

Telefonica

Results

January – September 2016



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01 

Q3 16 Highlights

Mr. José María Álvarez-Pallete
Chairman & CEO



Q3: Sustainable improvements on all fronts

Strategy is working:
back to growth

- **Transformation process is paying off**
 - **CapEx intensification ahead of peers** allowed quality differentiation (Spain, Brazil, HispAm)
 - **Transition from voice to data** almost concluded; data keeps growing healthy and voice has been largely bundled
- **Next steps, accelerating growth**
 - **CapEx/Sales peak behind us**; OpCF growth to accelerate. Interest costs to continue declining
 - **Consolidation driven synergies** in BRA, GER
 - **Improve ROCE**

Q3 proof points:
Accelerating
OIBDA, OpCF,
EPS, FCF growth
& Deleverage

- **Service revenue +1.4%** y-o-y organic, stable from Q2
- **Pick-up in OIBDA to +3.1%** y-o-y organic (+2.4 p.p. q-o-q improvement)
- **OpCF +10.8%** organic (+9.3 p.p. q-o-q improvement)
- **External factors (FX) improving**; reported Q3 OIBDA almost flat (-1.0% y-o-y; -7.1% in Q2)
- **€2.6Bn net debt reduction** in the last 3M to €49.98Bn
- **Strong cash conversion; Q3 FCF of €1.5bn**, up 7.1% y-o-y leading to €2.3bn in 9M (+91.9%)

Operating
improvement
is sustainable

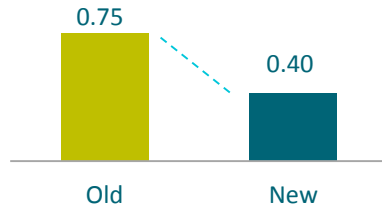
- **Spain**: Sustaining very solid financials; increasing market value (OIBDA keeps growing; OpCF growth accelerating)
- **Brazil**: Stellar performance, expanding market share and margins at the same time (Q3: OpCF +37.9% y-o-y organic)
- **Hispam**: OIBDA back to growth (Q3: +6.3% y-o-y organic; +9.7 p.p. q-o-q improvement)
- **Germany**: Successful execution of synergies (OIBDA margin +2.2 p.p. y-o-y organic ex non-recurrent)
- **UK**: Better trends in revenues & profitability; best UK mobile operator: sustained market outperformance

Sustainable organic
deleverage

- **Dividend reset**; growing FCF
- **Consistent organic deleverage**
- **Portfolio optimisation policy**: strategically driven

New financial objectives to ensure sustainable remuneration and consistent deleverage

DPS



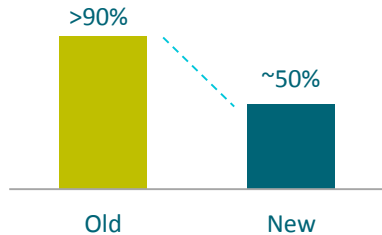
• **2017 Remuneration**

- €0.40/sh. to be paid in cash in 2 tranches: €0.20/sh. in Q4 17 plus €0.20/sh. in Q2 18

• **Revised 2016 remuneration**

- €0.35/sh. in voluntary scrip dividend in Q4 16 plus €0.20/sh. in cash in Q2 17

Pay-out assuming FCF of €4Bn/yr



- **Sustainable pay-out, with growing FCF**
- **Allows for recurrent excess retained FCF**

Objective

Solid investment grade credit rating, aiming to ratios compatible with BBB/Baa2 levels

- **Consistent organic deleverage**

2016 Outlook

2016 Guidance (Constant FX 2015; ex-VZ; ex-UK)	Guidance 2016E	9M 16
Revenue	>4%	+3.0%
OIBDA margin	Stabilising vs. 2015	+0.4 p.p.
CapEx/Sales	Around 17%	15.3%

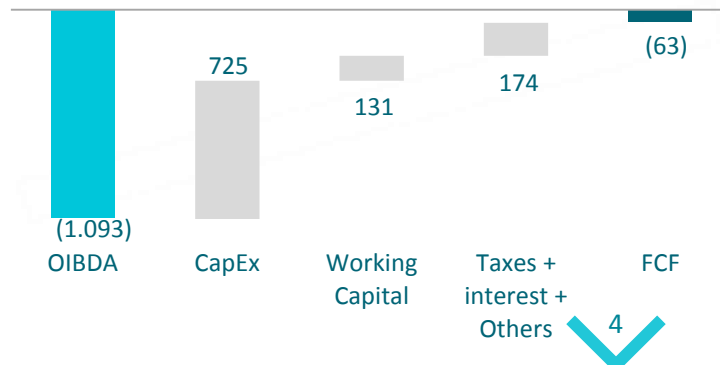
Service
Revenues
+4.4%

Financials in a nutshell

€ in millions	9M 16			Q3 16		
	Reported	Reported y-o-y	Organic y-o-y	Reported	Reported y-o-y	Organic y-o-y
Revenue	38,315	(6.7%)	0.8%	13,080	(5.9%)	(0.2%)
Service revenue	35,511	(5.2%)	2.2%	12,148	(4.1%)	1.4%
OIBDA	11,931	(4.6%)	3.1%	4,175	(1.0%)	3.1%
OIBDA Margin	31.1%	0.7 p.p.	0.7 p.p.	31.9%	1.6 p.p.	1.0 p.p.
OpCF (ex-spectrum)	6,256	(1.4%)	5.7%	2,144	8.6%	10.8%
Net Income	2,225	(22.0%)		983	38.5%	
EPS	0.41	(23.6%)		0.19	44.8%	
FCF	2,315	91.9%		1,500	7.1%	
Net Financial Debt	49,984	0.7%				

9M 16: Negative FX effect in OIBDA neutralised at FCF level

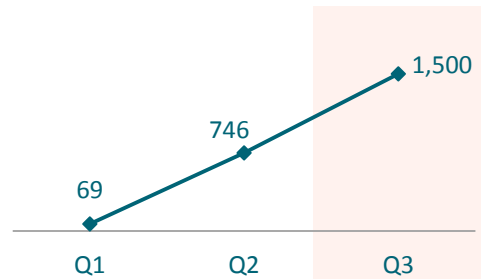
(€ in millions)



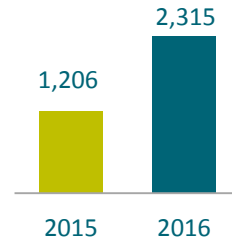
LatAm FX impact to ease further in Q4

Robust FCF generation; improving markedly

2016 FCF (€ in millions)



9M FCF (€ in millions)



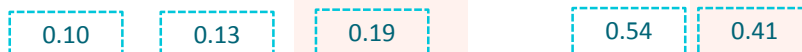
Enhancing performance throughout the year

- **+€1,109m y-o-y in 9M (+91.9%)**
 - Lower spectrum, CapEx, financial payments, taxes & dividend to minorities
- **+€754m q-o-q** on the back of improvements across the board, despite greater investments and spectrum payments
 - FCF ex-spectrum accelerating in Q3 (+30.8% y-o-y)

FCFS (€)



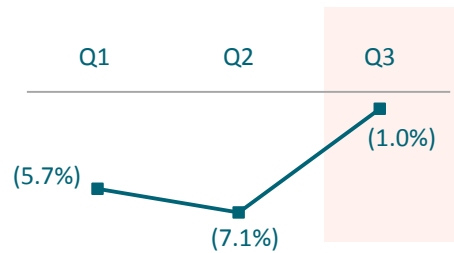
EPS (€)



