

Telefónica

Results

January – June 2016

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01



Q2 16 Highlights

Mr. José María Álvarez-Pallete
Chairman & CEO



Q2 16 Highlights; strategy is working

Profitable growth remained solid

- **Service revenue +1.5%**, offsetting handset sales (-18.0%)
 - Data monetisation driver continue their positive trend (Non-SMS data revs +16.0%)
 - Av. Rev/Access +2.0% capitalising on fiber, smartphones, LTE and Pay TV
- **Maintaining focus on efficiencies & merger synergies**
 - Growing OIBDA, margin and OpCF

Best technology platforms

- **Fiber premises passed 32.9m; LTE coverage 55%** (84% in Europe)
- **Building the future** (new customer knowledge platform linked to Big Data; offering a differential experience)

Improved competitive position

- **Spain:** OpCF back to growth
- **Brazil & Germany:** Margins boosted by synergies (proving TEF's capacity to extract value from them)
- **UK:** Distinctive customer growth, loyalty and brand awareness
- **Hispan:** Increasing value penetration

Committed to deleverage

- **Best in class diversification; further improvement of operations and FX drag to ease in H2**
- **FCF €815m in H1 to significantly improve along the year**
- **Broad diversity of potential debt reduction measures**, combined with attractive debt re-financing opportunity

?: y-o-y organic

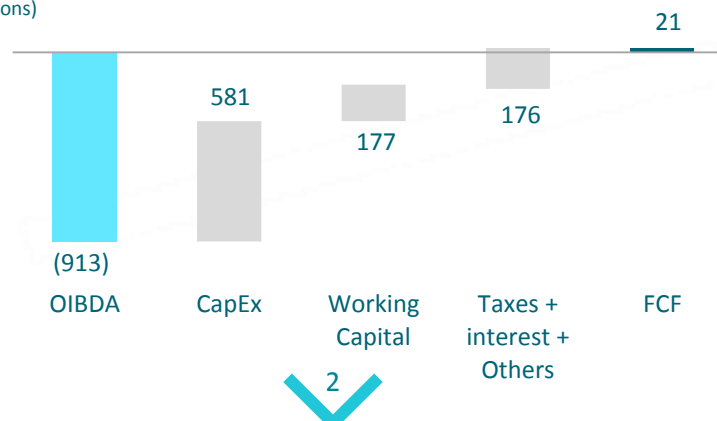
2016 guidance; dividend & mid-term leverage confirmed

Key financials (UK full consolidation)

€ in millions	H1 16			Q2 16		
	Reported	Reported y-o-y	Organic y-o-y	Reported	Reported y-o-y	Organic y-o-y
Revenue	25,235	(7.1%)	1.3%	12,723	(7.7%)	(0.2%)
Service revenue	23,364	(5.7%)	2.7%	11,824	(6.1%)	1.5%
OIBDA	7,756	(6.4%)	3.1%	3,918	(7.1%)	0.8%
OIBDA Margin	30.7%	0.2 p.p.	0.5 p.p.	30.8%	0.2 p.p.	0.3 p.p.
OpCF (ex-spectrum)	4,112	(5.9%)	3.3%	1,968	(3.1%)	1.4%
Net Income	1,241	(42.1%)		693	(54.5%)	
EPS	0.23	(45.2%)		0.13	(55.6%)	
FCF	815	c.s.		746	c.s.	
Net Financial Debt	52,568	2.7%				

Negative FX effect in OIBDA offset at FCF level

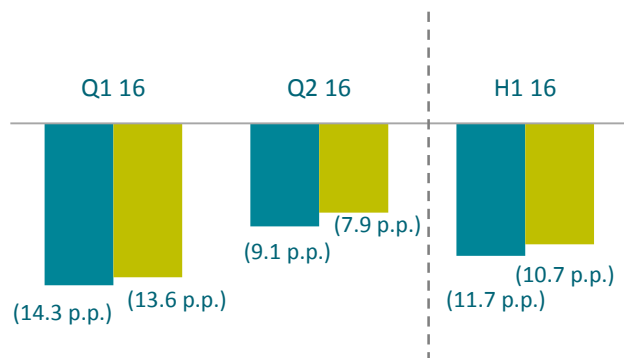
(€ in millions)



H1 affected by FX and perimeter impacts

FX impact (y-o-y)

■ Revenues ■ OIBDA

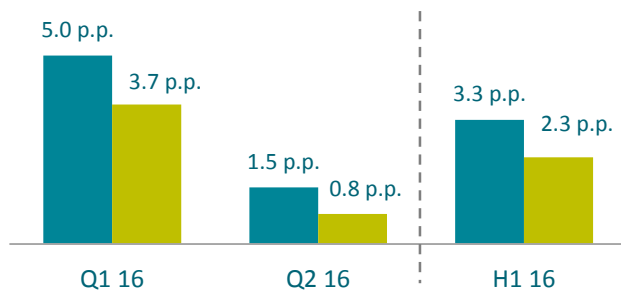


FX to ease in H2 16

- H1 16 results impacted by average FX, following sharp depreciation
 - Q3 15: BRL and COP
 - Q4 15: ARS

Perimeter impact (y-o-y)

■ Revenues ■ OIBDA



Perimeter; no impact in H2 16

- GVT & DTS consolidated in May-15

Full-year guidance on track

2016 Guidance (Constant FX 2015; ex-VZ; ex-UK)	Guidance 2016E	H1 16
Revenue	>4%	+5.0%
OIBDA margin	Stabilising vs. 2015	+0.1 p.p.
CapEx/Sales	Around 17%	15.1%

