

# 2016 Consolidated Management Report<sup>1</sup>

## Business model

Telefónica is one of the world's leading communications services providers. Our objective is to create, protect and promote fixed and mobile connections for our customers helping them to take control of their digital lifestyle. Therefore, we offer our customers connectivity, simple products and services and also the security that we protect their data, managing it in a responsible way.

In order to develop its business model, Telefónica has an organizational structure completely focused on customers and incorporates the digital offering as the main focus for commercial policies. The structure gives greater visibility to local operations, bringing them closer to the corporate decision-making center, simplifying the global structure and strengthening the transverse areas to improve flexibility and agility in decision making. On top of the transverse areas, which are led by the Chief Commercial Digital Officer, who is responsible for fostering revenue growth, and the Chief Global Resources Officer who is in charge of the efficiency of the cost side, the organizational structure is composed of the following segments: Telefónica Spain, Telefónica United Kingdom, Telefónica Germany, Telefónica Brazil and Telefónica Hispanoamérica (comprised of our consolidated subsidiaries in Argentina, Chile, Peru, Colombia, Mexico, Venezuela, Central America, Ecuador and Uruguay). These segments include the information related to wireline, wireless, DSL, TV, and other digital services provided in each country or countries.

The Telefónica Group's strategy aims to:

- Enhance value through:
  - Offering excellent connectivity, for which, our infrastructure management and our continuous investment in network are key. We aim to return the control over the data to our customers.
  - Providing a bundled offer with video and digital services. We offer our customers additional data in order to amplify their services, such as video or digital services, through unique, simple and clear offers.
  - Providing increased customer value and customer experience with digital access, aiming to offer the best products, solutions and contents.
- With the following enablers:
  - End-to-end Digitalization. We reduce our legacy investments to improve virtualization, reduce physical servers, data centers and applications, digitalization of IT systems and processes, digitalization of front- and back office, offering a true digital experience to our customers.
  - Big Data and Innovation to add value to our customers and return the control over data to our customers.
  - Continued focus on capital allocation in our legacy investments and simplification processes in order to continue investing.

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<sup>1</sup> This Management Report has been prepared taking into consideration the "Guidelines on the preparation of annual corporate governance reports for listed companies" published by the CNMV in July 2013.

Moreover, Telefónica has increased its presence in key markets. In 2014 Telefónica acquired E-Plus (through Telefónica Germany) and in 2015 Telefónica acquired DTS (through Telefónica Spain) and GVT (through Telefónica Brazil).

On February 10, 2016, Telefónica announced the creation of "Telxius" a company which brings together certain infrastructure assets of the Group in several countries, which will enable the management of the Telefónica Group's infrastructure on a global scale with a more specialized and focused approach, with the aim of increasing the services provided to other operators, improving the return on capital invested and allowing Telefónica to participate more actively in the growth opportunities that exist in the industry, including the possibility of incorporating third party assets.

## Trend evolution

In 2016, Telefónica made great progress towards long-term sustainable and profitable growth in service revenues, continuing to increase efficiencies and capturing synergies thanks to the integrated vision of the businesses, processes and technologies. This allowed us to maintain a strong investment effort in order to be able to offer our customers excellent connectivity. In recent years, the Company has moved forward in its business transformation:

- Firstly, Telefónica has defined a new business model with data-oriented offers, bundled services, including converged fixed and mobile services, as well as digital capabilities as part of the global transformation focused on responding to the change in our customers' consumer habits. An essential part of our effort has been the investment in fiber- and LTE networks, which we believe will allow the monetization of data as well as of digital services. In this way, Telefónica has significantly increased data accesses, including 82 million smartphones accesses, 4.8 million Pay TV accesses and 6.6 million fiber accesses during the 2014-2016 period. Additionally, average revenue per access increased by 2.8% year-on-year over the 2015-2016 period, from a year-on-year increase of 1.9% over the 2014-2015 period.
- Secondly, changing consumer habits have resulted in a decreasing demand for voice services and an increasing demand for data, due to video downloads and internet connectivity through smartphones. This new trend has allowed us since 2015 to compensate the drop in voice revenues (excluding falls in interconnection tariffs) with higher data and service over connectivity, to be able to start seeing a positive trend in average revenue per access in the majority of our markets.
- Thirdly, Telefónica has reinforced its competitive position thanks to an active management of the asset portfolio and to the consolidation of its participation in key markets in 2015: Germany (with the acquisition of E-Plus), Brazil (with the acquisition of GVT) and Spain (with the acquisition of DTS). These strategic acquisitions in key markets coupled with divestments in non-strategic markets, have allowed Telefónica to capture significant synergies.
- Lastly, Telefónica launched in 2014 a simplification program focused on increasing growth and capturing synergies across the board; commercial offer simplification; IT network and global process modernization (through higher investments in IT and commercial systems as well as call center costs reduction); and improving sales channels with a more efficient back office. All these measures allow for the liberalization of resources that can be used for transformation, improving network and accelerating the digitalization process.

On the other hand, various factors have contributed to the fact that Telefónica has experienced a downward trend in some key financial performance indicators during the 2014-2016 period.

- First, changes in foreign exchange rates, particularly in 2015 with the depreciation of the Brazilian real against the euro and the effects of the depreciation of the Venezuelan bolivar. In 2016 such currencies continued to depreciate and the Company's results were also affected by devaluations in the United Kingdom, Argentina and Mexico, adversely and significantly affecting revenue growth.
- Second, the high inflation in certain countries affected cost growth in numerous markets where Telefónica is present which were not offset by the increase in tariffs.
- Third, after a period of significant expansion, Telefónica has generally reduced the scope of its activities and exited certain countries in recent years to reduce its level of indebtedness and strengthen Telefónica's capacity for future growth.

- Fourth, Telefónica's business is highly regulated, which affects its revenues and imposes costs on its operations. For example, regulation sets the fixed rates that Telefónica charges for calls received from other companies' networks, and regulators have progressively lowered these rates in recent years.
- Fifth, in recent years Telefónica has experienced an intense competition in the markets where it operates, resulting in more bundled offers and making it difficult to monetize value added services.
- In the last two years, within the above mentioned simplification process, Telefónica has redefined its processes, readapting its resource necessities, resulting in various provisions which have affected, results in 2015 as well as in 2016.

In the 2014-2016 period these negative factors have contributed to a downward trend in some of Telefónica's key market indicators, such as the Profit for the year (-26.2% during the period). On the other hand, the positive result of the strategy with a focus on sustainable and profitable growth is reflected in the Revenue trend during the 2014-2016 period, up 3.3%.

## Services and products

New digital technologies are the main driving force of social and economic transformation today. This premise is the basis upon which we build our vision: we want to provide access to digital life, using the best technology and without leaving anyone behind.

Connectivity is our ally in reducing the digital divide and, due to our fixed and mobile network infrastructure and the services we develop around it, we can aid progress in the communities in which we operate.

To move towards this vision, at Telefónica we work on three basic fronts:

- 1) Providing access to technology through digital inclusion, in other words, by means of network roll-out and an accessible and affordable offer for all sectors of the population.
- 2) Developing innovative services that add value to our connectivity and which we develop through innovation: Big Data, the Internet of Things (IoT), eHealth, digital education and eFinances.
- 3) Incorporating sustainability principles to all of our product development processes.

### Mobile business

Telefónica offers a wide variety of mobile and related services and products to personal and business customers. Although they vary from country to country, Telefónica's principal services and products are as follows:

- **Mobile voice services:** Telefónica's principal service in all of its markets is mobile voice telephony.
- **Value added services:** Customers in most of the markets have access to a range of enhanced mobile calling features, including voice mail, call hold, call waiting, call forwarding and three-way calling.
- **Mobile data and Internet services:** Current data services offered include Short Messaging Services, or SMS, and Multimedia Messaging Services, or MMS, which allow customers to send messages with images, photographs, sound recordings and video recordings. Customers may also receive selected information, such as news, sports scores and stock quotes. Telefónica also provides mobile broadband connectivity and Internet access. Through mobile Internet access, customers are able to send and receive e-mail, browse the Internet, download games, purchase goods and services in m-commerce transactions and use Telefónica's other data and software services.
- **Wholesale services:** Telefónica has signed network usage agreements with several MVNOs in different countries.
- **Corporate services:** Telefónica provides business solutions, including mobile infrastructure in offices, private networking and portals for corporate customers that provide flexible online billing.
- **Roaming:** Roaming agreements allow Telefónica customers to use their mobile handsets when they are outside their service territories, including on an international basis.
- **Fixed wireless:** Telefónica provides fixed voice telephony services through mobile networks in Brazil, Venezuela, Argentina, Peru, Mexico, Ecuador, El Salvador, Guatemala and Nicaragua.

- **Trunking and paging:** Telefónica provides digital mobile services for closed user groups of clients and paging services in Spain and most of its operations in Latin America.

### Fixed-line telephony business

The principal services Telefónica offers in its fixed businesses in Europe and Latin America are:

- **Traditional fixed telecommunication services:** Telefónica's principal traditional fixed telecommunication services include PSTN lines; ISDN accesses; public telephone services; local, domestic and international long-distance and fixed-to-mobile communications services; corporate communications services; supplementary value added services (including call waiting, call forwarding, voice and text messaging, advanced voicemail services and conference-call facilities); video telephony; business oriented value-added services; intelligent network services; leasing and sale of handset equipment; and telephony information services.
- **Internet and broadband multimedia services:** the principal Internet and broadband multimedia services include Internet service provider service; portal and network services; retail and wholesale broadband access through ADSL, naked ADSL (broadband connection without the monthly fixed line fee); narrowband switched access to Internet for Universal Service, and other technologies. Telefónica also offers high-speed Internet services through fiber to the home (FTTH) in certain markets (primarily Spain, Brazil and Chile) and VDSL-based services (primarily Spain and Germany). Telefónica also offers VoIP services in some markets.
- **Data and business-solutions services:** the data and business-solutions services principally include leased lines; virtual private network, or VPN, services; fiber optics services; the provision of hosting and application, or ASP, service, including web hosting, managed hosting, content delivery and application, and security services; outsourcing and consultancy services, including network management, or CGP; and desktop services and system integration and professional services.
- **Wholesale services for telecommunication operators:** the wholesale services for telecommunication operators principally include domestic interconnection services; international wholesale services; leased lines for other operators; network deployment; and local loop leasing under the unbundled local loop regulation framework). It also includes bit stream services, bit stream naked, wholesale line rental accesses and leased ducts for other operators' fiber deployment.

