

Telefonica

Capital Structure Strategy and New IFRS for 2018

Telefónica Group
23 March 2018



Finance and Accounting session

Pablo Eguirón

Global Director of Investor Relations

Key Objectives

Laura Abasolo
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

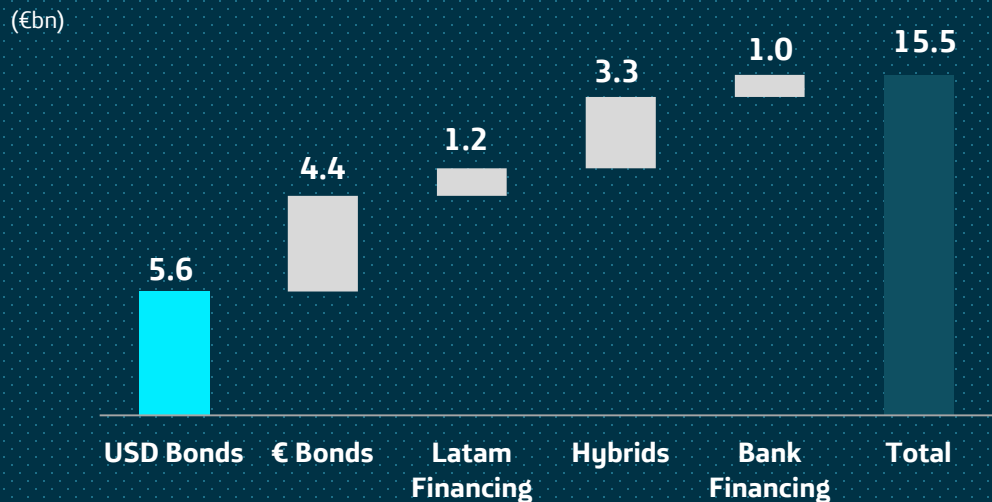
Implications and main changes of new accounting standards

Capital Structure Strategy

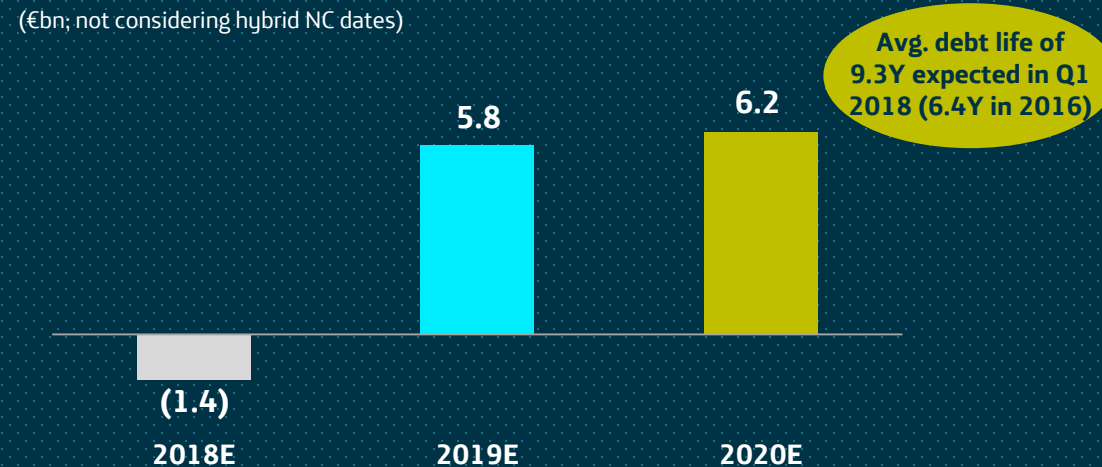
Jesús Romero
Deputy Chief Financial Officer

Long term financing strengthened our balance sheet in 2017 and YTD

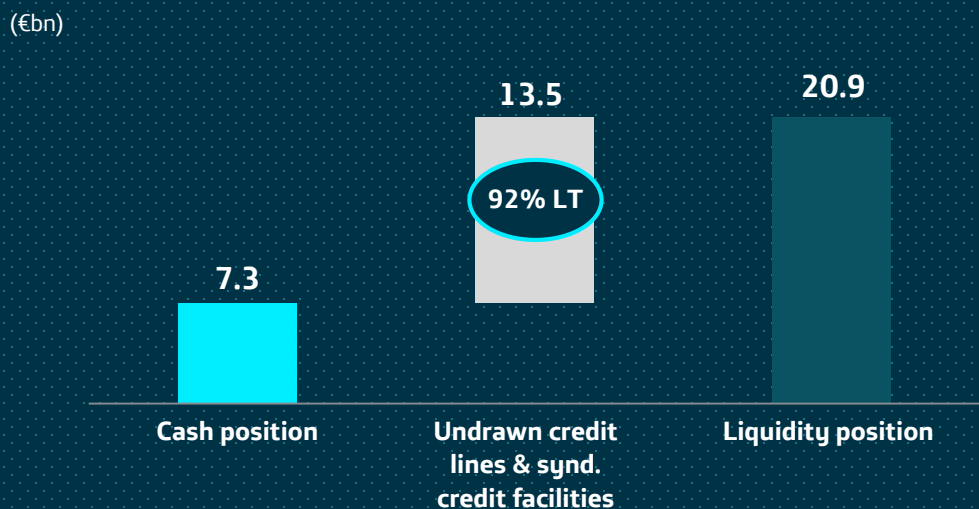
Sources of long-term financing (FY 17 & 2018 YTD)



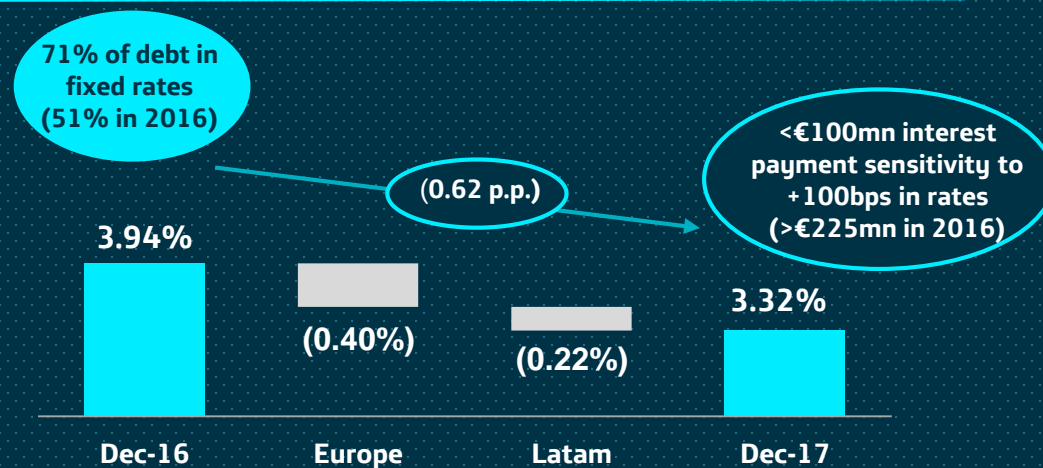
Net Debt maturities (March 2018 PF with 2018 YTD issues)



Liquidity position (Dec-17)



Interest payments cost (Dec-17)



