | 23/10/2020 | 2.595% | Annual | 191,998 | 946 | 209,118 | 1,031 |
| 61 | 10/04/2014 | 10/04/2017 | Euribor 3m + 0.75% | Quarterly | - | - | - | 200,189 |
| 62 | 27/05/2014 | 27/05/2022 | 2.242% | Annual | 1,247,212 | 17,186 | 1,246,648 | 17,186 |
| 63 | 04/06/2014 | 10/04/2017 | Euribor 3m + 0.75% | Quarterly | - | - | - | 100,605 |
| 64 | 23/06/2014 | 23/06/2017 | \$Libor 3m+0.66% | Quarterly | - | - | - | 474,297 |
| 65 | 17/10/2014 | 17/10/2029 | 2.932% | Annual | 797,195 | 4,869 | 797,019 | 4,869 |
| 66 | 18/06/2015 | 19/06/2017 | Euribor 3m + 0.33% | Quarterly | - | - | - | 299,939 |
| 67 | 21/07/2015 | 21/07/2022 | Euribor 6m + 0.83% | Half-yearly | 66,821 | 169 | 66,782 | 194 |
| 68 | 14/09/2015 | 14/09/2021 | 1.477% | Annual | 997,851 | 4,370 | 997,309 | 4,370 |
| 69 | 11/12/2015 | 11/12/2017 | Euribor 3m + 0.53% | Quarterly | - | - | - | 99,995 |
| 70 | 13/04/2016 | 13/04/2022 | 0.75% | Annual | 1,396,785 | 7,692 | 1,396,059 | 7,692 |
| 71 | 13/04/2016 | 13/04/2026 | 1.46% | Annual | 1,345,778 | 14,299 | 1,345,320 | 14,299 |
| 72 | 17/10/2016 | 17/10/2020 | 0.318% | Annual | 1,247,684 | 849 | 1,246,866 | 848 |
| 73 | 17/10/2016 | 17/10/2031 | 1.93% | Annual | 746,712 | 2,994 | 746,517 | 2,994 |
| 74 | 28/12/2016 | 28/12/2051 | 4.00% | Annual | 149,970 | 49 | 149,974 | 49 |
| 75 | 17/01/2017 | 17/01/2025 | 1.528% | Annual | 1,246,323 | 18,359 | - | - |
| 76 | 17/01/2017 | 17/10/2028 | 2.318% | Annual | 498,266 | 2,394 | - | - |
| 77 | 25/01/2017 | 25/01/2019 | Euribor 3m + 0.40% | Quarterly | 150,000 | 37 | - | - |
| 78 | 08/03/2017 | 08/03/2027 | 4.103% | Half-yearly | 1,245,945 | 16,162 | - | - |
| 79 | 08/03/2017 | 08/03/2047 | 5.213% | Half-yearly | 1,653,862 | 27,361 | - | - |
| 80 | 17/03/2017 | 17/10/2028 | 2.318% | Annual | 199,014 | 958 | - | - |
| 81 | 18/04/2017 | 18/04/2037 | 4.900% | Annual | 165,855 | 5,767 | - | - |
| 82 | 28/04/2017 | 08/03/2047 | 5.213% | Half-yearly | 426,586 | 6,780 | - | - |
| 83 | 12/09/2017 | 12/01/2028 | 1.715% | Annual | 1,245,679 | 6,508 | - | - |
| | | | | | 29,438,640 | 4,248,937 | 27,377,145 | 5,898,022 |

The fair value of the credits granted to Telefónica, S.A. was €36,461,775 thousand at 31 December 2017 and €35,812,706 thousand at 31 December 2016.

The calculation of the fair value for investments in group companies and associates of the Company has required, for each currency and subsidiary, of a credit spread curve using the prices of the Telefónica Group's bonds and credit derivatives (where pertinent).

The maturities of the **non-current assets** in this category at 31 December 2017 and 2016 are:

| (Expressed in thousands of euros) | 2017 | 2016 |
|-----------------------------------|-------------------|-------------------|
| Between 1 and 2 years | 3,481,118 | 3,897,304 |
| Between 2 and 3 years | 4,591,475 | 3,444,599 |
| Between 3 and 4 years | 3,283,680 | 4,796,687 |
| Between 4 and 5 years | 3,570,188 | 3,449,940 |
| More than 5 years | 14,512,179 | 11,788,615 |
| TOTAL NON-CURRENT ASSETS | 29,438,640 | 27,377,145 |

7. EQUITY

7.1 Share capital

The share capital at 31 December 2017 comprised 62,000 shares, each with a nominal value of 1 euro. Telefónica, S.A. is the Sole-Shareholder of the Company.