### Digital services

The main highlights in services developed by Telefónica Digital are:

- **Video/TV services:** IPTV services (Internet protocol), over-the-top network television services, and cable and satellite TV. Advanced pay TV services are also offered, such as high-definition TV (HDTV), Multiroom (allowing clients to watch different TV channels in different rooms), Digital Video Recording (DVR), Multiscreen (all contents in everywhere), CatchUp contents, third party contents and Cloud Video Services (such as Last 7 days, RestartTV and Cloud DVR). In addition, Telefónica offers accessible content with subtitles, audio description and sign language functionalities through the Movistar+ 5s service. The aim is to contribute toward the inclusion of disabled people across the country.
- **IoT (Internet of Things):** Telefónica Global IoT portfolio services include:
  - **Smart Connectivity:** horizontal services including mostly basic users (machines) managed through two different connectivity platforms, SmartM2M (developed and owned by Telefónica) and Jasper (third party developed)

- **Smart Services:** full end-to-end “device + connectivity + application” solutions targeting to four pre-defined specific vertical sectors: Cities, Mobility, Energy and Retail
- **Personal IoT:** set of services, focused on the B2C segment, supporting usual healthcare, safety and fitness practice through different electronic and communication processes (SMS and push messages, web-based solutions, tracking, wearables).
- **Financial services and other payment services:** These services allow final customers and financial institutions to make money transfers, payments and mobile recharges.
- **Security services:** A broad set of facilities (Managed Security, Cloud and Comms Security, Cybersecurity (threats, vulnerabilities and antifraud platforms)) targeting to protect information stored in different end customers’ devices and networks from unauthorized access, use, disclosure, disruption or destruction, and including 11Paths developed services such as Latch, FaasT, Metashield or Tacyt.
- **Cloud computing services:** Includes Managed Cloud, which allows us to build fully managed infrastructure environments for large enterprises and also manage the complex tools and applications that run on top of that infrastructure; and in addition, for small and medium sized businesses “All-in” Bundles (Comms+Devices+Cloud). Telefónica is bundling offers based on a Cloud Service Broker that provides a vast self-service experience to the customer and a large set of capabilities, flexibility and a comprehensive commercial offer.
- **Advertising:** Portfolio of marketing channels that third party brands can use to acquire and engage with customers. Traditional channels such as messaging are utilized alongside new channels like programmatic display and sponsored connectivity – all fueled by powerful customer data.
- **Big Data:** Includes the product “Smart Steps” which helps retailers, municipalities and public security bodies to understand the influx of people. Anonymous mobile data network and aggregates are used to calculate the influx of people in an area. Telefónica also offers B2B opt-in services to the financial sector (Smart Digits) for improving fraud prevention and credit scoring in Brazil, United Kingdom and Chile. Recently a Smart Steps joint venture has been launched with China Unicom based out of Beijing to sell data insights in China.

## 2016 highlights

In 2016 Telefónica has taken further steps aimed at achieving profitable and sustainable long-term growth, and improving in efficiencies and synergies, which resulted in a higher OIBDA (+14.3% year-on-year in reported terms). Additionally, the investment levels over total revenues continued above 17% with a total amount of 8,928 million euros, with more than 2,000 million euros dedicated to LTE and ultra broad band ("UBB"). The Company closed the year with a total of 350 million accesses, representing a stable growth level (0.7% versus 2015), where the downward growth trend in prepay and fixed voice was more than compensated by the growth in value customers. Post-pay customers, which grew by 6.3% year-on-year, reaching 111 million customers, while fiber customers amounted to 7.3 million customers at December 2016, representing a 18.9% increase year-on-year.

In 2016, **revenues** totaled 52,036 million euros, down 5.2% compared to 2015 in reported terms. **OIBDA** totaled 15,118 million euros in 2016, up 14.3% in reported terms. In organic terms (which term and calculation is explained further below), OIBDA was up 4.7%, due mainly to the positive evolution of all the regions mainly as a consequence of the integration synergies in Telefónica Brazil and Telefónica Germany, the positive evolution of service revenues and the continuous effort in efficiency and simplification.

Telefónica's **total accesses** totaled 350.0 million as of December 31, 2016. Group accesses increased by 0.7% year-on-year, mainly as a result of the solid growth in accesses in Telefónica Germany, Telefónica United Kingdom and Telefónica Hispanoamérica. By service, it is worth highlighting the higher commercial activity based on high value customers, resulting in a sustained growth of the contract mobile segment (smartphones and LTE) and fiber. It is worth mentioning, the growth in accesses in Telefónica Hispanoamérica (representing 39% of the Group's total accesses as of December 31, 2016) up by 0.9% year-on-year, the growth in accesses in Telefónica Germany (representing 14% of the Group's total) up by 2.0% year-on-year and the growth in accesses in Telefónica United Kingdom (representing 7% of the Group's total) up by 1.9% year-on-year.

The below table shows the evolution of accesses over the past two years as of December 31 of such years:

### ACCESSES

Thousands of accesses	2015(*)	2016	%Reported YoY
Fixed telephony accesses (1)	39,734.9	38,280.1	(3.7%)
Internet and data accesses	21,365.3	21,652.1	1.3%
Broadband (2)	20,971.3	21,194.9	1.1%
Fiber	7,393.1	9,162.9	23.9%
Mobile accesses	272,103.9	276,450.0	1.6%
Prepay	167,845.1	165,663.2	(1.3%)
Contract	104,258.8	110,786.8	6.3%
M2M	11,526.3	14,002.0	21.5%
Pay TV	8,271.6	8,289.0	0.2%
<b>Final Clients Accesses</b>	<b>341,475.6</b>	<b>344,671.1</b>	<b>0.9%</b>
<b>Wholesale Accesses</b>	<b>6,062.8</b>	<b>5,300.9</b>	<b>(12.6%)</b>
<b>Total Accesses</b>	<b>347,538.4</b>	<b>349,972.1</b>	<b>0.7%</b>

Notes:

(\*) Accesses include GVT and DTS customers since May 1, 2015. There were no variations in organic terms during the period.

(1) Includes "fixed wireless" and Voice over IP accesses.

(2) Includes DSL, satellite, optic fiber, cable modem and broadband circuits.



The below table shows the evolution of accesses by segment:

Accesses 2016	YoY variation	% Over Total Accesses	
		2015	2016
Spain	(1.8%)	12.1%	11.8%
United Kingdom	1.9%	7.3%	7.4%
Germany	2.0%	13.9%	14.1%
Brazil	0.3%	27.9%	27.8%
Hispanoamérica	0.9%	38.7%	38.8%
Others	40.7%	0.1%	0.1%

The Group's strategy is based on capturing growth in its markets, especially on attracting high-value customers.

**Mobile accesses** totaled 276.5 million at December 31, 2016, up 1.6% compared to December 31, 2015, affected mainly by the increase in the number of contract accesses, up 6.3% year-on-year, continuing to increase their weight over total mobile accesses reaching 40.1% (+1.8 p.p. year-on-year).

**Smartphone accesses** maintained a strong growth rate (up 16.6% year-on-year), totaling 147 million accesses and reaching a penetration rate over total accesses of 57.1% (+7.6 p.p. year-on-year), reflecting the Company's strategic focus on the growth of its data services.

**Fixed broadband accesses** stood at 21.2 million at December 31, 2016, up 1.1% year-on-year. UBB accesses stood at 9.2 million at December 31, 2016.

**TV accesses** totaled 8.3 million at December 31, 2016, remaining stable year-on-year (+0.2%) due to the effort in capturing high value customers in Telefónica Brazil and Telefónica Hispanoamérica.

The table below shows the evolution of our estimated access market share for mobile and DSL for the past two years.

#### Competitive Position Evolution

Telefónica	Mobile Market Share (1)	
	2015	2016
Spain	30.8%	30.5%
United Kingdom	27.2%	26.8%
Germany	38.1%	37.9%
Brazil	28.4%	30.2%
Argentina	32.3%	33.3%
Chile	36.7%	33.4%
Peru	49.7%	44.0%
Colombia	22.4%	23.2%
Venezuela	34.2%	37.8%
Mexico	22.7%	24.2%
Central America	33.2%	34.1%
Ecuador	29.7%	31.0%
Uruguay	34.9%	33.1%

(1) Internal estimation in both years

Telefónica	DSL Market Share (1)	
	2015	2016
Spain	43.5%	42.5%
Brazil	28.1%	28.0%
Argentina	29.4%	28.6%
Chile	39.4%	36.4%
Peru	80.5%	78.7%
Colombia	18.1%	16.6%

(1) Internal estimation in both years

## 2016/2015 Consolidated results

In this section, we discuss changes in the Group's consolidated income statements for 2016 and 2015. Changes in the Group's consolidated income statements for 2015 and 2014 are discussed in a separate section further below.

Consolidated Results Millions of euros	Year ended December 31				Variation	
	2015(*)		2016		2016 vs 2015	
	Total	% of revenues	Total	% of revenues	Total	%
Revenues	54,916	100.0%	52,036	100.0%	(2,880)	(5.2%)
Other income	2,011	3.7%	1,763	3.4%	(248)	(12.3%)
Supplies	(16,547)	(30.1%)	(15,242)	(29.3%)	1,305	(7.9%)
Personnel expenses	(10,349)	(18.8%)	(8,098)	(15.6%)	2,251	(21.8%)
Other expenses	(16,802)	(30.6%)	(15,341)	(29.5%)	1,461	(8.7%)
<b>OPERATING INCOME BEFORE DEPRECIATION AND AMORTIZATION (OIBDA)</b>	<b>13,229</b>	<b>24.1%</b>	<b>15,118</b>	<b>29.1%</b>	<b>1,889</b>	<b>14.3%</b>
Depreciation and amortization	(9,704)	(17.7%)	(9,649)	(18.5%)	55	(0.6%)
<b>OPERATING INCOME</b>	<b>3,525</b>	<b>6.4%</b>	<b>5,469</b>	<b>10.5%</b>	<b>1,944</b>	<b>55.2%</b>
Share of loss of investments accounted for by the equity method	(10)	(0.0%)	(5)	(0.0%)	5	(54.3%)
Net financial expense	(2,609)	(4.8%)	(2,219)	(4.3%)	390	(14.9%)
<b>PROFIT BEFORE TAX</b>	<b>906</b>	<b>1.6%</b>	<b>3,245</b>	<b>6.2%</b>	<b>2,339</b>	<b>n.m.</b>
Corporate income tax	(155)	(0.3%)	(846)	(1.6%)	(691)	n.m.
<b>PROFIT FOR THE YEAR</b>	<b>751</b>	<b>1.4%</b>	<b>2,399</b>	<b>4.6%</b>	<b>1,648</b>	<b>n.m.</b>
Attributable to equity holders of the Parent	616	1.1%	2,369	4.6%	1,753	n.m.
Attributable to non-controlling interests	135	0.2%	30	0.1%	(105)	(77.9%)

(\*) Amended data: comparative information was amended to cease to present the results of Telefónica United Kingdom as discontinued operations.

### Adjustments made to calculate organic variations

Year-on-year changes referred to in this document as "organic" or presented in "organic terms" intend to present year-on-year variations on a comparable basis, by considering a constant perimeter of consolidation and constant exchange rates and by making certain other adjustments which are described herein. "Organic variations" should not be viewed in isolation or as an alternative to reported variations.