Key Finance objectives – guarantee solvency and liquidity

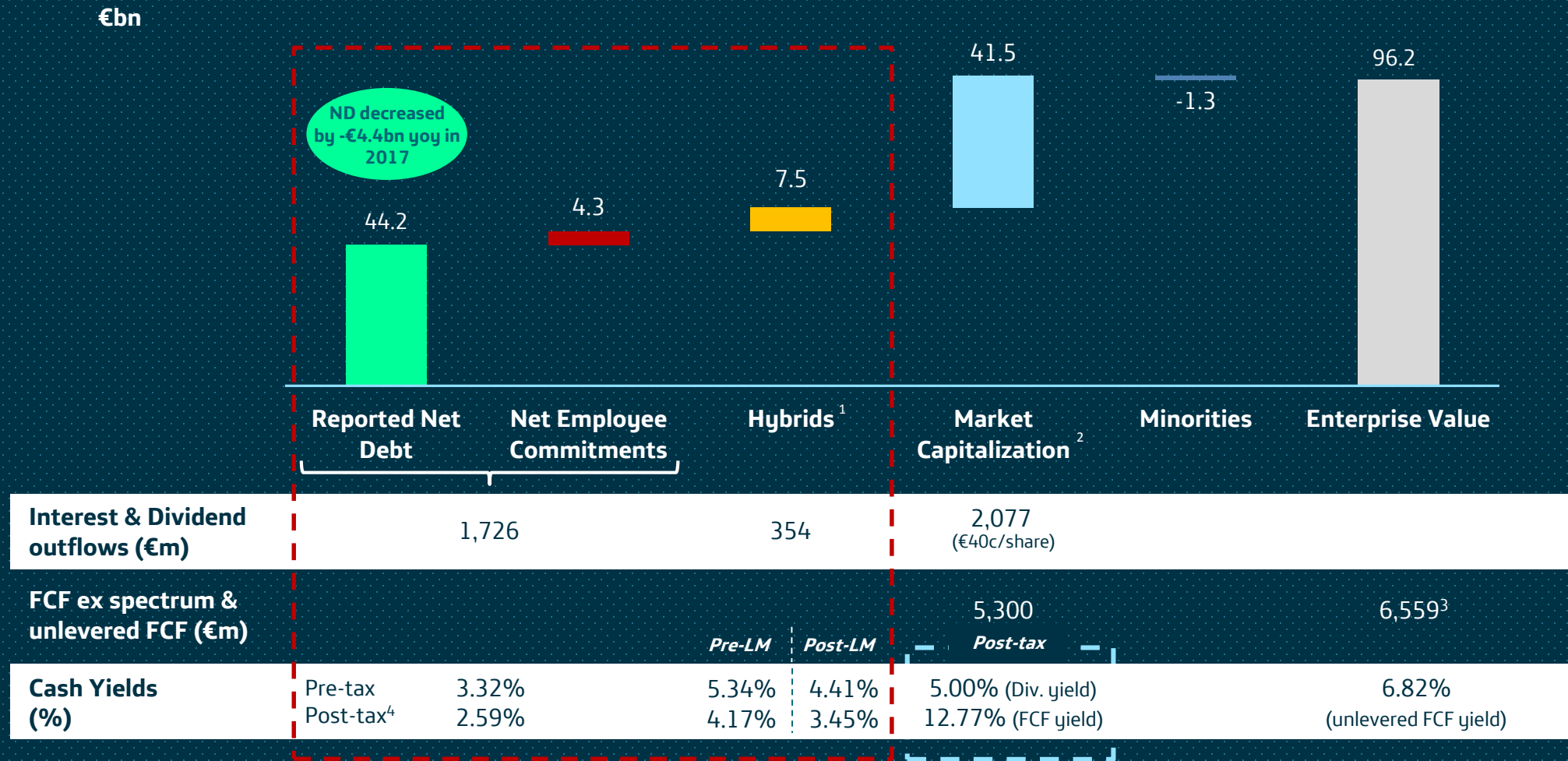
1. Fully committed to a solid investment grade credit rating (BBB/Baa2)

