THE NEW TELEFÓNICA

Madrid, November 27th, 2019.

To Telefónica’s stakeholders

Dear friends,

A new era begins today.

And that’s why these lines are undoubtedly the most important ones that I have written to you since I was appointed chairman of Telefónica. In this letter, I am going to talk to you about the world that is coming and our response to the changes that this new world will bring about.

Society, our customers, our shareholders, and all those who work and have a relationship with us, are going to find a new Telefónica. A new Telefónica that, rooted in our history, we have designed to continue to be at the forefront of the new challenges posed by today’s changing world. Today I am going to talk to you about the new Telefónica.

The fourth revolution is indisputably a technological revolution, but it is also a social revolution that will alter our immediate future. A revolution that will generate billions of euros of value and will probably help us to solve challenges that until now society has not been able to conquer. We cannot imagine many of the things that this revolution is going to bring us, but we know that, for it to be good for everyone, it must be fair and inclusive. It must be human.

I have no doubt that Telefónica wants to contribute and we will play a fundamental role, assuming our responsibility.

Companies that do not understand that the world is changing, socially, technologically and economically, are destined to disappear. Companies that do not assume their responsibility in this new world will cease to be relevant in the short term. Executives who are not committed to the long term and sustainability are not being responsible.

We are proud of the social relevance of many of the things we do. Our business activity creates 1.2 million direct and indirect jobs, contributes of 10 billion euros per year in taxes and an impact on GDP of more than 53 billion euros in the countries where we operate. We fulfil and will fulfil our mission: ‘to make our world more human, by connecting lives’ in a sustainable way.

Telefónica has been present for almost a century in our homes, in our companies, in our streets, in our emotions. It has become an important part of our daily lives and a driving force in social progress in the countries in which we are present. As technology evolves, we have gotten ahead so that that the benefits of these advances would reach all of society. First there was fixed telephony, then the irruption of mobile and broadband and in more recent decades the data revolution. Today, we offer all these advances to 340 million customers. Behind each one there are personal stories. Hundreds of millions of people, 83 million households and more than 6.5 million businesses trust us every day. But this revolution does not stop, and it does not wait for anyone.

I have been at Telefónica for twenty years and I have been fortunate enough to live some of the pages of our history. I know that changes are not easy. Deciding to change is not easy. It is hard and it is full of challenges. And for this reason, few dare to do it in a decisive way. But Telefónica history requires us to live up to the challenge.
A CHANGING WORLD THAT REQUIRES FORESIGHT

I was referring earlier to the changes that are coming. On one hand, the explosion of connectivity and Artificial Intelligence and the new needs of our customers - the central axis of our strategy - require innovative, intelligent and sustainable technology solutions that generate a positive impact on the environment and help manage the digital transition. Cloud, IoT, Big Data or cybersecurity are terms we hear most often. They represent a huge opportunity for our customers, and for us as well. And we are ready to take advantage of it.

On the other hand, geopolitical, macroeconomic and regulatory uncertainties and high competition in the sector require an increasingly demanding allocation of capital. If in the past the low penetration of voice and data services assured future growth, the current maturity of the markets and the appearance of new competitors subject to different rules demand a highly focused and alternative strategic approach in order to continue growing. We must recognise that the model that has allowed us to get this far successfully is close to being exhausted. And once again, we want to be pioneers, seeking new formulas for growth, offering the best service to our customers and managing resources as efficiently as possible.

Finally, the speed of change in our sector pushes us towards cultural change. But it is not just the environment around us; our team is also asking for it. In July I asked all my colleagues at Telefónica a question: what measures would you implement to improve the company? And I want to acknowledge how proud I am of all of them, for the involvement and commitment they showed. I received more than a thousand responses. I read and analysed all of them. And the conclusions were very clear: they are motivated to work in a simpler company with more agile processes; in a company where customer experience is the central axis, and in a company that acts with values in the new digital world. Because it is as important to manage climate change or the energy transition as it is to manage the digital transition.

REIMAGINING TELEFÓNICA

At Telefónica, we have the mission of imagining the company we want to have for the future. It is up to us to design a company for the next 100 years. An ambitious, responsible and sustainable company, full of opportunities. A company that can face a revolution that provides so many opportunities and raises uncertainties. It is up to us to envision it, design it and build it, as others have done before us. And we have done so. We have envisioned it, we have designed it and we want to begin building the path towards it.

We envision a company that is starting to grow strongly.

We envision a company of telecom business units that have the best networks, fully digitalised and are benchmarks in efficiency. With fibre and 5G, cognitive systems based on AI that, in real time, turn networks into examples of virtualisation, softwarisation and clouditisation, and where simplicity reigns. With the best customer service, the best commercial channels and the most admired brands. Open to third parties, making them the best technology distribution platforms in the societies we serve. Units that grow and generate the greatest pride of belonging.

We envision a company with cutting-edge technology units that compete face-to-face with the best in the world and grow vigorously, taking advantage of the opportunities that this revolution opens up for us. Capable of designing leading digital products and services to meet new customer needs, and with the best infrastructure to capture the explosion of data traffic, which will continue to grow exponentially.

We envision a company that can attract and motivate its people, and that fulfils its social mission and helps to build a better, fairer and more sustainable world, where technology is at the service of people and not the other way around.
OUR ACTION PLAN

For this reason, I have presented an action plan to the Board of Directors of Telefónica that has been approved today, and which will serve to accelerate the transformation of the company. This action plan revolves around three axes.