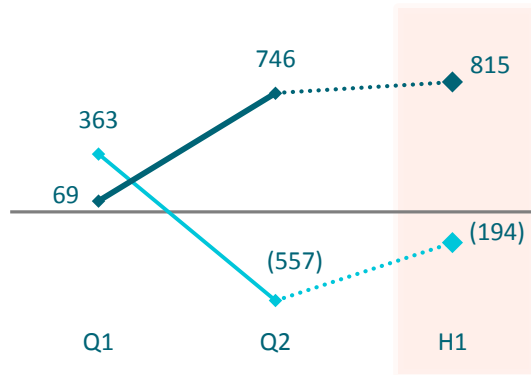
Service
Revenues
+6.4%

Dividend	€0.75/sh. €0.35/sh. voluntary scrip Nov-16 €0.4/sh. cash Q2 17
Share buyback: % share capital cancelled (treasury) (BoD to decide in H2 16)	1.5%
Mid-term target Net Financial Debt / OIBDA <2.35x	3.20x Jun-16

Strong FCF performance in Q2 16

FCF (€ in millions)

—◆— 2015 —◆— 2016



FCFS (€)

0.01	0.15	0.17
------	------	------

EPS (€)

0.10	0.13	0.23
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Cash generation improvement (y-o-y and q-o-q)

- **Robust H1 FCF y-o-y** (+€1,009m) on the back of:
 - Better performance of OpCF in Q2
 - Lower spectrum, CapEx, financial payments & minorities
 - Higher WC consumption (partly due to spectrum) & slightly higher taxes impacted by non-recurrents in H1 15
- **FCF sequential improvement** (+€677m) mainly due to WC and financial expenses, offsetting higher taxes, Capex and minorities

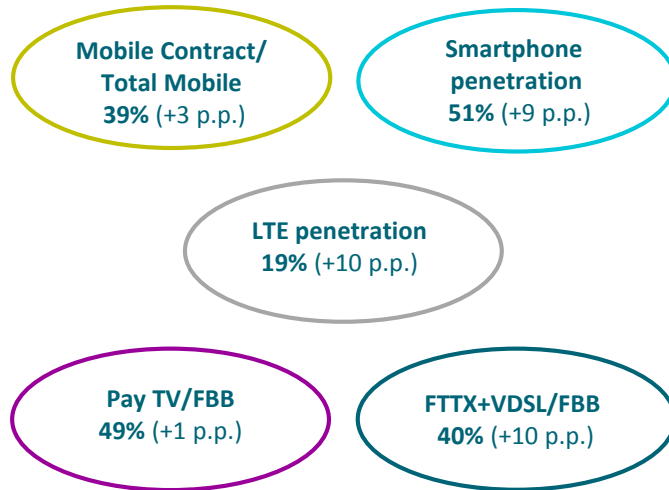
FCF to improve in H2 16

- Expected improvement in operational performance (OIBDA)
- Lower FX headwinds
- Seasonality of WC & other factors

Continued strong momentum with quality customers

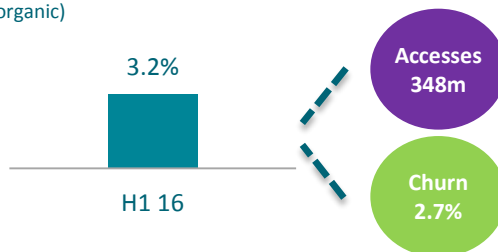
Expanding reach

Jun-16 (y-o-y)



Avg. Revenue / Access

(y-o-y organic)

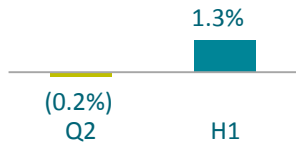


Securing a distinctive top-line growth profile

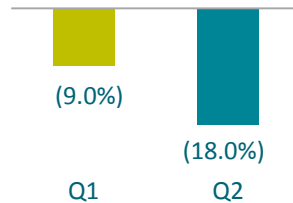
- **Exploiting growth opportunities to foster service revenues**
 - X2 LTE accesses vs. Jun-15
 - 1.7m smartphones added to base in Q2
 - +31% y-o-y FTTX + VDSL accesses
 - Fast adoption of Pay TV (+5% y-o-y)
- **Increasing bundling with FTTX/4G, allowing high-end pricing power**
- **Increasing customer lifetime value**
 - Strong Q of customer retention (churn -0.2 p.p. q-o-q)
 - Innovative value propositions
 - Best customer experience

Resilient growth of service revenues

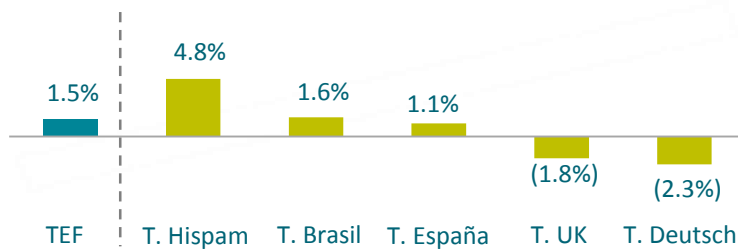
Total Revenues (y-o-y organic)



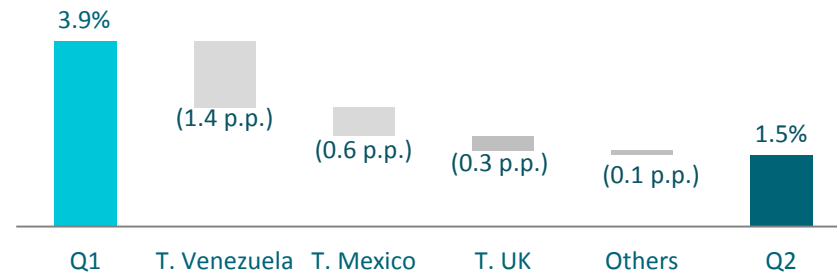
Handset Revenues (y-o-y organic)



Q2 Service Revenues (y-o-y organic)



Service Revenues (y-o-y organic)



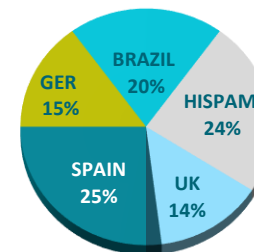
Quality of revenues

- Service revenues growth offset handset sales
- Service revenues expansion higher than total revenues in all segments
 - Consistent trends in Q2 in Brazil & Spain vs. Q1
- Lower handset sales impacting Q2; worsening trends in all business