Telefónica Emisiones, S.A.U. is registered as a Sole-Shareholder Company in the Companies Registry, where the identity of the Sole-Shareholder is on record.

7.2 Reserves

According to the Spanish Corporate Enterprises Act, the legal reserve, as long as it does not exceed the limit of 20% against the share capital, cannot be distributed to the Sole-Shareholder and may only be allocated, when there are no further reserves available, to offset losses.

The reserve can also be used to increase share capital in the part exceeding 10% of the already increased share capital amount.

The legal reserve is fully funded. The remaining reserves are available reserves.

8. FINANCIAL LIABILITIES

The breakdown of financial liabilities at 31 December 2017 and 2016 is as follows:

| (Expressed in thousands of euros) | Note | 2017 | 2016 |
|---|------|-------------------|-------------------|
| Non-current financial liabilities | | 29,434,837 | 27,470,113 |
| Long-term debts: Debentures and other marketable debt securities | 8.1 | 29,434,837 | 27,374,052 |
| Long-term debts with Group companies and associates for consolidated taxation | 8.2 | - | 96,061 |
| Current financial liabilities | | 4,248,130 | 5,896,701 |
| Short-term debts: Debentures and other marketable debt securities | 8.1 | 4,247,443 | 5,896,033 |
| Short-term debts with group companies and associates | 8.2 | - | 453 |
| Other payables | | 239 | 210 |
| Suppliers, group companies and associates | 8.3 | 448 | 2 |
| Current income tax payable | | - | 3 |

In 2017, the Company issued debentures with long-term maturities guaranteed by Telefónica, S.A. for a total of €7,323,758 thousand (issuances denominated in euros and US dollars), and redeemed debentures of €5,229,690 thousand.

8.1 Debentures and other marketable debt securities

Long-term and short-term debts entail the different issuances of debentures and bonds that the Company issued between 2006 to 2017 in Euros, US Dollars, Pounds Sterling, Czech Crowns, Yens, and Swiss Francs. The issuances of debentures and bonds are guaranteed by Telefónica, S.A. and listed on the stock exchange in London, New York, Zurich and Taipei. The breakdown is as follows:

(Expressed in thousands of euros)

