Capital Structure Strategy
and
New IFRS for 2018
Finance and Accounting session

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Global Director of Investor Relations
Key Objectives

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Chief Financial and Control Officer
Key Objectives

**Capital Structure Strategy**
- Guarantee Solvency and Liquidity
- Interest rates and FX volatility management
- Cost optimization across capital structure

**New IFRS for 2018**
- Implications and main changes of new accounting standards
Long term financing strengthened our balance sheet in 2017 and YTD

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

<table>
<thead>
<tr>
<th>Source</th>
<th>(Ebn)</th>
</tr>
</thead>
<tbody>
<tr>
<td>USD Bonds</td>
<td>5.6</td>
</tr>
<tr>
<td>€ Bonds</td>
<td>4.4</td>
</tr>
<tr>
<td>Latam Financing</td>
<td>1.2</td>
</tr>
<tr>
<td>Hybrids</td>
<td>3.3</td>
</tr>
<tr>
<td>Bank Financing</td>
<td>1.0</td>
</tr>
<tr>
<td>Total</td>
<td>15.5</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Year</th>
<th>(Ebn; not considering hybrid NC dates)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018E</td>
<td>(1.4)</td>
</tr>
<tr>
<td>2019E</td>
<td>5.8</td>
</tr>
<tr>
<td>2020E</td>
<td>6.2</td>
</tr>
</tbody>
</table>

### Liquidity position (Dec-17)

<table>
<thead>
<tr>
<th>Category</th>
<th>(Ebn)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash position</td>
<td>7.3</td>
</tr>
<tr>
<td>Undrawn credit lines &amp; synd. credit facilities</td>
<td>13.5</td>
</tr>
<tr>
<td>Liquidity position</td>
<td>20.9</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Sources</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>LT</td>
<td>71%</td>
</tr>
<tr>
<td>Fixed</td>
<td>92%</td>
</tr>
</tbody>
</table>

### Interest payments cost (Dec-17)

<table>
<thead>
<tr>
<th>Source</th>
<th>Interest Cost</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dec-16</td>
<td>3.94%</td>
<td>(0.62 p.p.)</td>
</tr>
<tr>
<td>Europe</td>
<td>(0.40%)</td>
<td>(0.22%)</td>
</tr>
<tr>
<td>Latam</td>
<td>3.32%</td>
<td></td>
</tr>
</tbody>
</table>

71% of debt in fixed rates (51% in 2016)

<€100mn interest payment sensitivity to +100bps in rates (>€225mn in 2016)

Source: Telefónica
Key Finance objectives – guarantee solvency and liquidity

1. Fully committed to a solid investment grade credit rating (BBB/Baa2)
2. Current liquidity covers debt maturities in excess of two years
3. Manage and hedge main risks – focus on interest rates and FX

Meet key objectives while optimizing costs across our capital structure
### Capital structure breakdown and pricing of debt vs. equity

<table>
<thead>
<tr>
<th>€bn</th>
<th>Reported Net Debt</th>
<th>Net Employee Commitments</th>
<th>Hybrids</th>
<th>Market Capitalization</th>
<th>Minorities</th>
<th>Enterprise Value</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>44.2</td>
<td>4.3</td>
<td>7.5</td>
<td>41.5</td>
<td>-1.3</td>
<td>96.2</td>
</tr>
</tbody>
</table>

**Interest & Dividend outflows (€m)**
- Reported Net Debt: 1,726
- Net Employee Commitments: 354
- Hybrids: 2,077 (€40c/share)
- Enterprise Value: 6,559

**FCF ex spectrum & unlevered FCF (€m)**
- Pre-tax: 5,300
- Post-tax: 6,82% (unlevered FCF yield)

**Cash Yields (%)**
- Pre-tax: 3.32% (Post-LM: 3.45%)
- Post-tax: 2.59% (Post-LM: 3.45%)

**Pre-tax cash flows**
- FCF ex spectrum plus financial payments net of taxes and adjusted for minorities
- FCF yield: 12.77%

**Post-tax cash flows**
- FCF yield: 12.77%

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1. Hybrids valued at issuance date
2. Data as of 20/03/2018. Source: Bloomberg
3. FCF ex spectrum plus financial payments net of taxes and adjusted for minorities
4. Assuming TEF’s effective cash tax rate of 21.5%

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

Source: Telefónica
Historical trend in financial payments and key trade-offs in costs

1. **Average Maturity:**
   - Low maturities = lower cost; in context of rising interest rates, preferable to increase average debt life.