Q2 growth levered on strategic business

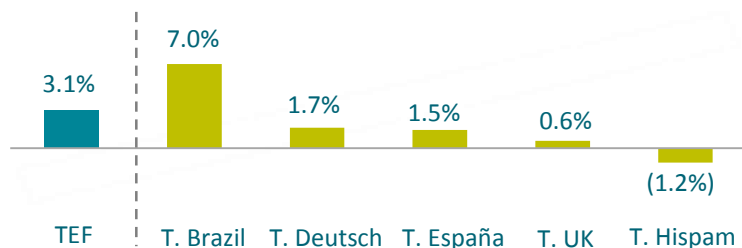
- **BB Connectivity & SoC** growing robustly and increasing weight to 47% o/total (+6 p.p. y-o-y)
- **Declining Voice & Access** (43% o/total; -5 p.p. y-o-y)
- **Continued demand for mobile data** (Non-SMS revs. +16.0% y-o-y)

Revenue (H1 16)



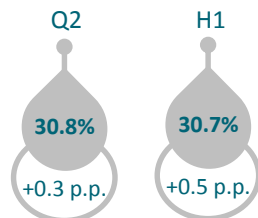
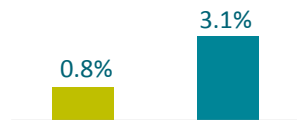
Sustaining OIBDA growth, strong diversification

H1 OIBDA (y-o-y organic)



OIBDA 2016 (y-o-y organic)

● OIBDA Margin (y-o-y organic)

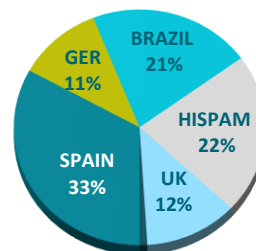


High operating leverage

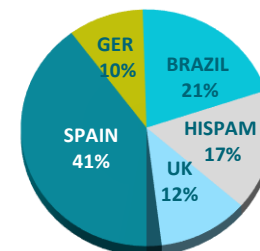
Ongoing synergies & efficiencies improvements

- OIBDA growth for 8th Q in a row
- Outstanding OpEx in Q2 (-0.8% y-o-y organic); outpacing revenue decline
 - Merger synergies on track (BZ, DE)
 - Redundancy programs driving personnel savings (Spain, BZ, ...)
 - Global simplification initiatives across regions
- Broad-based y-o-y margin improvement in Q2, except in Hispam
- Ongoing organic OpCF growth in Q2 (H1: +3.3% y-o-y)
 - Back to growth in Spain (Q2: +1.0% y-o-y)
 - Brazil maintains its robust increase (H1: +33.6% y-o-y)

OIBDA (H1 16)



OpCF ex-spectrum (H1 16)



Clear data monetisation results

Q2 mobile data traffic
+50% y-o-y

LTE traffic 32% of
mobile data traffic
(+4 p.p. y-o-y)

Smartphone
penetration

51%

Contract
72%

Prepaid
40%

Q2 LTE dynamics

Traffic (y-o-y)

3x

Usage uplift

68%

ARPU uplift

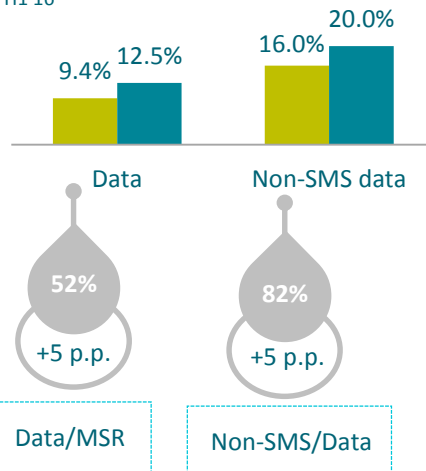
~10%

LTE data upselling; ARPU growth

- LTE customers 50.1m (x2 y-o-y)
 - Q2 avg. usage/per smartphone +34% y-o-y (955 MB/month)
- Prepaid data ARPU uplift in Latam (Q2: +18% y-o-y)
 - T. Hispam opportunity; smartphone penetration 30%
- Contract data monetisation via traffic dynamisation and upselling

Data Revenues (y-o-y organic)

■ Q2 16 ■ H1 16

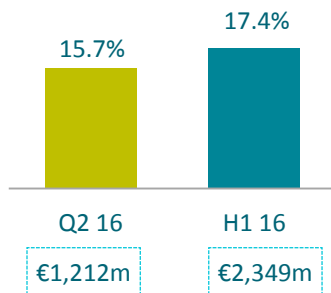


Fixed data opportunity ahead

- Booming FBB traffic (Q2: +50% y-o-y)
- Fiber quality and speed fostering usage

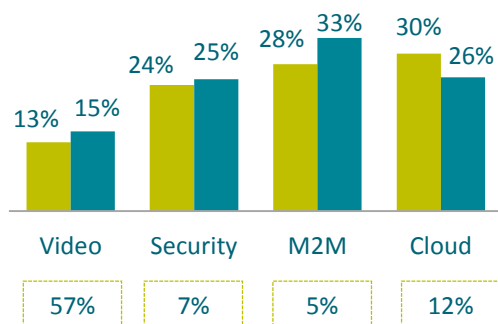
Digital Services: enhancing customer experience

Revenues (y-o-y organic)



Solid growth (y-o-y organic)