| Issuances | Issue date | Maturity Date | Coupon | Payment frequency | 2017 Non-current liabilities | 2017 Current liabilities | 2016 Non-current liabilities | 2016 Current liabilities |
|-------------|------------|---------------|--------------------|-------------------|------------------------------|--------------------------|------------------------------|--------------------------|
| EMTN 3 | 02/02/2006 | 02/02/2018 | 5.375% | Annual | - | 886,219 | 876,222 | 42,873 |
| EMTN 4 | 02/02/2006 | 02/02/2026 | 5.375% | Annual | 561,887 | 27,543 | 582,956 | 28,582 |
| SHELF C | 20/06/2006 | 20/06/2036 | 7.045% | Half-yearly | 1,654,721 | 3,590 | 1,882,805 | 4,085 |
| EMTN 9 | 31/01/2007 | 30/12/2021 | Euribor 6m + 0.83% | Half-yearly | 54,981 | 2 | 54,977 | 1 |
| EMTN 10 | 31/01/2007 | 31/01/2018 | Euribor 3m + 0.70% | Quarterly | - | 24,015 | 23,994 | 16 |
| SHELF G | 02/07/2007 | 03/07/2017 | 6.221% | Half-yearly | - | - | - | 684,466 |
| SHELF I | 06/07/2009 | 15/07/2019 | 5.877% | Half-yearly | 833,321 | 22,594 | 947,829 | 25,711 |
| EMTN 20 | 10/11/2009 | 11/11/2019 | 4.693% | Annual | 1,748,584 | 11,250 | 1,747,973 | 11,220 |
| EMTN 21 | 10/12/2009 | 09/12/2022 | 5.289% | Annual | 731,273 | 2,335 | 758,672 | 2,416 |
| SHELF L | 26/04/2010 | 27/04/2020 | 5.134% | Half-yearly | 1,165,675 | 10,654 | 1,325,873 | 12,123 |
| EMTN 24 | 16/09/2010 | 18/09/2017 | 3.661% | Annual | - | - | - | 1,009,974 |
| EMTN 25 | 08/10/2010 | 08/10/2029 | 5.445% | Annual | 449,280 | 5,648 | 466,156 | 5,861 |
| EMTN 26 Tr1 | 07/02/2011 | 07/02/2017 | 4.75% | Annual | - | - | - | 1,250,948 |
| SHELF N | 16/02/2011 | 16/02/2021 | 5.462% | Half-yearly | 1,248,259 | 25,616 | 1,419,891 | 29,150 |
| EMTN 26 Tr2 | 21/03/2011 | 07/02/2017 | 4.75% | Annual | - | - | - | 104,249 |
| EMTN 26 Tr3 | 07/02/2012 | 07/02/2017 | 4.75% | Annual | - | - | - | 125,051 |
| EMTN 29 | 21/02/2012 | 21/02/2018 | 4.797% | Annual | - | 1,561,362 | 1,498,754 | 61,704 |
| EMTN 30 | 12/03/2012 | 12/03/2020 | 5.597% | Annual | 787,609 | 35,557 | 816,949 | 36,898 |
| EMTN 31 | 30/03/2012 | 30/03/2017 | 3.934% | Annual | - | - | - | 47,626 |
| EMTN 32 | 11/07/2012 | 11/07/2018 | 4.25% | Half-yearly | - | 75,557 | 81,022 | 1,632 |
| EMTN 33 Tr1 | 19/09/2012 | 05/09/2017 | 5.811% | Annual | - | - | - | 1,019,162 |
| EMTN 34 Tr1 | 19/10/2012 | 20/01/2020 | 4.71% | Annual | 1,198,491 | 53,423 | 1,197,912 | 53,423 |
| EMTN 35 Tr1 | 14/12/2012 | 14/12/2018 | 2.718% | Annual | - | 213,800 | 232,533 | 300 |
| EMTN 35 Tr2 | 14/12/2012 | 14/12/2022 | 3.45% | Annual | 127,904 | 209 | 139,323 | 228 |
| EMTN 37 | 22/01/2013 | 23/01/2023 | 3.987% | Annual | 1,496,803 | 56,036 | 1,496,292 | 56,047 |
| EMTN 38 | 27/03/2013 | 26/03/2021 | 3.961% | Annual | 982,509 | 30,386 | 977,663 | 30,386 |

