

Results

January – March 2017

Telefonica

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

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01 

Q1 17 Highlights

Mr. José María Álvarez-Pallete
Chairman & CEO



Sustainable business model; differential quality

Delivering growth (reported and organic)

- Sustained **fiber, LTE, smartphone** growth driving **avg. rev per access** (+2.1% org.)
- **Financials in euro terms reflecting FX tailwind effect**
- **Accelerating OpCF growth trends across the board**; outstanding performance
- **EPS up 48.8%**



Further advance in transformation

- **Introduction of AURA**: a new type of relationship with our customers, based on cognitive intelligence
- **Cost reductions** (structural & simplification); **synergies** (from acquisitions)
- **Encouraging** response from **"M4M"** tariffs; growing demand for quality



Strengthening balance sheet

- **Mar-17 Net Debt** €47.5Bn incl. Telxius stake sale
- **FCF x8.7** y-o-y to **€599m** up to March, offsetting traditional Q1 seasonality
- **De-risking B/S**; extending avg. debt life to 8.29 yrs post Q1 financing at historical low rates

Guidance and dividend reiterated

Q1 performance fully consistent with FY outlook

2017E Guidance (Organic)	Guidance 2017E	Q1 17
Revenues	Stable (in spite of regulation: ~-1.2 p.p.)	1.5% (regulation -1.1 p.p.)
OIBDA margin	Expansion up to 1 p.p.	(0.0 p.p.)
CapEx ex-spectrum/Sales	Around 16%	12.2%

2017 Dividend	To be paid in 2017/18
Interim Dec-17	€0.20/sh. Cash
Final Jun-18	€0.20/sh. Cash

Dividends to be paid in 2017 calendar year amount to €0.40/sh.:

- Cash dividend 16th Jun-17; €0.20/sh.
- Cash dividend 14th Dec-17; €0.20/sh.

MAINTAINING A SOLID INVESTMENT GRADE RATING

Growth + Sustainable Dividend + Deleverage

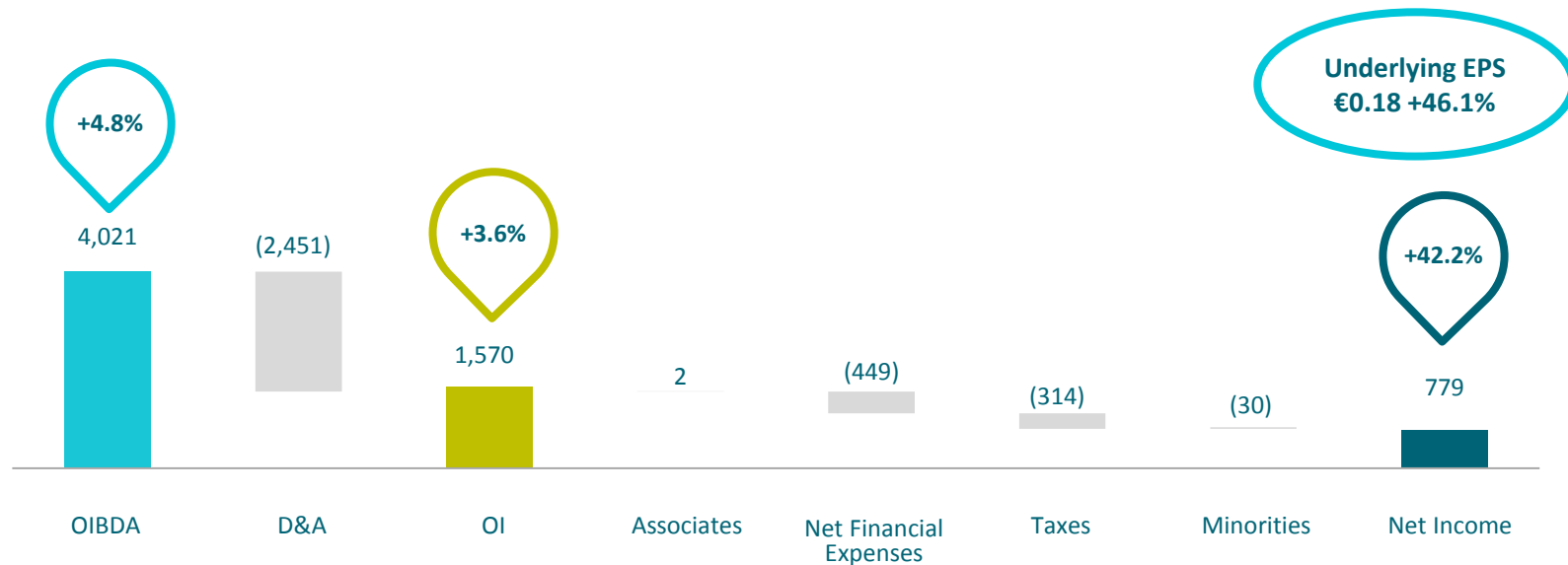
Financials in a nutshell

€m	Q1 17		
	Reported	Reported y-o-y	Organic y-o-y
Revenues	13,132	5.0%	1.5%
Service revenues	12,187	5.6%	1.7%
OIBDA	4,021	4.8%	1.3%
OIBDA Margin	30.6%	(0.1 p.p.)	(0.0 p.p.)
<i>OIBDA Underlying</i>	4,109	6.5%	
OpCF (ex-spectrum)	2,404	12.1%	8.9%
Net Income	779	42.2%	
EPS	0.14	48.8%	
FCF	599	8.7x	
Net Financial Debt	48,766	(2.7%)	

1st Q with positive effect of FX since Q1 15

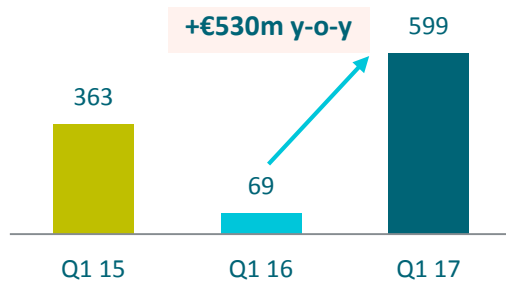
- Revenue: +3.7 p.p. y-o-y; OIBDA: +5.0 p.p. y-o-y
- Most Latam currencies with positive contribution, specially BRL

Reported growth accelerating at net income level

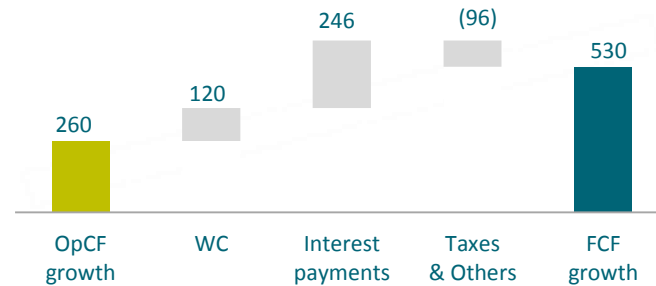


Accelerating free cash flow generation in Q1

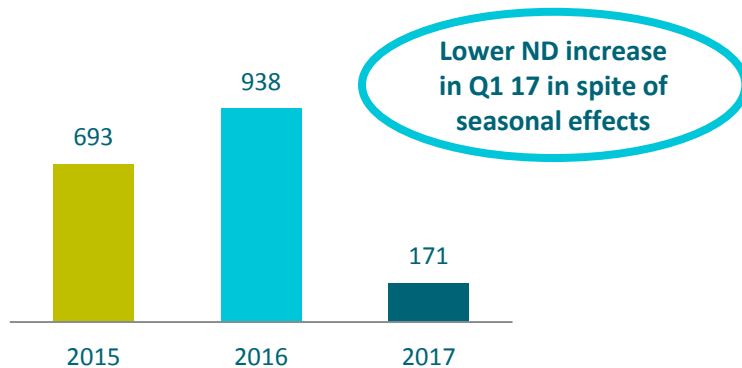
FCF (€m)