For purposes of this report, 2016/2015 "organic" variation is defined as the reported variation as adjusted to exclude the impacts detailed below:

- **Foreign exchange effects and hyperinflationary adjustments in Venezuela:** we have excluded the impact of changes in exchange rates by assuming constant average foreign exchange rates year on year. In particular, we have used the average foreign exchange rates of 2015 for both years.

Foreign exchange rates had a negative impact on our reported 2016 results, mainly due to the depreciation versus the euro of various Latin American currencies (in particular the Argentine peso, the Brazilian real and, to a lesser extent, the Venezuelan bolivar), and the pound sterling.

We have also excluded the impact of hyperinflationary adjustments in Venezuela by reversing such adjustments.

- **Changes in the scope of consolidation:** we have excluded the impact of changes in our consolidation perimeter in 2016 and 2015. The main changes in our consolidation perimeter in such years related to the consolidation of GVT in Telefónica Brazil since May 2015 and the consolidation of DTS in Telefónica Spain since May 2015. In addition, Telefé was sold in November 2016.

In order to exclude the impact of these changes in our perimeter for the calculation of organic variations, the 2015 comparative figures:

- include GVT's results from January 1 to April 30, 2015;
- include DTS's results from January 1 to April 30, 2015;
- exclude Telefé's results from November 1 to December 31, 2015.
- **Restructuring costs:** we have excluded the impact in 2016 and 2015 of certain restructuring costs, mainly those related to the first Collective Agreement of Related Companies in Spain, restructuring processes relating to Germany and Brazil and the Group's simplification program in global areas.

The distribution by segment of the restructuring costs is as follows (impacts on OIBDA):

Million euros	2015	2016
Telefónica Spain (Individual Suspension Plan)	2,896	789
Telefónica Spain (other restructuring plans)	-	48
Telefónica Brazil	7	40
Telefónica Germany	74	89
Telefónica United Kingdom	4	37
Telefónica Hispanoamérica	38	84
Other companies	198	293
<b>Total restructuring costs</b>	<b>3,217</b>	<b>1,380</b>

- **Results of tower sales:** the results attributable to the sale of towers in 2016 and 2015 have been excluded.

In 2016, the results from the sale of towers totaled 1 million euros, mainly in Telefónica Hispanoamérica. In 2015, the results from the sale of towers totaled 65 million euros, distributed as follows: Telefónica Spain (38 million euros), Telefónica Brazil (10 million euros) and Telefónica Hispanoamérica (18 million euros, mainly in Chile).

- **Irrevocable commitment with Fundación Telefónica:** in 2015 we have excluded the expense (325 million euros) resulting from Telefónica, S.A.'s irrevocable commitment to make a donation to Fundación Telefónica in order to provide this entity with the financing required so that it can carry out its existing or new social programs and non-profit activities in the short and medium term.
- **Adjustment to the final purchase price of E-Plus:** in 2015 we have excluded the result from the difference between the preliminary purchase price of E-Plus (as estimated at the end of the valuation period) and the final purchase price agreed with KPN, totaling 104 million euros (which had a 102 million euros positive impact on OIBDA, net of costs related to the acquisition).
- **Spectrum acquisition:** we have excluded the impact of spectrum acquisitions in 2016 and 2015.

In 2016, these acquisitions totaled 345 million euros, 284 million euros corresponding to Telefónica Perú, 48 million euros corresponding to Telefónica Brasil, 7 million euros corresponding to Telefónica Spain and 6 million euros corresponding to Telefónica Germany.

In 2015 these acquisitions totaled 1,585 million euros, 1,198 million euros corresponding to Telefónica Germany, 49 million euros corresponding to Telefónica Spain and 338 million euros corresponding to Telefónica Hispanoamérica (mainly Argentina and Ecuador).

- **Gains or losses on the sale of companies:** the gains obtained or losses incurred from the sale of companies have not been included in organic variations.

In 2016 the 199 million euros in profit obtained from the sale of Telefé and the 29 million euros obtained from the sale of Telecomunicaciones Personalizadas were not included. Similarly, the loss of 16 million euros incurred in the sale of Vocem was also not included.

- **Impairment of goodwill:** the impairment losses on goodwill have not been included in organic variations.

In 2016, the impairment loss on the goodwill assigned to Telefónica Venezolana and Telefónica Móviles Mexico amounting to 124 and 91 million euros, respectively, has been excluded.

In 2015, the impairment loss on the goodwill generated by the acquisition of Telefónica Digital Inc. amounting to 104 million euros was excluded.

- **Other adjustments:** we have excluded the impact of the impairment resulting from the deterioration in certain minority participations, totaling 23 million euros in 2015. We have also excluded the impact of the provisions recorded in Telefónica Spain to optimize the distribution network (18 and 30 million euros in 2016 and 2015, respectively).

The table below shows 2016/2015 variations in reported and organic terms (the latter, calculated in accordance with the adjustments referred to above) of certain income statement and other measures:

TELEFÓNICA 2016	YoY variation	
	% Reported YoY	% Organic YoY
Revenues	(5.2%)	1.3%
Other income	(12.3%)	(13.9%)
Supplies	(7.9%)	(3.1%)
Personnel expenses	(21.8%)	1.9%
Other expenses	(8.7%)	0.2%
<b>OIBDA</b>	<b>14.3%</b>	<b>4.7%</b>
<b>Operating income</b>	<b>55.2%</b>	<b>8.3%</b>
CapEx	(14.7%)	3.9%
<b>OpCF (OIBDA-CapEx)</b>	<b>n.m.</b>	<b>5.6%</b>

The table below shows the contribution to reported growth of each item considered to calculate the organic variations, as explained above. For each line item, the contribution to reported growth, expressed in p.p., is the result of dividing the amount of each impact (on a net basis when the impact affects both years) by the consolidated reported figure for the previous year.

	Contribution to reported growth (percentage points)									
TELEFÓNICA 2016	Exchange rate effect and hyperinflation	Perimeter change	Restructuring costs	Towers sales	Commitment with Fundación	Adjustments to the final purchase price of E-Plus	Spectrum acquisition	Capital gains/losses on sale of companies	Impairments	Other adjustments
Revenues	(8.0)	1.4	--	--	--	--	--	--	--	--
Other income	(3.9)	1.7	--	(3.2)	--	(5.2)	--	11.3	--	--
Supplies	(6.7)	1.9	--	--	--	--	--	--	--	--
Personnel expenses	(7.0)	1.1	(17.2)	--	--	--	--	--	--	--
Other expenses	(8.7)	1.3	(0.1)	0.0	(1.9)	0.0	--	0.1	0.7	(0.2)
<b>OIBDA</b>	<b>(8.8)</b>	<b>1.3</b>	<b>13.6</b>	<b>(0.5)</b>	<b>2.5</b>	<b>(0.8)</b>	--	--	<b>(0.8)</b>	<b>0.3</b>
<b>Operating income</b>	<b>(20.2)</b>	<b>(0.9)</b>	<b>51.1</b>	<b>(1.8)</b>	<b>9.2</b>	<b>(2.9)</b>	--	<b>6.0</b>	<b>(3.1)</b>	<b>1.0</b>
Capex	(7.9)	1.5	--	--	--	--	(11.7)	--	--	--
<b>OpCF (OIBDA-CapEx)</b>	<b>(12.4)</b>	<b>0.2</b>	<b>65.1</b>	<b>(2.3)</b>	<b>11.7</b>	<b>(3.7)</b>	<b>44.1</b>	<b>7.6</b>	<b>(4.0)</b>	<b>1.3</b>

## Results discussion

**Revenues** totaled 52,036 million euros in 2016, decreasing 5.2% compared to 2015 in reported terms. This decrease was mainly attributable to the impact of changes in foreign exchange rates and hyperinflation in Venezuela (-8.0 p.p.), which was partially offset by the changes in the consolidation perimeter, which contributed with 1.4 p.p. to the year-on-year growth. In organic terms, revenues increased 1.3% due to the increase in service revenues offset by the decrease in handset revenues affected by the extension of handset lifecycles.

The structure of revenues reflects Telefónica's business diversification, the segment with the largest contribution to our revenues in 2016 was Telefónica Spain, representing 24.4% (+1.8 p.p. compared to 2015), followed by Telefónica Hispanoamérica, representing 24.2% despite the adverse impact of exchange rates and hyperinflation in Venezuela (-2.0 p.p. compared to 2015), and Telefónica Brazil, representing 21.3% (+1.2 p.p. compared to 2015).

**Mobile business revenues** totaled 32,401 million euros in 2016 (of which 28,030 million euros corresponded to service revenues and 4,032 million euros corresponded to handset revenues) down 8.8% year-on-year in reported terms. This decrease was mainly attributable to the impact of changes in foreign exchange rates and hyperinflation in Venezuela (-8.7 p.p.). Excluding this impact, the year-on-year decrease was 0.1%, mainly due to the decrease of mobile revenues in Europe due to less handsets revenues that offset the increase of mobile revenues in Telefónica Hispanoamérica and in Telefónica Brazil as a result mainly of the increase in the customer base and data adoption.

**Mobile service revenues**, which is included in mobile business revenues, totaled 28,030 million euros in 2016, down 7.5% year-on-year in reported terms explained by the impact of changes in foreign exchange rates and hyperinflation in Venezuela (-8.9 p.p.). Excluding this impact, mobile service revenues increased year-on-year by 1.5% due mainly to the higher customer base and higher data consumption.

**Mobile data revenues**, which is included in mobile service revenues, totaled 14,663 million euros in 2016, up 2.1% in reported terms. This increase was mainly attributable to higher consumption of data by our customers, which was partially offset by the impact of changes in foreign exchange rates and hyperinflation in Venezuela (-10.2 p.p.). Excluding this impact, mobile data revenues increased by 12.3% due mainly to the increase of non-SMS data revenues (up 19.7%) and higher use of data per customer. Mobile data revenues accounted for 52% of mobile service revenues in 2016, up 4.9 p.p. compared to 2015 in reported terms.

**Fixed revenues** totaled 18,187 million euros in 2016, up 1.9% year-on-year in reported terms. This increase was mainly attributable to the full year of consolidation of GVT and DTS in 2015 (which accounted for +4.7 p.p. of the year-on-year increase), which was partially offset by the impact of changes in foreign exchange rates and hyperinflation in Venezuela (-6.9 p.p.). Excluding these impacts, fixed revenues increased 3.9%. This increase was mainly due to higher broad band connection revenues and Pay-TV revenues as a result of the commercial actions carried out by the Company in order to increase our value proposition and the higher customer base in Pay-TV.

**Other income** totaled 1,763 million euros in 2016, including the profit obtained from the sale of Telefé (199 million euros) and Telecomunicaciones Personalizadas (29 million euros). It also included income derived from the sale of towers totaling 1 million euros.