2. **Floating vs. Fixed Rates:**
   - Floating = lower cost; in context of rising interest rates, safer to increase weight of fixed rate debt.

3. **FX Mix:**
   - Cost in euros are lower than in LatAm currencies; consider expected FX changes and compare extra financial cost vs. FX impact on principal.

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

TEF inventory of listed fixed income instruments by currency

Source: Bloomberg. Data as of March 20th

Bond issues in 2017-18 YTD

Yield to maturity (%) vs. Years to maturity for EUR, GBP, USD bonds.
Credit market depth is critical, specially in long tenors

Total Corporate IG issuance\(^1\) in 2017 – 300bn in EUR, 728bn in USD and 36bn in GBP

Maturity breakdown

<table>
<thead>
<tr>
<th>Total Corporate IG issuance(^1) in 2017 – 300bn in EUR, 728bn in USD and 36bn in GBP</th>
</tr>
</thead>
<tbody>
<tr>
<td>EUR</td>
</tr>
<tr>
<td>USD</td>
</tr>
<tr>
<td>GBP</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Years</th>
<th>Yield</th>
<th>Euro Bonds</th>
<th>USD Bonds</th>
<th>Latam Financing</th>
<th>Hybrids</th>
<th>Bank Financing</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oct-16</td>
<td>4</td>
<td>6.5</td>
<td>5.6</td>
<td>1.2</td>
<td>3.3</td>
<td>2.5</td>
<td>19.0</td>
</tr>
<tr>
<td>Oct-16</td>
<td>15</td>
<td>0.32%</td>
<td>0.75</td>
<td>0.15</td>
<td>1.25</td>
<td>0.15</td>
<td>1.25</td>
</tr>
<tr>
<td>Dec-16</td>
<td>35</td>
<td>1.93%</td>
<td>4.00%</td>
<td>1.53%</td>
<td>1.53%</td>
<td>2.32%</td>
<td>2.32%</td>
</tr>
<tr>
<td>Jan-17</td>
<td>8</td>
<td>4.00%</td>
<td>1.53%</td>
<td>2.32%</td>
<td>2.32%</td>
<td>11.75</td>
<td>11.75</td>
</tr>
<tr>
<td>Jan-17</td>
<td>0.5</td>
<td>1.72%</td>
<td>1.72%</td>
<td>1.72%</td>
<td>1.72%</td>
<td>1.72%</td>
<td>1.72%</td>
</tr>
<tr>
<td>Jan-17</td>
<td>0.2</td>
<td>0.15</td>
<td>0.15</td>
<td>0.15</td>
<td>0.15</td>
<td>0.15</td>
<td>0.15</td>
</tr>
<tr>
<td>Mar-17</td>
<td>1.25</td>
<td>1.25</td>
<td>1.25</td>
<td>1.25</td>
<td>1.25</td>
<td>1.25</td>
<td>1.25</td>
</tr>
<tr>
<td>Sep-17</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
</tr>
<tr>
<td>Jan-18</td>
<td>9.5</td>
<td>9.5</td>
<td>9.5</td>
<td>9.5</td>
<td>9.5</td>
<td>9.5</td>
<td>9.5</td>
</tr>
</tbody>
</table>

1. Source: UBS Corporate Debt Capital Markets
2. Floating rate note (Euribor 4m + 40 bps)
Source: Telefónica
**Derivatives – turn a 30Y USD coupon of 4.895% into 3.17% in €**