Higher FCF y-o-y (+€530m)



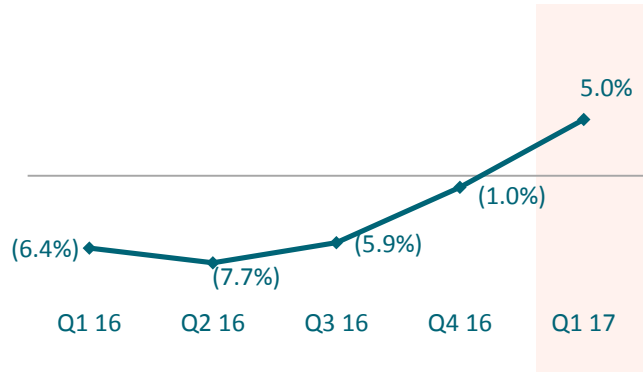
Q1 q-o-q change in Net Debt (€m)



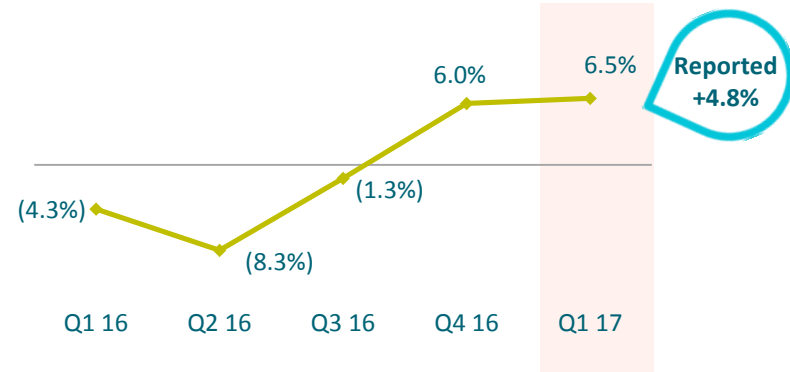
FCF to improve throughout the year

Significant recovery in reported trends

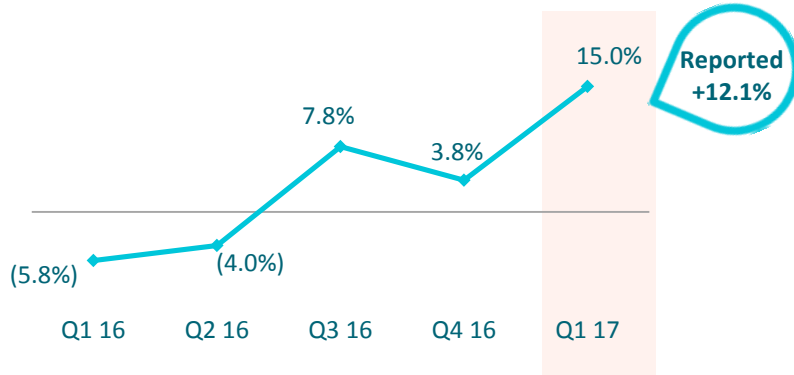
Revenues (y-o-y reported)



OIBDA (y-o-y underlying)

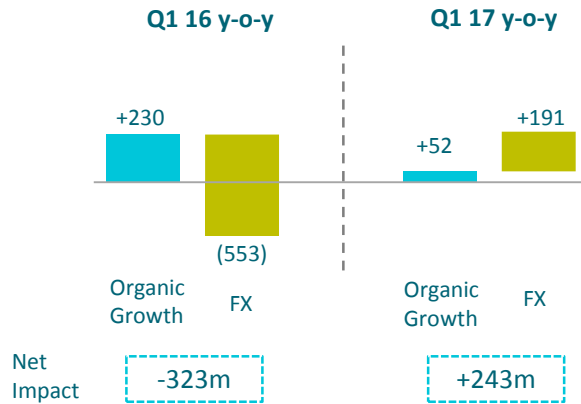


OpCF (y-o-y underlying)



Organic performance and FX driving growth

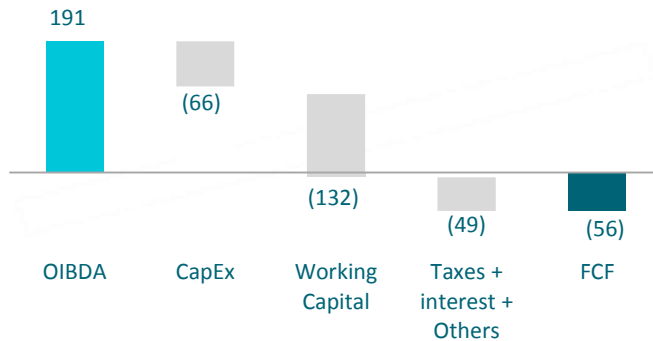
OIBDA: Organic growth & FX impact (€m)



Strong currency contribution

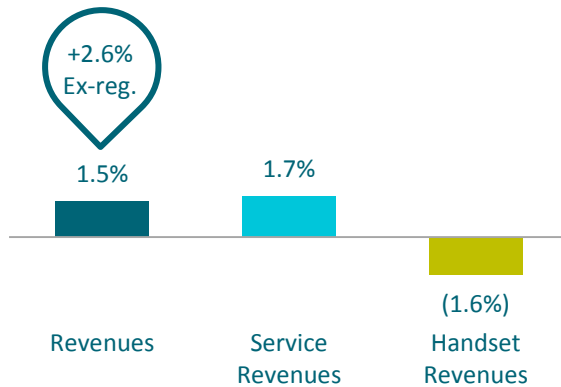
- **Positive FX impact y-o-y, reverting 2016 negative trend**
 - +€191m in OIBDA vs. -€553m in Q1 16
 - Q1 y-o-y: +3.7 p.p. to revenues; +5.0 p.p. to OIBDA
 - Q1: BRL, CLP, COP & PEN appreciation more than offsetting GBP, VEF, ARS and MXN depreciation
- **2017 FX impact:** at current rates FX to continue as tailwind in Q2
- FX effect mitigated at FCF

FX impact in Q1 FCF (€m)



Steady organic growth of Revenues & OIBDA

Q1 17 (y-o-y organic)



Q1 17 Profitability (y-o-y organic)



Delivering growth from service revenues

- **Service Revenues +1.7%, despite regulation** (-1.1 p.p.)
 - Hispam (+2.1 p.p.), BZ (+0.4 p.p.) & UK (+0.3 p.p.) to Q1 y-o-y org
- **BB & SoC revs. +5.3 p.p. y-o-y to 51% o/total**

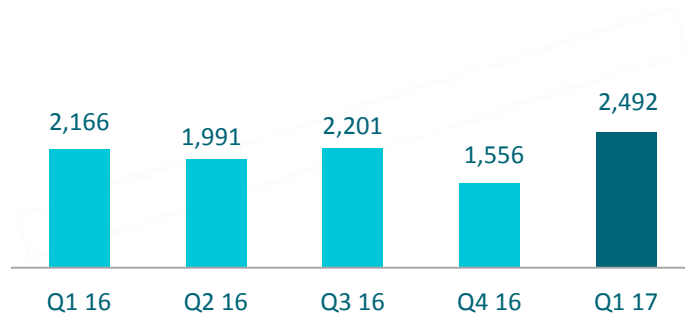
Stable profitability

- **Continuous focus on efficiencies & synergies**
- **Diversification value**
 - OIBDA contributors: BZ (+1.5 p.p.) Hispam (+1.4 p.p.), Germany (+0.1 p.p.) and UK (+0.1 p.p.)
 - Margin expansion in BZ & DE; flat in Spain; erosion in UK & Hispam