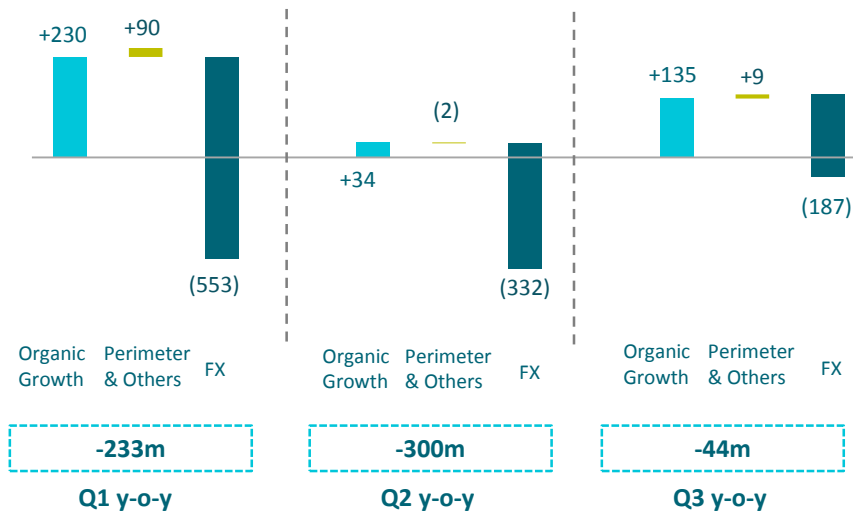
**On the right path to deliver stronger FCF in Q4
FY16 FCF >€4Bn**

Strong recovery in reported OIBDA

2016 Reported OIBDA (y-o-y)



OIBDA y-o-y trends (€ in million)



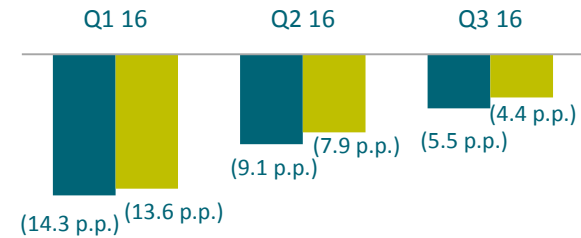
FX negative impact to dramatically ease in H2 16

- **Sequential improvement of FX y-o-y drag** (+3.6 p.p. y-o-y in revenues & +3.4 p.p. in OIBDA mainly due to BRL)
- **ARS and GBP** main FX detractors in Q3
 - Q4 15 ARS devaluation to ease y-o-y comps in Q4 16

No perimeter effect from Q3 16

FX impact (y-o-y)

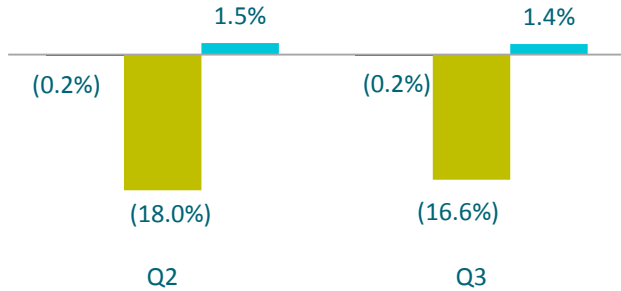
■ Revenues ■ OIBDA



Steady growth of service revenues

2016 Revenues (y-o-y organic)

■ Total ■ Handset sales ■ Service revenues

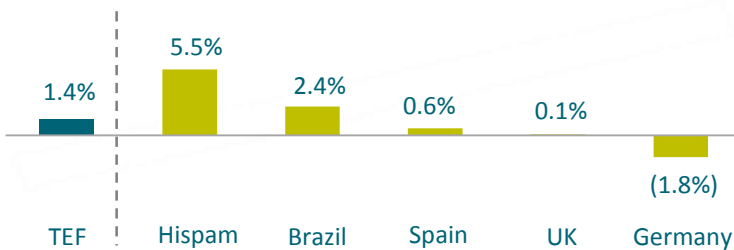


Consistent performance of service revs q-o-q

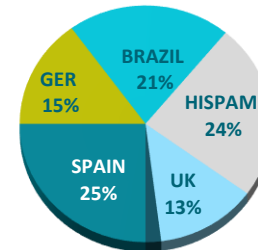
- Brazil & Hispam accelerating in Q3; UK & Germany improving trends
- Q3 total revenue stable even with pressure from handset sales
- Q3 BB Connectivity & SoC 49% o/total; +7 p.p. y-o-y
 - Increasing growth opportunities (IoT, cloud, video,...)
- Strong demand for mobile data (Non-SMS revs +20.0% vs. Q3 15)

Outstanding diversified portfolio

Q3 Service Revenues (y-o-y organic)

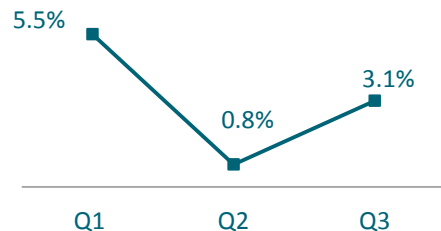


Revenue (9M 16)

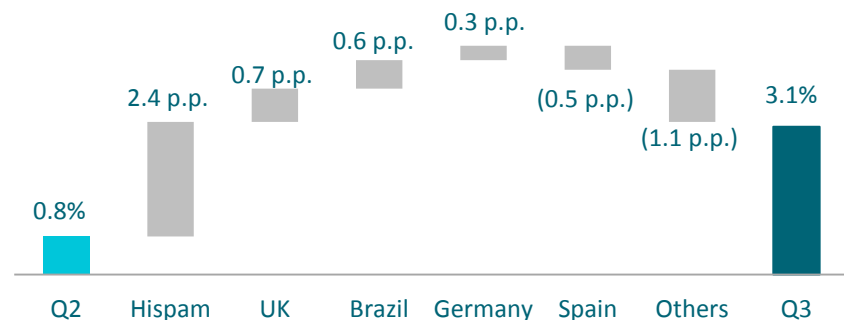


Accelerating organic OIBDA increase

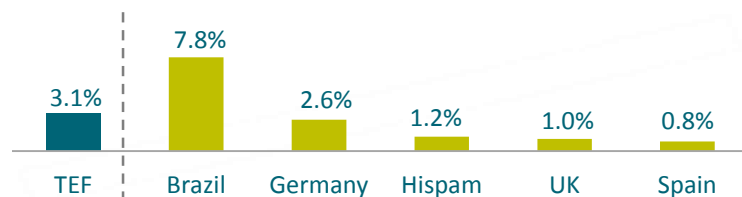
2016 OIBDA (y-o-y organic)



OIBDA (y-o-y organic)



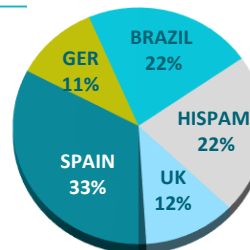
9M OIBDA (y-o-y organic)



9M organic OIBDA growth across the board

- +240 bps ramped-up in OIBDA q-o-q
- OpEx discipline continues to excel (Q3: -1.6% y-o-y; Q2: -0.8%)
- Extracting savings from merger synergies & cost efficiencies (redundancy programs; commercial efficiency; network optimisation)