Continued on the next page

Continuation of the table from the previous page

| Issuances | Issue date | Maturity Date | Annual interest rate | Payment frequency | 2017 Non-current liabilities | 2017 Current liabilities | 2016 Non-current liabilities | 2016 Current liabilities |
|-------------|------------|---------------|----------------------|-------------------|------------------------------|--------------------------|------------------------------|--------------------------|
| SHELF O | 29/04/2013 | 27/04/2018 | 3.192% | Half-yearly | - | 1,047,885 | 1,184,893 | 6,730 |
| SHELF P | 29/04/2013 | 27/04/2023 | 4.57% | Half-yearly | 623,657 | 5,080 | 709,433 | 5,781 |
| EMTN 39 | 29/05/2013 | 29/05/2019 | 2.736% | Annual | 749,372 | 12,143 | 748,987 | 12,143 |
| EMTN 40 | 23/10/2013 | 23/10/2020 | 2.595% | Annual | 192,017 | 946 | 209,147 | 1,031 |
| EMTN 42 Tr1 | 10/04/2014 | 10/04/2017 | Euribor 3m + 0.75% | Quarterly | - | - | - | 200,166 |
| EMTN 43 | 27/05/2014 | 27/05/2022 | 2.242% | Annual | 1,247,386 | 16,738 | 1,246,858 | 16,738 |
| EMTN 42 Tr2 | 04/06/2014 | 10/04/2017 | Euribor 3m + 0.75% | Quarterly | - | - | - | 100,121 |
| SHELF Q | 23/06/2014 | 23/06/2017 | \$Libor 3m+0.65% | Quarterly | - | - | - | 474,333 |
| EMTN 44 | 17/10/2014 | 17/10/2029 | 2.932% | Annual | 797,286 | 4,820 | 797,116 | 4,820 |
| EMTN 45 | 18/06/2015 | 19/06/2017 | Euribor 3m + 0.33% | Quarterly | - | - | - | 299,946 |
| EMTN 46 | 21/07/2015 | 21/07/2022 | Euribor 6m + 0.83% | Half-yearly | 66,847 | 169 | 66,814 | 194 |
| EMTN 47 | 14/09/2015 | 14/09/2021 | 1.477% | Annual | 998,102 | 4,370 | 997,625 | 4,370 |
| EMTN 48 | 11/12/2015 | 11/12/2017 | Euribor 3m + 0.53% | Quarterly | - | - | - | 100,003 |
| EMTN 49 | 13/04/2016 | 13/04/2022 | 0.75% | Annual | 1,396,938 | 7,537 | 1,396,247 | 7,537 |
| EMTN 50 | 13/04/2016 | 13/04/2026 | 1.46% | Annual | 1,345,958 | 14,148 | 1,345,520 | 14,148 |
| EMTN 51 | 17/10/2016 | 17/10/2020 | 0.318% | Annual | 1,247,774 | 817 | 1,247,002 | 817 |
| EMTN 52 | 17/10/2016 | 17/10/2031 | 1.93% | Annual | 746,797 | 2,974 | 746,615 | 2,974 |
| EMTN 53 | 28/12/2016 | 28/12/2051 | 4.00% | Annual | 149,964 | 49 | 149,999 | 49 |
| EMTN 54 | 17/01/2017 | 17/01/2025 | 1.528% | Annual | 1,246,376 | 18,210 | - | - |
| EMTN 55 Tr1 | 17/01/2017 | 17/10/2028 | 2.318% | Annual | 498,322 | 2,382 | - | - |
| EMTN 56 | 25/01/2017 | 25/01/2019 | Euribor 3m + 0.40% | Quarterly | 149,984 | 20 | - | - |
| SHELF R | 08/03/2017 | 08/03/2027 | 4.103% | Half-yearly | 1,245,960 | 16,107 | - | - |
| SHELF S Tr1 | 08/03/2017 | 08/03/2047 | 5.213% | Half-yearly | 1,647,067 | 27,285 | - | - |
| EMNT 55 Tr2 | 17/03/2017 | 17/10/2028 | 2.318% | Annual | 198,962 | 953 | - | - |
| EMNT 57 | 18/04/2017 | 18/04/2037 | 4.900% | Annual | 165,694 | 5,742 | - | - |
| SHELF S Tr2 | 28/04/2017 | 08/03/2047 | 5.213% | Half-yearly | 433,348 | 6,821 | - | - |
| EMTN 58 | 12/09/2017 | 12/01/2028 | 1.715% | Annual | 1,245,729 | 6,451 | - | - |
| | | | | | 29,434,837 | 4,247,443 | 27,374,052 | 5,896,033 |

The fair value of the debentures and bonds that the Company issued was €36,433,161 thousand at 31 December 2017 and €35,793,706 thousand at 31 December 2016.

The calculation of the fair value for the Company's financial debt instruments has required an estimated credit spread curve for each currency using the listed prices of the debentures and credit derivatives, the same ones used for financial assets (refer to Note 6).

The maturities of the **non-current liabilities** in this category at 31 December 2017 and 2016 are:

| (Expressed in thousands of euros) | 2017 | 2016 |
|--------------------------------------|-------------------|-------------------|
| Between 1 and 2 years | 3,481,260 | 3,897,418 |
| Between 2 and 3 years | 4,591,566 | 3,444,790 |
| Between 3 and 4 years | 3,283,852 | 4,796,883 |
| Between 4 and 5 years | 3,570,349 | 3,450,156 |
| More than 5 years | 14,507,810 | 11,784,805 |
| TOTAL NON-CURRENT LIABILITIES | 29,434,837 | 27,374,052 |

8.2 Long-term debts with group companies and associates

This heading entails long-term payables to Telefónica S.A., in its capacity as parent of the tax group to which the Company pertains, and amounts to €0 thousand (€96,061 thousand in 2016).

8.3 Short-term debts with group companies and associates / Suppliers, group companies and associates

These headings contain short-term accounts payable to:

- (i) Telefónica S.A., in its capacity as parent of the tax group to which the Company pertains, and amounts to €0 thousand (€453 thousand in 2016) and
- (ii) Telefónica Europe, B.V. for re-billing credit rating services, which amounts to €448 thousand (€0 thousand in 2016).

9. TAX SITUATION

Under prevailing tax regulations, tax returns may not be considered final until they have either been inspected by tax authorities or until the four-year inspection period has expired. The Company has the four recent years open for inspection insofar as all applicable taxes.