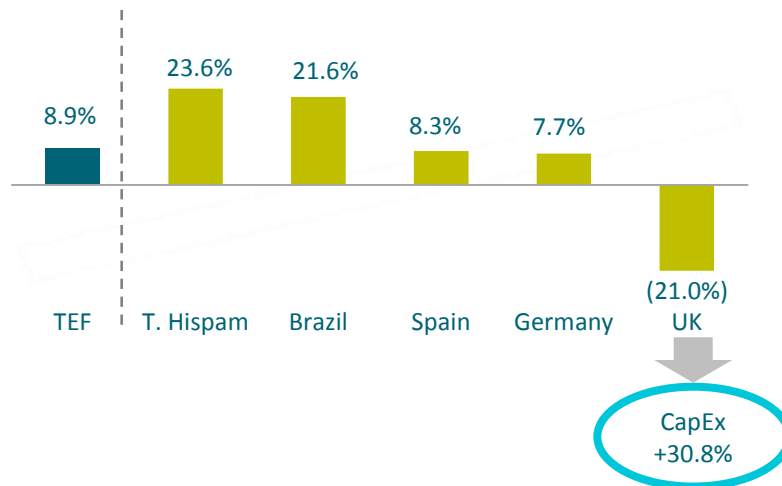
Boosting OpCF growth; high cash conversion

OpCF underlying (OIBDA-CapEx ex-spectrum)

(€m)



OpCF growth (y-o-y organic)



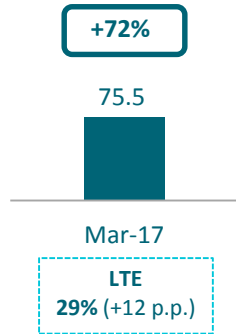
Operating leverage and lower CapEx intensity

- Robust business performance
- Q1 CapEx €1,621m (-8.4% y-o-y org.)
- All segments accelerating trends (q-o-q org.)
 - Spain (+10.1 p.p.)
 - Germany (+14.6 p.p.)
 - UK (+18.9 p.p.)
 - Brazil (+24.5 p.p.)
 - Hispam (+1.6 p.p.)

Enhanced network and offer fostering data growth

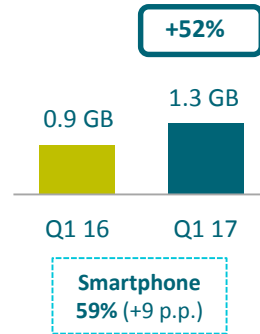
LTE accesses (m)

☐ Penetration

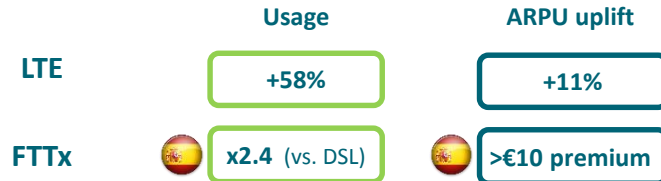


Data usage/smartphone

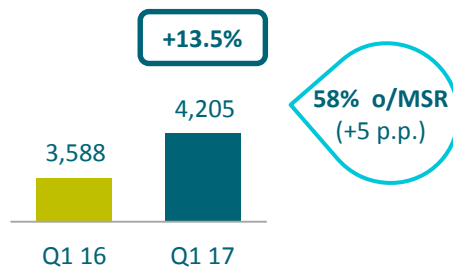
☐ Penetration



LTE and Fiber uplift (Q1 17)



Mobile Data Revenues (€m; y-o-y organic)



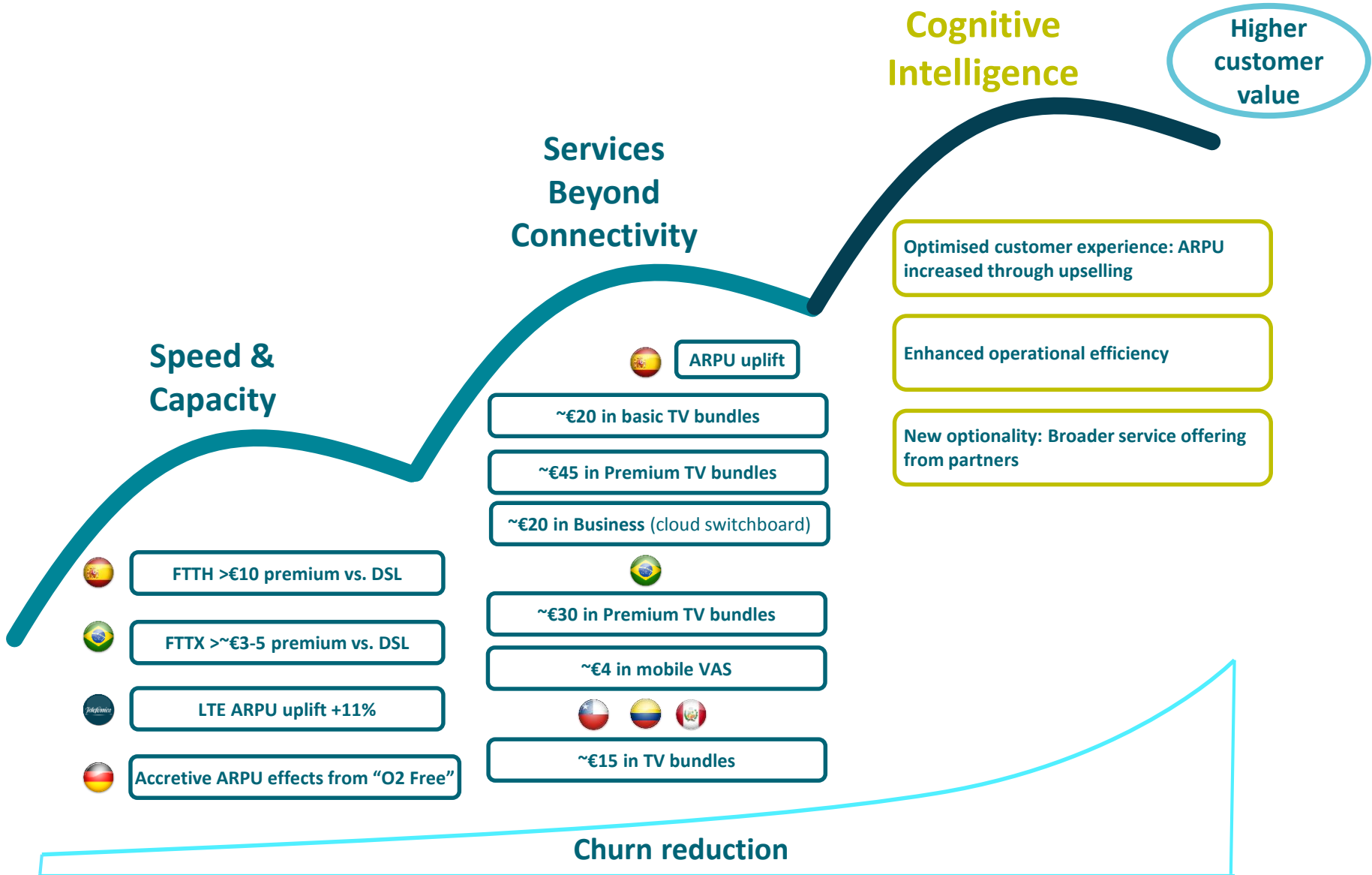
Proven data monetisation

- **Delivering value in Latam: recurrent plans & tiered schemes**
 - ~20% ARPU uplift after data adoption
 - 45% smartphone penetration in prepay (+7 p.p. y-o-y)
- **Continued upselling to higher value tariffs**
 - New data test in Chile (100GB extra for 3 months)
 - 8GB in “Fusión” main mobile line (Spain)
 - Data sharing & family plans
- **Spain: “More for More” in all convergent plans**