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



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

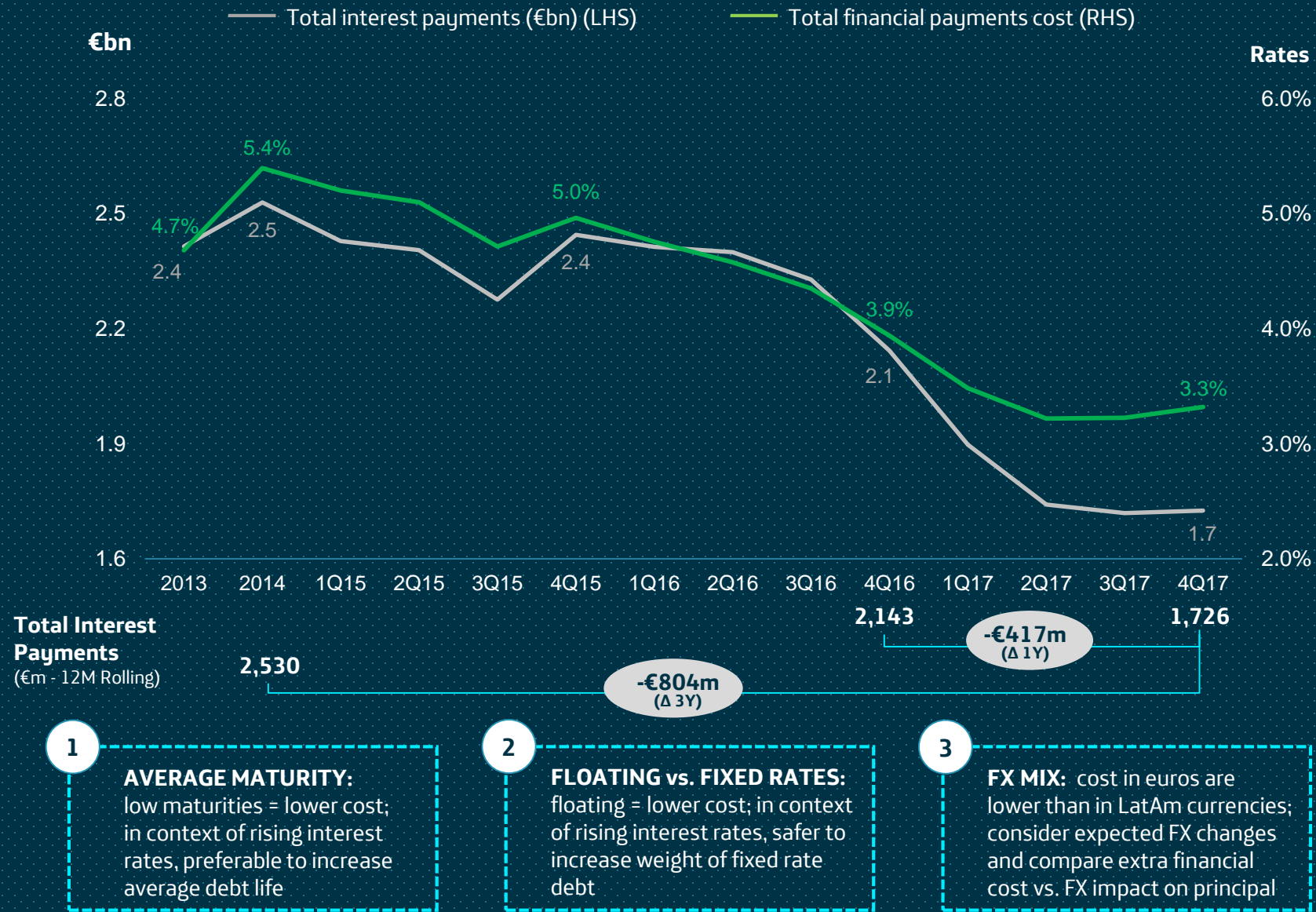
1. Hybrids valued at issuance date

2. Data as of 20/03/2018. Source: Bloomberg

3. FCF ex spectrum plus financial payments net of taxes and adjusted for minorities

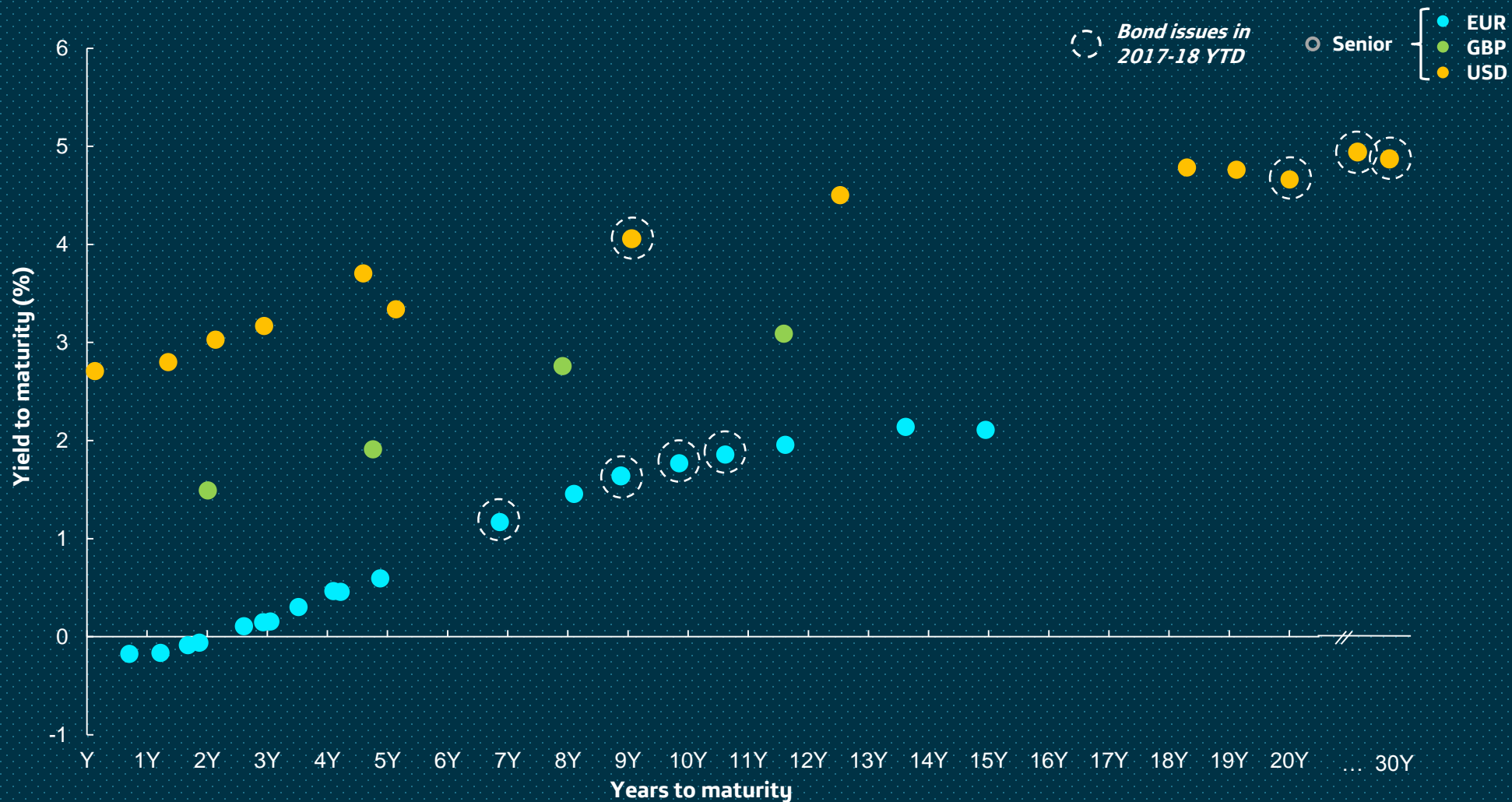
4. Assuming TEF's effective cash tax rate of 21.9%

Historical trend in financial payments and key trade-offs in costs



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

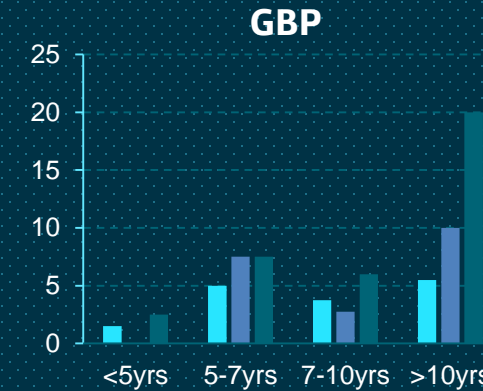
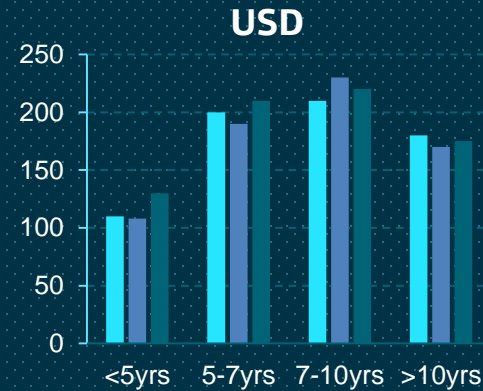
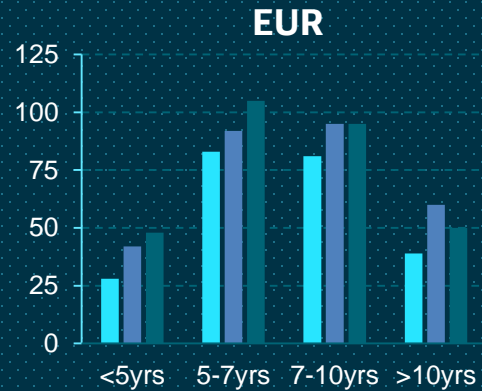
TEF inventory of listed fixed income instruments by currency



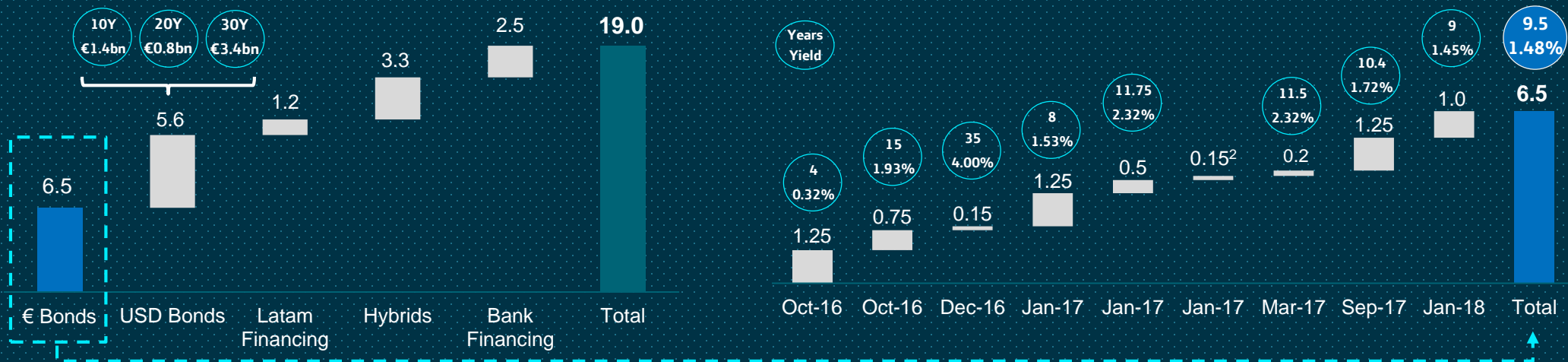
Credit market depth is critical, specially in long tenors

Total Corporate IG issuance¹ in 2017 – 300bn in EUR, 728bn in USD and 36bn in GBP