OIBDA (9M 16)

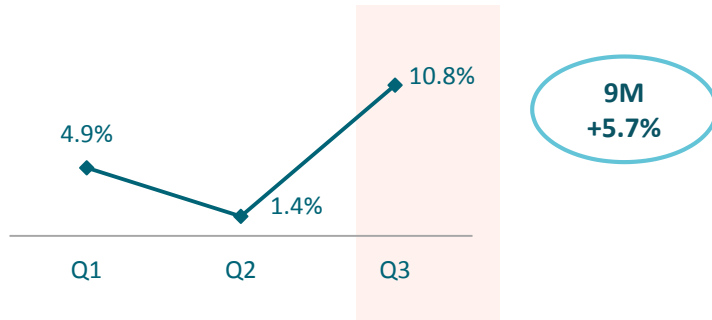


OIBDA margin progression in Q3

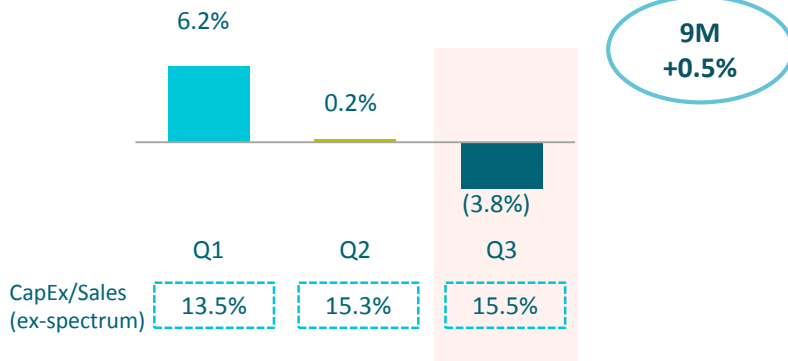
- 31.9%; +1.0 p.p. y-o-y organic
- Expanding margin y-o-y in all segments
- 9M margin 31.1% (+0.7 p.p. y-o-y organic)

Outstanding OpCF upturn on higher OIBDA growth

2016 OpCF (ex-spectrum; y-o-y organic)



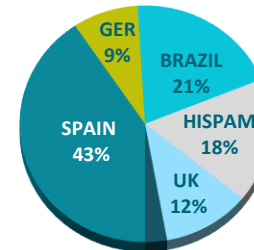
2016 CapEx (y-o-y organic)



High operating leverage

- **Cost & CapEx efficiencies and optimisation**
- **Brazil & Spain main contributors to organic OpCF**
 - Spain (43% o/total) +7.1% vs. Q3 15 y-o-y ex non-recurrents
 - Brazil (21% o/total) +37.9% y-o-y in Q3
- **9M OpCF margin 16.3%**

OpCF ex-spectrum (9M 16)



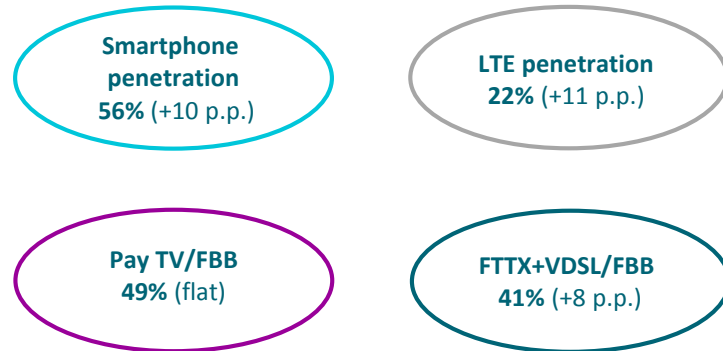
79% CapEx in growth & transformation

- **Continued investments in differential platforms to excellent connectivity**
- **9M CapEx (ex-spectrum)/Sales 14.8%** (flat y-o-y organically)
- Q3 y-o-y reflects phasing effects

High-value strategy across geographies

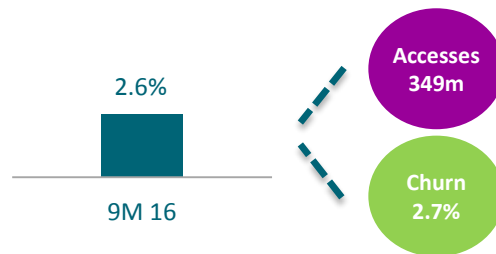
Delivering the goods

Sep-16 (y-o-y)



Positive customer lifetime value

Avg. Revenue/Access (y-o-y organic)



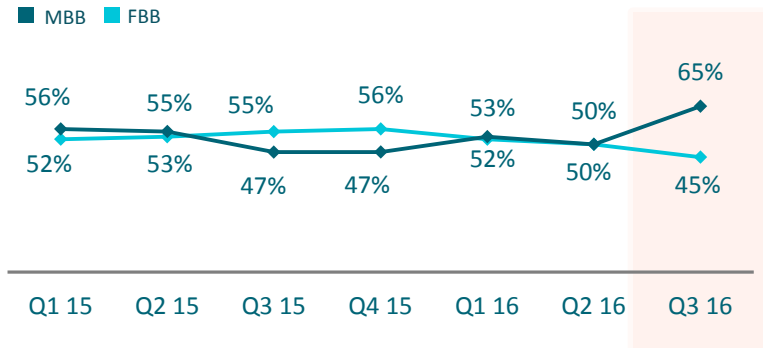
Excelling in growth

- Seizing the 4G opportunity (x1.9 LTE accesses vs. Sep-15)
- Continued traction in FTTX & VDSL (+26% y-o-y connected cust.)
- Strong progression in Pay TV (+3% y-o-y to 8.4m)
- “More for More” tariff actions (i.e. Spain, Germany, Colombia ...)
- High-end pricing power (further progress in bundling FTTX/4G)
- Differential customer experience
- Rewarding loyalty: Churn reduction -0.3 p.p. y-o-y in Q3

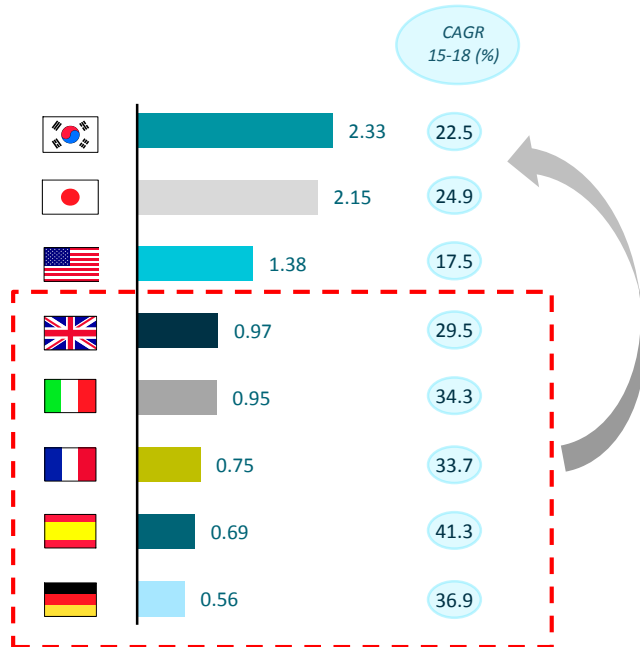
Quality customer led-strategy focused on network evolution to provide more opportunities to deliver superior revenues

Significant upside from data consumption

Sustained data traffic explosion (y-o-y growth)