In 2015, other income included the positive result from the E-Plus price adjustment (104 million euros), the positive impact from the expired payment obligation (98 million euros) in Telefónica Brazil and the spectrum swap with AT&T in Telefónica Mexico carried out in December 2015 (79 million euros). Other income also included in 2015 income derived from the sale of real estate (78 million euros) and the sale of towers totaling 65 million euros in Telefónica Spain.

**Total expenses**, which include supply costs, personnel costs and other expenses (principally external services and taxes) but do not include amortization and depreciation expenses, were 38,681 million euros in 2016, down year-on-year 11.5% in reported terms. This decrease was mainly attributable to the impact of changes in foreign exchange rates and hyperinflation in Venezuela (-7.5 p.p.). The costs are explained in detail below:

- **Supplies** amounted to 15,242 million euros in 2016, down 7.9% year-on-year in reported terms mainly as a result of the impact of foreign exchange rates and hyperinflation in Venezuela (-6.7 p.p.). In organic terms, supplies expenses decreased by 3.1% year-on-year, mainly due to lower handset consumption associated with a longer handset lifecycle, and lower interconnection costs.
- **Personnel expenses** amounted to 8,098 million euros in 2016, down 21.8% in reported terms year-on-year compared to 2015. This decrease was mainly attributable to the restructuring provision of 1,336 million euros, principally in Telefónica Spain, accounting for 17.2 p.p. of the year-on-year decrease. In organic terms, personnel costs increased 1.9% year-on-year due to inflationary pressure in some Latin American countries and the internalization of services in Telefónica Brazil, which was partially offset by the savings generated from restructuring plans in recent years.

The average headcount was 132,120 employees in 2016, down 1.1% compared to 2015.

- **Other expenses** amounted to 15,341 million euros in 2016, down 8.7% in reported terms. This decrease was mainly attributable to the impact of foreign exchange rates and hyperinflation in Venezuela (-8.7 p.p.) In organic terms, other expenses remained flat year-on-year (+0.2%), principally due to savings in commercial costs, benefitting from higher synergies in Telefónica Spain, Telefónica Brazil and Telefónica Germany, which offset in part the negative impact of the inflation rates in some Latin American countries resulting in higher network costs.

**OIBDA** was 15,118 million euros in 2016, up 14.3% in reported terms as a result of various factors that affect comparability, mainly the lower restructuring costs in 2016 (1,380 million euros) compared to 2015 (3,217 million euros), which accounted for 13.6 p.p. of the year-on-year increase, the provision related to the agreement between Telefónica, S.A. and Fundación Telefónica registered in 2015 (+2.5 p.p.), the impact of the consolidation of GVT, DTS and Telefé (+1.3 p.p.) and the capital gain from the sale of Telefé, Telecomunicaciones Personalizadas and Vocem (+1.6 p.p.). These factors more than offset the impact of changes in foreign exchange rates and hyperinflation in Venezuela (-8.8 p.p.), the adjustments made to the final acquisition price of E-Plus in 2015 (-0.8 p.p.), the impairment loss on goodwill (-0.8 p.p.) and finally the lower sale of towers (-0.5 p.p.). In organic terms, OIBDA grew 4.7% due mainly to the positive evolution of all the regions as consequence of the positive evolution of service revenues, integration synergies captured in Telefónica Brazil and Telefónica Germany and the continuous effort to contain costs.

**OIBDA margin** stood at 29.1% in 2016, up 5 p.p. compared to 2015 in reported terms. In organic terms OIBDA margin was 31.5% and increased 1 p.p. compared to 2015 thanks to the increase in service revenues and higher content costs.

By segments, the main contributors to Group OIBDA were Telefónica Spain with 29.6% (+11.9 p.p. compared to 2015 due to lower restructuring cost provision in 2016), Telefónica Brazil with 24.6% (-2.4 p.p. compared to 2015) and Telefónica Hispanoamérica with 23% (reducing its contribution by 9.9 p.p. compared to 2015 due to the lower contribution of Argentina, Peru and Mexico).

**Depreciation and amortization** amounted to 9,649 million euros in 2016, down 0.6% year-on-year in reported terms, mainly due to the impact of foreign exchange rates and hyperinflation in Venezuela partially offset by the consolidation of GVT and DTS. The total depreciation and amortization charges



arising from purchase price allocation processes amounted to 801 million euros in 2016, down 10% year-on-year.

**Operating income (OI)** in 2016 totaled 5,469 million euros, up 55.2% in reported terms compared to 2015 for the reasons set forth above. In organic terms, operating income grew 8.3% year-on-year mostly as a result of cost savings.

The **share of loss of investments accounted for by the equity method** for 2016 was a loss of 5 million euros (compared to a loss of 10 million euros in 2015).

**Net financial expense** amounted to 2,219 million euros in 2016, 14.9% lower than the previous year, due to savings from the management of debt (pound sterling hedges linked to Telefónica United Kingdom and the lower cost of debt in European currencies). On the other hand, the higher finance income resulting from the inflation in Venezuela was mainly offset by the income from the sale of equity investments, with the capital loss from the sale of the 1.5% stake in China Unicom (155 million euros) in 2016, and the positive impact from the divestment of the holding in Telecom Italia, S.p.A. (380 million euros) in 2015.

**Corporate income tax** amounted to 846 million euros in 2016. Considering a pre-tax profit of 3,245 million euros, the effective tax rate stood at 26.1%, 9.0 p.p. higher than the 2015 effective tax rate, due to lower tax credits recognition in 2016.

As a result of the foregoing, **profit for the year attributable to equity holders of the parent** for 2016 was 2,369 million euros (616 million euros in 2015).

**Profit attributable to non-controlling interest** reached 30 million euros, 105 million euros less than in 2015, mainly due to the increase in losses attributable to minority interests at Telefónica Germany, offset by the lower profit attributable to minority interests in Telefónica Brazil.

## 2016/2015 Segment results

### TELEFÓNICA SPAIN

The below table shows the evolution of accesses in Telefónica Spain over the past two years as of December 31 of such years:

#### ACCESSES

Thousand of accesses	2015	2016	%Reported YoY
Fixed telephony accesses (1)	10,005.6	9,720.2	(2.9%)
Internet and data accesses	6,000.0	6,094.5	1.6%
Broadband (2)	5,962.0	6,067.3	1.8%
Fiber	2,223.0	2,998.3	34.9%
Mobile accesses	17,258.5	17,237.7	(0.1%)
Prepay	2,777.1	2,329.3	(16.1%)
Contract	14,481.4	14,908.4	2.9%
M2M	1,778.8	2,006.3	12.8%
Pay TV	3,671.5	3,657.0	(0.4%)
<b>Final Clients Accesses</b>	<b>36,935.6</b>	<b>36,709.4</b>	<b>(0.6%)</b>
<b>Wholesale Accesses</b>	<b>5,037.7</b>	<b>4,525.5</b>	<b>(10.2%)</b>
<b>Total Accesses</b>	<b>41,973.3</b>	<b>41,234.9</b>	<b>(1.8%)</b>

Notes:

(\*) There were no variations in organic terms during the period.

(1) PSTN (including Public Use Telephony) x1; ISDN Basic access x1; ISDN Primary access; 2/6 Digital Access x30. Company's accesses for internal use included. Includes VoIP and Naked ADSL.

(2) Include ADSL, satellite, fiber optic and retail broadband circuit.

In 2016 the commercial activity was leveraged on the differentiated assets of the Company and, in the second half of 2015 was strengthened by the convergent offer "Movistar Fusión+" launched in July 2015. During the first semester of 2016 the tariffs of the consumer segment, fundamentally broadband, postpaid mobile and "Fusion" were revised and, on July 3, 2016 a new "Movistar Fusión+" portfolio was launched, increasing the value offered to customers and tailoring it to their preferences. Basic bundles now include content from the Spanish "La Liga", to which "UEFA Champions and Europe League" are added in ultrafast packages; and the new "Movistar Fusión+" bundles include additional mobile lines and Premium TV content. It is important to highlight the good evolution of the second mobile line included in "Fusion+ Contigo" since its launching on June 1, 2016.

Churn evolution was positive in 2016, especially taking into account the elimination of "Fusión" long-term contracts on August 1, 2015, reflecting the higher loyalty of the customers with bundles services. This fact has resulted in a positive performance of commercial activity in 2016, broadband net adds grew by 39% year-on-year, there were more than 775 thousand new fiber accesses, and mobile contract net adds continued growth (+0.4 million customers). In fixed telephony the net loss of accesses decreased by 35.5% year-on-year.

Telefónica Spain had 41.2 million accesses at the end of December 2016, down 1.8% year-on-year, explained by the decrease in prepay mobile accesses and fixed telephony accesses. Retail accesses also declined by 0.6% year-on-year.

"**Movistar Fusión**", with a customer base of 4.3 million with 2.5 million additional wireless lines to the base offer as of December 31, 2016, maintained a solid year-on-year growth (+5% and +26% respectively compared to December 2015) and contributed 83% of the fixed retail broadband customer base (3.0% year-on-year) and 73% of the wireless contract customer base (6 p.p. year-on-year). There

was significant growth in the penetration of the high value services of “Movistar Fusión”, with 37% of the customer base already using 100 Mb or 300 Mb ultra-fast broadband (+8 p.p. year-on-year) and 68% of the customer base with Pay-TV as of December 31, 2016 (+5 p.p. year-on-year).

**Fixed accesses** decreased 2.9% year-on-year, with a net loss of 285 thousand accesses in the year 2016. This decrease was mainly due to a slower fixed access market evolution.

**Retail broadband accesses** presented 105 thousand new accesses in 2016, totaling 6.1 million accesses (+1.8% year-on-year) due to a low churn (1.4% in 2016, +0.02 p.p. year-on-year).

**Fiber accesses** showed a good evolution in terms of net adds (0.8 million new accesses in 2016), reaching 3.0 million customers in 2016 (up 34.9% compared to 2015), 49% of which corresponded to broad band accesses (+12 p.p. year-on-year), and with more than 775 thousand new accesses in 2016. Ultra-speed fiber accesses, with 100 or 300 Mb (with additional ARPU of 10 euros, including VAT) reached 2.0 million accesses (68% of total fiber accesses). At December 31, 2016 the fiber deployment reached 17.1 million premises, 2.7million more than at December 31, 2015, and continues to be the largest in Europe.

Total **mobile accesses** stood at 17.2 million, down 0.1% compared with year-end 2015 as a result of the decrease in prepaid accesses. The contract access base accelerated its growth during 2016, growing by 2.9% year-on-year. Smartphone penetration stood at 70.9% of the mobile voice base (+4.6 p.p. compared to year-end 2015) and significantly boosted data traffic growth to 62% year-on-year in 2016 due to the higher number of customers with the renewed portfolio containing superior data packages.

LTE network rollout continued to progress well and coverage reached (based on our estimates) approximately 91% of the population at the end of 2016, up 16 p.p. compared to 2015, due to the deployment of the 800 MHz. As a result, the LTE customer base reached 6.0 million customers in 2016, almost doubling the customer base in 2015, while penetration reached 40% (+19 p.p. year-on-year).