■ Q2 16 ■ H1 16
 □ Weight o/ total revs. Q2 16



Building on solid platforms

- **Video:** 8.4m accesses (+5% y-o-y)
 - Introduction of new functionalities and success of own productions
- **Cloud:**
 - Chile & Brazil: new “Open Telefónica Cloud” services
- **Security:**
 - Two new Security Operations Centres in Mexico & Spain
 - New strategic alliances to integrate with own security solutions
- **M2M:**
 - Consolidating Smart m2m platform as strategic asset to win key industry references
- **Financial Services:**
 - O2 Mobile Banking, Germany’s first mobile-only bank, launched commercially
- **Telefónica Open Future_:**
 - Integrating startups’ services internally and into customer offering

TGR: Technology excellence

Enlarged UBB footprint

Premises Passed with Fibre



32.9m
FTTX
+14% y-o-y

20.7m
FTTH
+19% y-o-y

LTE Coverage (%PoP)

55%
(+12 p.p. y-o-y)

Further progress on All-IP



Network modernisation

- **All-IP upgrade: More capability & efficiency**
 - Native VoWiFi in Germany based on IMS (IP Multimedia Subsystem)
 - New metro network in Spain; OTN (Optical Transport Network)
- **Global Centers: Standardisation & simplification**
 - Devices: HGU (Home Gateway Unit) already in Spain & Brazil
- **Innovation:**
 - SON (Self Optimizing Networks) to improve 70m customers' experience
 - Telefónica awarded best NFV/SDN solution
 - Agreements with main vendors to evolve 5G architecture

E2E Digitalisation

Big Data platforms for Real Time decision

14.7 PB
(x 3 y-o-y)

Consolidation Online Charging Systems

51%
Single OCS
customers

Full Stack

15 countries
on track

02 

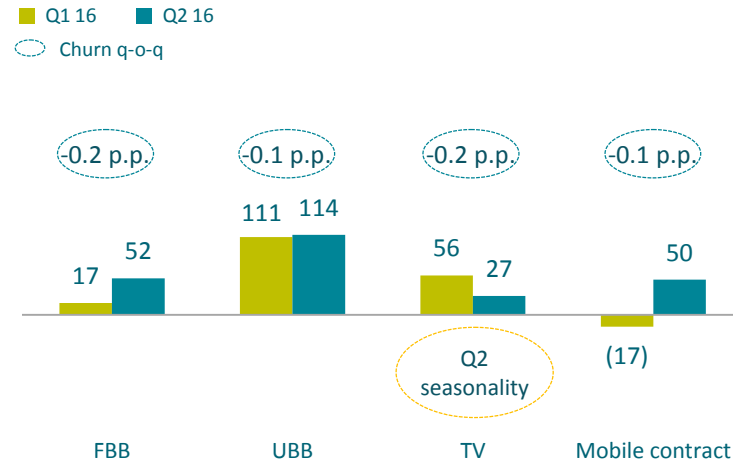
Q2 16 Results

Mr. Angel Vilá
CSFO



Spain: Commercial momentum gaining pace

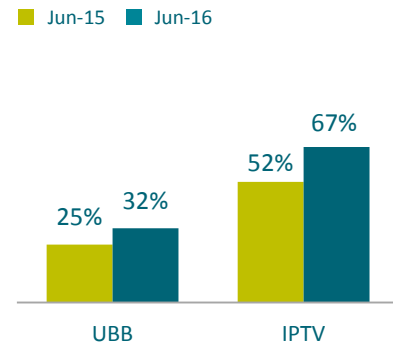
Quarterly net adds ('000)



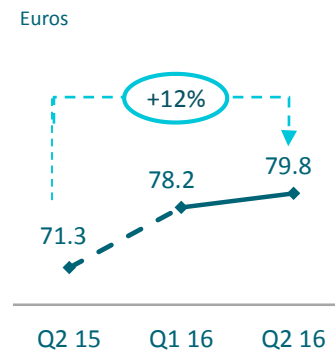
Unique platform

- **High customer stickiness**
 - Fusion churn: 1.1% in Q2 (-0.2 p.p. q-o-q)
- **Best-in-class UBB network in Europe**
 - FTTH coverage: 15.7m premises passed (H1: +1.4m)
 - LTE coverage: 86% pop (+3 p.p. q-o-q)
- **Continuous quality upgrade of quad-play offer**
 - Innovative TV (VoD off-line, shift TV,...), 300 Mb symmetry, HGU,..

"Fusión" high value



"Fusión" ARPU



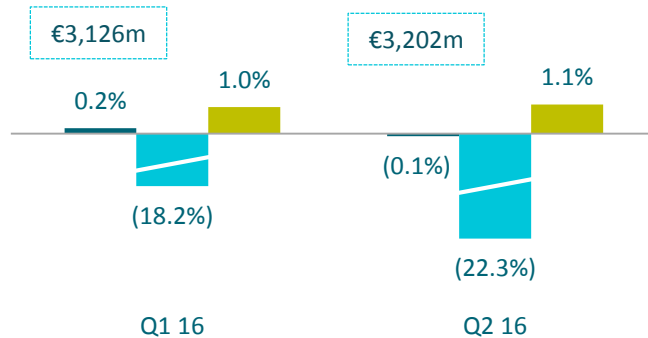
Consistent upselling

- **"Fusión" remains unabated** (subs: +10% y-o-y)
 - Penetration upside
- **New step on the "more for more" strategy launched in July**
 - Smart bundling (Premium TV & mobile add-ons)

Spain: Further progress in the new growth cycle

Revenues (y-o-y organic)

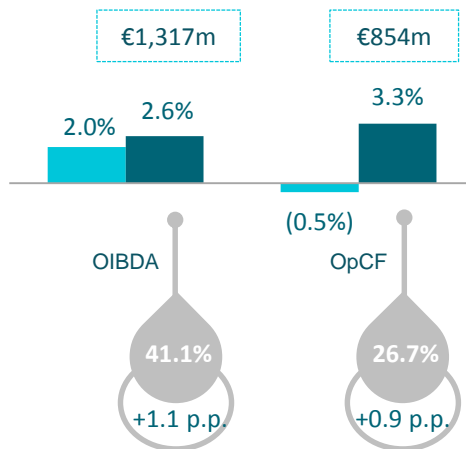
■ Total ■ Handset sales ■ Service Rev.
□ Total Revenues