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

<table>
<thead>
<tr>
<th>Notional</th>
<th>Currency</th>
<th>Coupon (%)</th>
<th>HEDGING ACTIVITY</th>
</tr>
</thead>
<tbody>
<tr>
<td>$1,250m</td>
<td>USD</td>
<td>Fixed (30Y T-Bond 3.165% + TEF Spread 1.73%)</td>
<td>Pay out</td>
</tr>
<tr>
<td>$1,250m</td>
<td>USD</td>
<td>Floating (USD LIBOR 3M)</td>
<td>Pay out</td>
</tr>
<tr>
<td>$1,250m</td>
<td>EUR</td>
<td>Floating (EURIBOR 3M) +/- (basis spread + 0.07%)</td>
<td>Pay out</td>
</tr>
<tr>
<td>$1,250m</td>
<td>USD</td>
<td>Fixed (TEF spread 1.73%)</td>
<td>Pay in</td>
</tr>
<tr>
<td>$1,250m</td>
<td>EUR</td>
<td>Fixed (30Y Swap 1.58%)</td>
<td>Pay out</td>
</tr>
<tr>
<td>€1,022m</td>
<td>EUR</td>
<td>Floating (EURIBOR 3M)</td>
<td>Pay in</td>
</tr>
<tr>
<td>€1,022m</td>
<td>EUR</td>
<td>Fixed (30Y Swap + TEF spread +/- basis spread)</td>
<td>Pay out</td>
</tr>
</tbody>
</table>

1. **Interest Rate Swap (IRS) to shift fixed USD debt to floating**
2. **Currency Interest Rate Swap (CIRS) to hedge FX and basis (spread) risks due to notional exchange**
3. **Currency Interest Rate Swap (CIRS) to hedge TEF margin credit risk (spread)**
4. **Interest Rate Swap (IRS) to shift floating EUR debt to fixed**

**RESULT**

30Y EUR “synthetic” bond with a fixed coupon of 3.17% (maturity March 2048)

1. Assuming FX USD/EUR = 1.222
Trade offs (1) – increased average debt life (6.4Y to 9.3Y in 5Qs)

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

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt</td>
<td>5.4</td>
<td>7.4</td>
<td>5.8</td>
<td>7.7</td>
<td>6.4</td>
<td>6.1</td>
<td>3.0</td>
<td>0.6</td>
<td>2.2</td>
<td>0.3</td>
<td>0.3</td>
<td>1.3</td>
<td>1.3</td>
<td>3.7</td>
<td></td>
</tr>
</tbody>
</table>

**December 2016 (Liquidity: €21.3 bn)**
- Perpetual bonds: 1.1, 0.9, 5.1

**€9.7bn debt maturities**
- 2025: 0.6
- 2026: 2.2
- 2027: 0.3
- 2028: 0.3
- 2029: 1.3
- 2030: 1.3
- >2030: 3.7

**March 2018 PF with 2018 YTD issues (Liquidity: €20.9bn as of Dec-17)**
- Perpetual bonds: 5.8, 6.2, 5.2

**€18.5bn debt maturities**
- (+90.8% vs. Dec-16)
- 2025: 1.7
- 2026: 2.9
- 2027: 1.9
- 2028: 2.1
- 2029: 2.0
- 2030: 1.3
- >2030: 7.3

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

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

- **% of Debt in Fixed Rates**
  - 2013: 71%
  - 2014: 70%
  - 2015: 48%
  - 2016: 51%
  - 2017: 71%
  - Change:

- **Sensitivity to +100bps in interest rates (€m)**
  - 2013: +118
  - 2014: +111
  - 2015: Δ +134m
  - 2016: Δ -13m
  - 2017: Δ -141m

- **Total financial payments costs**
  - 2013: 4.7%
  - 2014: 5.4%
  - 2015: 5.0%
  - 2016: 4.6%
  - 2017: 7.9%
  - 2018: 8.1%

- **Avg. Debt maturity (yrs)**
  - 2013: 7.4
  - 2014: 6.8
  - 2015: 5.7
  - 2016: 5.6
  - 2017: 6.4
  - 2018: 3.3

- **EUR Swap 10Y**
  - 2013: 1.6%
  - 2014: 2.2%
  - 2015: 0.9%
  - 2016: 0.5%
  - 2017: 0.3%
  - 2018: 0.7%

- **EUR Swap 3M**
  - 2013: 0.2%
  - 2014: 0.2%
  - 2015: 0.0%
  - 2016: -0.2%
  - 2017: -0.3%
  - 2018: -0.3%
Trade offs (3) – FX hedging strategy produced positive results