Average data consumption per user (GB/month)



Source: Analysys Mason as of Dec-2015 for cellular data traffic and cellular connections (SIMs excl. 2G devices)

Higher speeds driving data usage y-o-y

- High demand requires stronger networks
- Fiber: key driver to maintain strong fixed data growth
 - FTTH data consumption in Spain 2x DSL
- Evidence suggest MBB usage can double
 - MBB consumption in Asian countries >2x Europe

Disruptive data proposals; more recurring revenues

MBB accesses (y-o-y)

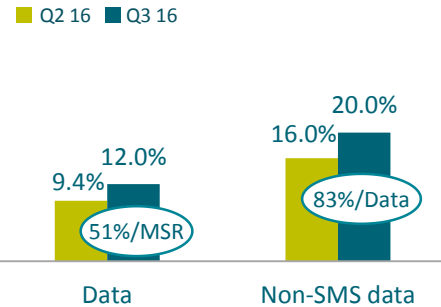
Smartphone +20%

LTE x2.5

Q3 Avg. usage/smartphone (y-o-y)

+40% → 1 GB

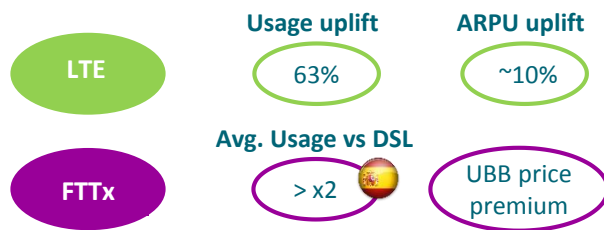
Q3 Data revenues (y-o-y organic)



Scale and tiered pricing boosting revenues

- Reaping prepaid opportunity in Latam with recurrent plans
 - Prepaid data ARPU uplift
 - T. Hispam smartphone penetration at 32%
 - 🇧🇷 New prepaid data portfolio (Sep-16)
- Developing innovative contract schemes to play elasticity
 - 🇪🇸 "O2 Free": more content for higher price points
 - 🇧🇷 "Roaming like at Home"

Key engines delivering monetisation

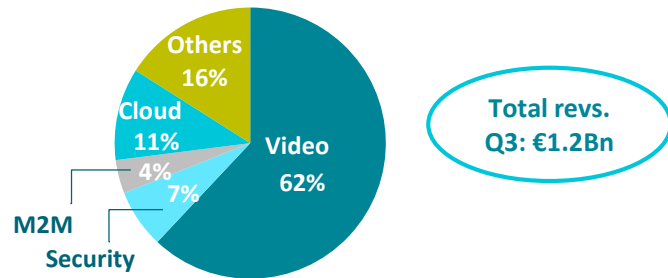


LTE & UBB: Upselling and increasing ARPU

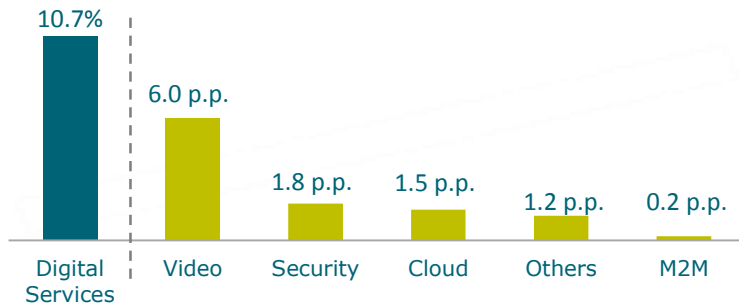
- Q3 LTE traffic x3 y-o-y
 - LTE: 36% of mobile data traffic (+16 p.p. y-o-y)
 - Mobile data traffic ramped-up: +65% y-o-y
- Q3 FBB traffic +45% y-o-y
 - Intensive video usage due to fiber and content bundling

Digital Services: Value accretive initiatives

Q3 Digital Services Rev. Mix



Q3 Contribution to Digital Revenue growth (y-o-y organic)



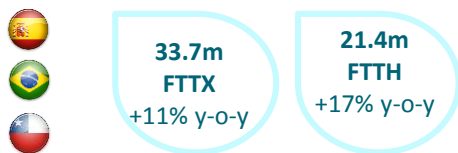
Holistic view beyond connectivity

- **VIDEO: Premium content and user experience**
 - Spain: Evolved functionalities (Home Zone)
 - Latam: Premium content agreement with Vivendi
- **CLOUD: Enlarged scale in hybrid solutions**
 - 8th “Virtual Data Center” opened in Miami
 - “Open Telefónica Cloud” launched in Mexico (already in Chile & Brazil)
- **SECURITY: In-house innovation & leading partnerships**
 - “Path6”: proprietary technology to detect large-scale vulnerabilities in mobile apps
- **M2M: Leading telco platform**
 - A “Leader” in Gartner’s “Magic Quadrant Managed Machine-to-Machine Services, Worldwide” for 3rd year running
- **Telefónica Open Future_: At the forefront of innovation**
 - UK government agreement to accelerate cybersecurity start-ups

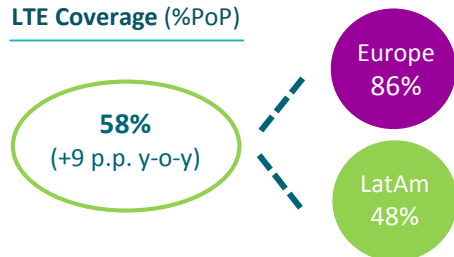
TGR: Continued technological transformation

Enlarging UBB footprint

Premises Passed with Fibre (millions)



LTE Coverage (%PoP)



Further progress on All-IP



Network developments

- **Network Quality & User Experience enhancement**
 - Real Time network and Quality of Experience monitoring
 - Building a **Smart WiFi** Home experience
 - New set-top platform to power **HD and Ultra HD video services**
- **Innovation:**
 - Inauguration of 5G laboratory
 - Successful trial of **4G** high speed data transfer: **up to 800 Mbps**
 - 1st Version of OSM (**Open Source Mano**) launched
 - Extending **SON automation** solution across our footprint

E2E Digitalisation

Big Data platforms for Real Time decision

18.6 PB (x4 y-o-y)

- **Full Stack on-going transformation**
 - Peru: in progress in mobile; Brazil: migrating fixed customers
- **Spain: Online channel** evolution (ie. MiTV Recommendations)
- **Germany: Systems consolidation** (TEF DE + E-Plus)
- Advancing in **global systems deployment**

02 

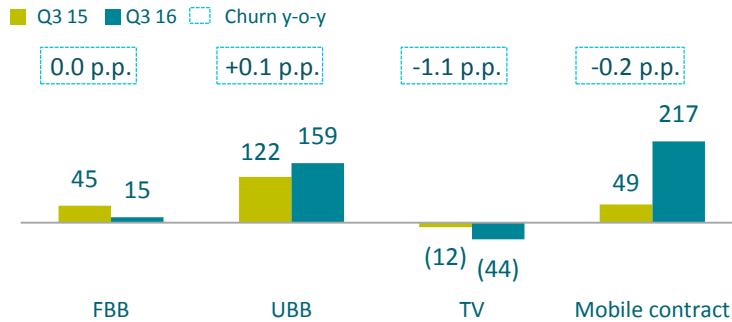
Q3 16 Results

Mr. Angel Vilá
CSFO

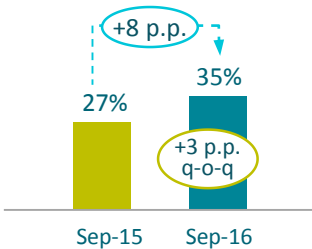


Spain: Increasing value in customer base

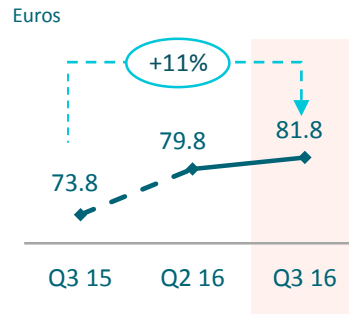
Net adds ('000)