Sound increase in data volumes; more upside

- **Q1 LTE traffic 2.7x y-o-y; Mobile data traffic +68%**
- **Q1 Fixed data traffic +31% fostered by UBB**

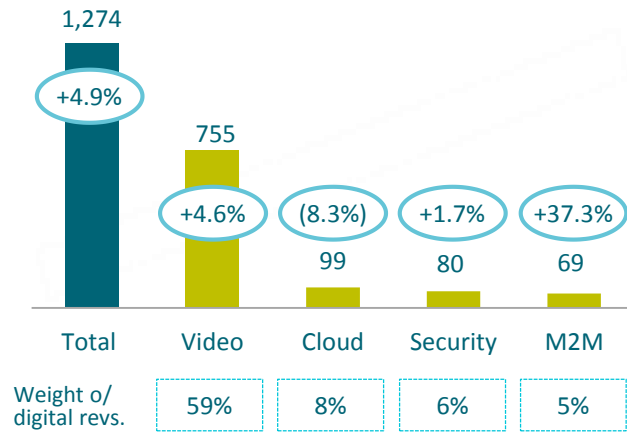
A new wave of data monetisation opportunities



Digital Services: Distinctive model

Q1 17 Digital Services Revenues (€m)

○ y-o-y organic



Video: differential contents & widening partnerships

- Sustained revenue growth +4.6%
 - ARPU growth across footprint
 - Successful customer development on Premium TV offering
- International distribution agreements to monetise own production 🇪🇸
- Pay TV accesses growth in Hispam 🌐

Increasingly relevant digital player

- **CLOUD:** Focusing on value proposition for SME segment
- **SECURITY:** Strengthening partnerships in B2B (Palo Alto, Fortinet, McAfee, Subex) and B2C (Allot)
- **M2M:** Rollout of flagship projects across main geographies; global strategy for “Low Power Wide Area” communications

TGR: UBB deployment and E2E Digitalisation

Enhancing speeds and capacity

Access Network

~40m FTTx/Cable premises passed



LTE coverage
(64% pop.)

88% Europe (+7 p.p.)
56% Latam (+12 p.p.)

OSS + Core Network

- New system for FTTH deployment tasks assignment (2017E: -40% time-to-resolution)
- vEPC (virtual Evolved Packet Core) deployment started for 13 countries



Digital Capabilities and Innovation driving transformation

Network evolution



VoIP
6.4m customers

VoLTE+ VoWiFi

Global Centers

2 new in Q1

- Platforms
- Legacy networks transformation

Innovation

- First ETSI NFV interoperability event
- 5G: Remote vehicle driving

E2E Digitalisation

Enabling new capabilities

- New features driving better customer experience**
 - ✓ Real-Time experience
 - ✓ Omni channel
 - ✓ Self-management
 - ✓ Automation
 - ✓ Agility

50% E2ED Enablement

Q1 milestones

- ✓ Full Stack: Peru 2.5m accesses migrated
- ✓ Progressing Single Online Charging System in ARG & MEX
- ✓ Boosting data capabilities:
 - Big Data: 1 new platform in Ecuador
 - Real Time Decision: 12 use cases

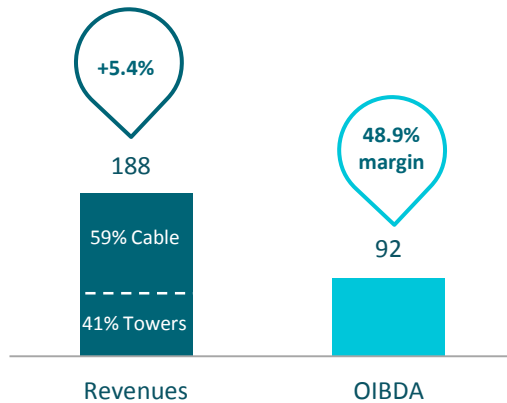
15% Full Stack customers

28.7 PB
(x3 y-o-y)

Telxius: Solid performance

Q1 Financials (€m)

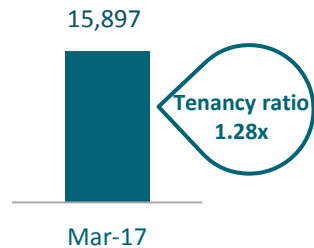
(y-o-y organic)



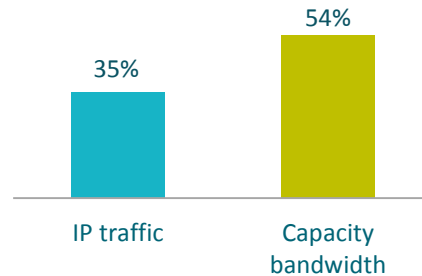
Leading telecom infrastructure Co.

- **Balanced asset portfolio:** solid revs. + strong profitability
- **Towers:** 27 new sites under build to suit program with TEF in Q1
- **Submarine Cable:** solid traffic growth on current network (>65,000km)
- **Ongoing deployment of 2 new submarine cables** (active in 2018)
 - BRUSA: 8 fiber pairs; 10,700 km connecting Brazil, Puerto Rico & USA
 - MAREA: ownership of 4 fiber pairs (o/ 8 in total); 6,600 km connecting Virginia Beach (US) & Bilbao (Spain)

Towers (# sites)



Submarine Cable (y-o-y)



02 

Q1 17 Results

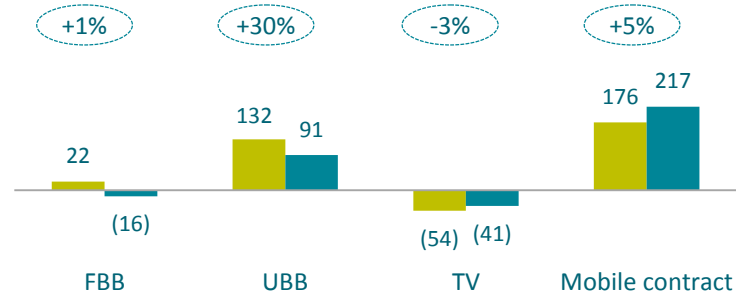
Mr. Ángel Vilá
CSFO



Spain: Trading skewed to high value

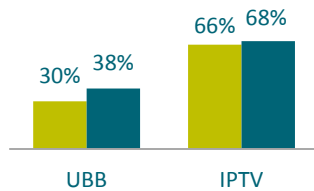
Net adds ('000)

■ Q4 16 ■ Q1 17 ○ Base y-o-y



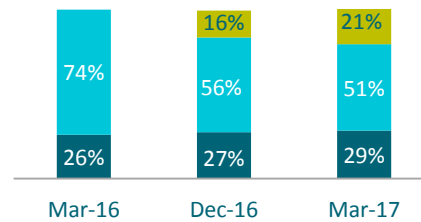
"Fusión" high-value penetration

■ Mar-16 ■ Mar-17

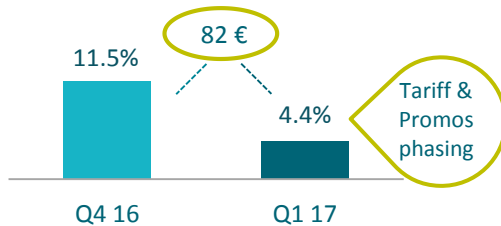


"Fusión" mix (% base)

■ Low ■ Mid ■ High



Fusión ARPU growth (y-o-y)



Successful smart bundling dynamic

- "Fusión" upselling gaining traction
 - "Fusión" high-end: 21% of base (Fusión+2 and above)
 - "Fusión" customers (+4%); stable churn
- Mobile base growth (for the first time since Q2 11)
 - Additional mobile lines in "Fusión": +41%
- Better IP TV net adds limiting TV loss
- FBB base largely in fibre (52% o/FBB; +11 p.p.)