Revenues (-€1,653m)  
- FX reduces OpEx

OIBDA (-€717m)  
- FX reduces CapEx, Taxes & others

FCF (-€171m)  
- FX reduces Net Debt

Net Debt (-€639m)

FX impact in FCF is mitigated, "natural hedge"

Debt structure more than offsets FCF impact

<table>
<thead>
<tr>
<th>Year</th>
<th>OIBDA</th>
<th>FCF</th>
<th>Net Debt</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>(616)</td>
<td>(103)</td>
<td>(611)</td>
</tr>
<tr>
<td>2016</td>
<td>(1,175)</td>
<td>(166)</td>
<td>(91)</td>
</tr>
<tr>
<td>2017</td>
<td>(717)</td>
<td>(171)</td>
<td>(639)</td>
</tr>
</tbody>
</table>

FCFS 2017 (€)

- Total: 0.97
- Europe ex-financial payments: 0.90
- Dividend: 0.34
- Total interest payments (before taxes): 0.40

European FCF significantly...  
...exceeds dividends and interest payments...  
...LatAm is all upside
Levels of FX debt constantly monitored relative to FX fair value views

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

- **UNDERVALUATION**: Decrease debt in BRL
- **OVERVALUATION**: Increase debt in BRL
- **PPP since Jan'16**
- **PPP since Jul'11**
- **Fair Value (+/- 1 st. dev.)**

PPP: Purchasing Power Parity
FX hedging in 2016 – decision making based on economic profit analysis

Financial impact of bringing Net Debt/OIBDA to benchmark

Theoretical impact under benchmark

Economic Profit

<table>
<thead>
<tr>
<th>Currency</th>
<th>FX Impact on net debt</th>
<th>Financial impact of bringing Net Debt/OIBDA to benchmark</th>
<th>Theoretical impact under benchmark</th>
<th>Economic Profit</th>
</tr>
</thead>
<tbody>
<tr>
<td>GBP</td>
<td>-91</td>
<td>+380</td>
<td>+337</td>
<td>+626</td>
</tr>
<tr>
<td>BRL</td>
<td>+380</td>
<td>-91</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rest</td>
<td>+337</td>
<td>+626</td>
<td>+717m</td>
<td></td>
</tr>
<tr>
<td>TOTAL</td>
<td>-91</td>
<td>+380</td>
<td>+337</td>
<td>+626</td>
</tr>
</tbody>
</table>
Executed 1\textsuperscript{st} large EU hybrid liability management; annual savings >€60m

### Hybrids Pre-LM

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

### Hybrids Post-LM

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

1. FX: 0.88 GBP/EUR
2. COLTEL Hybrid (FX: 1.20 USD/EUR)
3. €473m outstanding; assumes exercise at first call date (Sept 18)
### Implied costs of equity component of recently issued hybrid bonds

<table>
<thead>
<tr>
<th></th>
<th>NOTIONAL</th>
<th>COUPON (%)</th>
<th>COST (€m)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Hybrid Dec-17 (5.5Y)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hybrid</td>
<td>1,000</td>
<td>2.625%</td>
<td>26.3</td>
</tr>
<tr>
<td>EUR senior</td>
<td>500</td>
<td>0.40%</td>
<td>2.0</td>
</tr>
<tr>
<td>Equity</td>
<td>500</td>
<td>4.85%</td>
<td>24.3</td>
</tr>
<tr>
<td><strong>Implied cost of Equity (post tax)</strong></td>
<td></td>
<td></td>
<td>3.79%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>NOTIONAL</th>
<th>COUPON (%)</th>
<th>COST (€m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hybrid</td>
<td>1,250</td>
<td>3.0%</td>
<td>37.5</td>
</tr>
<tr>
<td>EUR senior</td>
<td>625</td>
<td>0.95%</td>
<td>5.9</td>
</tr>
<tr>
<td>Equity</td>
<td>625</td>
<td>5.05%</td>
<td>31.6</td>
</tr>
<tr>
<td><strong>Implied cost of Equity (post tax)</strong></td>
<td></td>
<td></td>
<td>3.95%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>NOTIONAL</th>
<th>COUPON (%)</th>
<th>COST (€m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hybrid</td>
<td>1,000</td>
<td>3.875%</td>
<td>38.8</td>
</tr>
<tr>
<td>EUR senior</td>
<td>500</td>
<td>1.64%</td>
<td>8.2</td>
</tr>
<tr>
<td>Equity</td>
<td>500</td>
<td>6.11%</td>
<td>30.6</td>
</tr>
<tr>
<td><strong>Implied cost of Equity (post tax)</strong></td>
<td></td>
<td></td>
<td>4.77%</td>
</tr>
</tbody>
</table>

Consider hybrids as attractive long term components of our capital structure.