Maturity breakdown

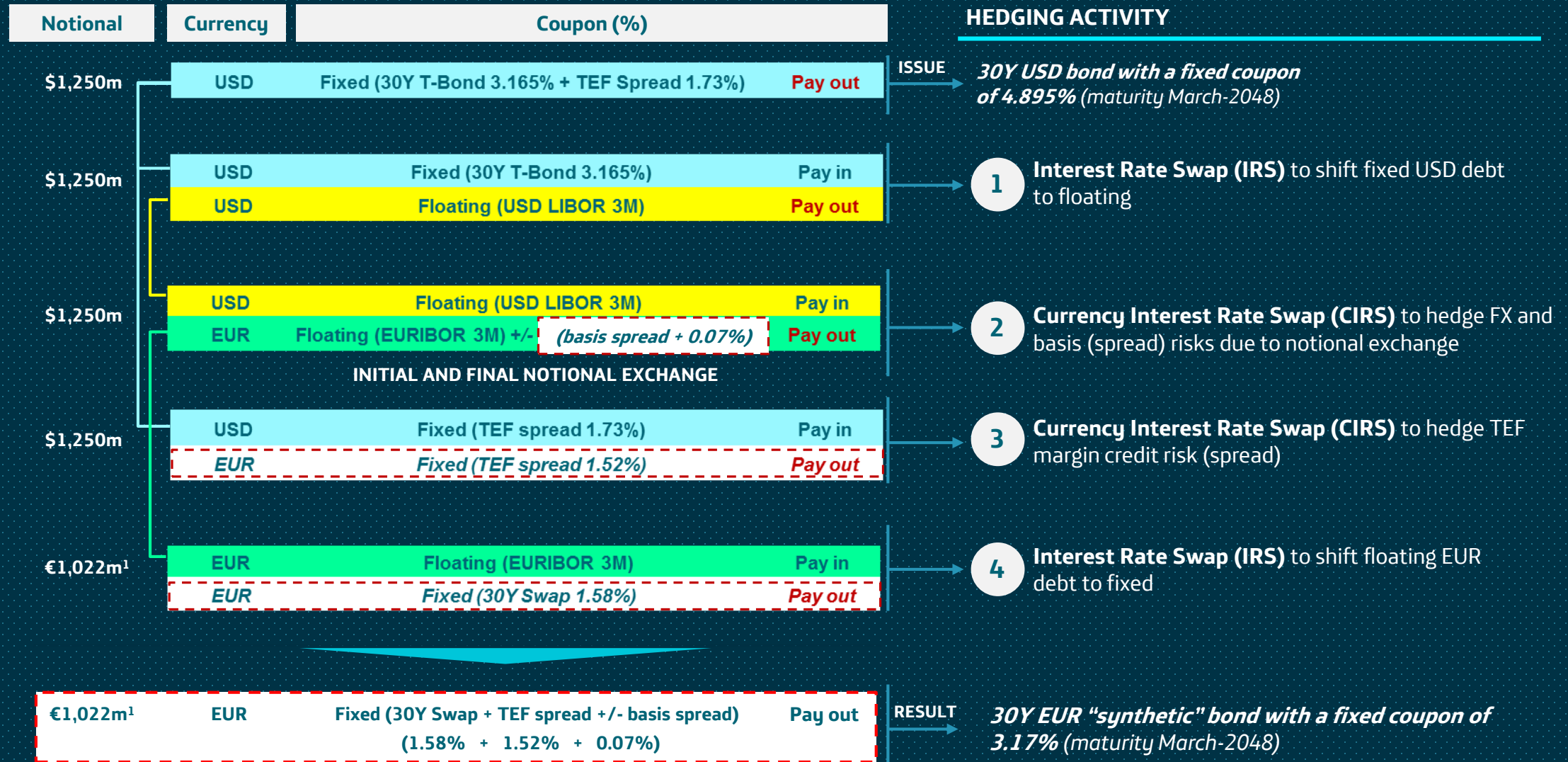


TEF: clear focus of long-term financing in last six quarters (between October 16 to March 18 in €bn)



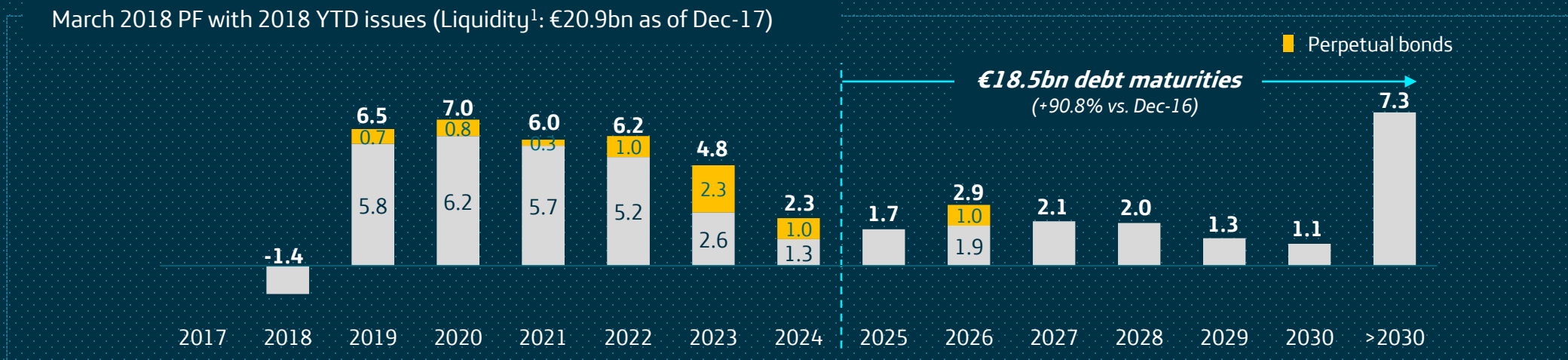
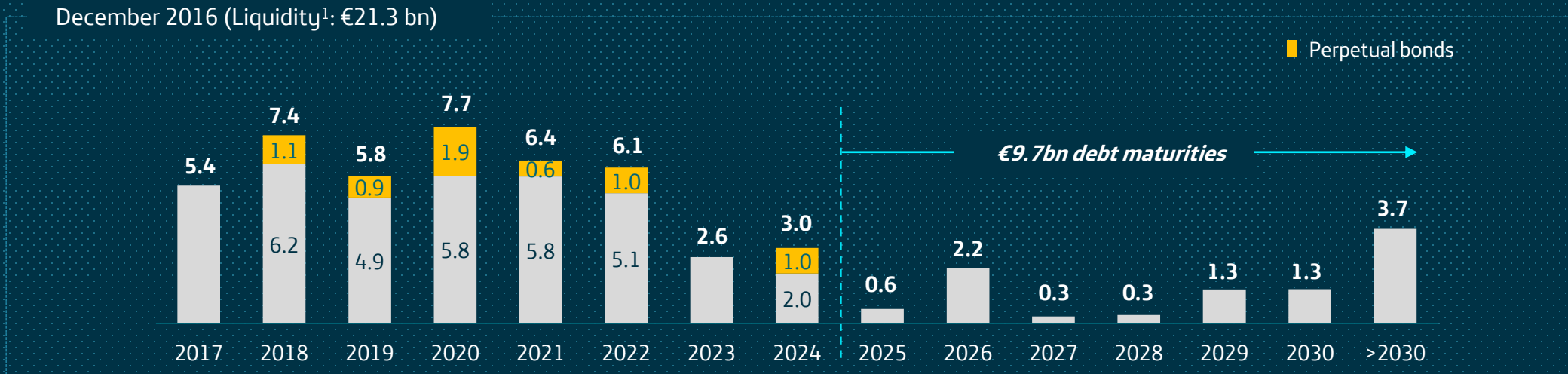
Derivatives – turn a 30Y USD coupon of 4.895% into 3.17% in €

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%



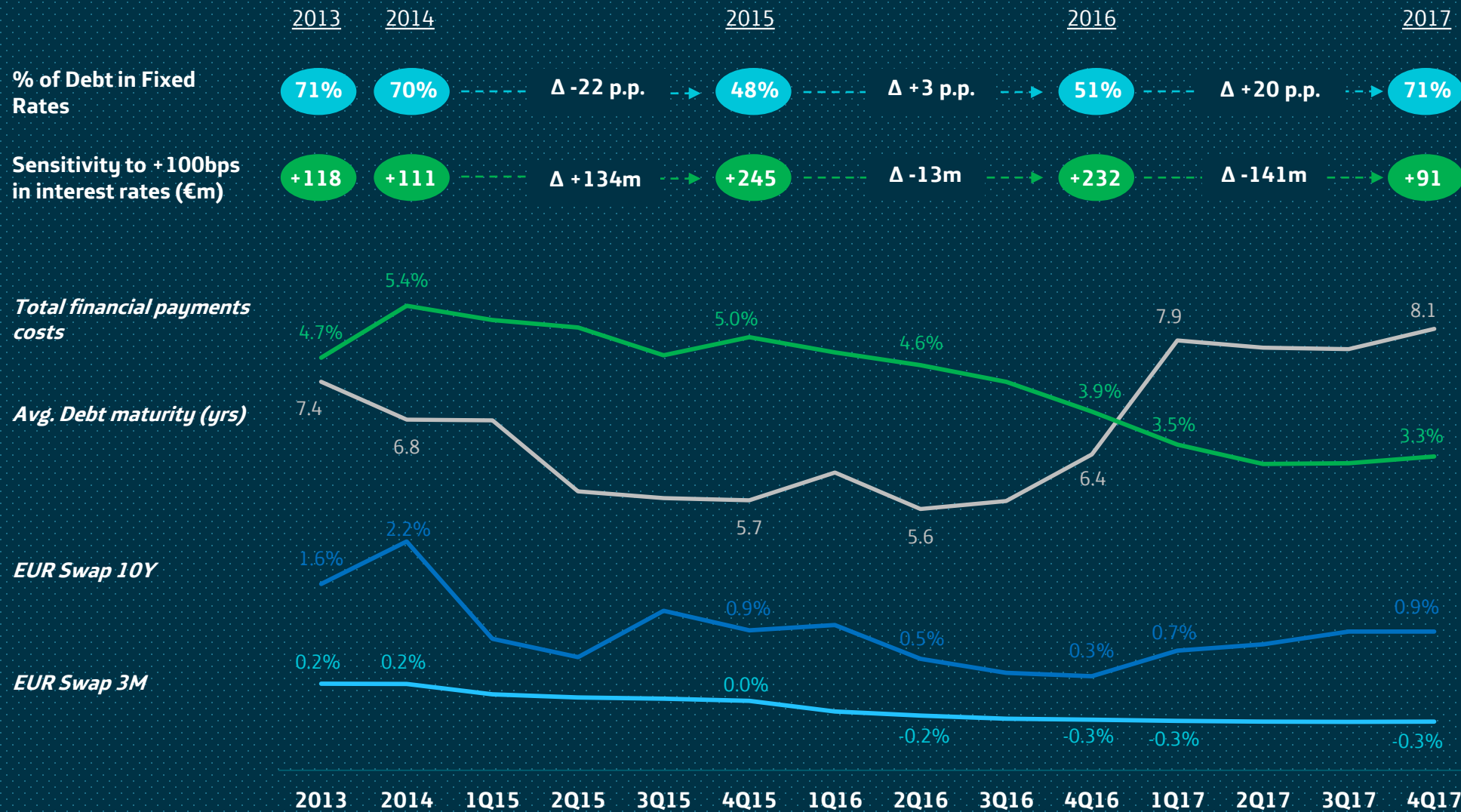
Trade offs (1) – increased average debt life (6.4Y to 9.3Y in 5Qs)