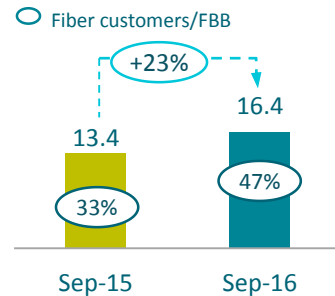
UBB/"Fusión"



"Fusión" ARPU



FTTH (premises passed in millions)



17% fiber take-up (+3 p.p. y-o-y)

Growing momentum in upselling

- **Early results of new "Movistar Fusión+"** (launched in July)
 - Boost in mobile portability
 - Highest-ever UBB net adds
 - More premium TV packs
- **Focus on higher value to foster ARPU uplift and loyalty**
 - Promoting symmetric UBB & Premium TV
 - Increasing mobile add-ons
- **Resilient churn** (despite tariff update)

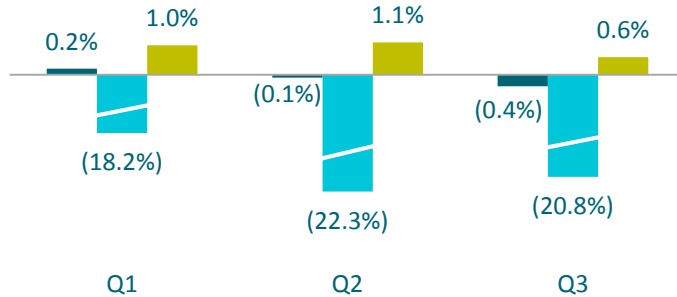
Leveraging unparalleled quality assets

- **Market-leader in network coverage: 4G, FTTH, satellite**
 - LTE: 90% pop. (+24 p.p. y-o-y)
- **Best-in-class TV experience**
 - All premium content
 - Richer UX: innovative functionalities & equipment

Spain: Stable revenue and growing margins

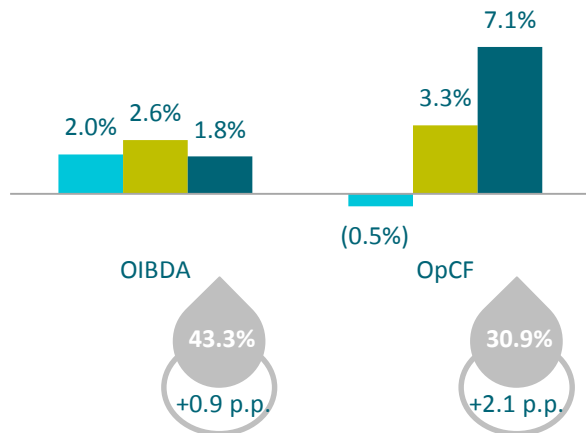
2016 Revenues (y-o-y organic)

■ Total ■ Handset sales ■ Service Rev.



Strong Profitability (y-o-y organic ex-non recurrents)

■ Q1 16 ■ Q2 16 ■ Q3 16 ● Margin



Ongoing growth of service revenues

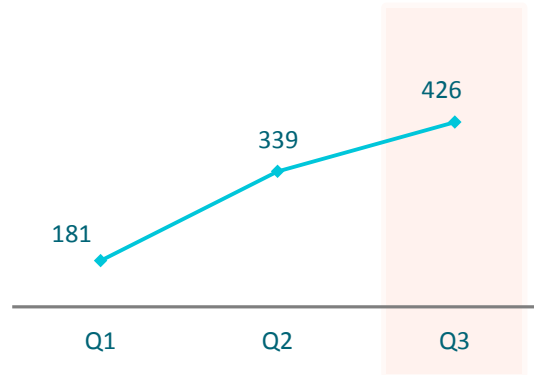
- Sustained trend despite tougher comps in Q3
 - Step up in “Consumer” growth fuelled by “Fusión” (+20.5% y-o-y)
 - “Business” revenue affected by IT seasonality (to reverse in Q4)
 - “Other revenue” growth improved despite lower TV wholesale

Solid OIBDA and cash conversion

- Continued cost cutting: OpEx -0.3% y-o-y in Q3
 - Savings from Redundancy Programme (€133m in Q2+Q3 16)
 - Increased cost of new football season since mid-August
- Consistent margin expansion y-o-y & q-o-q
- OpCF growth for 2nd quarter in a row

Germany: Incremental synergies in H2

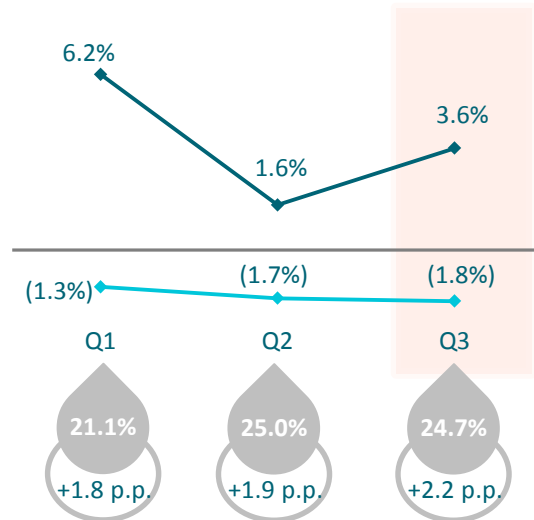
Contract net adds ('000)



Q3 contract churn: 1.5% (-0.2 p.p. y-o-y)

2016 Financials (y-o-y ex non-recurrent)

■ OIBDA ■ MSR ● OIBDA margin & margin y-o-y



LTE driving growth

- **Data monetisation bearing fruits leveraged on**
 - 4G customer base at 10.6m (+12% q-o-q)
 - Avg data usage 1.6 Gb (+15% q-o-q)
- **“O2 Free” launch in October** supports operational momentum
- **Dynamic competitive environment in Q3**; early signs of easing pressure in non-premium segment
- **Stabilisation of ARPU trends q-o-q**

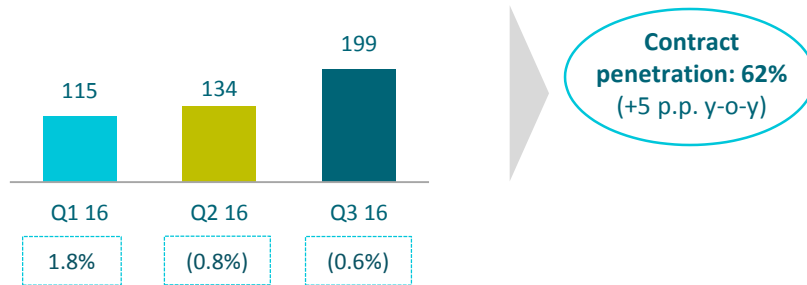
OIBDA growth ramping-up

- **MSR performance stable q-o-q; improving trends ex-regulation**
 - Sustained non-SMS data growth (Q3: +13.2% y-o-y)
 - Roaming & MTRs drag 0.9 p.p. y-o-y in Q3 (Q2: -0.2 p.p.)
 - Continued decline of handset sales (Q3: -24.5% y-o-y; Q2: -25.5%)
- **Incremental synergies in H2**: Q3: €30m; 9M: €125m; site & employee restructuring
- **Transformation OpEx lessening**; finalised contract customer migration
- **Q3 CapEx +30.4%** y-o-y with phasing back-end loaded (9M: +5.7%)