Profitability

(y-o-y organic ex-real estate in Q2 15)

■ Q1 16 ■ Q2 16 ● Margin
□ Total OIBDA



Sustainable service revenues growth

- **Accelerating service revenues increase** despite negative calendar effect from “Fusión” tariffs update
- **All revenue segments delivering y-o-y growth in Q2**
 - Convergence and IT drive Business improvement

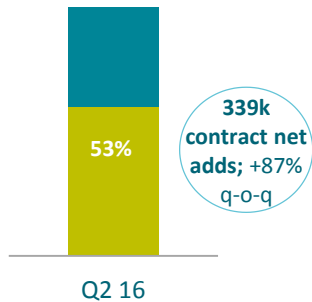
Improved OIBDA & OpCF; efficiency gains

- **Savings from Redundancy Program since Q2**
 - Q2 OpEx: -1.9% y-o-y (Q1: -1.3%)
- **Commercial process simplification** (Q2 commercial cost: -18% y-o-y)
- **Sustainable margin expansion**
- **OpCF increasing in Q2 y-o-y**; despite Q2 CapEx +1.2% y-o-y

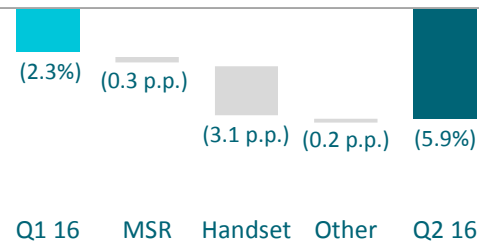
Germany: Outstanding OpCF; synergies on track

Contract Gross Adds mix

■ GA retail ■ GA partners

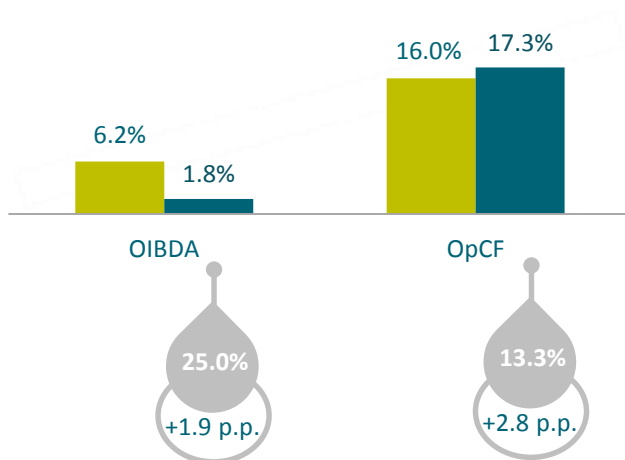


Revenues (y-o-y)



Financial (y-o-y ex non-recurrent)

● Margin ■ Q1 16 ■ Q2 16



Strong trading of partner brands

- **Increasing competition in non-premium** (aggressive pricing)
- **Revenues pressure in Q2**
 - Lower handset sales y-o-y (Q2: -25.5% y-o-y; Q1: -5.5%)
 - MSR showed wholesale mix; legacy base headwinds and regulation
- **Further progress on LTE: Coverage at 77% (+7 p.p. y-o-y)**
 - Ramp-up of non-SMS data revs in Q2 to 13.6% y-o-y
 - Avg. data usage of contract LTE O2 consumer +16% q-o-q to 1.4G

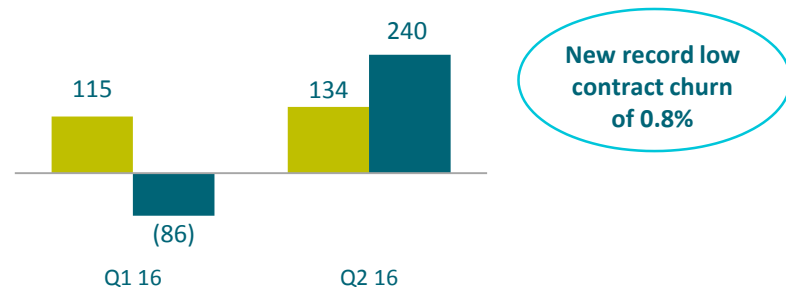
OIBDA margin expansion to remain

- **Incremental savings from H2:** Q2 synergies (€40m); H1 (€95m)
- **OpEx transformation peaking in H1** (brand, retention)
- **Outlook confirmed but CapEx guidance** reduced to 'mid to high single-digit % growth'
- **Proposal for annual dividend growth** over next 3 years (2016: €0.25/sh.)

UK: Strong trading; leading loyalty

Net adds ('000)

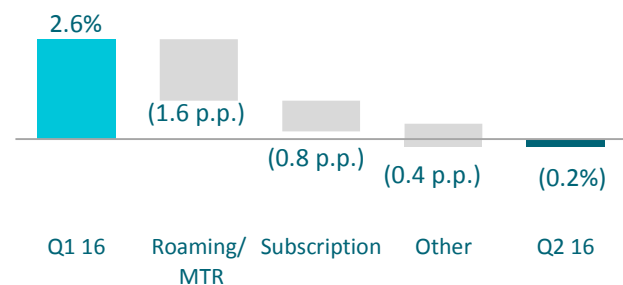
■ Total ■ Contract



Continued customer growth

- Strongest quarterly net additions in 6 quarters
- Contract customers: 61% of the total; +5 p.p. y-o-y
- Fast LTE deployment
 - 91% outdoor coverage (+18 p.p. y-o-y)
 - Penetration at 43% of base (+17 p.p. y-o-y)
 - Customers up 64% y-o-y to 9.5 m

Mobile Service Revenues (y-o-y ex "O2 Refresh")