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

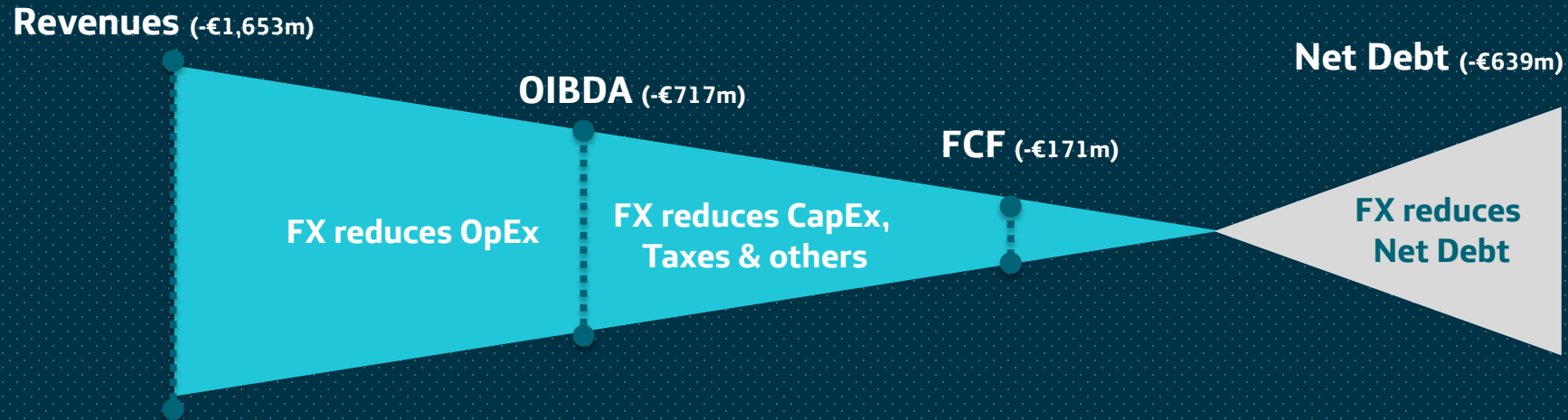


1. Includes Cash position and undrawn credit lines & syndicated credit facilities

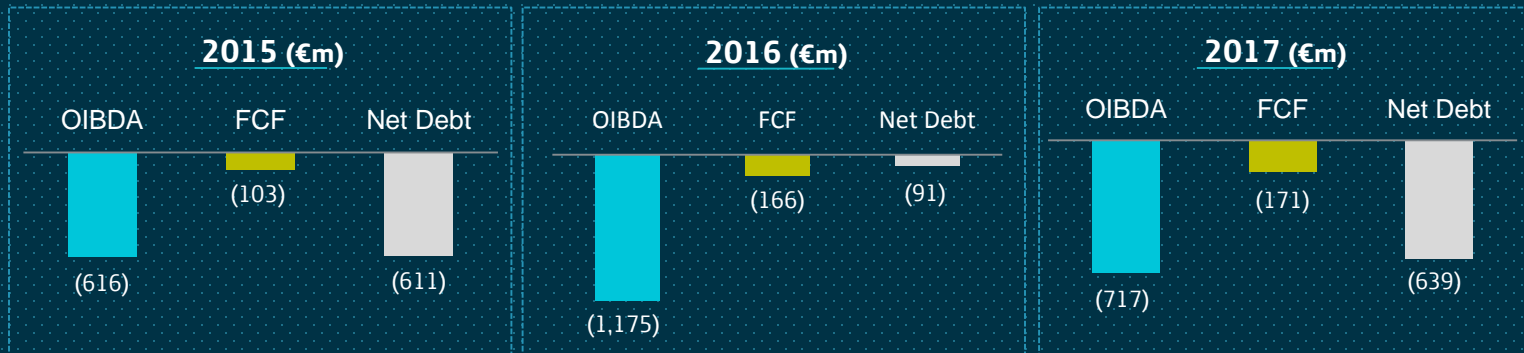
Trade offs (2) – increased fixed vs. floating rate debt



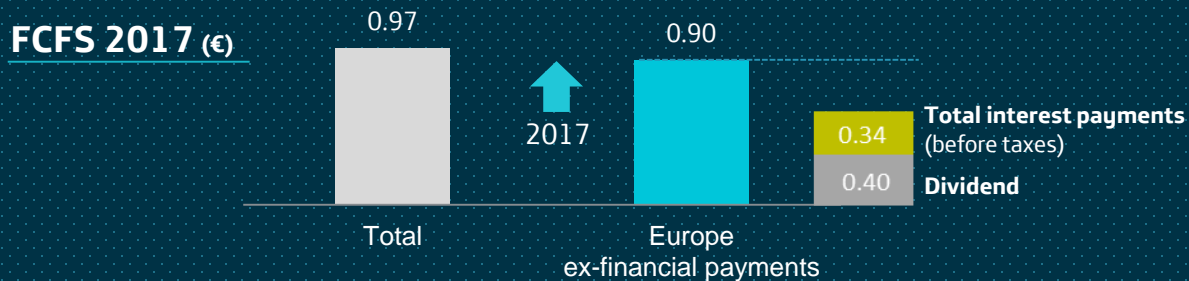
Trade offs (3) – FX hedging strategy produced positive results



FX impact in FCF is mitigated, "natural hedge"