**Pay-TV accesses** reached 3.7 million, in line with the previous year, including 613 thousand satellite TV accesses from DTS.

Given the high penetration level of the convergent offer “Fusión”, the revenue breakdown by service is considered to be increasingly less relevant in 2016. For this reason, Telefónica Spain has disclosed a new revenue breakdown that management believes is more meaningful.

The table below shows the evolution of Telefónica Spain's results over the past two years:

Millions of euros

TELEFÓNICA SPAIN	2015	2016	% Reported YoY	% Organic YoY (3)
Revenues	12,402	12,713	2.5%	(0.1%)
<b>Consumer (1)</b>	<b>6,129</b>	<b>6,536</b>	<b>6.6%</b>	<b>1.8%</b>
Fusion	3,368	4,095	21.6%	21.6%
Out of Fusion	2,761	2,441	(11.6%)	(20.0%)
<b>Corporate</b>	<b>3,473</b>	<b>3,423</b>	<b>(1.4%)</b>	<b>(1.4%)</b>
Communications	2,799	2,708	(3.3%)	(3.3%)
IT	674	716	6.2%	6.2%
<b>Others (2)</b>	<b>2,152</b>	<b>2,257</b>	<b>4.8%</b>	<b>3.2%</b>
Other income	516	476	(7.6%)	(6.4%)
Supplies	(2,996)	(3,375)	12.7%	4.4%
Personnel expenses	(5,173)	(2,997)	(42.1%)	(6.2%)
Other expenses	(2,413)	(2,350)	(2.6%)	(4.8%)
<b>OIBDA</b>	<b>2,336</b>	<b>4,467</b>	<b>91.2%</b>	<b>1.4%</b>
OIBDA margin	18.8%	35.1%	16.3 p.p.	0.6 p.p.
Depreciation and amortization	(1,898)	(1,830)	(3.6%)	(4.8%)
<b>Operating income (OI)</b>	<b>438</b>	<b>2,637</b>	<b>n.m.</b>	<b>5.1%</b>
CapEx	1,827	1,847	1.1%	3.0%
OpCF (OIBDA-CapEx)	509	2,621	n.m.	0.6%

Notes:

(1) Consumer revenues also include freelance revenues.

(2) Other revenues include wholesale, subsidiaries and other revenues.

(3) See adjustments made to calculate organic variation below.

Adjustments made to calculate organic variations

As explained above, year-on-year changes referred to in this document as "organic" or presented in "organic terms" intend to present year-on-year variations on a comparable basis.

With respect to Telefónica Spain, we have made the following adjustments in order to calculate 2016/2015 variations in organic terms:

- **Changes in the scope of consolidation:** DTS was included in Telefónica's consolidation perimeter on May 1, 2015. In order to exclude the impact of this change in the perimeter for the calculation of organic variations, the 2015 comparative figures include DTS's results from January 1 to April 30, 2015.
- **Restructuring costs:** the impact of certain restructuring costs related to the Voluntary Suspension Plan in Spain and amounting to 837 million and 2,896 million euros in 2016 and 2015, respectively, has been excluded.
- **Results of tower sales:** the result obtained by Telefónica Spain from the sale of towers in 2015 totaling 38 million euros, has been excluded. Telefónica Spain recognized no result from the sale of towers in 2016.
- **Spectrum acquisition:** we have excluded the impact of spectrum acquisitions in 2016 and 2015, which totaled 7 and 49 million euros, respectively.
- **Gains or losses on the sale of companies:** in 2016, the gain obtained from the sale of Telecomunicaciones Personalizadas for 29 million euros was excluded.

- **Optimization of the distribution network:** the impact of the provisions recorded for 18 million and 30 million euros in 2016 and 2015, respectively, have been excluded.

The table below shows 2016/2015 variations in reported and organic terms (the latter, calculated in accordance with the adjustments referred to above) of certain income statement and other measures, and the contribution of each item for which we have adjusted to our reported growth:

TELEFÓNICA SPAIN 2016	YoY variation		Contribution to reported growth (percentage points)					
	% Reported YoY	% Organic YoY	Perimeter change	Restructuring costs	Towers sales	Spectrum acquisition	Capital Gains/losses on sale of companies	Spain distribution channel
Revenues	2.5%	(0.1%)	2.6	--	--	--	--	--
Other income	(7.6%)	(6.4%)	0.1	--	(7.4)	--	5.6	--
Supplies	12.7%	4.4%	7.9	--	--	--	--	--
Personnel expenses	(42.1%)	(6.2%)	0.5	(39.8)	--	--	--	--
Other expenses	(2.6%)	(4.8%)	2.8	--	--	--	--	(0.5)
<b>OIBDA</b>	<b>91.2%</b>	<b>1.4%</b>	<b>(0.2)</b>	<b>88.1</b>	<b>(1.6)</b>	<b>--</b>	<b>1.2</b>	<b>0.5</b>
CapEx	1.1%	3.0%	0.4	--	--	(2.3)	--	--
<b>OpCF (OIBDA-CapEx)</b>	<b>n.m.</b>	<b>0.6%</b>	<b>(2.2)</b>	<b>n.m.</b>	<b>(7.5)</b>	<b>8.2</b>	<b>5.6</b>	<b>2.3</b>

## Results discussion

**Revenues** in Telefónica Spain in 2016 were 12,713 million euros, up 2.5% year-on-year in reported terms mainly as a result of the consolidation of DTS since May 1, 2015 (which accounted for +2.6 p.p. of the year-on-year increase). In organic terms, revenues were flat year-on-year, as lower handset revenues were offset by higher service revenues.

Given the high penetration level of the convergent offer (which means the offer of more than a single service for a single price), the revenue breakdown by service is considered to be increasingly less relevant. For this reason, Telefónica Spain has established a new revenue breakdown that management believes is more meaningful.

- **Consumer revenues** (6,536 million euros in 2016) grew by 6.6% year-on-year in reported terms, as a result of the consolidation of DTS since May 1, 2015 (+4.8 p.p. of the year-on-year increase). In organic terms, these revenues increased 1.8% year-on-year, mainly driven by the growth in ARPU and in the number of customers. It is worth highlighting the strong growth in "Fusión" revenues during 2016 (4,095 million euros, +21.6% year-on-year) which more than offset the drop in "non-Fusión" revenues.
- **Business revenues** (3,423 million euros in 2016) decreased by 1.4% year-on-year in reported terms, improving the year-on-year trend, mainly due to a better evolution in communications revenues evolution and higher IT revenues. During 2016, business revenues showed a path of stabilization, supported by the commercial offer renovation, with integrated connectivity solutions, IT and digital services, all of them key for the digitalization of the businesses.
- **Other revenues**, which include wholesale, subsidiaries and other revenues (2,257 million euros in 2016) grew by 4.8% year-on-year in reported terms, due to the growth in wholesale TV revenues and fixed ingoing voice revenues.

**Fusión ARPU** was 80.4 euros in 2016, up 12.0% year-on-year in reported terms, boosted by the demand of higher value packages and the tariff revisions, as well as the improvement in the customers' mix

stimulated by the renovation of the portfolio that took place in August, 2016 including mobile additional lines and additional contents in the convergent offers.

**OIBDA** amounted to 4,467 million euros in 2016, up 91.2% year-on-year in reported terms, as a consequence of the provisions recorded in 2015 totaling 2,896 million euros relating to restructuring cost by the "Employment Suspension Plan" and 30 million euros relating to restructuring of the distribution channel. The OIBDA reported in 2016 also included 837 million euros of provisions due to the Individual Suspension Plan and other restructuring plans, and 18 million euros of provision due to the restructuring of the distribution channel.

In organic terms OIBDA increased 1.4% year-on-year, mainly due to the higher service revenues, lower personnel costs (down by 6.2% year-on-year in organic terms which is mainly explained by the savings generated by the "employment suspension plan" (207 million euros) since April 2016) and lower other expenses, which dropped 2.6% in reported terms and down 4.8% in organic terms excluding changes in the perimeter of consolidation, principally due to lower commercial costs, which in total offset the increase of supplies (+12.7% in reported terms, +4.4% in organic terms) impacted by higher content costs and IT equipment purchases.

**OIBDA margin** was 35.1% in 2016 in reported terms and 41.6% in organic terms, up 16.3 p.p. year-on-year in reported terms.

## TELEFÓNICA UNITED KINGDOM

As explained above, the consolidated income statement for 2015 appearing in the Consolidated Financial Statements has been amended to retroactively show the reclassification of Telefónica United Kingdom's results as continuous operations. Therefore, these results do not match the results published for such period. Consequently, segmented information has been modified for 2015.

The table below shows the evolution of accesses in Telefónica United Kingdom over the past two years as of December 31 of such years:

### ACCESSES

Thousands of accesses	2015	2016	%Reported YoY
Fixed telephony accesses (1)	247.1	272.6	10.3%
Internet and data accesses	21.0	23.7	12.8%
Broadband	21.0	23.7	12.8%
Mobile accesses	25,018.8	25,462.7	1.8%
Prepay	10,561.4	9,701.4	(8.1%)
Contract	14,457.4	15,761.3	9.0%
M2M (2)	2,383.9	3,266.9	37.0%
<b>Final Clients Accesses</b>	<b>25,286.9</b>	<b>25,759.0</b>	<b>1.9%</b>
<b>Total Accesses</b>	<b>25,286.9</b>	<b>25,759.0</b>	<b>1.9%</b>

Notes:

(1) Includes "fixed wireless" and Voice over IP accesses.

(2) Includes 720 thousand M2M accesses on the global platform since the first quarter 2016.

In 2016, Telefónica United Kingdom maintained market momentum, as a result of the O2 brand recognition, the commercial proposal success and the customer loyalty. These factors have allowed the company to keep growing in a competitive market.

The **total access** base grew 1.9% year-on-year and stood at 25.8 million at December 31, 2016, mainly driven by a 1.8% increase in the mobile customer base.

The contract **mobile customer** base grew 9.0% year-on-year and reached 15.8 million accesses, with a broadly stable 61.9% share over the total mobile base driven by the incorporation of 720 thousand M2M accesses on the global platform, not accounted before. Net adds reached 444 thousand accesses due to the solid contribution of postpay accesses. Smartphone penetration reached 68.4% of the total mobile accesses base, up 8.0 p.p. year-on-year, driven by the continued growth of LTE customers (+36.1% year-on-year reaching 10.4 million at December 31, 2016). LTE penetration reached 47% of the total mobile access base.

The prepay access base decreased 8.1% year-on-year to 9.7 million at December 31, 2016.