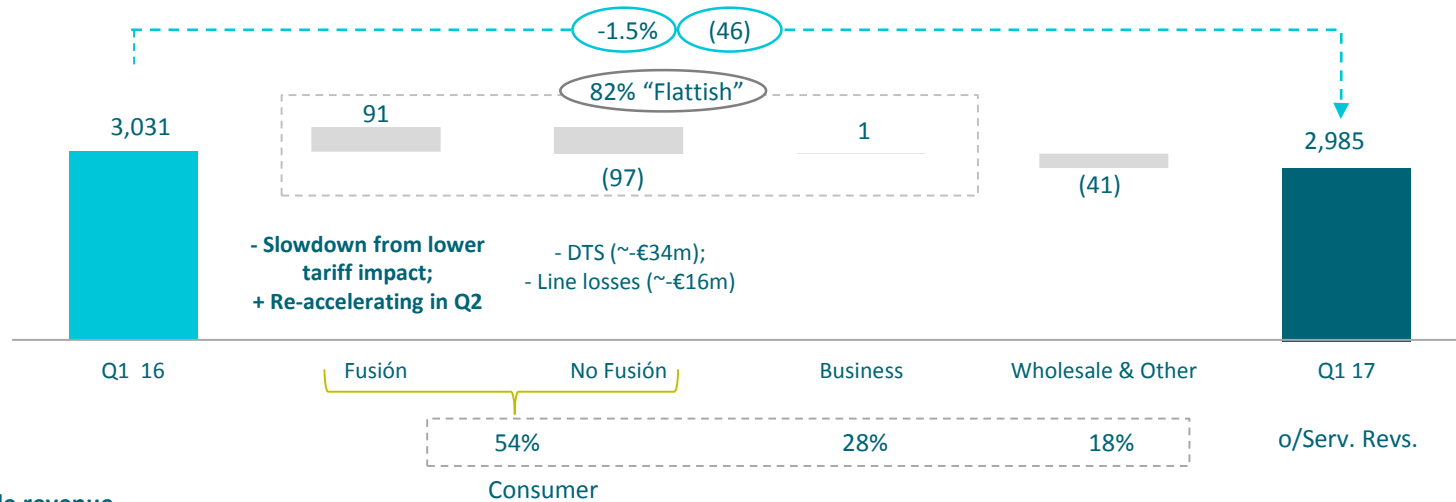
Differential assets

- Largest FTTH in Europe: 17.5m prem. passed
 - 18% uptake at Mar-17 (retail)
 - Upside in retail + wholesale uptake
- Leading TV platform: Exclusive content & features
- LTE expansion: 96% pop. coverage

Spain: Zoom on revenue evolution

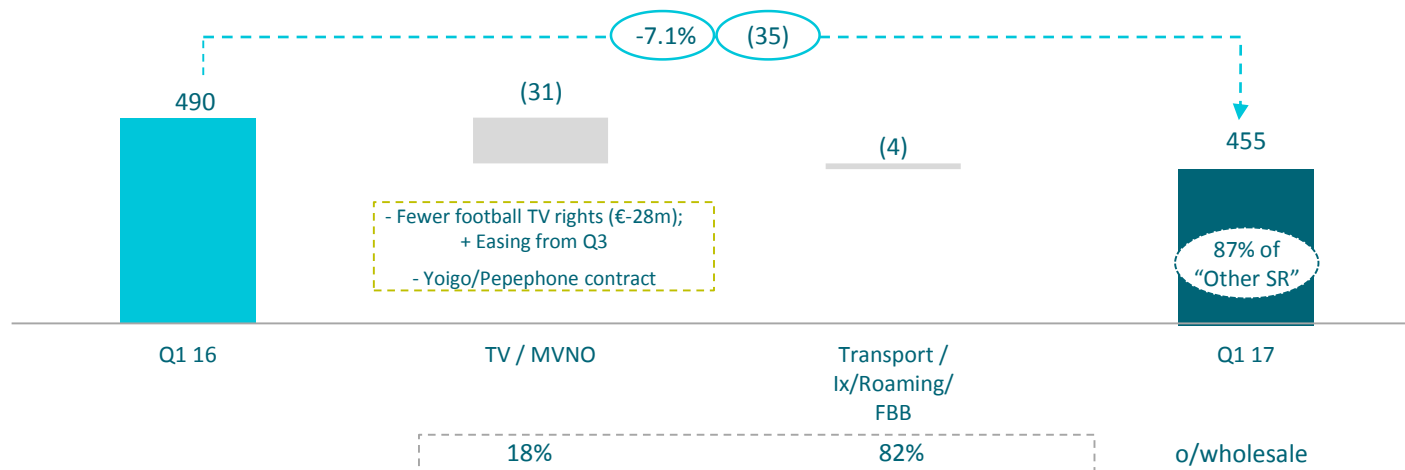
Service revenues to improve from Q2

(€m; organic)



Wholesale revenue

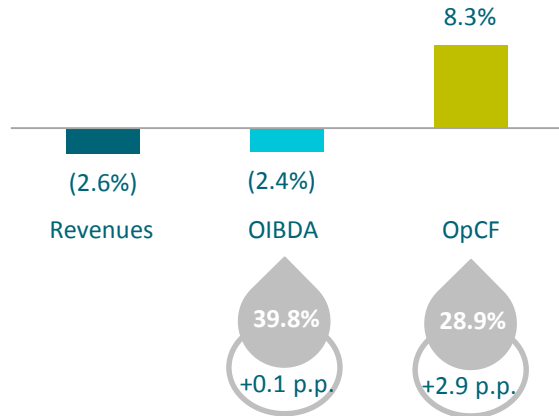
(€m)



Spain: Accelerating operating cash flow growth

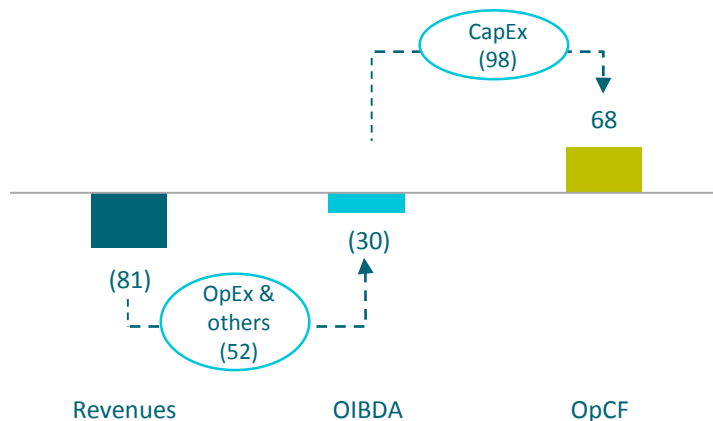
Strong Profitability (Q1 y-o-y organic)