---

1. Assuming TEF’s effective cash tax rate of 21.9%
Source: Telefónica
Main takeaways

- Objectives – guarantee solvency and liquidity; solid investment grade credit rating (BBB/Baa2)
- Hedge interest rate and FX risks while optimizing capital structure costs
- In 2017 we strengthened our balance sheet ahead of potentially higher interest rates
- Refinanced €19bn since Oct 2016, equivalent to 34% of total debt and 20% of enterprise value
- Q1 2018: issued €3bn in senior bonds, executed €2.25bn hybrid LM and refinanced €5.5bn RCF

Stronger balance sheet and solid track record of risk management
New IFRS for 2018

Marta Soto
Head of Accounting Policies
Overview
IFRS 15: The new revenue standard

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

**Higher comparability**

**Higher consistency**

**EFFECTIVE DATE...**

... January 1st 2018

... Partial Retrospective approach adopted by Telefónica

**CORE OF THE STANDARD...**

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

**CHANGES IN REVENUE RECOGNITION...**

... New revenue mix

... Variations in timing of revenue recognition

**AND IN SOME COST RECOGNITION...**

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

**IMPACTS (*)**:

Opening pre-tax equity 2018: €+1.0 Bn

Estimated P&L impact based on FY17:

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

(*) Unaudited figures
IFRS 9: Financial Instruments

Main changes

Classification & Measurement

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

Impairment

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

Hedge Accounting

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

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

No relevant impact expected in P&L FY18
IFRS 15 in detail
Applying a 5 Step Model to determine **when and how to recognise revenue**

**Identifying the contract**
- Agreement that creates enforceable rights and obligations

**Identifying performance obligations**
- Good or services that are **distinct**; or
- A **series** of specified goods or services substantially the same **with same pattern of transfer to the customer**

**Determining the transaction price**
- The amount to which an entity expects to be entitled **in exchange for transferring promised goods or services to a customer**

**Allocating the transaction price**
- To each performance obligation **based on the relative standalone selling price**

**Recognising revenue**
- When a performance obligation is satisfied by transferring the good or service to the customer

**Other aspects: Cost Capitalization**
- **Capitalization** of incremental costs for obtaining a contract if the amortization period is over 12 months long

**Areas of major impact for Telefónica**
IFRS 15: Basic Adjustment

Step 4 implications through an example...
... affecting those offers with a discount on the handset or the service, or both

Revenue = Billing

The difference is reflected in the Balance Sheet

Handset Price with service (\( ^* \)) S./200
Total Contract = S./2,900
SSPR = S./740
(\( ^* \)) SSP = S./925

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

Key points
- Total revenue of contracts is the same
- Time of recognition differs
- Revenue mix changes
- New B/S items: contract assets and contract liabilities

P&L Impact

Balance Sheet Impact

Cash conversion over the contract term
IFRS 15: Cost Capitalisation

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

Let's see an example...

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

Key points:
- **Sales commissions with deferral period longer than 12 months**
- **New B/S item: Capitalized costs**

**Before...**

<table>
<thead>
<tr>
<th>Expenses</th>
<th>Months</th>
</tr>
</thead>
<tbody>
<tr>
<td>30 €</td>
<td>30</td>
</tr>
</tbody>
</table>

**One shot recognition**

**...After**

**OPEX accrual in accordance with the pattern of transfer of the services**

**P&L Impact**

**Balance Sheet Impact**

**Key points**

- **Sales commissions with deferral period longer than 12 months**
- **New B/S item: Capitalized costs**
The following charts represent the estimated equity impact on a pre-tax basis of €+1.0 Bn distributed by areas of impact and segments.