The table below shows the evolution of Telefónica United Kingdom's results over the past two years:

Millions of euros

TELEFÓNICA UNITED KINGDOM	2015	2016	% Reported YoY	% Organic YoY (1)
Revenues	7,837	6,861	(12.5%)	(1.5%)
Mobile service revenues	5,778	5,121	(11.4%)	(0.3%)
Other income	170	148	(12.7%)	(1.8%)
Supplies	(3,769)	(3,226)	(14.4%)	(3.7%)
Personnel expenses	(549)	(528)	(3.9%)	1.2%
Other expenses	(1,760)	(1,546)	(12.1%)	(1.1%)
<b>OIBDA</b>	<b>1,929</b>	<b>1,709</b>	<b>(11.4%)</b>	<b>1.7%</b>
OIBDA margin	24.6%	24.9%	0.3 p.p.	0.8 p.p.
Depreciation and amortization	(1,196)	(1,090)	(8.9%)	2.6%
<b>Operating income (OI)</b>	<b>733</b>	<b>619</b>	<b>(15.5%)</b>	<b>0.2%</b>
CapEx	883	931	5.5%	18.7%
OpCF (OIBDA-CapEx)	1,046	778	(25.6%)	(12.7%)

(1) See adjustments made to calculate organic variation below.

Adjustments made to calculate organic variations

As explained above, year-on-year changes referred to in this document as "organic" or presented in "organic terms" intend to present year-on-year variations on a comparable basis.

With respect to Telefónica United Kingdom, we have made the following adjustments in order to calculate 2016/2015 variations in organic terms:

- **Exchange rate effect:** we have excluded the impact of changes in exchange rates by assuming constant average foreign exchange rates year on year. In particular, we have used the average foreign exchange rates of 2015 for both years.
- **Restructuring costs:** we have excluded the impact in 2016 and 2015 of restructuring costs, amounting to 37 and 4 million euros, respectively.

The table below shows 2016/2015 variations in reported and organic terms (the latter, calculated in accordance with the adjustments referred to above) of certain income statement and other measures, and the contribution of each item for which we have adjusted to our reported growth:

TELEFÓNICA UNITED KINGDOM 2016	YoY variation		Contribution to reported growth (percentage points)	
	% Reported YoY	% Organic YoY	Exchange rate effect	Restructuring costs
Revenues	(12.5%)	(1.5%)	(11.0)	--
Other income	(12.7%)	(1.8%)	(10.9)	--
Supplies	(14.4%)	(3.7%)	(10.7)	--
Personnel expenses	(3.9%)	1.2%	(12.0)	6.9
Other expenses	(12.1%)	(1.1%)	(11.0)	--
<b>OIBDA</b>	<b>(11.4%)</b>	<b>1.7%</b>	<b>(11.1)</b>	<b>(2.0)</b>
CapEx	5.5%	18.7%	(13.2)	--
<b>OpCF (OIBDA-CapEx)</b>	<b>(25.6%)</b>	<b>(12.7%)</b>	<b>(9.3)</b>	<b>(3.6)</b>



## Results discussion

Total **revenues** were 6,861 million euros in 2016, down by 12.5% year-on-year in reported terms mainly due to the depreciation of the pound sterling (which accounted for -11 p.p. of the year-on-year decrease). In organic terms, revenues decreased by 1.5% year-on-year due mainly to lower handset sales, which declined by 8.0% year-on-year.

**Mobile service revenues** totaled 5,121 million euros in 2016, down by 11.4% year-on-year in reported terms due mainly to the depreciation of the pound sterling (which accounted for -11.1 p.p. of the year-on-year decrease). Excluding this impact, mobile service revenues decreased by 0.3% due to the “Refresh” commercial model as well as the low interconnection fares. Under the Refresh commercial model, certain revenues related to handset are not considered as mobile service revenues, but as handset revenues.

Mobile **ARPU** decreased by 12.1% year-on-year in reported terms due mainly to the depreciation of the pound sterling. In organic terms, **ARPU** went down by 1.1% adversely affected by the “Refresh” model, while data ARPU increased by 2.3%. In the “Refresh” model handset revenues are not considered as mobile service revenues, but as handset revenues and ARPU does not reflect the handset revenues.

TELEFÓNICA UNITED KINGDOM	2015	2016	%YoY	%Organic YoY
Voice Traffic (millions of minutes)	90,527	93,306	3.1%	3.1%
<b>ARPU (EUR)</b>	<b>19.4</b>	<b>17.0</b>	<b>(12.1%)</b>	<b>(1.1%)</b>
Prepay	7.7	7.5	(3.1%)	9.7%
Contract (1)	33.5	28.8	(14.1%)	(3.5%)
<b>Data ARPU (EUR)</b>	<b>11.3</b>	<b>10.3</b>	<b>(9.0%)</b>	<b>2.3%</b>
% non-SMS over data revenues	59.4%	61.4%	2.0 p.p.	2.0 p.p.

Notes:

(1) Excludes M2M.

**OIBDA** totaled 1,709 million euros in 2016, down 11.4% year-on-year in reported terms, as a result mainly of the depreciation of the sterling pound. In organic terms, OIBDA increased by 1.7% year-on-year due to the reduction of costs offset by lower service revenues.

The **OIBDA margin** stood at 24.9% in 2016, with an increase of 0.3 p.p. in reported terms compared to 2015. In organic terms, OIBDA margin stood at 25.5%.

## TELEFÓNICA GERMANY

The below table shows the evolution of accesses in Telefónica Germany over the past two years as of December 31 of such years:

### ACCESSES

Thousands of accesses	2015	2016	%Reported YoY
Fixed telephony accesses (1)	1,997.8	2,010.3	0.6%
Internet and data accesses	2,330.6	2,324.5	(0.3%)
Broadband	2,098.0	2,104.0	0.3%
VDSL	516.8	805.5	55.9%
Mobile accesses	43,062.8	44,320.7	2.9%
Prepay	23,979.4	23,784.0	(0.8%)
Contract	19,083.4	20,536.6	7.6%
M2M	632.0	787.8	24.6%
<b>Final Clients Accesses</b>	<b>47,391.2</b>	<b>48,655.5</b>	<b>2.7%</b>
<b>Wholesale Accesses</b>	<b>972.0</b>	<b>691.0</b>	<b>(28.9%)</b>
<b>Total Accesses</b>	<b>48,363.2</b>	<b>49,346.4</b>	<b>2.0%</b>

Notes:

(1) Includes "fixed wireless" and Voice over IP accesses.

During 2016 Telefónica Germany maintained market momentum with the launch of a new Premium portfolio called "O2 Free" on October 5, 2016, which underpins the company's data monetization strategy, offering more content at a higher price with a clear focus on retaining and developing the premium customer base. Competitive pressure in the non-premium segment is showing some signs of improvement. At the same time, Telefónica Germany delivered on its integration milestones, generating additional savings in line with its synergy targets.

The **total access** base grew 2.0% year-on-year and stood at 49.3 million at December 31, 2016, mainly driven by a 2.9% increase in the mobile base (which reached 44.3 million).

The contract **mobile customer** base grew 8% year-on-year and reached 20.5 million accesses, with a broadly stable 46.3% share over the total mobile base. Net adds reached 1.5 million accesses due to the solid contribution of partners (second brands). Smartphone penetration reached 59% of the total mobile access base, up 5.2 p.p. year-on-year driven by the continued growth of LTE customers (+53% year-on-year reaching 12.1 million at December 31, 2016) which reflects the continuous demand by customers for high speed mobile data access. LTE penetration reached 27% of the total mobile access base.

The prepay access base remained broadly stable year-on-year (-0.8%) at 23.8 million. The prepay segment lost 195 thousand accesses in 2016 due to the partner segment.

The retail broadband access loss trend continued to improve, with 6 thousand net additions in 2016. VDSL registered 289 thousand net additions (+60% year-on-year) in 2016 and continued to benefit from the continued strong demand, while the wholesale DSL customer base continued to fall due to the planned dismantling of the legacy infrastructure.

The table below shows the evolution of Telefónica Germany's results over the past two years:

Millions of euros				
TELEFÓNICA GERMANY	2015	2016	% Reported YoY	% Organic YoY (1)
Revenues	7,888	7,503	(4.9%)	(4.9%)
<b>Mobile Business</b>	<b>6,832</b>	<b>6,498</b>	<b>(4.9%)</b>	<b>(4.9%)</b>
Mobile service revenues	5,532	5,437	(1.7%)	(1.7%)
<b>Fixed Business</b>	<b>1,043</b>	<b>981</b>	<b>(5.9%)</b>	<b>(5.9%)</b>
Other income	265	146	(45.0%)	(9.3%)
Supplies	(2,712)	(2,452)	(9.6%)	(9.6%)
Personnel expenses	(655)	(646)	(1.4%)	(7.9%)
Other expenses	(2,928)	(2,757)	(5.8%)	(5.0%)
<b>OIBDA</b>	<b>1,858</b>	<b>1,794</b>	<b>(3.4%)</b>	<b>2.9%</b>
OIBDA margin	23.6%	23.9%	0.4 p.p.	1.9 p.p.
Depreciation and amortization	(2,128)	(2,211)	3.9%	3.9%
<b>Operating income (OI)</b>	<b>(270)</b>	<b>(417)</b>	<b>54.2%</b>	<b>9.8%</b>
CapEx	2,230	1,108	(50.3%)	6.8%
OpCF (OIBDA-CapEx)	(372)	686	c.s.	(2.1%)

(1) See adjustments made to calculate organic variation below.

#### Adjustments made to calculate organic variations

As explained above, year-on-year changes referred to in this document as "organic" or presented in "organic terms" intend to present year-on-year variations on a comparable basis.

With respect to Telefónica Germany, we have made the following adjustments in order to calculate 2016/2015 variations in organic terms:

- **Restructuring costs:** we have excluded the impact of restructuring costs associated with simplification processes implemented in Germany. In 2016, restructuring costs had an 89 million euros impact on OIBDA. In 2015, restructuring costs had a 74 million euros impact on OIBDA.
- **Adjustments to the final purchase price of E-Plus:** in 2015 we have excluded the result from the difference between the preliminary purchase price of E-Plus (as estimated at the end of the valuation period) and the final purchase price agreed with KPN, totaling 104 million euros (which had 102 million euros positive impact on OIBDA, net of costs related to the acquisition).
- **Spectrum acquisition:** the CapEx organic variation exclude spectrum acquisition, which in 2015 amounted to 1.198 million euros (6 million euros in 2016).