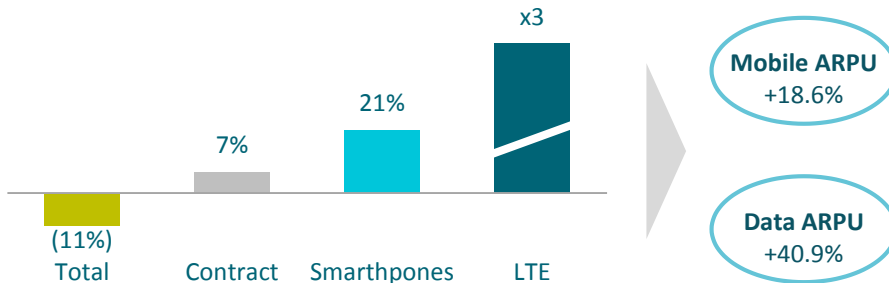
OIBDA margin expansion in Q2 (26.6%; +0.1 p.p. y-o-y)

- Q2 MSR broadly flat (ex-O2 Refresh) y-o-y
- Top line pressure in Q2 (ex "O2 Refresh")
 - Handset sales market wide slowdown (-11.6% y-o-y)
 - Roaming + MTRs (-2.0 p.p. in Q2 y-o-y)
- OpEx decline y-o-y (phasing of marketing spend and underlying savings)
- Increased investments in LTE (H1 CapEx: +6.3% y-o-y)

Brazil: Best positioned in the market

Mobile accesses (y-o-y)

○ ARPU Q2 y-o-y

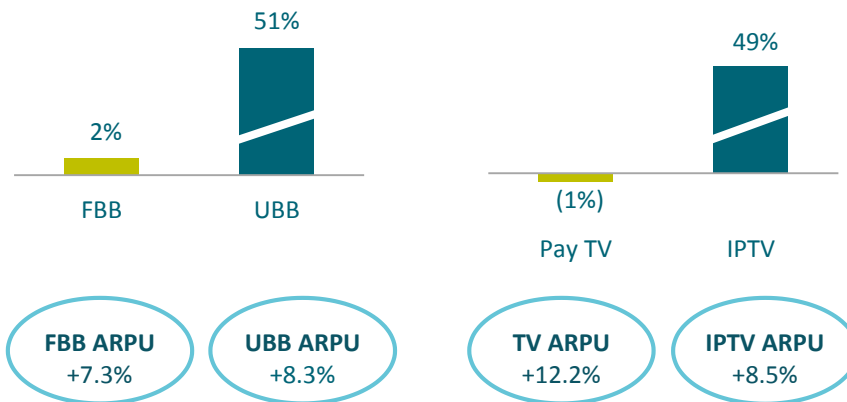


Superior quality; Outperforming peers

- **Mobile:**
 - **Best 3G & 4G coverage** (89% population)
 - **Best satisfaction** and perceived **quality** (*Anatel* survey)
 - 42.3% contract market share (LTM: 55% share of net adds)
 - **Prepaid:** Selective commercial approach

Fixed access (y-o-y)

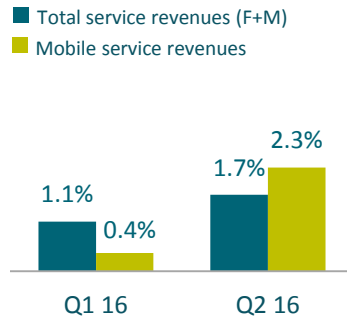
○ ARPU Q2 y-o-y



- **Fixed:**
 - **Increasing speed** fostering ARPU expansion
 - 16.1m homes passed with fiber/4.0m connected
 - Shortening the loop in the legacy copper network in SP
 - **Leader in UBB** with 54% market share
 - **Successful cross-selling** between former GVT and Vivo customers: All stores already selling fixed products

Brazil: Growing market share with margin expansion

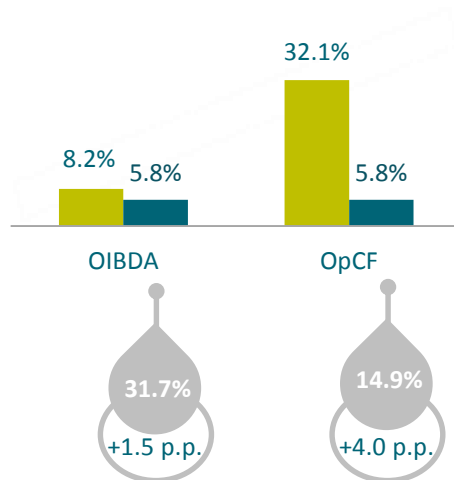
Service Revenues (y-o-y organic)



Service Revenues
market share 35%
(+0.8 p.p. vs. Q1 15)

Financials (y-o-y organic)

● Margin ■ Q1 16 ■ Q2 16



Synergies above
estimates; raising
ambition to R\$25Bn

Sustaining revenue growth

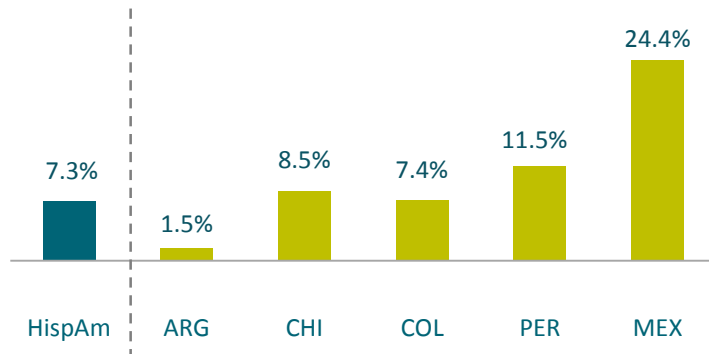
- **Q2 MSR accelerated** to +3.9% y-o-y ex-regulation
 - Data revs. continues ramping-up (Q2: +24.8% y-o-y)
- **Q2 fixed revs.** decelerated to +0.8% y-o-y mainly due to regulation (-21% since Feb-16). **Growth engines:** Pay TV and FBB
- **Handset sales** y-o-y (Q2: -19.2%; Q1: -10.9%) affected by targeted commercial activity and macro