The Company's Joint Directors and their tax advisors consider that, in the event of a tax inspection, no significant tax contingencies would arise as a result of varying interpretations of the tax legislation applicable to the Company's transactions.

The reconciliation between accounting profit and the corporate income tax base for 2017 and 2016 was:

| (Expressed in thousands of euros) | 2017 | 2016 |
|-----------------------------------|--------------|----------------|
| Accounting profit before taxes | 2,136 | 2,989 |
| Permanent Differences | - | - |
| Temporary differences | - | 384,244 |
| Taxable profit of the year | 2,136 | 387,233 |
| Short-term tax payables | 534 | 747 |
| Long-term tax payables | - | 96,061 |
| Other impacts | - | 242 |
| Income tax | 534 | 989 |

The Company files consolidated tax returns for Corporate Income Tax within Tax Group No. 24/90, whose parent company is Telefónica, S.A., with Tax ID (CIF) No. A28015865. Given that the year's results was a profit, an account was registered for consolidated tax payable corresponding to 25% thereof (€534 thousands).

During 2017, the Company has settled 2017 Corporate Income Tax payments (for Telefónica, S.A.) of €163 thousand and payments in concept of settling the 2016 Corporate Income Tax of €453 thousand.

As a result of the advanced payment settlements for the 2017 Corporate Income Tax in the present year between the Company and Telefónica, S.A., as the parent company of the tax group, the debtor balance for consolidated taxation amounts to €1,644 thousands.

In application of article 16 of the Spanish Corporate Tax Act (Law 27/2014), which establishes a limit on the deductibility of financial expenditures, on 31 December 2016 the Company registered deferred tax assets of €96,061 thousand under *Long-term tax receivable for deferred taxes*. The mentioned asset was registered when considering that the tax group to which the Company pertains would have a future operating income (EBIT) permitting its application. In this regard, after ascertaining the 2017 operating profit of the tax group, the

company fully reverted the deferred taxes so as to conclude with a balance of €0 under *Long-term tax receivable for deferred taxes* at 31 December 2017.

10. REVENUES AND EXPENSES

10.1 External services

| (Expressed in thousands of euros) | 2017 | 2016 |
|-----------------------------------|--------------|--------------|
| Independent professional services | 371 | 236 |
| Other services | 1,429 | 929 |
| Bank services and similar | 1 | 4 |
| TOTAL EXTERNAL SERVICES | 1,801 | 1,169 |

“Independent professional services” and tax exchange and certification agent for paying coupons mainly include audit expenses and “Other services” primarily contain expenses incurred for services rendered by: (i) credit rating agencies, (ii) commissions for listing bonds on the New York Stock Exchange, (iii) payment agent for Company debt issuance programmes, and (iv) fees for outsourced accounting and reporting services.

10.2 Financial revenues

"Financial revenue" with Group companies and associates mainly includes revenue from credits granted to Telefónica, S.A.

10.3 Financial expenses

“Financial expenses” with third parties include expenses incurred during the respective years corresponding to valid obligations.

10.4 Exchange rate differences

The breakdown of assets and liabilities in a foreign currency at 31 December is as follows:

| 2017 (Expressed in thousands of euros) | Swiss Francs | US Dollars | Pounds Sterling | Czech Crowns | Yens | Total |
|--|---------------------|-------------------|------------------------|---------------------|-------------|-------------------|
| Assets | | | | | | |
| Credits to companies | 534,841 | 10,193,933 | 3,487,637 | - | 75,560 | 14,291,971 |
| Liabilities | | | | | | |
| Debentures and other marketable debt securities | 534,891 | 10,191,600 | 3,487,365 | - | 75,557 | 14,289,414 |
| 2016 (Expressed in thousands of euros) | Swiss Francs | US Dollars | Pounds Sterling | Czech Crowns | Yens | Total |
| Assets | | | | | | |
| Credits to companies | 582,512 | 8,718,097 | 3,617,818 | 47,622 | 82,662 | 13,048,711 |
| Liabilities | | | | | | |
| Debentures and other marketable debt securities | 582,562 | 8,713,103 | 3,617,585 | 47,626 | 82,654 | 13,043,530 |