UK: Robust performance; market leading loyalty

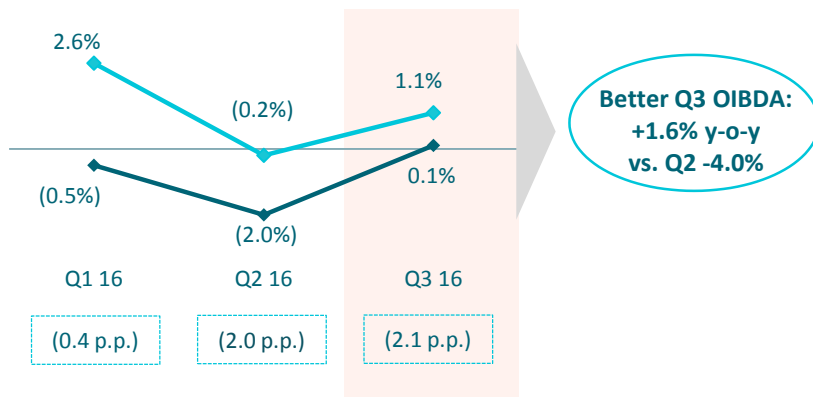
Contract net adds ('000)

Blended ARPU ex "O2 Refresh" (y-o-y)



MSR (y-o-y)

Ex "O2 Refresh" (light blue) | Reported (dark blue)
Roaming & MTR impact (dashed box)



Attracting and retaining in contract

- **Mobile customer base 25.4m**
 - 45% LTE penetration (+15 p.p. y-o-y)
 - Data usage continues to grow (+65% y-o-y)
- **Sustained market-leading contract churn of 0.9%**
- **High levels of customer satisfaction and best brand awareness**
 - MNO with lowest level of complaints (*Ofcom*)
- **93% LTE outdoor coverage (+15 p.p. y-o-y)**

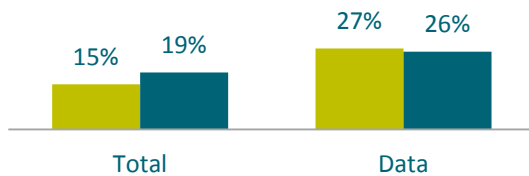
OIBDA margin expansion (27.3%; +1.0 p.p.)

- **Q3 MSR strengthened**
 - Roaming seasonality ("O2 Travel") positive impact
 - Non-SMS data revenue growth (+9.4% y-o-y; +4.5 p.p. vs. Q2)
 - Avg. subscription per user (+8.2% y-o-y ex "O2 Refresh")
 - Subscription 76% o/total ARPU (69% Q3 15)
- **OIBDA increase** driven by revenue flow and overall cost control
- **Continued growth in CapEx** on ongoing LTE rollout (Q3: +18.0% y-o-y)

Brazil: ARPU growth in key services

Mobile ARPU (y-o-y)

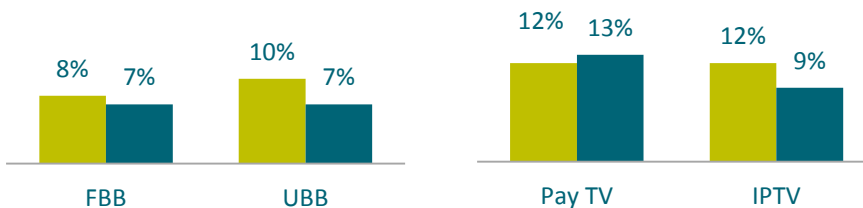
■ Q3 16 ■ 9M 16



Leader in postpaid:
42% market share(*)

Fixed ARPU (y-o-y)

■ Q3 16 ■ 9M 16



55% UBB
Market share(*)

9% Pay TV
Market share(*)

(*) At August 2016

Data-centric strategy

Mobile

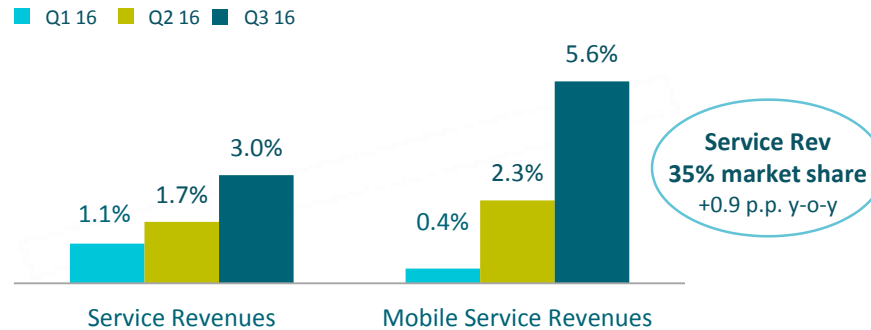
- **Differential quality network allow us to capture value**
 - Q3 contract net adds: 865k (x2.3 q-o-q)
 - 54% share in contract net adds in LTM
- **LTE x2.4 y-o-y** (27% penetration, +17 p.p. y-o-y)
- **Data consumption increased on 4G adoption**
 - Main cities: 47% of data traffic is 4G
- **Improvement on prepaid top-ups** (+1.7% Q3/Q2)

Fixed

- **Successful cross-selling**
 - All stores already selling fixed products
- **UBB accesses: 4.1m** (+8% y-o-y)
 - 16.9 m homes passed with fiber
- **Strong IPTV accesses** (+39% y-o-y) on FTTH take-up

Brazil: Strong margin expansion; OpCF +38%

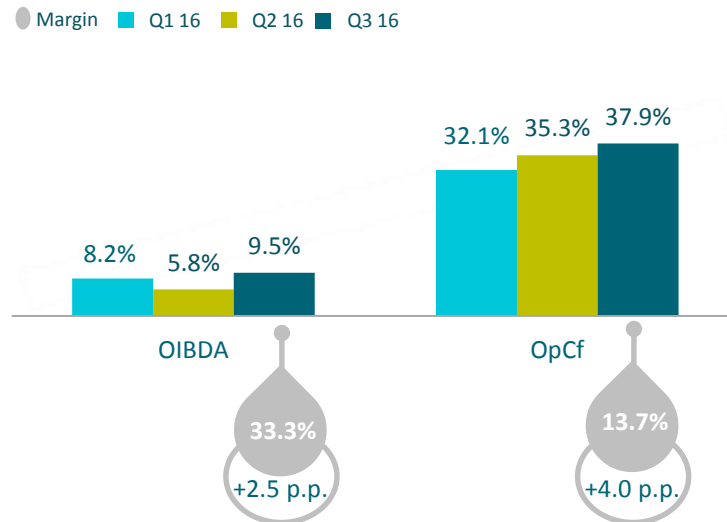
Service Revenues (y-o-y organic)