Deeper efficiency, synergies and financial discipline

- **Sequential Improvement in OpEx** (Q2: -2.8% y-o-y; Q1: -1.0%) well below inflation (+8.8%)
 - Rational commercial approach. Better trend on energy cost
 - Q2 operational synergies: €37m (H1: €85m)
- **Solid execution of synergies** (already secured 55% of NPV of best case) + **additional opportunities** identified during integration process with a trending **NPV +13% above the best case scenario**
- **Widening investment gap;** 15.6% CapEx/Sales (16.5% before CapEx synergies)

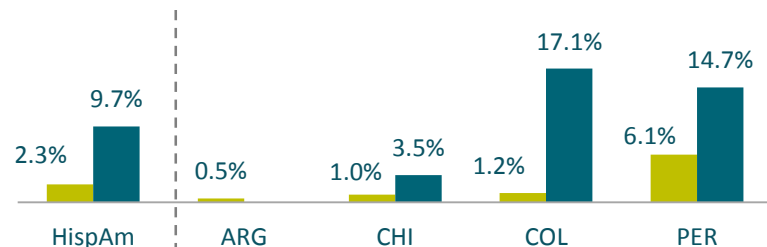
HispAm: Reinforcing leadership in high-value

Contract accesses (y-o-y)



FBB & Pay TV accesses (y-o-y)

■ FBB ■ Pay TV



Quality investments paying-off

- T. HispAm:
 - **Strong performance in contract**
 - Net adds x2.5 vs. Q2 15
 - **Very intense competition**, mainly Peru and Chile, hitting prepaid performance
 - **Rapid take-up of new services y-o-y**
 - Smartphone & LTE penetration: +6 p.p. y-o-y
 - **Accelerating fixed transformation** (bundling 41%; +5 p.p. y-o-y)
 - Delivering higher speeds (56% > 4 Mbps; +5 p.p. y-o-y)
 - Positive Q2 Pay TV net adds in main markets

HispAm: Healthy growth in top line

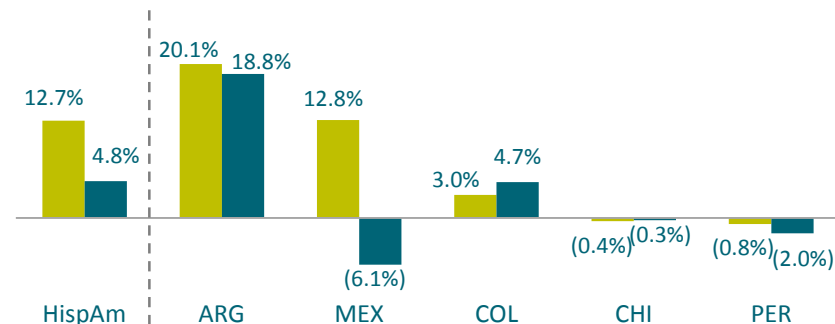
Revenue (organic y-o-y)

■ Change vs. Q1 16 y-o-y contribution



Service Revenue (organic y-o-y)