The breakdown of foreign currency transactions is as follows:

| 2017 (Expressed in thousands of euros) | Swiss Francs | US Dollars | Pounds Sterling | Czech Crowns | Yens | Total |
|--|---------------------|-------------------|------------------------|---------------------|-------------|----------------|
| Interest income | 16,385 | 547,683 | 186,845 | 460 | 3,361 | 754,733 |
| Interest expenses | 16,333 | 546,141 | 186,770 | 454 | 3,366 | 753,064 |
| 2016 (Expressed in thousands of euros) | Swiss Francs | US Dollars | Pounds Sterling | Czech Crowns | Yens | Total |
| Interest income | 16,731 | 477,877 | 201,126 | 1,867 | 4,986 | 702,587 |
| Interest expenses | 16,679 | 476,508 | 200,915 | 1,843 | 4,996 | 700,941 |

The breakdown of **exchange rate differences on financial instruments recognised in the profit and loss statement** is as follows:

| (Expressed in thousands of euros) | 2017 | 2016 |
|---|--------------------|------------------|
| Credits to companies | | |
| Transactions settled in the year | 75,805 | 67,114 |
| Transactions pending settlement at year end | 1,566,611 | 303,039 |
| | 1,642,416 | 370,153 |
| Trade and other payables | | |
| Transactions settled in the year | (76,187) | (67,145) |
| Transactions pending settlement at year end | (1,566,544) | (302,943) |
| | (1,642,731) | (370,088) |

Positive and negative foreign exchange differences are generated by the different issuances and credits issued in a foreign currency, and are measured at year-end to the exchange rates then prevailing.

11. RELATED-PARTY TRANSACTIONS

11.1 Related parties

Company transactions in 2017 with related parties, carried out under market conditions, and the nature of the relationship, are as follows:

| | Nature of the relationship |
|-------------------------|----------------------------|
| Telefónica, S.A. | Group parent |
| Telfisa Global, B.V. | Group company |
| Telefónica Europe, B.V. | Group company |

11.2 Balances

Balances kept with related parties are as follows:

| (Expressed in thousands of euros) | Group parent 2017 | Other group companies 2017 | Group parent 2016 | Other group companies 2016 |
|--|----------------------|-------------------------------------|----------------------|-------------------------------------|
| Long-term credits (Note 6) | 29,438,640 | - | 27,377,145 | - |
| Short-term credits (Note 6) | 4,248,937 | - | 5,898,022 | - |
| Accounts receivable, group companies consolidated taxation | 1,644 | - | - | - |
| Cash and cash equivalents | - | 4,430 | - | 3,176 |
| Long-term debts for consolidated taxation (Note 8) | - | - | 96,061 | - |
| Short-term debts (Note 8) | - | 448 | 455 | - |

11.3 Transactions

The transactions made with related parties are as follows:

| (Expressed in thousands of euros) | Group parent 2017 | Other group companies 2017 | Group parent 2016 | Other group companies 2016 |
|--|-------------------|----------------------------|-------------------|----------------------------|
| External services (Note 10.1) | - | - | - | 10 |
| Financial revenue –Interests (Note 10.2) | 1,334,775 | 17 | 1,336,928 | 1 |
| Exchange rate differences (Note 10.4) | (1,642,346) | (385) | (370,082) | (6) |

12. OTHER INFORMATION

12.1 Auditors' fees

PriceWaterhouseCoopers Auditores, S.L., statutory auditor of Telefónica Emisiones, S.A.U., received a remuneration of €98 thousand in 2017, corresponding to financial statement auditing services and other services related with issuing *comfort letters*.

The remuneration paid to the different companies integrated in the global organisation of EY (erstwhile Ernst & Young), which includes Ernst & Young, S.L., the firm that audited Telefónica Emisiones, S.A.U. in 2016, was €98 thousand, corresponding to financial statement auditing services and other services related with issuing *comfort letters*.

12.2 Information from Directors

In 2017, the Joint Directors of the Company received no remuneration of any sort. The Company granted no advances, loans or credits whatsoever, assumed no obligations in terms of pensions, retirement plans and insurance payments for Joint Directors.

Pursuant to articles 229 and 230 of the Corporate Enterprises Act, the Joint Directors reported that they were not involved in any conflicts of interest with the Company.

12.3 Information on the environment

At 31 December 2017 and 2016, there were no significant assets dedicated to protecting and improving the environment, and no relevant expenses of this nature were incurred during the year. Additionally, during the years ending on 31 December 2017 and 2016, no subsidies or grants of an environmentally related nature were received.

The Company's Joint Administrators consider the environmental risks that could arise from the Company's activities as minimum and, in any case, appropriately covered, and consider that no additional liabilities will arise in relation to such risks.