The table below shows 2016/2015 variations in reported and organic terms (the latter, calculated in accordance with the adjustments referred to above) of certain income statement measures and CapEx and the contribution of each item for which we have adjusted to our reported growth:

YoY variation			Contribution to reported growth (percentage points)		
TELEFÓNICA GERMANY 2016					
	% Reported YoY	% Organic YoY	Restructuring costs	Adjustments to the final purchase price of E-Plus	Spectrum acquisition
Revenues	(4.9%)	(4.9%)	--	--	--
Other income	(45.0%)	(9.3%)	--	(39.4)	--
Supplies	(9.6%)	(9.6%)	--	--	--
Personnel expenses	(1.4%)	(7.9%)	6.4	--	--
Other expenses	(5.8%)	(5.0%)	(0.9)	(0.1)	--
<b>OIBDA</b>	<b>(3.4%)</b>	<b>2.9%</b>	<b>(0.8)</b>	<b>(5.5)</b>	<b>--</b>
CapEx	(50.3%)	6.8%	--	--	(53.5)
<b>OpCF (OIBDA-CapEx)</b>	<b>c.s.</b>	<b>(2.1%)</b>	<b>4.1</b>	<b>27.4</b>	<b>n.m.</b>

## Results discussion

Total **revenues** were 7,503 million euros in 2016, down 4.9% year-on-year in reported terms due mainly to the lower service revenues and handset sales.

**Mobile service revenues** totaled 5,437 million euros in 2016, decreasing 1.7% year-on-year in reported terms due mainly to the impact of termination and roaming tariffs, the increasing share of partner segment (second brands) within the customer base and the competitive pressure. Telefónica Germany continued to focus on data revenues, which increased by 5.3% and accounted for 55% of mobile service revenues in 2016. Non-P2P SMS data revenues amounted to 2,300 million euros (increasing +13.1% year-on-year) and non-P2P SMS data revenues accounted for 76.9% of the total data revenues (+5.3 p.p. year-on-year).

**Fixed revenues** were 981million euros in 2016 (down 5.9% year-on-year), due to lower wholesale revenues driven by the planned decommissioning of the legacy ULL platform.

**Mobile ARPU** was 10.3 euros in 2015 (down 3.7% year-on-year), while contract ARPU stood at 16.5 euros (down 4.1% year-on-year), as a result of the high pricing pressure in a competitive market, higher share of wholesale customers in the customer base and the consequent change in the weight of retail to wholesale. Data ARPU was 5.7 euros (+3.4% year-on-year).

TELEFÓNICA GERMANY	2015	2016	%YoY
Voice Traffic (millions of minutes)	117,877	113,896	(3.4%)
<b>ARPU (EUR)</b>	<b>10.7</b>	<b>10.3</b>	<b>(3.7%)</b>
Prepay	5.8	5.7	(1.6%)
Contract (1)	17.2	16.5	(4.1%)
<b>Data ARPU (EUR)</b>	<b>5.5</b>	<b>5.7</b>	<b>3.4%</b>
% non-SMS over data revenues	71.6%	76.9%	5.3 p.p.

Notes:

(1) Excludes M2M.

**OIBDA** totaled 1,794 million euros in 2016, decreasing 3.4% year-on-year in reported terms as a result mainly of the previously mentioned positive impact of the final purchase price of E-plus in 2015 (-5.5 p.p.)

and the lower restructuring costs recorded in 2016 (-0.8 p.p.). In organic terms, OIBDA grew by 2.9% year-on-year, driven by the synergies captured in integration (approximately 150 million euros in 2016) mainly by employees restructuring and infrastructure dismantling.

The **OIBDA margin** stood at 23.9% in reported terms for 2016, up 0.4 p.p. compared to 2015 (+1.9 p.p. in organic terms).

## TELEFÓNICA BRAZIL

The below table shows the evolution of accesses in Telefónica Brazil over the past two years as of December 31 of such years:

### ACCESSES

Thousands of accesses	2015	2016	%Reported YoY
Fixed telephony accesses (1)	14,654.5	14,338.4	(2.2%)
Internet and data accesses	7,195.5	7,383.2	2.6%
Broadband	7,129.5	7,311.0	2.5%
Fiber and VDSL	3,779.9	4,171.0	10.3%
Mobile accesses	73,261.3	73,769.8	0.7%
Prepay	42,194.4	40,387.2	(4.3%)
Contract	31,066.9	33,382.6	7.5%
M2M	4,234.7	5,005.1	18.2%
Pay TV	1,787.9	1,712.7	(4.2%)
<b>Final Clients Accesses</b>	<b>96,899.3</b>	<b>97,204.2</b>	<b>0.3%</b>
<b>Wholesale Accesses</b>	<b>22.3</b>	<b>17.9</b>	<b>(19.5%)</b>
<b>Total Accesses</b>	<b>96,921.5</b>	<b>97,222.2</b>	<b>0.3%</b>

Notes:

(\*) There were no variations in organic terms during the period.

(1) Includes "fixed wireless" and Voice over IP accesses.

Telefónica Brazil closed the year 2016 improving its competitive position in the mobile as well as in the fixed market. In the mobile business, leadership has been maintained in the higher value segments, which permitted the operator to capture mobile market revenue growth in 2016. In the fixed business, the transformation towards fiber and Pay-TV was strengthened after the integration of GVT in May 2015.

Revenues and OIBDA evolution was positively supported by the acceleration of mobile data and the good evolution of fiber and Pay-TV. Additionally, Telefónica Brazil carried out costs control measures and generated benefits from the synergies with GVT that offset the adverse macroeconomic situation in Brazil.

However, results in 2016 were adversely affected by the interconnection tariff reduction in the mobile business (-33.8%) and in the retail fixed-mobile tariff (-20.6%), fixed-local (-65.9%) and fixed-interurban (-21.3%) since February 25, 2016.

Telefónica Brazil reached 97.2 million **accesses** at December 31, 2016, up 0.3% compared with December 2015.

In the **mobile business**, the strategic focus remained on gaining and retaining high value customers, reaching a market share of 42.1% in the contract segment as of December 31, 2016 (Source: Anatel), preserving the leadership. Telefónica Brazil maintained its market leadership in terms of total accesses with a market share of 30.2% as of December 2016 (source: Anatel), driven by the contract clients growth (7.5% year-on-year), and offset the fall in prepaid clients (-4.3% year-on-year). An improvement has been experienced on the "familiar plans", giving the chance to proceed to data sharing among the

same family, as well as progress in online client assistance through “meu vivo”, acclaiming one of Vivo’s strengths and continuing with constant upgrades.

In its **fixed business**, Telefónica Brazil maintained its strategic focus on fiber deployment, with 17 million premises passed with fiber at December 31, 2016 and 4.3 million homes connected. Traditional accesses decreased 2.2% due to the fixed-mobile substitution. Retail broadband accesses totaled 7.3 million accesses at the end of 2016, increasing 2.5% year-on-year. Among them, 59% accesses were connected with FTCC. Pay TV customers reached 1.7 million as of December 31, 2016, down 4.2% in reported terms due mainly to the macroeconomic situation and a commercial strategy based in value clients gaining. IPTV accesses increased in relevance representing 13% of total Pay TV accesses.

The table below shows the evolution of Telefónica Brazil’s results over the past two years:

Millions of Euros				
TELEFÓNICA BRAZIL	2015	2016	% Reported YoY	% Organic YoY (1)
Revenues	11,060	11,097	0.3%	0.9%
<b>Mobile Business</b>	<b>6,906</b>	<b>6,669</b>	<b>(3.4%)</b>	<b>1.7%</b>
Mobile service revenues	6,495	6,357	(2.1%)	3.1%
<b>Fixed Business</b>	<b>4,154</b>	<b>4,428</b>	<b>6.6%</b>	<b>(0.2%)</b>
Other income	416	348	(16.3%)	(16.6%)
Supplies	(2,568)	(2,249)	(12.4%)	(10.9%)
Personnel expenses	(1,042)	(1,167)	11.9%	3.1%
Other expenses	(4,293)	(4,315)	0.5%	2.0%
<b>OIBDA</b>	<b>3,573</b>	<b>3,714</b>	<b>3.9%</b>	<b>5.3%</b>
OIBDA margin	32.3%	33.5%	1.2 p.p.	1.4 p.p.
Depreciation and amortization	(1,916)	(2,038)	6.4%	2.5%
<b>Operating income (OI)</b>	<b>1,657</b>	<b>1,676</b>	<b>1.1%</b>	<b>8.8%</b>
CapEx	2,105	2,138	1.6%	(2.9%)
OpCF (OIBDA-CapEx)	1,468	1,576	7.3%	17.8%

(1) See adjustments made to calculate organic variation below.

#### Adjustments made to calculate organic variations

As explained above, year-on-year changes referred to in this document as “organic” or presented in “organic terms” intend to present year-on-year variations on a comparable basis.

With respect to Telefónica Brazil, we have made the following adjustments in order to calculate 2016/2015 variations in organic terms:

- **Exchange rate effect:** we have excluded the impact of changes in exchange rates by assuming constant average foreign exchange rates year on year. In particular, we have used the average foreign exchange rates of 2015 for both years.
- **Changes in the scope of consolidation:** GVT was included in Telefónica’s consolidation perimeter in May 2015. In order to exclude the impact of this change in the perimeter for the calculation of organic variations, the 2015 comparative figures include GVT’s results from January 1 to April 30, 2015.
- **Restructuring costs:** we have excluded the impact of restructuring costs associated with the simplification processes implemented in Telefónica Brazil. In 2016, these restructuring costs totaled 40 million euros. In 2015, these restructuring costs totaled 7 million euros

- **Results of tower sales:** the results attributable to the sale of towers have been excluded (10 million euros in 2015).
- **Spectrum acquisition:** the impact of spectrum acquisitions has been excluded (48 million euros in 2016).

The table below shows 2016/2015 variations in reported and organic terms (the latter, calculated in accordance with the adjustments referred to above) of certain income statement and other measures, and the contribution of each item for which we have adjusted to our reported growth:

TELEFÓNICA BRAZIL 2016	YoY variation		Contribution to reported growth (percentage points)				
	% Reported YoY	% Organic YoY	Exchange rate effect	Perimeter change	Restructuring costs	Towers sales	Spectrum acquisition
Revenues	0.3%	0.9%	(5.2)	4.6	--	--	--
Other income	(16.3%)	(16.6%)	4.4	(7.9)	--	2.3	--
Supplies	(12.4%)	(10.9%)	(4.6)	3.4	--	--	--
Personnel expenses	11.9%	3.1%	(5.8)	11.0	3.3	--	--
Other expenses	0.5%	2.0%	(5.2)	3.7	--	--	--
<b>OIBDA</b>	<b>3.9%</b>	<b>5.3%</b>	<b>(5.4)</b>	<b>5.1</b>	<b>(1.0)</b>	<b>(0.3)</b>	--
CapEx	1.6%	(2.9%)	(5.3)	7.6	--	--	2.4
<b>OpCF (OIBDA- CapEx)</b>	<b>7.3%</b>	<b>17.8%</b>	<b>(5.6)</b>	<b>1.4</b>	<b>(2.4)</b>	<b>(0.7)</b>	<b>(3.5)</b>

## Results discussion

**Revenues** totaled 11,097 million euros in 2016, up 0.3% in reported terms and 0.9% year-on-year in organic terms, due mainly to the depreciation of the Brazilian real (which accounted for -5.2 p.p. of the evolution) and the consolidation of GVT (+4.6 p.p.). In organic terms, the year-on-year variation of 0.9% was principally due to the good evolution in the mobile business (+1.7% year-on-year), which was partially offset by the impact of the regulatory interconnection tariff reduction, impacting resulting in a reduction in fixed revenues, that decreased by 0.2%.