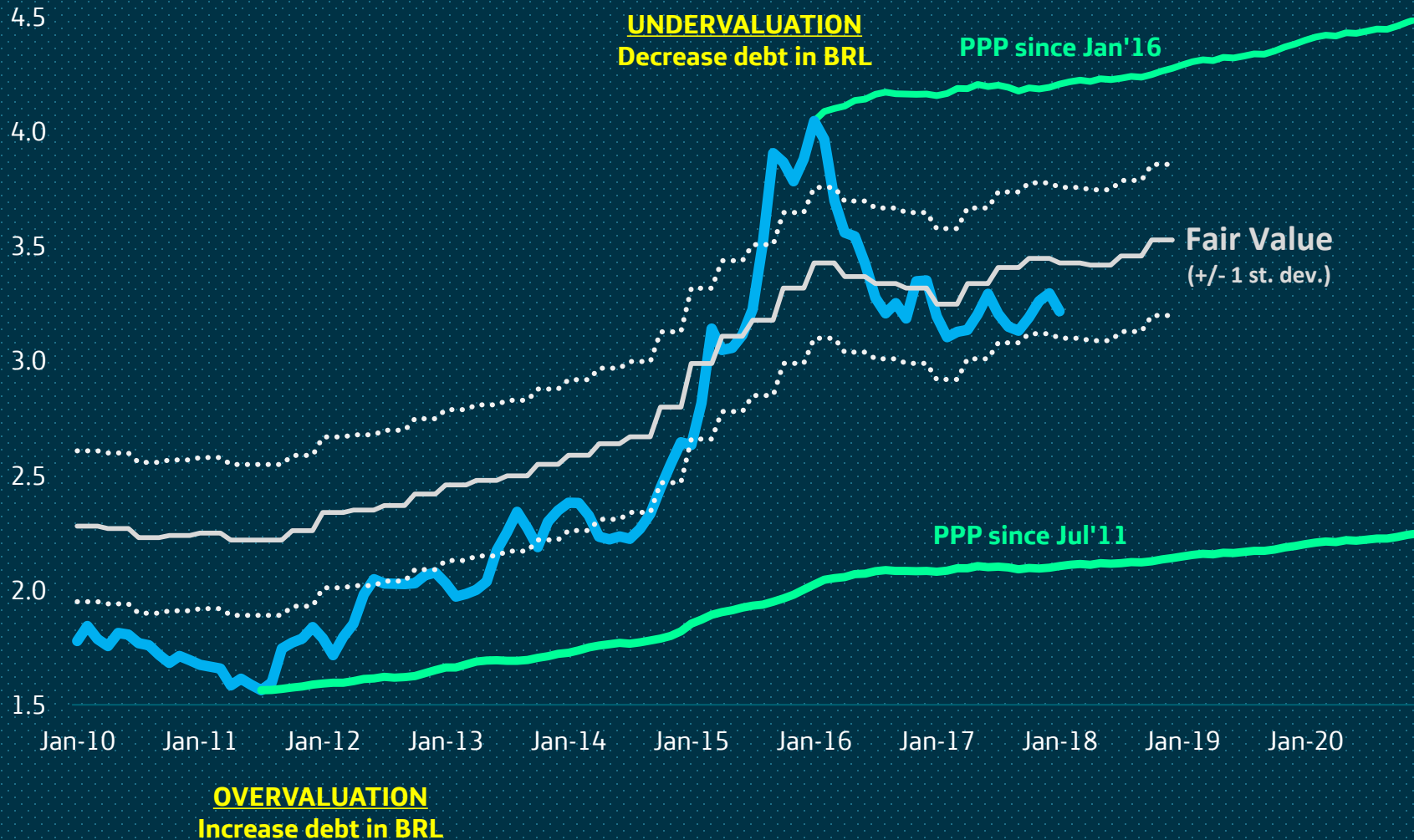
Debt structure more than offsets FCF impact



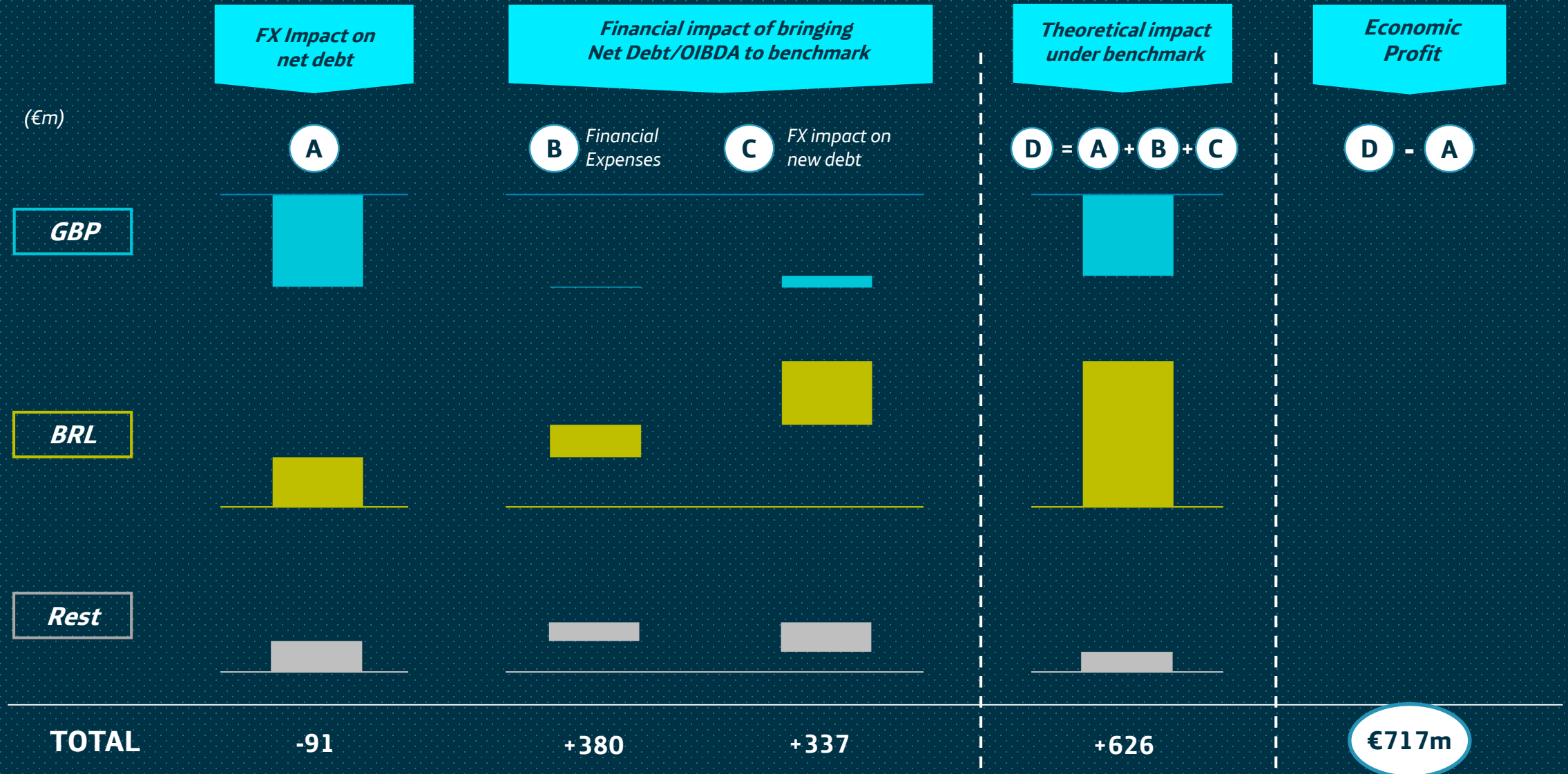
European FCF significantly...
 ...exceeds dividends and interest payments...
 ...LatAm is all upside

Levels of FX debt constantly monitored relative to FX fair value views

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



FX hedging in 2016 – decision making based on economic profit analysis



Executed 1st large EU hybrid liability management; annual savings >€60m

Hybrids Pre-LM

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

Hybrids Post-LM

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

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

A Hybrid Dec-17 (5.5Y)

	NOTIONAL	COUPON (%)	COST (€m)
Hybrid	1,000	2.625%	26.3
EUR senior	500	0.40%	2.0
Equity	500	4.85%	24.3
Implied cost of Equity (post tax¹)		3.79%	

B Hybrid Mar-18 (5.7Y)

	NOTIONAL	COUPON (%)	COST (€m)
Hybrid	1,250	3.0%	37.5
EUR senior	625	0.95%	5.9
Equity	625	5.05%	31.6
Implied cost of Equity (post tax¹)		3.95%	

C Hybrid Mar-18 (8.5Y)

	NOTIONAL	COUPON (%)	COST (€m)
Hybrid	1,000	3.875%	38.8
EUR senior	500	1.64%	8.2
Equity	500	6.11%	30.6
Implied cost of Equity (post tax¹)		4.77%	

Consider hybrids as attractive long term components of our capital structure

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

Major changes and implications of the new standard

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



Higher comparability
Higher consistency



IMPACTS (*):
Opening pre-tax equity 2018:
€+ 1.0 Bn

Estimated P&L impact based on FY17:

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

(*) Unaudited figures

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



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

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

No relevant impact expected in P&L FY18

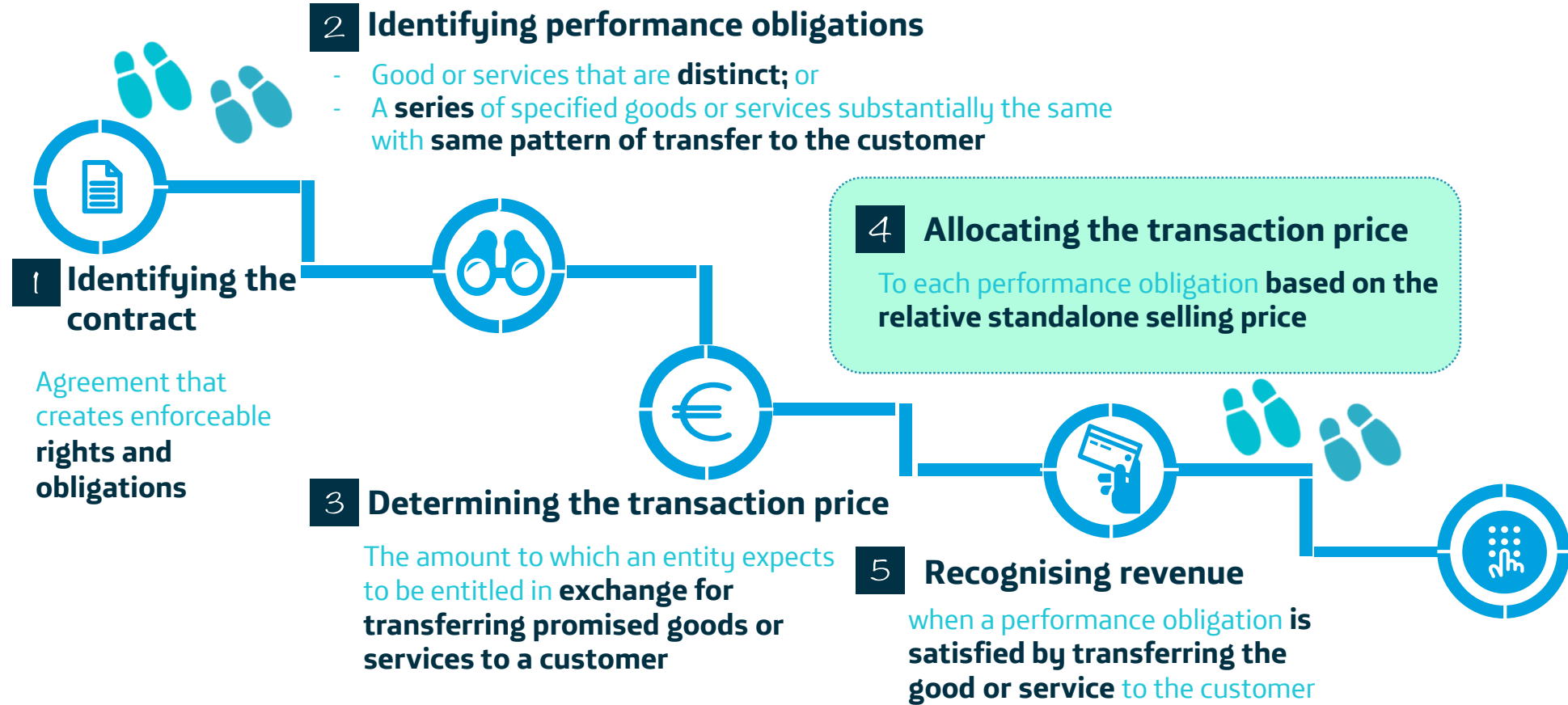
Hedge Accounting

- 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

IFRS 15 in detail

IFRS 15: The model

Applying a 5 Step Model to determine **when and how to recognise revenue**



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

Tipo de contrato: **Línea Nueva**
Con Plan vuelo 4G S/150

- > Samsung Galaxy J7
- > Precio del equipo: S/200
- > Cargo fijo: S/150 al mes por 18 meses.

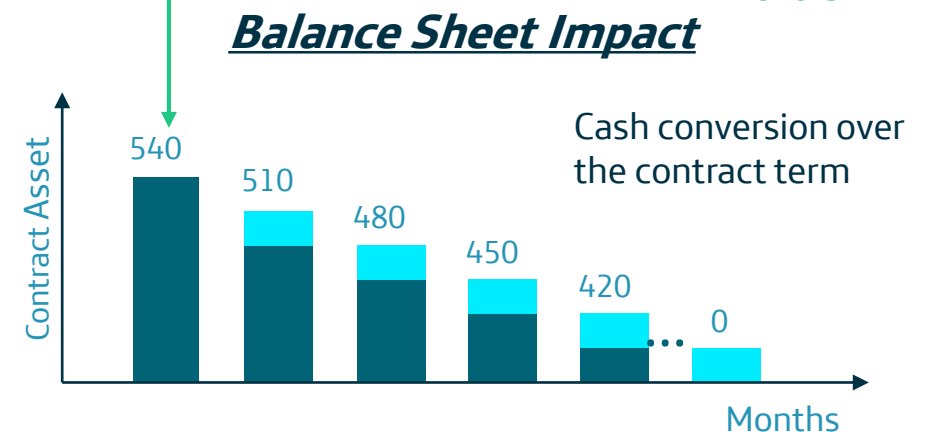
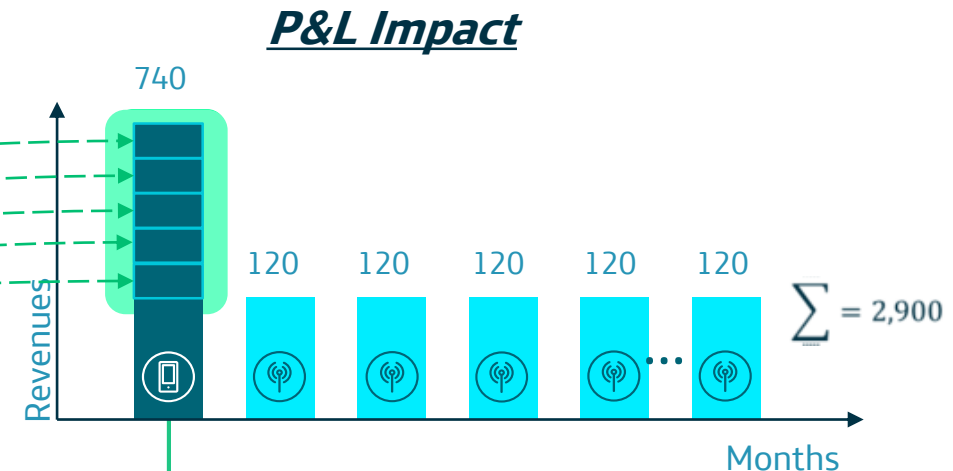
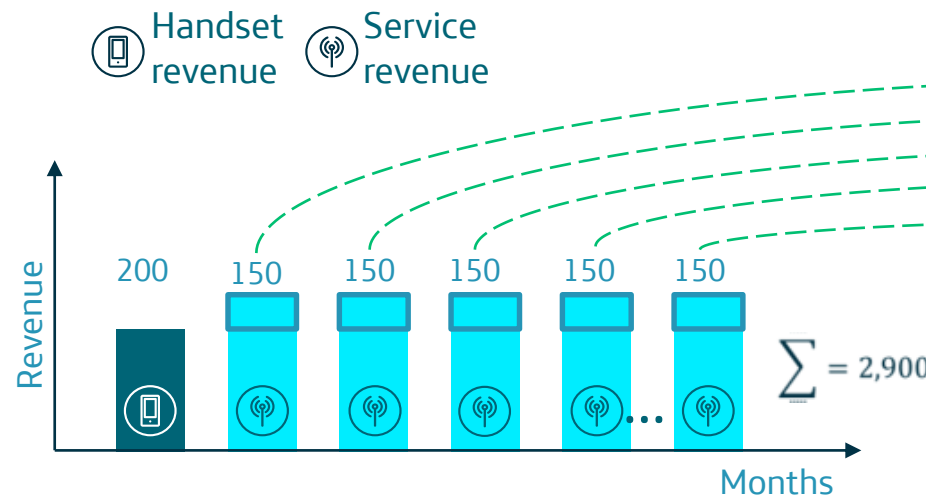
S./150 per month during 18 months
Total = S./2,700

Handset Price with service(*) S./200

Total Contract = S./2,900

SSPR = S./740

(*) SSP = S./925



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



IFRS 15: Cost Capitalisation

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

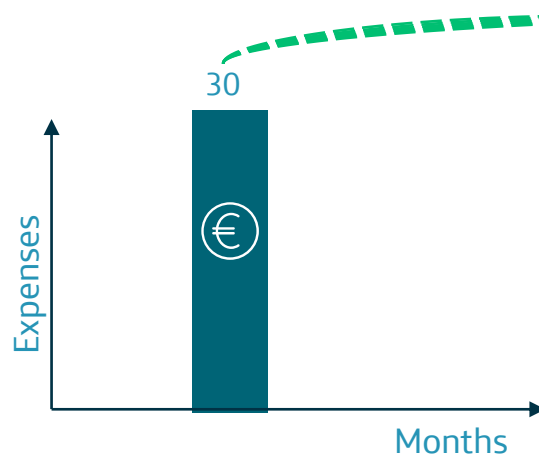


Let's see an example...