**Areas of impact**
- 70% Contract Assets & Contract Liabilities
- 30% Capitalised costs

**Segment Distribution**
- Spain: 36%
- UK: 38%
- Brazil: 12%
- North Hispam: 5%
- Germany: 4%
- South Hispam: 5%
- Spain: 12%
- UK: 38%
- Brazil: 5%
- North Hispam: 4%
- Germany: 36%
- South Hispam: 5%

Unaudited figures
## IFRS 15: Estimated contribution per region

### Non-relevant impacts in any segment

Estimated P&L impact based on FY17

*Unaudited figures*

<table>
<thead>
<tr>
<th>Region</th>
<th>Revenue</th>
<th>OIBDA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spain</td>
<td><img src="Image" alt="Telephone" /></td>
<td><img src="Image" alt="Telephone" /></td>
</tr>
<tr>
<td>Brazil</td>
<td><img src="Image" alt="Telephone" /></td>
<td><img src="Image" alt="Telephone" /></td>
</tr>
<tr>
<td>Germany</td>
<td><img src="Image" alt="Telephone" /></td>
<td><img src="Image" alt="Telephone" /></td>
</tr>
<tr>
<td>UK</td>
<td><img src="Image" alt="Telephone" /></td>
<td><img src="Image" alt="Telephone" /></td>
</tr>
<tr>
<td>North HISPAM ¹</td>
<td><img src="Image" alt="Telephone" /></td>
<td><img src="Image" alt="Telephone" /></td>
</tr>
<tr>
<td>South HISPAM ²</td>
<td><img src="Image" alt="Telephone" /></td>
<td><img src="Image" alt="Telephone" /></td>
</tr>
<tr>
<td><strong>Total Group</strong></td>
<td>Revenue: € -60 Mill -0.1% over Revenue</td>
<td>OIBDA: € -80 Mill -0.5% over OIBDA</td>
</tr>
</tbody>
</table>

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

² South HISPAM: Argentina, Peru, Chile and Uruguay
Key Takeaways

Laura Abasolo
Chief Financial and Control Officer
Key Takeaways

Capital Structure Strategy

Impressive refinancing exercise: €19bn

Solid risk management track record

Healthier Balance Sheet

New IFRS for 2018

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

Guidance not affected under new standards
Q&A Session

Laura Abasolo
Jesús Romero
Marta Soto
Pablo Egurión
Appendix
Telefónica Group will use portfolios as a method of clustering similar contracts. wherever possible

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

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

Contracts with customers completed before the effective date of January 1st 2018 do not create adjustments to the financial statements and will therefore not have any effect for the Telefónica Group.
This document and the Q&A session may contain forward-looking statements and information (hereinafter, the “Statements”) relating to the Telefónica Group (hereinafter, the “Company” or “Telefónica”) or otherwise. These Statements may include financial forecasts and estimates based on assumptions or statements regarding plans, objectives and expectations that make reference to different matters, such as the customer base and its evolution, growth of the different business lines and of the global business, market share, possible acquisitions, divestitures or other transactions, Company’s results and other aspects related to the activity and situation of the Company.

The Statements can be identified, in certain cases, through the use of words such as “forecast”, “expectation”, “anticipation”, “aspiration”, “purpose”, “belief” or similar expressions or variations of such expressions. These Statements reflect the current views of Telefónica with respect to future events, do not represent, by their own nature, any guarantee of future fulfilment, and are subject to risks and uncertainties that could cause the final developments and results to materially differ from those expressed or implied by such Statements. These risks and uncertainties include those identified in the documents containing more comprehensive information filed by Telefónica before the different supervisory authorities of the securities markets in which its shares are listed and, in particular, the Spanish National Securities Market Commission.

Except as required by applicable law, Telefónica does not assume any obligation to publicly update the Statements to adapt them to events or circumstances taking place after the date hereof, including changes in the Company’s business or business development strategy or any other unexpected circumstance.

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In October 2015, the European Securities Markets Authority (ESMA) published guidelines on Alternative Performance Measures (APM), applicable to regulated information published from July 3, 2016. Information related to APM used in this presentation are included in the our consolidated financial statements and consolidated management report for the year 2017 submitted to the Spanish National Securities Market Commission (CNMV), Note 2, page 283 of the .pdf filed. Recipients of this document are invited to read it.

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