- The first involves prioritising the markets where we can be relevant and grow with a long-term sustainable model.
- The second is to promote opportunities with the greatest potential for growth, while at the same time leveraging the value of our infrastructure.
- And thirdly, to increase agility and improve efficiency.

In line with this plan, the Board has approved 5 decisions:

1. **Prioritise Spain, Brazil, the UK and Germany, as key markets in which Telefónica can provide differential value to its customers and grow in a sustainable manner.**

   Today, **Spain, Brazil, the UK and Germany** are our main markets.

   In recent years we have strengthened our position in these geographies, both organically and inorganically, improving the value proposition we offer to customers, making a major effort to improve customer experience on the most advanced ultra-broadband networks.

   These are large markets, with growth potential, where our scale and leadership allow us to be more ambitious, and where we are going to focus our investments in order to be even more relevant and grow.

2. **Operational spin-off of the businesses in Hispanoamérica.**

   The history of Telefónica cannot be understood without our 30 years of commitment to Latin America. It has made us a better company. We have always shown a strong commitment to the region, even in its most difficult moments. It is also a region with which I have a special relationship, and in which I have spent most of my career in Telefónica.

   Until a few years ago, our operations in Latin America were the driving force behind the company’s growth. However, the particular conditions in these markets have had an impact on the business, reducing its contribution in recent years for various reasons (macro and regulatory environment, greater competitive pressure, insufficient scale or volatility of currencies), and despite the enormous efforts of our local teams, which have always shown a strong commitment.

   This situation has led us to adopt a new model for these operations, which will now be managed as an autonomous unit with a dedicated team. With this step, we begin the review of our portfolio of assets in Hispanoamérica, with the dual objective of modulating our exposure to the region, while creating the conditions to maximize its value, both via growth, consolidation and potential corporate operations.

   The objective is to guarantee the best value proposition to our clients in a sustainable manner.

3. **Launch of Telefónica Tech, to boost growth in areas with greater potential.**

   This newly created unit will bring together the most advanced value proposition for the B2B segment, focusing on three businesses: cybersecurity, IoT and Big Data, and cloud.

   With this move, we want to boost growth in these services which are already collectively growing revenue by over 30% annually and can be considered unicorns, gaining market share with recognition as leaders.

   Telefónica Tech will integrate the global units currently dedicated to the development and provision of these services, in order to deepen management focus and achieve greater scale. It will leverage the muscle and local reach of the commercial teams in each country to sell its services and aspires to export the value proposition to other countries in which we are not present, through alliances.

   The unit’s high growth potential will also serve to continue attracting new technological talent and potential partners.
4. **Creation of Telefónica Infra**, to highlight the value of our assets and develop alternative models of infrastructure deployment that accelerate growth.

Leveraging the attractiveness and strength of Telxius, and with 50.01% of Telxius as the first asset, Telefónica Infra will encompass our stakes in telecommunications infrastructure vehicles that enable us to reinforce our technology platforms, serving both Telefónica's operators and third parties.

Telefónica Infra's ambition is to be one of the largest telecommunications infrastructure units in the world, ready to channel the traffic explosion, and it will allow us to exploit the value of a unique portfolio of assets and attract potential partners. The management team of this new company will focus on the development and monetization of towers, distributed antenna systems, data centres (including EDGE), greenfield fibre projects and submarine cables, among others.

5. **Evolving the operating model to increase agility, speed up execution and maximise synergies between all Telefónica units.**

Throughout our history, we have made important efforts to allow us to position Telefónica as best-in-class in efficiency. And in recent years we have launched various initiatives, both in our local operating businesses and globally, to take advantage of the benefits of digitalisation, achieving significant progress to date.

In order to gain agility and accelerate the execution of our strategy, it is time to evolve our operating model. Because if we want to be simple, transparent and agile with customers, we must simplify ourselves first.

To this end, we are adapting the role and operation of the corporate centre to the new reality of the company, focusing on all those activities that provide differential value to all the units of the new Telefónica – the operating businesses, Telefónica Tech and Telefónica Infra - eliminating some existing duplications with the structures of the operating businesses and reducing complexity. In addition, the corporate centre will enable us to maximise synergies between all units and crystallise the value of our scale.

At the same time, we have set ourselves a higher level of ambition in our plans to simplify and digitalise the rest of our operations, focusing on reducing complexity, improving efficiency and achieving operational excellence.

**THE FUTURE OF TELEFÓNICA BEGINS TODAY**

Saint-Exupéry wrote that "the essential is invisible to the eyes". Change is our essence. As I told you in the last Annual General Shareholders meeting, Telefónica is a company forged in change. And today, it changes again. It goes back to its essence. It envisions the future again. A future that passes through its networks and requires it to play a key role.

Living in this moment of time is exciting. We find ourselves at a crossroads again and we choose the same path as our predecessors: the path of change. These are profound changes that require courageous decisions. My twenty years in Telefónica and experience in different areas have allowed me to get to know the company and its people very well. I know that the commitment of all those who form part of Telefónica, their passion and the trust they transmit, will allow us to take advantage of the new waves of opportunities and face the challenges with enthusiasm and optimism.

It is impossible to predict the future, but I am convinced that the best way to predict it is to create it.

Today, we begin to write the future of Telefónica.

José María Álvarez-Pallete

Chairman & CEO of Telefónica