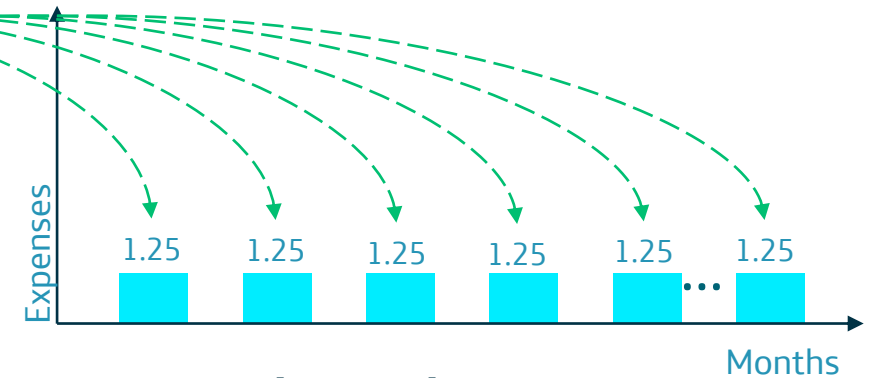
A dealer is paid a commission of 30 € for a new contract with a customer. The total duration of the contract is 24 months

Before...	...After
<p>One shot recognition </p>	<p> OPEX accrual in accordance with the pattern of transfer of the services</p>

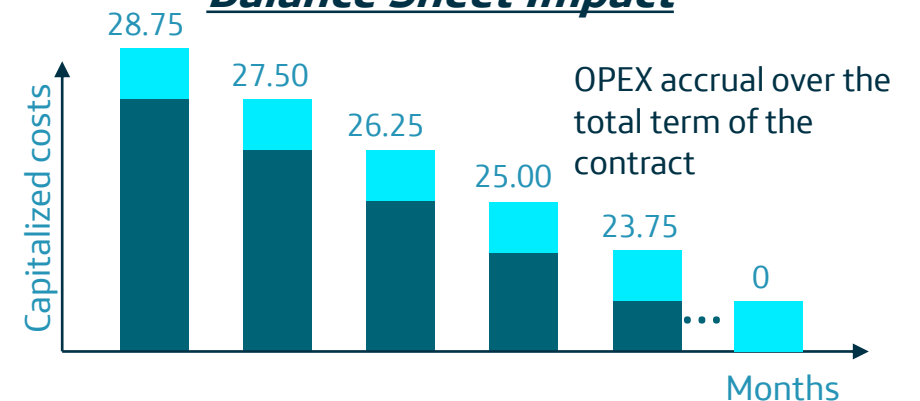
P&L Impact



P&L Impact



Balance Sheet Impact



Key points

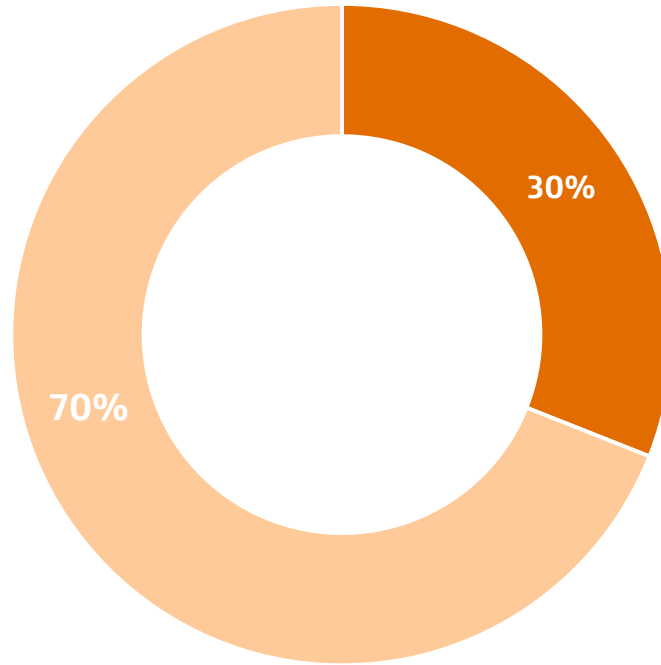
-  Sales commissions with deferral period longer than 12 months
- New B/S item: Capitalized costs

IFRS 15: Opening equity impact 2018

The following charts represent the estimated equity impact on a pre-tax basis of €+1.0 Bn distributed by areas of impact and segments

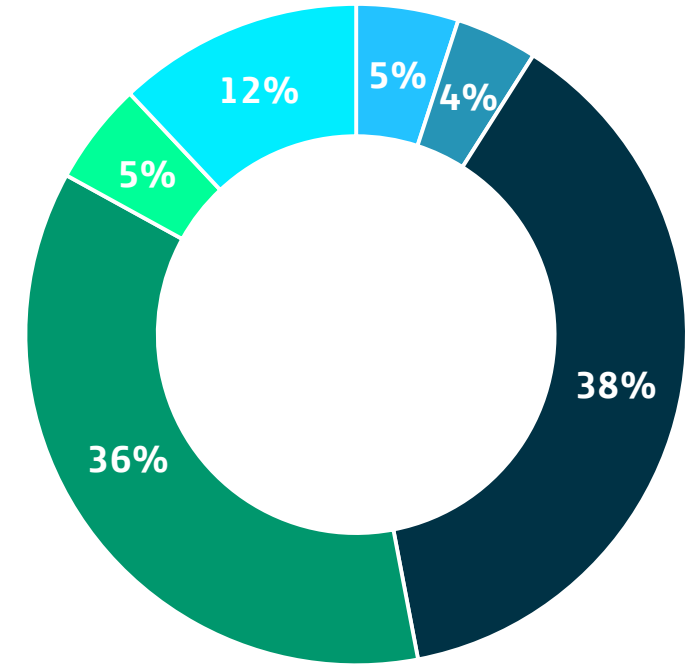


Areas of impact



- Contract Assets & Contract Liabilities
- Capitalised costs

Segment Distribution






































































- Spain
- Brazil
- Germany
- UK
- North Hispam
- South Hispam

Unaudited figures

IFRS 15: Estimated contribution per region

**Non-relevant
impacts in any
segment**

	Revenue					OIBDA				
 Spain										
 Brazil										
 Germany										
 UK										
 North HISPAM ¹										
 South HISPAM ²										
 Total Group	Revenue: € -60 Mill -0.1% over Revenue					OIBDA: € -80 Mill -0.5% over OIBDA				

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

² South HISPAM: Argentina, Peru, Chile and Uruguay

Unaudited figures

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 Eguirón

Appendix



IFRS 15: Practical Expedients

The Standard contains certain **practical expedients** for the adoption of revenue recognition



TRANSITION

Telefónica Group will adopt the **cumulative transitional approach**, recognizing the cumulative effect of the initial application of the Standard as an adjustment in equity in 2018



PORTFOLIO APPROACH

Telefónica Group will **use portfolios as a method** of clustering similar contracts, wherever possible



FINANCIAL COMPONENT

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**



COSTS

Telefónica Group will **not capitalize incremental costs**, that would create an asset with an amortization period of **one year or less** and recognize the costs as expenses directly upon incurrence



MODIFIED CONTRACTS

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



COMPLETED CONTRACTS

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



Telefonica

Disclaimer

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.

This document and the Q&A session may contain summarized, non-audited or non-GAAP financial information. The information contained herein and therein should therefore be considered as a whole and in conjunction with all the public information regarding the Company available, including any other documents released by the Company that may contain more detailed information.

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.

Neither this document nor the Q&A session nor any of their contents constitute an offer to purchase, sale or exchange any securities, a solicitation of any offer to purchase, sale or exchange of any securities, or a recommendation or advice regarding any security.