■ Q1 16 ■ Q2 16



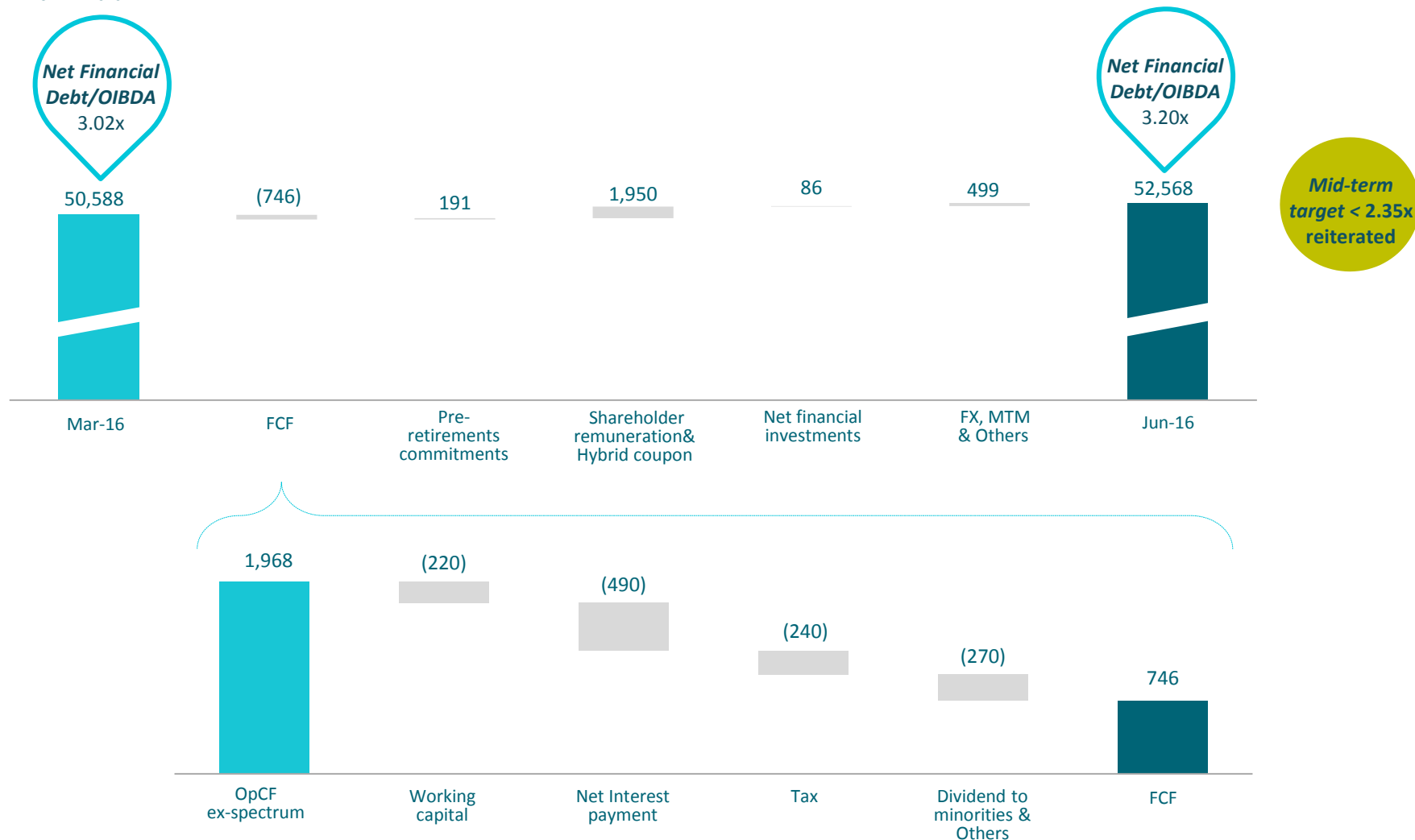
Peers' outperformance in broad markets

- **Robust Q2 fixed revenues: +16.1% y-o-y**
- **Sequential deterioration of OIBDA y-o-y** (Q2: -3.4%; Q1: +0.8%) affected by MEX and VZ
 - FX, competition (higher interconnection costs) and inflation: drivers of margin erosion (-2.0 p.p. y-o-y)
- **MÉXICO:**
 - Intense competition in H1, but easing in recent weeks. Gaining market share
- **PERÚ:**
 - OIBDA and margin improving in Q2 on efficiencies and strong performance in fixed business
- **ARGENTINA:**
 - Steady revenue increase in Q2 & improving OIBDA trends
- **CHILE:**
 - Very solid fixed revenue performance; OIBDA growth impacted by higher commercial costs and FX
- **COLOMBIA:**
 - Improved revenue growth; OIBDA and margin declining (inflation & commercial investments)

Leverage impacted by Q2 dividend payment

Net Financial Debt

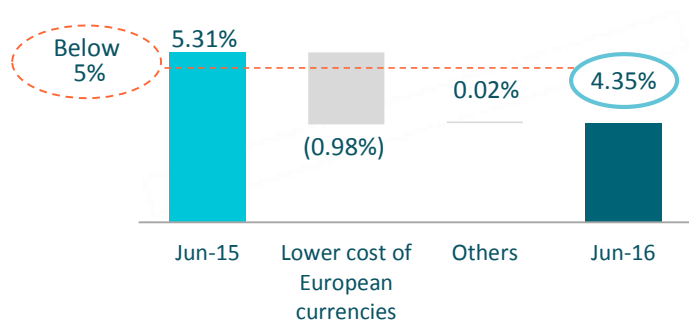
€ in millions



Strong liquidity to face upcoming maturities

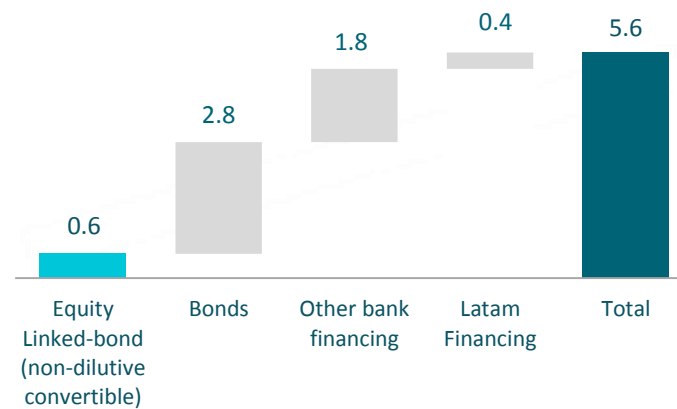
Effective interest cost: 96 b.p. lower y-o-y

--- Guidance



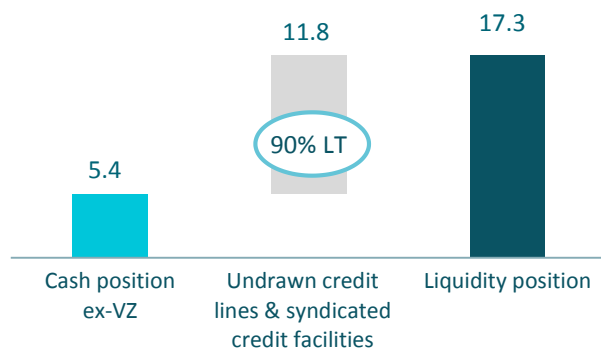
Sources of long-term financing (Jun-16)

€ in billions



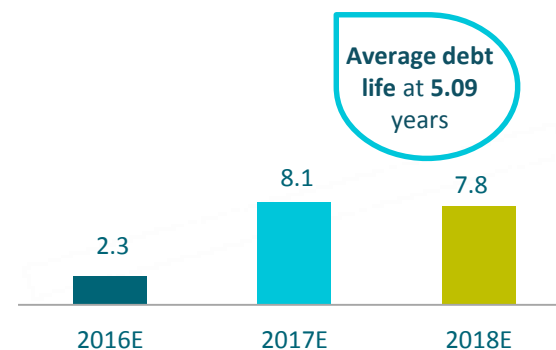
Liquidity position (Jun-16)

€ in billions



Net debt maturities (Jun-16)

€ in billions; not considering hybrid NC dates



Summary: Structural transformation

Executing
and
building
for the
future

- **Networks upgrades & product differentiation driving commercial activity:** growing value & improving sustainability
- **Strengthening market positioning across markets**
- **Ongoing efficiencies & synergies driving margin expansion**
- **Profitable organic growth continues, improvement expected in H2**
- **FX headwinds expected to ease in H2**
- **Improving FCF generation, H2 to benefit from seasonality**

2016 guidance; dividend & mid-term leverage confirmed

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