

LETTER TO  
**TELEFÓNICA'S SHAREHOLDERS** 2020





# Letter to Telefónica's Shareholders

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José María Álvarez-Pallete  
Chairman & CEO of Telefónica

The letter I sent to you this time last year concluded by stating that “The history of Telefónica is one of permanent change. Your Company, our Company, has been forged in change”.

When I wrote those words, I could never have imagined that we would be subjected to a test of change as abrupt and swift as that caused by the COVID19 pandemic.

Furthermore, it has turned out to be true that, as I also pointed out in that letter “At the most important crossroads in our life there are no signs” (Hemingway). Nevertheless, there are compasses. And in times of uncertainty, values must serve as the compass that sets us on the right path.

Our mission is that compass: “Making our world more human by connecting lives”.

That was precisely our response. And thanks to the clarity of our mission and our values, this crisis has brought out the best in Telefónica. Never before have we had such a strong sense of purpose.

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## TELEFÓNICA'S RESPONSE TO COVID-19

Throughout the month of March and in just a few short days the entire Western world came to a standstill. Planes were grounded, factories shut down, streets were deserted and shops, cinemas, schools and offices closed their doors; half of humanity locked themselves down in their homes.

Mobility and personal contact fell dramatically; passenger air traffic screeched to a virtual halt. All life moved from the physical to the virtual world: shops went online, cinemas went online, offices went online, schools went online.

Financial transactions inundated the Internet and the limited number of face-to-face payments migrated to credit cards and mobile phones. Wherever possible, telework became the norm. Students re-established contact with teachers through distance learning which, up to that point, accounted for only a small portion of education. Fiction passed through audio-visual platforms as did music, reading and other forms of leisure and entertainment. Family and friends resorted to land-line calls and video-conferences as their new meeting point.

Naturally, all of this activity had an immediate impact on the traffic carried by our networks. In only a few days, data traffic on our fixed-line networks increased by 25%, as did mobile and fixed-line calls which had been on the decline. We are talking about growth in a just a few weeks greater than that seen in all of 2019.

Telefónica became the support structure that kept the business, cultural, educational, labour and financial activity of our societies alive. Indeed, the health and administrative response to the

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emergency itself depended on our networks. It had become vital for the whole of society for us to fulfil our mission.

That was our first and primary contribution to this health, social and economic emergency: keep communications up and running. But it was certainly not the only one. Over the course of those difficult weeks we responded in other ways to our different stakeholders in all markets:

- Once again, we put people, the health of our employees, first. From the very outset, the company chose to put 95% of its staff on telework and to take care of our co-workers who had contracted the disease. The sense of belonging has always been strong at Telefónica, but in these days due to these extreme conditions we feel closer than ever.
- We acted quickly to ease the hardship our customers were experiencing due to confinement by increasing data volumes and extending our entertainment offering at no additional cost. Our relationship is commercial in nature, but we also want to enhance the human element.
- We responded to our suppliers by treating them as true partners and alleviating their need for liquidity.
- We responded to the financial constraints suffered by our millions of shareholders and opted to maintain the dividend of €0.40 per share. We are aware that many rely on their dividends as a significant part of their income.

- And, in general, we did our best to be useful to society as a whole: endowing a fund with €25 million for the purchase of medical equipment; providing connectivity for hospitals such as the one set up at IFEMA in Madrid and medicalised hotels; helping to bolster emergency services and even by making our technologically advanced buildings, such as the O2 Arena in London and the O2 Tower in Munich, available for public use. And through other initiatives such as #SUMAFUERZAS, a joint effort with the Red Cross; putting our digital training platforms at the disposal of society; and donating 10,000 tablets for vulnerable families through ProFuturo ... It is clear to us that while a company's raison d'être is to create wealth and add value to its shareholders, this also applies to the community at large that it is a part of.

Along these same lines, we made our technical, human and material resources available to government administrations and the Health System. This was our resolute response to an unprecedented situation. Nevertheless, we did not have to improvise; we simply had to fulfil our corporate purpose.

## LOOKING BEYOND THE EMERGENCY: THE WORLD AFTER COVID19

Over and above the specific circumstances of the emergency faced by different communities and also beyond the contribution made by our company to the collective response, this crisis has taught us some general lessons:

- i. It has been confirmed that telecommunications are a vital sector in contemporary societies. In fact, along with health and food, communications have stood out as one of the three great needs of human beings. Our sector is essential for people, for companies, for societies and for economies. Telecommunications companies are the backbone of our society. And these companies can only fulfil their role if they have robust networks.