12.4 Information on average payment period to suppliers. Third additional provision. “Duty to disclose” as prescribed in Spanish Law 15/2010 of 5 July.

Pursuant to the cited law, the following declaration is hereby made regarding the Company:

| | 2017 | 2016 |
|----------------------------------|--------------------|--------------------|
| | Days | Days |
| Weighted average maturity period | 37 | 45 |
| Ratio of payments | 37 | 48 |
| Ratio of outstanding invoices | 38 | - |
| | Thousands of euros | Thousands of euros |
| Total payments made in the year | 1,821 | 742 |
| Outstanding invoices | 21 | - |

Telefónica Emisiones, S.A.U. has adapted its internal processes and payment terms policies to Spanish Law 15/2010 (modified by Law 31/2014) and Royal Decree-law 4/2013, which in turn modify Law 3/2004, establishing measures to combat late payment in commercial transactions. Accordingly, the terms of contract of suppliers in the year 2017 have included payment terms equal to or less than 60 days, depending on the terms agreed by the parties.

12.5 Contracts executed with the Sole-Shareholder

The characteristics of the contracts entered into with the Sole- Shareholder, Telefónica, S.A. are detailed below, indicating the execution date and a brief description of the purpose, characteristics and obligations of the parties therein:

| Contract | Execution date | Purpose | Characteristics |
|-------------------------------|----------------|--|--|
| Framework Financing Agreement | 29/04/2005 | Granting loans to the Single Shareholder | The Company will grant loans under this Framework Agreement. |

12.6 Staff

The Company has no employees at the closing dates of 2017 and 2016.

13. NATURE AND EXTENT OF RISKS ARISING FROM FINANCIAL INSTRUMENTS

Telefónica, S.A. guarantees the financial debt issued by Telefónica Emisiones, S.A.U. on capital markets. The credit risk of the issuances is therefore similar to investing directly in Telefónica, S.A.

The terms and conditions of the financial assets maintained with Telefónica, S.A., contain terms and conditions that are similar to the ones for financial liabilities, and therefore substantially cover interest rate, exchange rate and liquidity risks.

14. EVENTS AFTER THE CLOSING DATE

The following Company-related events occurred between the 2017 closing date and the date on which these annual accounts were drawn up:

- On 22 January 2018, the Company issued debentures of €1,000 million with a maturity date of 22 January 2027 and annual coupon of 1.447%.

This issuance was made within the scope of the €40,000 million in Telefónica Emisiones, S.A.U.'s Euro Medium Term Notes Programme (EMTN Programme) with the guarantee of Telefónica, S.A. dated 29 June 2017.

- On 31 January 2018, the Company amortised a debt issuance of €24 million on its maturity date. These debentures, with a coupon of 0.70% Euribor at 3 months liquidated every quarter as matured, were issued on 31 January 2007 through the Company's EMTN Programme.
- On 2 February 2018, the Company amortised a debt issuance of 750 million pounds sterling on its maturity date. These debentures, with a coupon of 5.375% liquidated annually as matured, were issued on 2 February 2006 through the Company's EMTN Programme.

15. ADDITIONAL NOTE FOR ENGLISH TRANSLATION

These annual accounts were originally prepared in Spanish, In the event of discrepancy the Spanish-language version prevails.

These annual accounts are presented on the basis of accounting principles generally accepted in Spain, Consequently, certain accounting principles applied by the Company may not conform with generally accepted principles in other countries.



TELEFÓNICA EMISIONES, S.A.,
(Sole-Shareholder Company)

MANAGEMENT REPORT FOR THE YEAR ENDED 31 DECEMBER 2017

2017 Summary

During 2017, the Company continued carrying out the activities of its corporate purpose. The most significant events duly reflected in the 2017 profit and loss statement are:

- Operating losses of €1,804 thousand (€1,173 thousand in the previous year), with the most relevant item generated by expenses incurred with credit rating agencies.
- Positive financial revenues of €3,940 thousand (€4,162 thousand in the previous year) came from interests and commissions accrued in the loans granted to Telefónica, S.A.
- The combination of the two results above added to the expense for Corporate Income Tax of €534 thousand (€989 thousand in the previous year), results in a **profit in ordinary activity of €1,602 thousand** (€2,000 thousand in the previous year).