● Margin organic



Consistent efficiency gains (Q1 y-o-y organic)

(€m)



Growing OpCF +8.3% y-o-y

- Service revenues (-1.5%) reflecting tougher comps
- OIBDA evolution driven by top line (OpEx:-3.3%)
- Best-in-class cash conversion: easing CapEx cycle (-22.7%)

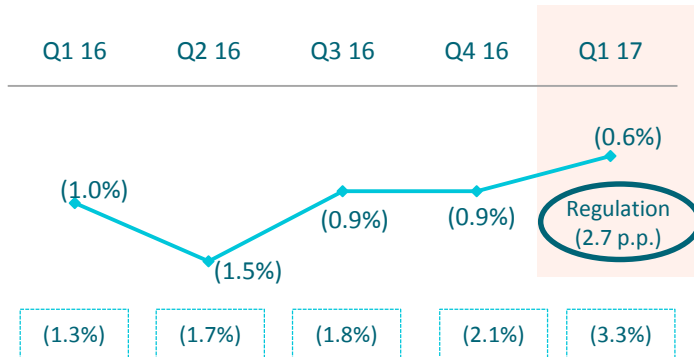
Service revenue to improve from Q2

- Consumer revs. (-0.4% y-o-y); negative calendar effect on “Fusión”
 - Tailwind from Q2 (tariff update in Apr-17)
- Business revs. (+0.1%) flat y-o-y
- Other revs. (-7.3%) from lower wholesale revs.
 - TV (-49%), MVNO (-12%)
 - Fiber wholesale to support mid-term growth
- High visibility on future savings (personnel, commercial, network....)
 - 2017 Redundancy Plan widened (Q1 provision: €76m)

Germany: Executing on synergies; improving quality

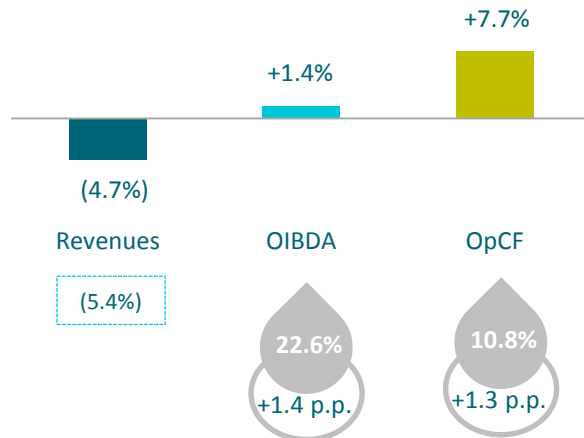
MSR ex-regulation (y-o-y organic)

MSR



Q1 17 Financials (y-o-y organic)

Margin Handset sales



Dynamic market

- **Focus on stimulating data growth**
 - LTE cust. +61%; penetration 32% (+11 p.p.); cov. 79% (+3 p.p.)
 - +52% avg. data usage O₂ LTE to 1.8GB
 - +67% mobile data traffic vs. Q1 16
 - “O₂ Free” data usage ~ 1.5x vs. prior portfolio
- **Contract**; 172k net adds
 - 55% of gross adds from partners (-2 p.p. q-o-q)
 - Easing price pressure in non-premium

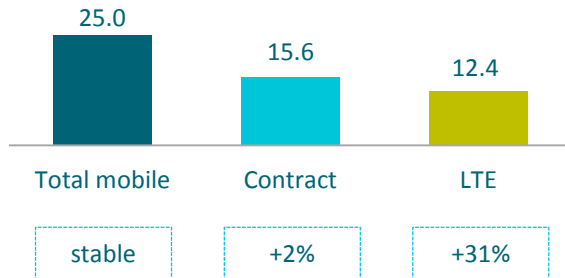
Robust profitability

- **Q1 Synergies**
 - ~€35m incremental OIBDA savings; FTE restructuring and network (~€160m in YE 17E)
 - Tougher comps vs Q1 16 (~€55m; ~€150m in FY 16), contribution of rollover effects
- **Headwinds from regulation + commercial costs** (“O₂ Free” + customer service quality)

UK: customer brand of choice

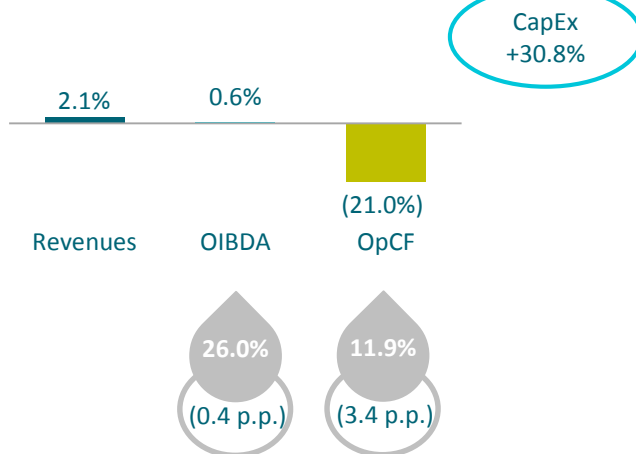
Accesses (Mar-17; m)

■ y-o-y



Q1 17 (y-o-y organic)

● Margin



Solid performance in a competitive market

- **Contract 63% o/total** (+1 p.p.)
 - Leading contract churn: 0.9% in Q1
- **57% LTE penetration** (+14 p.p.); **96% outdoor cov.** (+10 p.p.)
- **Avg. data usage per smartphone +57%** vs. Q1 16

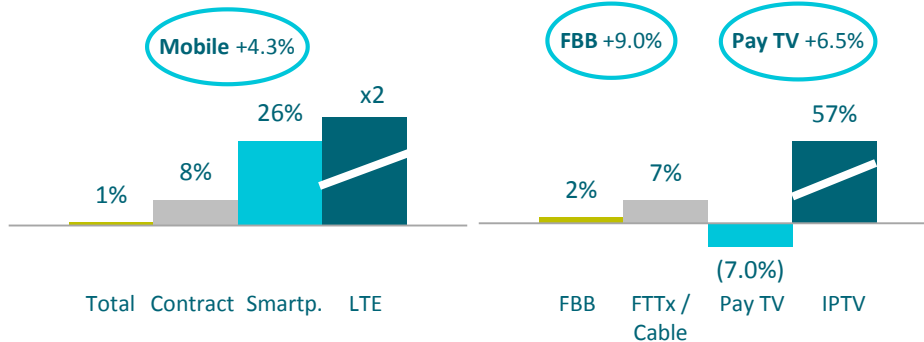
Continuing to drive revenue growth

- **MSR +1.2% y-o-y; maintaining trends**
 - + Higher avg. subscription & out-of-bundle spend
 - + Growing MVNO contribution
 - + Value customer base growth
 - Impact from roaming & MTRs (-2.0 p.p.)
- **Handset and other revs. +5.3%**
 - + New device launches & Smart Metering Implementation Programme
- **OIBDA** fuelled by revenue growth
- **CapEx**: accelerating LTE rollout

Brazil: Growing & expanding margins; OpCF +21.6%

Accesses (y-o-y)

○ ARPU (y-o-y l.c.)