This reaffirms the investment decisions Telefónica made in recent years —over €90 billion since 2012— to strengthen our networks and which enabled us to be in the best possible position to confront this situation.

We frequently mention that Spain is the number one country in Europe and ranks third in the OECD in terms of fibre coverage. This means that there is more fibre in rural parts of Spain than there is on average in Europe's urban areas. And the mobile network stands out as well with over 98% of the country enjoying 4G coverage. The events in recent weeks have shown that these numbers are more than mere anecdotal curiosities. They are the quantification of the robustness of a country facing an extreme emergency. The efforts we made years ago and that might have appeared to be over the top at that time have proven to be essential now.

***“What goes through our networks is not just voice and data. It is life itself that travels through our networks”***

- ii. In a few weeks of confinement, societies have travelled the same distance down the path of digital transformation that would have taken five years under normal conditions. The supply of technology is no longer driving this advance; it is now society and companies that are demanding this transformation. The pandemic is accelerating the digitisation process in all areas at rates that were unimaginable until just recently.

Public and business organisations as well as millions of people have discovered that a different sort of life is possible. What Telefónica has always believed in has now been proven: there are not two lives, one physical and one digital. There is only one life and what goes through our networks is not just voice and data.

It is life itself that travels through our networks as well as the solution to the needs of human beings.

- iii. This emergency has not only accelerated the emergence of the digital world but has also highlighted the risks of this acceleration and the need for renewed governance.

Health information systems have been subjected to severe attacks in a context of uncertainty and social distress. On-line teaching has once again highlighted the relevance of the social-digital divide. The proliferation of digital activity increases the importance of the debate regarding data ownership and privacy protection in the new digital age. These are precisely the issues that Telefónica's Digital Manifesto warned about and that urgently need to be addressed if we are to proactively manage a swift digital transition.

- iv. For the first time in history the world has had to deal with a veritable emergency in real time. In these months of 2020, we have comprehended its scope and seen how lives can be interrupted by a situation that is out of control. And this prompts us to take action as soon as possible against the climate emergency where digitisation has emerged as an essential part of the solution.

The fact is that our sector generates few emissions: despite a nearly four-fold increase in data traffic over the last 4 years, electricity consumption by the sector has actually declined slightly. Moreover, digital technology can provide solutions to reduce emissions by more than a third over the next ten years.

This has taught us that the world can reduce physical mobility by nearly 100% for extended periods of time but it would be inconceivable for it to reduce its communications by that same proportion. On this count, Telefónica also has an excellent service sheet: 80% of the energy we use is from renewable sources and that

percentage reaches 100% in Brazil and Europe. We prevent 3.2 times more emissions than we generate, the amount absorbed by nearly 53 million trees.

## ACTION PLAN TO BUILD THE NEW TELEFÓNICA

2020 will go down in the history of our company as the year we successfully passed the pandemic test, but will also be remembered as the year we reached important milestones in the execution of the Action Plan to build the New Telefónica which we presented in November of last year.

At that time, we announced five strategic decisions taken to generate value and a long-term positive impact for all our stakeholders. In short, to grow and be more efficient in a sustainable manner.

- 1) We decided to prioritise Spain, Brazil, Germany and the United Kingdom as key markets where we have four cutting-edge operators. We have strengthened our position in these markets by improving the value proposition that we offer to customers and by making a major effort to improve customer experience on the most advanced ultra-broadband networks. These are large markets that account for 80% of our revenues.
- 2) We decided to spin-off our businesses in Latin America, equipping them with a new organisational structure and dedicated team. This put us in a position to consider strategic alternatives to maintain a profitable presence in the region.
- 3) We launched Telefónica Tech with the aim of establishing a world leader in B2B digital services covering the fields of cybersecurity, Cloud, Internet of Things (IoT) and Big Data. We hit the ground running with unique advanced digital services in a sector growing at nearly 30% per annum.

- 4) We created Telefónica Infra which is emerging as one of the world's largest telecommunication infrastructure units. With this we intend to draw attention to the true value of these exceptional assets that today go largely unnoticed.
- 5) We decided to implement a new operating model to gain agility, speed up execution and maximise synergies between all Telefónica's units.