The financing operations carried out in 2017 entailed **issuing a total of €7,324 million in debt instruments** within the framework of Telefónica Emisiones, S.A.U.'s two debt issuance programmes guaranteed by Telefónica, S.A.: (i) the Euro Medium Term Notes (EMTN) Programme of €40,000 million, and (ii) the SHELF Programme.

2018 Targets

The Company is expected to continue its line of activity in the future, executing financial transactions for the purpose of securing financing for the Telefónica Group. In this regard, during 2018 the Company shall actively monitor the international capital markets so as to issue debentures (or any other financial instrument it deems appropriate) if the market conditions are right and if these meet the Company's financing requirements.

Capital Structure

Telefónica Emisiones, S.A. is a Sole-Shareholder Company with a share capital comprising 62,000 ordinary shares with a par value of 1 euro each. The Company's share capital is fully subscribed and paid up. Its Sole-Shareholder is Telefónica, S.A., a company legally established in Spain, with its registered office at Gran Vía 28, 28013 – Madrid.



TELEFÓNICA EMISIONES, S.A.,
(Sole-Shareholder Company)

Company Administration

Similar to the previous year, the Company has two Joint Directors who receive no remuneration for the discharge of their duties:

- (i) Eduardo José Álvarez Gómez and
- (ii) Francisco Javier Ariza Garrote

Treasury Shares

Similar to 2016, the Company made no purchases or other transactions with own shares.

Research and Development Activities

Telefónica Emisiones, S.A.U. had no research and development activities in 2017.

Weighted average maturity period

In 2017, the average supplier payment period for commercial transactions was less than 60 days.

Likewise, and pursuant to Spanish Law 15/2010 (amended by Law 31/2014) and Royal Decree-Law 4/2013, which in turn amend Law 3/2004, establishing measures to combat defaults in commercial transactions, in 2017 the Company did not enter into any agreements with commercial suppliers with average payment periods in excess of 60 days.

Financial instruments and risk management policy

Refer to Note 5.

Related-party transactions

The Company granted long-term financing to its shareholder, Telefónica, S.A., and kept asset balances with related companies.

Shareholder Remuneration

As in the previous year, the Company paid no dividends in 2017.

The Company's joint directors intend to propose to the Sole-Shareholder that the 2017 earnings be charged to voluntary reserves.



TELEFÓNICA EMISIONES, S.A.,
(Sole-Shareholder Company)

Annual Corporate Governance Report

Given that the Company is a Sole-Shareholder Company and its sole-shareholder is the listed company Telefónica, S.A., it is referred to the Annual Corporate Governance Report of Telefónica, S.A. by virtue of Article 9.4 of Order ECC/461/2013 of 20 March, which sets out the content and structure of the annual corporate governance report, annual report on remuneration and other reporting instruments for listed companies, banks and other entities that issue securities admitted to trading on official securities markets.

Subsequent Events

The following Company-related relevant events occurred between the 2017 closing date and the date on which these annual accounts were drawn up:

- On 31 January 2018, **the Company amortised a debt issuance of €24 million on its maturity date**. These debentures, with a coupon of 0.70% over Euribor at 3 months liquidated every quarter as matured, were issued on 31 January 2007 (through the Company's EMTN Programme).
- On 2 February 2018, **the Company amortised a debt issuance of 750 million pounds sterling on its maturity date**. These debentures, with a coupon of 5.375% liquidated annually as matured, were issued on 2 February 2006 (through the Company's EMTN Programme).
- On 22 January 2018, **issuance of debt instruments (under the EMTN Programme of 29 June 2017) of €1,000 million** with a maturity date of 22 January 2027 and annual coupon of 1.447%.



TELEFÓNICA EMISIONES, S.A.,
(Sole-Shareholder Company)

SIGNATURE VALIDATION

At their meeting on 20 February 2018, the Joint Directors of Telefónica Emisiones, S.A. (Sole-Shareholder Company) authorised the issuance of these annual accounts, comprising the balance sheet, income statement, statement of changes in equity, cash flow statement and notes for 2017, which form an integral part of this document.

These annual accounts and Management Report have been endorsed on all the pages. This document serves as a signature for all the documents comprising the annual accounts and management report.

(Signed on the original in Spanish)

Eduardo José Álvarez Gómez

Joint Director of

Telefónica Emisiones, S.A. (Sole-Shareholder Company)

(Signed on the original in Spanish)

Francisco Javier Ariza Garrote

Joint Director of

Telefónica Emisiones, S.A. (Sole-Shareholder Company)