Enhanced revenues trend; well ahead of the sector

- **Q3 total revs +1.1% in Q3 (9M: +0.9%)** despite macro headwinds and handset sales (-27.2% in Q3)
- **MSR accelerated driven by double digit postpaid growth and improved prepaid trends;** sustained data rev. growth in Q3 (+24.4%)
- **Ongoing increased in FBB and new services** (Q3: +11.8% y-o-y; 9M: +6.5%)
- **Regulation drags 2.2 p.p. to rev. y-o-y** (-2.4 p.p. in 9M)

Financials (y-o-y organic)



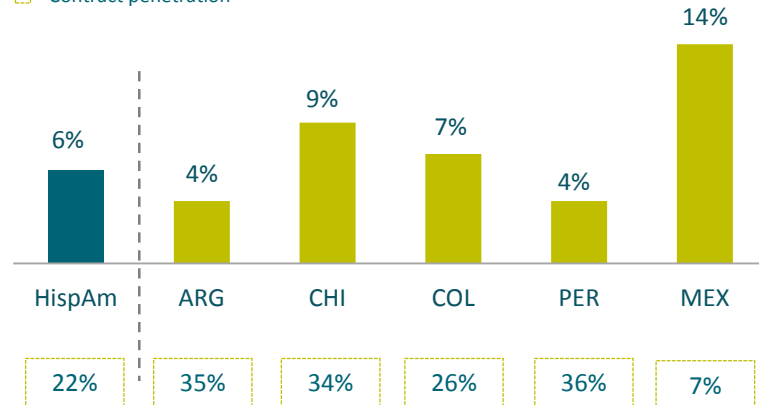
OIBDA acceleration: synergies and efficiencies

- **Cost reduction despite inflation** (Q3: -2.0%; 9M: -1.9%)
 - Lower commercial cost (more rational approach, brand unification)
 - Bad debt remained stable due to credit and collection actions
- **CapEx below initial guidance: optimisation and big data**
 - 16% CapEx/Sales including CapEx synergies (9M: +€83m)
- **Successful execution of operational synergies;** 9M: €229m (Q3: +€94m)
 - Already secured 2/3 of best case

HispAm: Focusing on value growth

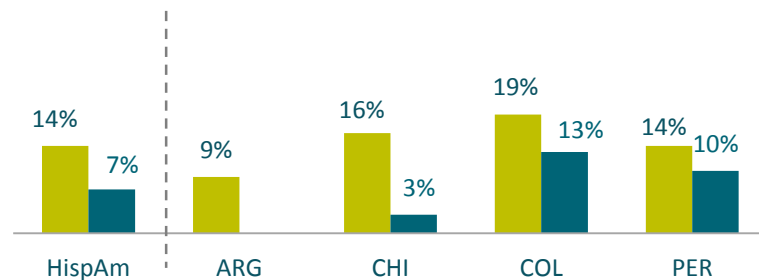
Contract accesses (y-o-y)

Contract penetration



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

FBB>4Mb Pay TV



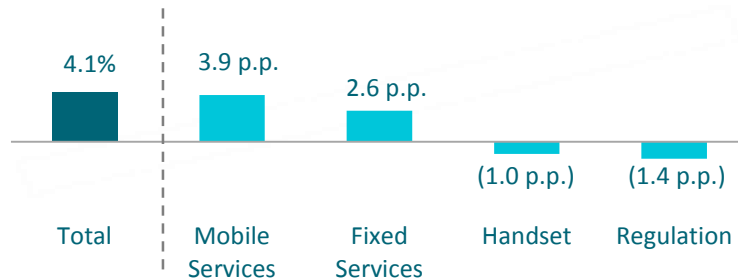
Maintaining growth despite intense competition

- **Leadership in contract segment in the region**
 - Contract ARPU >6x prepaid; churn >0.5x
 - Smartphone & LTE penetration 41% and 12% (+6 p.p. y-o-y respectively)
- **Mobile net adds improved in Q3**
 - 1.1m (x2.7 y-o-y; x8.4 q-o-q)
 - Positive prepaid net adds after 2 quarters
- **Further room to grow; 65% of mobile penetration in the region ⁽¹⁾**
- **Fixed business**
 - Bundling strategy (43% o/total, +6 p.p. y-o-y)
 - Focus on quality; delivering higher speeds (59% >4 Mbps; +7 p.p. y-o-y)
 - FBB accesses +1% y-o-y

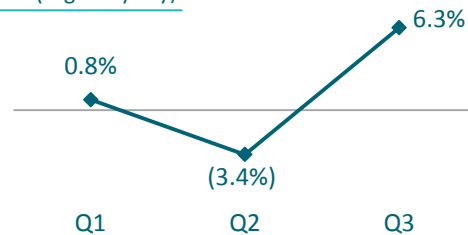
⁽¹⁾ Unique mobile subscriber according to Latin America GSMA 2016 report

HispAm: OIBDA back to growth; improving profitability

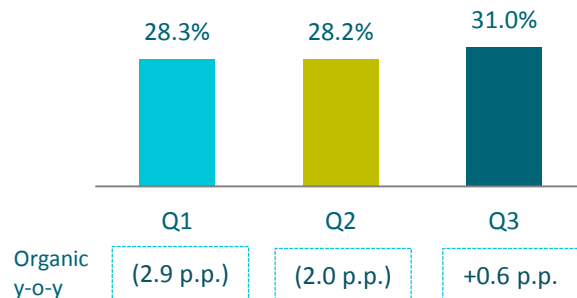
Contribution to Revenues growth Q3 (organic y-o-y)