In just six months, and despite the exceptional circumstances characterising this last quarter, we have already made great strides in these five areas:

- We are already managing businesses in Latin America as an operationally autonomous and independent unit and we have taken measures to prepare for a potential financial spin-off while we analyse all the alternatives to maintain a profitable presence in the region.
- Through Telefónica Tech we have signed important strategic agreements with Microsoft for cloud services and with Google for cybersecurity. The unit's management team is fully focused and is actively working on the carve-out of these businesses, the revenues of which continue to achieve double-digit growth.
- Telefónica Infra is promoting multiple infrastructure projects and we are moving forward at a good pace with the monetisation of our tower portfolio. Telxius, its main asset, continues to grow at a remarkable rate.
- The new operating model is also beginning to take shape despite the difficult conditions of confinement endured by our teams. We are capturing significant efficiencies through digitisation and simplification initiatives in all countries and we are clearly ahead of our peers when it comes to legacy management.
- Nevertheless, amidst all this activity, by far the biggest step was taken with one of our four key markets, the United Kingdom. The recently

announced agreement marks the creation of the leading converged operator, none other than the champion of UK connectivity.

This transaction merges our company O2, the UK's biggest, best and most admired mobile operator, with Virgin Media, the market leader in ultra-high-speed broadband with a unique entertainment platform. The combination of these two businesses makes us stronger in the second largest market in Europe offering enormous opportunities. Moreover, the merger of the two companies will result in very significant synergies estimated at £6,250 million.

This is the largest corporate transaction in Telefónica's history and was completed during the lockdown which says a lot about the management capacity of Telefónica's teams that had to work under the most extreme circumstances.

Likewise, in Brazil, another of our key markets, we are having conversations with Telecom Italia to buy Oi's mobile assets and hence strengthen our position in a market where we are already the undisputed leader.

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## 2019 RESULTS, AN IMPORTANT YEAR FOR TELEFÓNICA

2019's results should be seen as the prelude to the changes that we announced at the end of last year.

- To begin with, we met the financial guidance we had set for ourselves, both in terms of revenue growth and OIBDA, as well as investment.

## ***“Not only did we meet our financial guidance but we made headway on non-financial targets too”***

- We continue to gain relevance in the lives of our customers.
- We invest to ensure that our platforms continue to be the most technologically advanced.
- We continue to significantly reduce debt and generate record free cash flow.
- And all this has allowed us to maintain an attractive and sustainable dividend.
- It is true that net profit has suffered but this is due to a deliberate decision. We sacrificed an important part of our profits to cover, among other things, the restructuring costs we anticipate in executing our Action Plan.

Not only did we meet our financial guidance but we made headway on non-financial targets too:

- We deepened our commitment towards the environment and are helping to decarbonise the economy with our highly energy efficient digital solutions and fibre networks. Telefónica has once again been recognised as a global leader for its action against climate change.
- We have bolstered our position as a benchmark in efficiency, advancing in digitisation to offer a simple digital experience to our customers.

We reached new records in customer and employee satisfaction and were recognised as the most admired European Telco and leaders in ESG.

- We strengthened our corporate governance: in the last four years we renewed 65% of the Board of Directors. For the first time in our history, 30% of our directors are women and we continue to have a majority of independent directors.
- We again stood out as a driving force behind social progress insofar as our activity has an impact of more than €52,000 million on the GDP of the countries where we operate; we generate 1.1 million direct and indirect jobs and contribute nearly €9,000 million in the form of taxes.

It is now time to face the enormous challenge that the immediate future holds for all of us. We will do so with a detailed roadmap, i.e. the Action Plan that we drew up at the end of 2019 and that is paving the way towards the New Telefónica. We are encouraged more than ever in this new phase by the firm intention to move forward. Furthermore, we will do so feeling empowered as a community after overcoming the extreme test that the COVID19 crisis presented.



This result has only been possible thanks to a sound company culture forged over the course of decades and, above all, to the motivation of hard-working teams and a committed Board of Directors. The extreme situations that we had to face in recent months have strengthened more than ever, our personal ties.

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However, this overview of our most recent past and the immediate challenges that await us would be incomplete if I were not to express our gratitude to the recipients of this letter, the owners of Telefónica, its shareholders. Your trust and support, sometimes expressed and sometimes tacit, have been essential in making each and every one of these achievements possible. I would like to acknowledge that trust and assure you that, for the management team, this is the greatest stimulus to achieving the goals that lie ahead in this exciting stage as we approach the company's first centennial.



José María Álvarez-Pallete  
**Chairman & CEO of Telefónica**