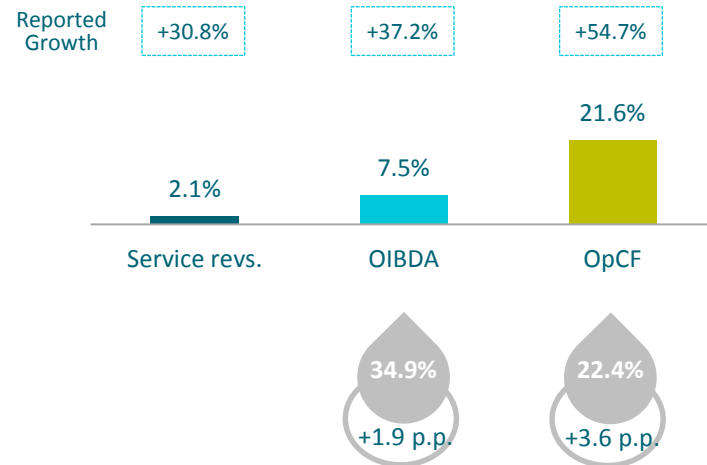


Commercial activity focus on value

- 30.5% mobile market share; 42.0% in contract; 34.5% in LTE
- Market leading contract churn (1.6%; - 0.1 p.p.)
- Mobile positive net portability every month in 2017
- **Enhancing customer experience**
 - 4G coverage to 65% (47% a year ago)
 - 17.4m fiber prem. passed (4.2m connected)

Financials (y-o-y organic)

● Margin



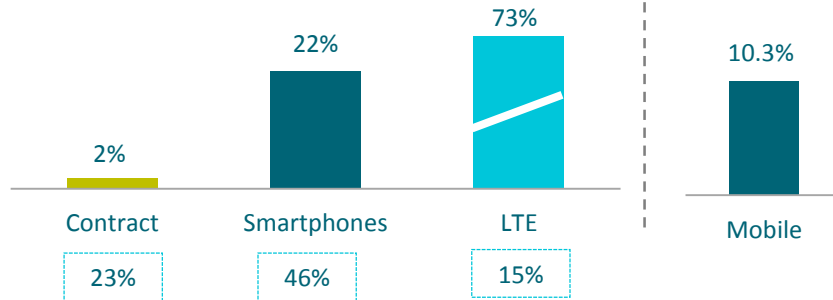
Continued improvement in profitability

- **Revenues up +1.6% on MSR acceleration (+5.1%)**
 - Data / MSR: 69% (+16 p.p.)
 - Robust FBB revs.; partially offsetting voice decline
 - Regulation dragging revs. by 2.1 p.p.
- **OpEx reduction** for 5th quarter in a row (Q1: -1.1%)
 - Successful execution op. synergies: NPV 76% of best case

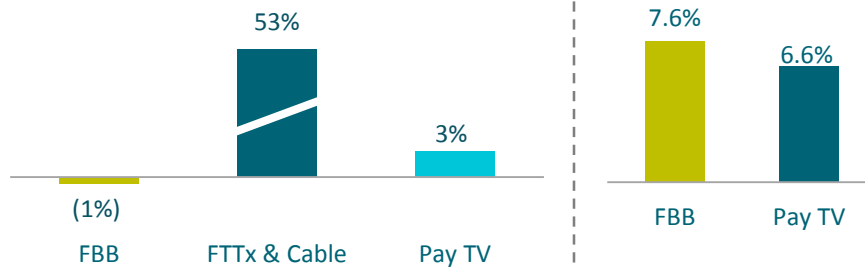
HispAm: Focus on quality growth

Accesses (y-o-y)

☐ Accesses penetration



Accesses (y-o-y)

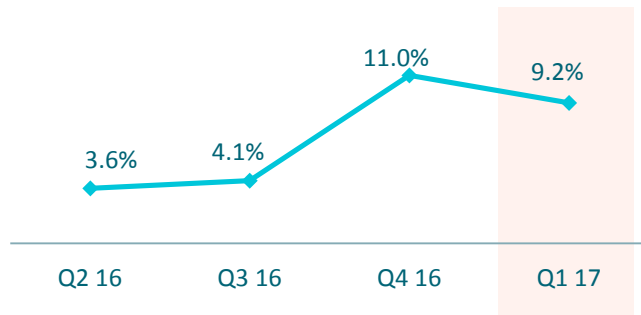


ARPU increases across services

- **Ongoing improvement in QoS**
 - LTE coverage 51%; +9 p.p. y-o-y
 - 5.0m prem. passed with FTTx/Cable (+1.7m in LTM)
- **ARGENTINA:**
 - Mobile ARPU uplift; tariff upgrades & growing volumes
 - Outstanding uptake on fiber connections: 41k net adds
- **MEXICO:**
 - Easing pricing competition driving ARPU stabilisation
 - Ongoing mobile contract improvement: positive net adds
- **CHILE:**
 - Steady growth in contract (5k net adds)
 - Growing FTTx (+22% to 329k connections; 1.2m prem. passed)
- **PERU:**
 - Trading affected by competition & natural disaster effects
 - Best-in-class assets: positive net adds in fixed
- **COLOMBIA:**
 - Good commercial momentum (contract accesses +6%)
 - Enhanced quality; positive FBB & Pay TV net adds

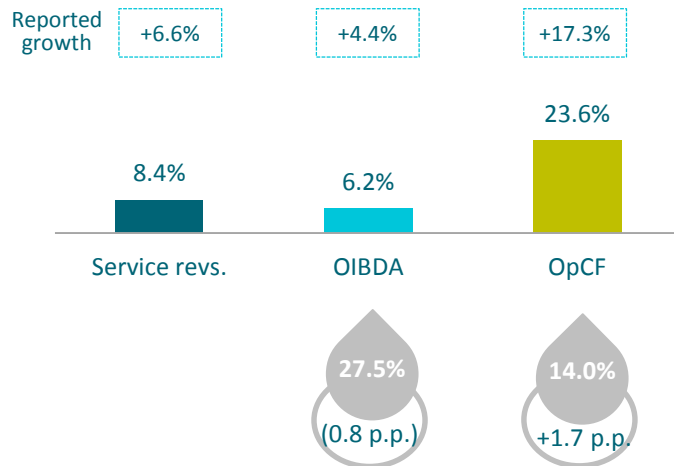
HispAm: Solid revenues, OIBDA and OpCF growth

Revenues (organic y-o-y)



Financials (y-o-y organic)