2016 OIBDA (organic y-o-y)



2016 OIBDA margin



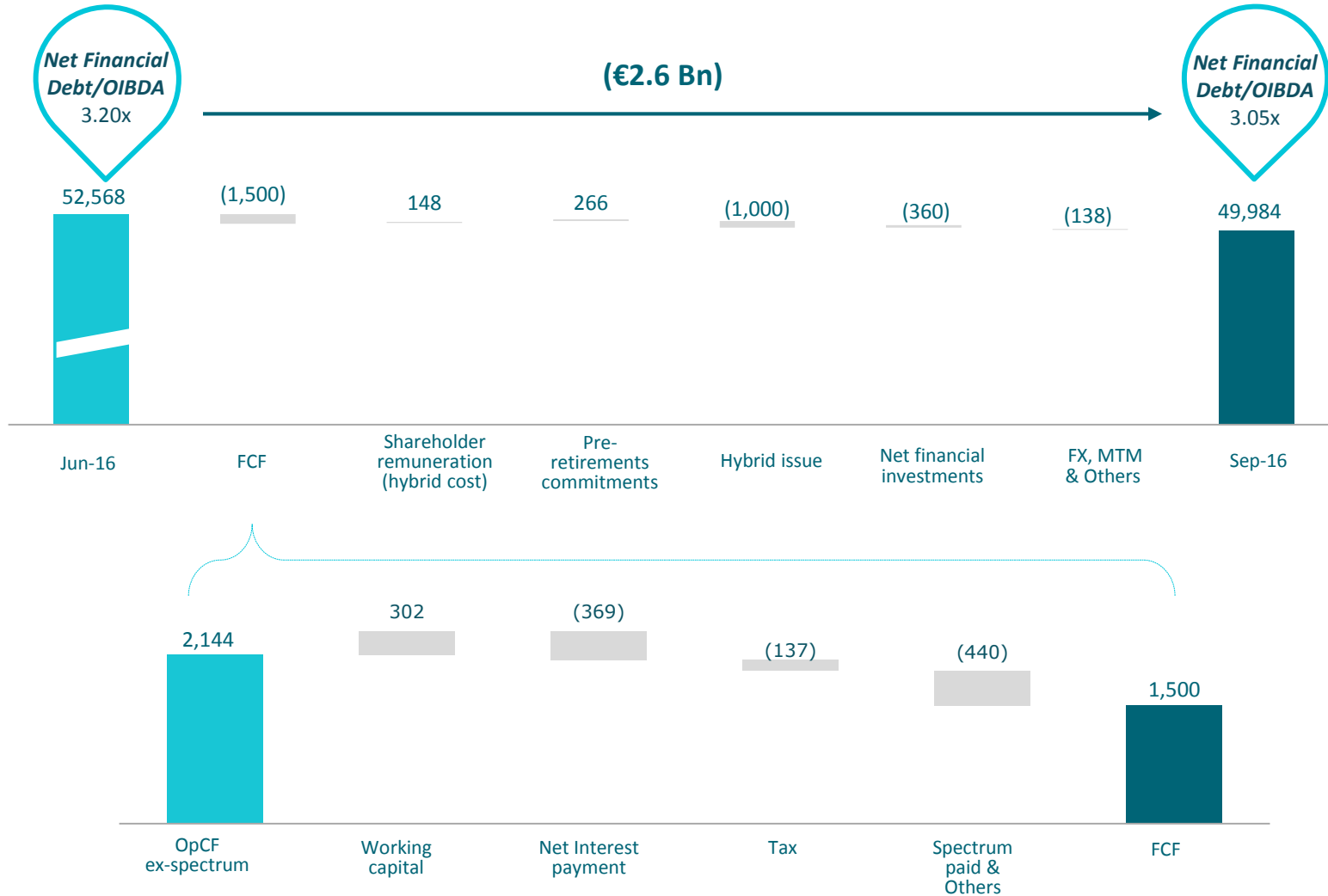
Improved financial trends in Q3

- OIBDA returned to growth y-o-y (+6.3%; Q2: -3.4%); sequential improvement in all countries except México and Peru**
 - Revs accelerated (+0.5 p.p. q-o-q) on MSR (Q3: +4.1% y-o-y)
 - OpEx improved y-o-y (+4.1%; Q2: +6.8%); more homogeneous comparison (higher comm. activity in Col & Arg from Q3 15)
- ARGENTINA:**
 - Ramping-up revenues, OIBDA and margin on successful campaigns, tariffs update, and efficiency measures
- COLOMBIA:**
 - OIBDA & MSR back to growth on trading improvement and more rational commercial approach
- CHILE:**
 - Revenue & Profitability remained broadly flat y-o-y on increased value services amid strong competition
- MEXICO:**
 - Challenging results continue affected by intense prepay competition
- PERU:**
 - Revenues continued affected by strong competition

Organic deleverage based on strong FCF generation

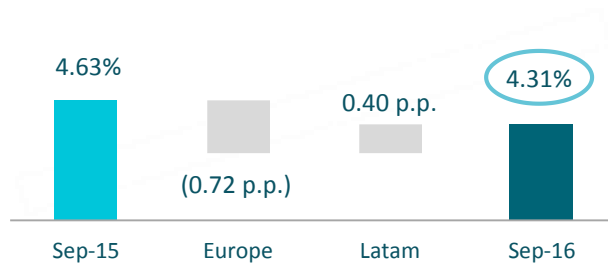
Net Financial Debt

€ in millions

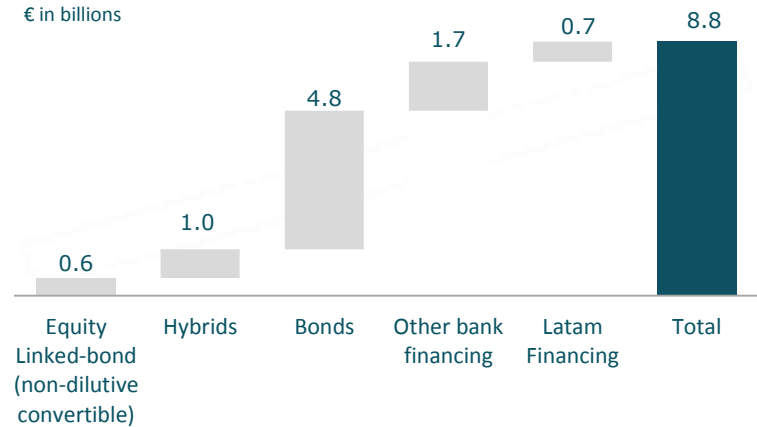


Attractive financing to reinforce liquidity

Interest payments cost

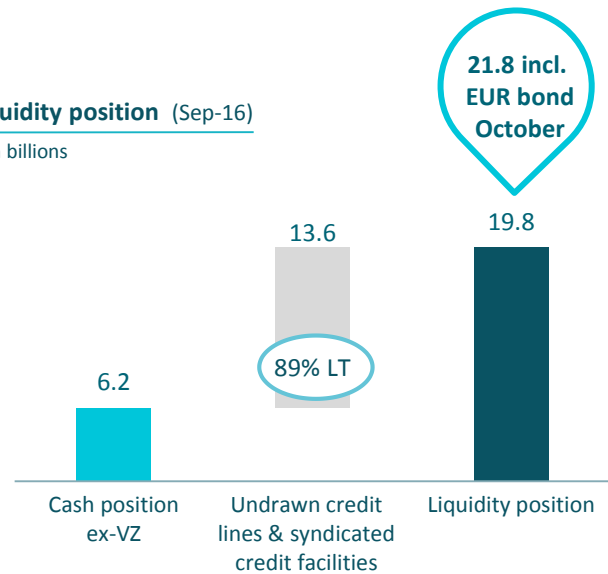


Sources of long-term financing (YTD)



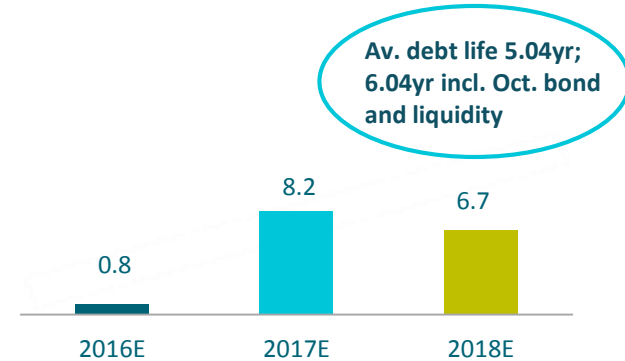
Liquidity position (Sep-16)

€ in billions



Net debt maturities (Sep-16)

€ in billions; not considering hybrid NC dates



Summary

- **Strategy execution: Back to growth**
 - Transformation process paying off
 - Next steps: accelerate growth
- **Q3 proof points**
 - Accelerating OIBDA, OpCF, EPS, FCF growth and deleverage
 - FX drag ease
- **Sustainable operating improvement**
 - All business units registering better fundamentals
 - Best-in class assets: networks, spectrum and differential offers
- **New targets to ensure sustainable remuneration and consistent deleverage**
 - DPS 2016: €0.55/sh.; 2017: €0.4/sh.

Organic deleverage accelerated

Growing FCF

Telefonica

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