● Margin

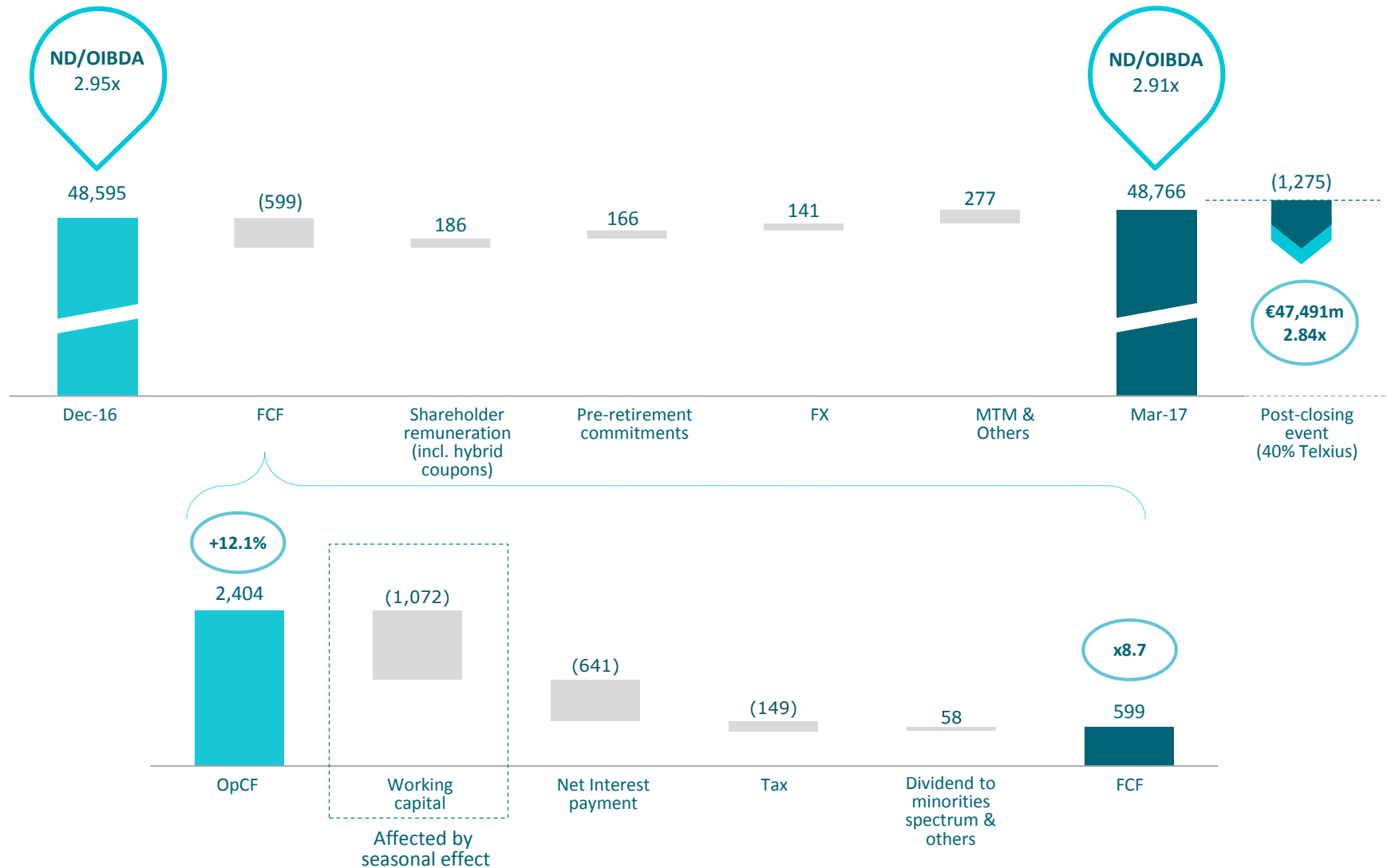


Robust y-o-y growth

- **Solid top line increase**
 - Double-digit MSR growth (+10.6%)
 - Fixed revenue +4.1%
 - **Slight OIBDA margin erosion** (-0.8 p.p.)
 - **OpCF up 23.6%**
-
- **ARGENTINA:** Outstanding revs. & OIBDA; margin +5 p.p.
 - **CHILE:** Top line & OIBDA impacted by lower prepay accesses, regulatory effects and IT seasonality
 - **PERU:** Intense competition explaining revs. & OIBDA decline; Q1 ARPU trend improving
 - **COLOMBIA:** Sound revs. (+4.4%) and OIBDA (+5.0%)
 - **MEXICO:** Revs. & OIBDA worsening on tougher comps (positive itx. effect in Q1 16) and despite improved ARPU trend

Leverage reduced on better operating performance

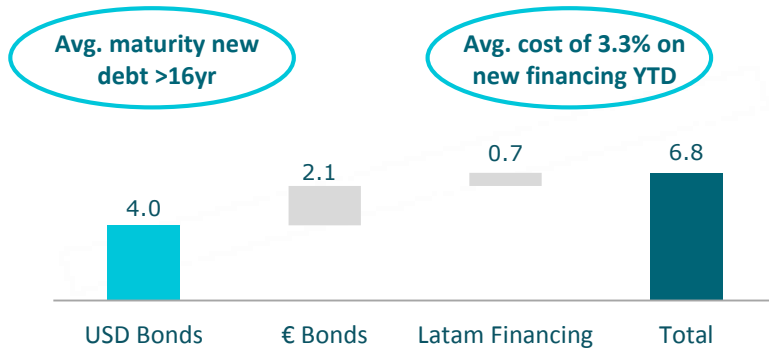
Net Financial Debt (€m)



Average debt life above 8 years

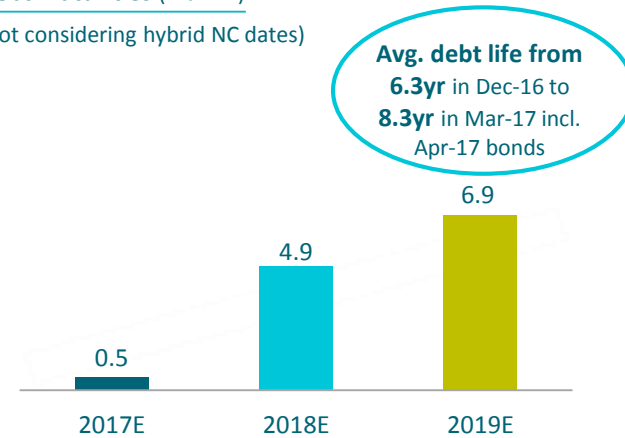
Sources of long-term financing (YTD)

(€bn)



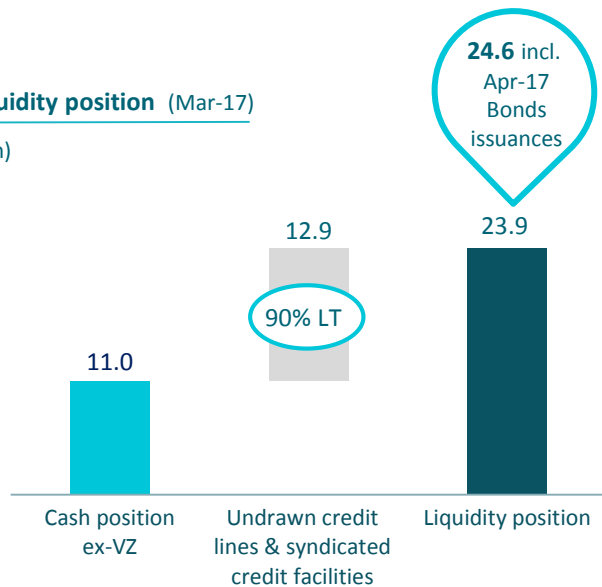
Net Debt maturities (Mar-17)

(€bn; not considering hybrid NC dates)

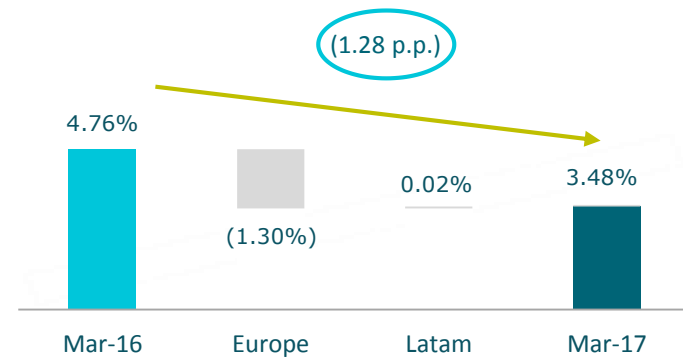


Liquidity position (Mar-17)

(€bn)



Interest payments cost



Summary

- **Solid performance with full-year guidance on track**
- **Distinctive OpCF generation and growth fuelling FCF**
- **Retaining benchmark profitability**
- **Outstanding EPS growth**
- **Reinforcing B/S: Deleverage; Active and diversified financing strategy**

Strong set of results; advancing in sustainable growth

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