- **Revenues from the mobile business** totaled 6,669 million euros in 2016, down 3.4% in reported terms due mainly to the depreciation of the Brazilian real (which accounted for -5.0 p.p. of the evolution). In organic terms, revenues from the mobile business increased by 1.7% due to the positive evolution of service revenues (+3.1% year-on-year) as a result of the good performance of outbound revenues, which in turn increased as a result of an increase in the customer base and the increased proportion of data revenues. This offsets the decrease in inbound revenues because of the fall in interconnection, due to the decrease of tariffs, and prepaid revenues associated with the customer base fall. Additionally, handsets' revenues slow down 23.9% in reported terms due to a lower commercial activity.
- **Fixed telephony revenues** totaled 4,428 million euros, up by 6.6% in reported terms due mainly to the impact of the consolidation of GVT (+12.3 p.p.) and partially offset by depreciation of the Brazilian real (which accounted for -5.6 p.p. of the evolution). In organic terms, revenues were down by 0.2%, mainly due to the regulatory impact of the decrease of the fixed-mobile and fixed-fixed tariffs that compensate the increase in broadband and new services revenues, which were up by 6.5% year-on-year in organic terms supported by the increase in fiber and Pay TV revenues.

The mobile **ARPU** increased 13.3% year-on-year in reported terms due mainly to the better quality of the customer base and the expansion of data revenues that compensate the depreciation of the Brazilian real. In organic terms, it increased 19.3% year-on-year as a consequence of the higher data ARPU which more than offset the negative impact of the reduction in the mobile termination rates. We believe the high quality of the client base is reflected in an increase in the outbound ARPU and the 25.3% growth in the data ARPU.

TELEFÓNICA BRAZIL	2015	2016	%YoY	%Local Currency YoY
Voice Traffic (millions of minutes)	379,430	373,074	(1.7%)	(1.7%)
<b>ARPU (EUR)</b>	<b>6.3</b>	<b>7.1</b>	<b>13.3%</b>	<b>19.3%</b>
Prepay	3.2	3.4	5.4%	11.2%
Contract (1)	13.3	12.9	(2.9%)	2.4%
<b>Data ARPU (EUR)</b>	<b>2.9</b>	<b>3.5</b>	<b>19.1%</b>	<b>25.3%</b>
% non-SMS over data revenues	82.9%	88.4%	5.5 p.p.	5.5 p.p.

Notes:

(1) Excludes M2M.

**OIBDA** stood at 3,714 million euros in 2016, up 3.9% in reported terms. This evolution was affected by the recognition of a 40 million euros related to a restructuring personnel plan in 2016 compared with the 7 million euros provision registered in 2015, the positive impact from the expired payment obligation (98 million euros) in 2015, the negative impact of the depreciation of the Brazilian real (-5.4 p.p.) and the consolidation of GVT (+5.1 p.p.). In organic terms, the year-on-year increase was 5.3% due to revenue improvement and cost efficiency compensating a worse macro scenario with higher inflation, more devaluation and greater insolvencies provision rates. Personnel expenses totaled 1,167 million euros in 2016, up 11.9% in reported terms as result mainly of the consolidation of GVT, which was partially offset by the depreciation of the Brazilian real. In organic terms, personnel expenses increased by 3.1% year-on-year due to higher social benefits and the internalization of network contractors that compensates benefits from restructuring plans and voluntary redundancy programs in 2016. In addition, supplies costs fell (-10.9% in organic terms) thanks to the positive impact of the interconnection tariff reduction and lesser devices consumption (commercial activity focused on profitable clients).

**The OIBDA margin** stood at 33.5% in reported terms for 2016, up 1.2 p.p. compared to 2015.



## TELEFÓNICA HISPANOAMÉRICA

The below table shows the evolution of accesses in Telefónica Hispanoamérica over the past two years as of December 31 of such years:

### ACCESSES

Thousands of accesses	2015	2016	%Reported YoY
Fixed telephony accesses (1)	12,829.8	11,938.6	(6.9%)
Internet and data accesses	5,667.8	5,707.9	0.7%
Broadband	5,610.4	5,570.7	(0.7%)
Mobile accesses	113,302.7	115,284.5	1.7%
Prepay	88,332.8	89,461.2	1.3%
Contract	24,969.8	25,823.3	3.4%
M2M	2,296.9	2,561.3	11.5%
Pay TV	2,812.2	2,919.2	3.8%
<b>Final Clients Accesses</b>	<b>134,612.4</b>	<b>135,850.3</b>	<b>0.9%</b>
<b>Wholesale Accesses</b>	<b>30.9</b>	<b>66.5</b>	<b>115.6%</b>
<b>Total Accesses T. Hispanoamérica</b>	<b>134,643.3</b>	<b>135,916.8</b>	<b>0.9%</b>

Notes:

(1) Includes "fixed wireless" and Voice over IP accesses.

**Total accesses** reached 135.9 million at December 31, 2016 (+0.9% year-on-year).

**Mobile accesses** totaled 115.3 million customers and grew 1.7% year-on-year, highlighting the higher quality of the customer base.

- In the contract segment, accesses grew 3.4% year-on-year. Growth was particularly strong in Argentina (+3.3%), Chile (+7.5%) and Colombia (+6.0%). Annual net adds reached 854 thousand customers, mainly due to the contribution of Argentina (+231 thousand accesses), Chile (+218 thousand accesses) and Colombia (+203 thousand accesses), benefitting from a successful strategy of migrations (from prepay to contract), as well as a higher amount of gross adds.
- In the prepay segment, accesses grew 1.3% year-on-year, with net adds of 1.1 million customers. Growth was driven mainly by Mexico (+1.5 million accesses), Colombia (+0.6 million accesses) and Central America (+0.8 million accesses), compensating the negative net adds in other markets like Peru (-1.2 million accesses) and Chile (-1.0 million accesses). Such increases were explained by strong price competition in the prepay segment, not followed by Movistar to avoid harming the quality levels of the network (avoiding reduced price offers), along with the focus on attracting high value customers that allowed the acceleration of migration processes from prepay to contract.
- The smartphone customer base grew 14.7% year-on-year to 46.1 million accesses, with a penetration over mobile accesses of 41.3% (+4.7 p.p. year-on-year), mainly due to the growth in all countries of the region. At the same time, 4G accesses continued growing, reaching 15.5 million accesses at the end of the year.

**Traditional fixed business accesses** stood at 11.9 million at December 31, 2016 (-6.9% year-on-year) with negative net adds of 0.9 million customers, affected by the erosion of traditional fixed business in the region, including Argentina (-4.0% year-on-year), Peru (-5.8% year-on-year), Chile (-5.4% year-on-year) and Colombia (-5.4% year-on-year).

**Broadband accesses** totaled 5.6 million at December 31, 2016 (-0.7% year-on-year), due to negative net adds in Colombia (-3.6%) and Argentina (-1.6%), which were not enough to offset the positive

performance of Peru (+2.4%). The penetration of fixed broadband accesses over traditional fixed business accesses was 46.7% at December 31, 2016 (+2.9 p.p. year-on-year). There was progressive migration towards data plans with higher speeds, with 62.1% of broadband accesses having a speed over 4Mb at December 31, 2016 (+9 p.p. year-on-year).

**TV accesses** totaled 2.9 million (+3.8% year-on-year), with net adds of 107 thousand customers as a result of an improvement in all the countries in the region that offer the service. Growth was particularly positive in Peru (+6.2%), Colombia (+5.9%) and Chile (+2.5%).

The table below shows the evolution of Telefónica Hispanoamérica's results over the past two years:

Millions of euros				
TELEFÓNICA HISPANOAMÉRICA	2015	2016	% Reported YoY	% Organic YoY (1)
Revenues	14,387	12,579	(12.6%)	7.5%
<b>Mobile Business</b>	<b>10,347</b>	<b>8,882</b>	<b>(14.2%)</b>	<b>6.3%</b>
Mobile service revenues	9,160	7,918	(13.6%)	7.0%
<b>Fixed Business</b>	<b>4,070</b>	<b>3,732</b>	<b>(8.3%)</b>	<b>12.2%</b>
Other income	347	274	(21.3%)	(10.4%)
Supplies	(4,176)	(3,704)	(11.3%)	4.4%
Personnel expenses	(1,686)	(1,584)	(6.1%)	22.8%
Other expenses	(4,516)	(4,088)	(9.5%)	7.0%
<b>OIBDA</b>	<b>4,356</b>	<b>3,477</b>	<b>(20.2%)</b>	<b>3.9%</b>
OIBDA margin	30.3%	27.6%	(2.6 p.p.)	(1.0 p.p.)
Depreciation and amortization	(2,241)	(2,190)	(2.3%)	7.5%
<b>Operating income (OI)</b>	<b>2,115</b>	<b>1,287</b>	<b>(39.1%)</b>	<b>0.5%</b>
CapEx	3,060	2,613	(14.6%)	6.5%
OpCF (OIBDA-CapEx)	1,296	864	(33.3%)	(0.3%)

(1) See adjustments made to calculate organic variation below.

### Adjustments made to calculate organic variations

As explained above, year-on-year changes referred to in this document as "organic" or presented in "organic terms" intend to present year-on-year variations on a comparable basis.

With respect to Telefónica Hispanoamérica, we have made the following adjustments in order to calculate 2016/2015 variations in organic terms:

- **Exchange rate effects and hyperinflationary adjustments in Venezuela:** we have excluded the impact of changes in exchange rates by assuming constant average foreign exchange rates year on year. In particular, we have used the average foreign exchange rates of 2015 for both years. We have also excluded the impact of hyperinflationary adjustments in Venezuela by reversing such adjustments.
- **Restructuring costs:** we have excluded the impact of restructuring costs in 2016 and 2015, amounting to 84 and 38 million euros, respectively.
- **Results of tower sales:** the results attributable to the sale of towers have been excluded (1 million euros in 2016 and 18 million euros in 2015).
- **Spectrum acquisition:** the impact of spectrum acquisitions has been excluded in 2016 (284 million euros, corresponding to Peru) and 2015 (338 million euros, mainly corresponding to Argentina and Ecuador).

- **Capital gains and losses on sales of companies:** gains and losses obtained from the sale of companies are excluded to calculate organic variations. In 2016, the profit from the sale of Telefé for 15 million euros was excluded.
- **Goodwill impairments:** Impairment losses from goodwill in consolidation are excluded to calculate organic variations. In 2016, the impairment loss on the goodwill assigned to Telefónica Venezolana and Telefónica Móviles Mexico amounting to 124 and 91 million euros, respectively.

The table below shows 2016/2015 variations in reported and organic terms (the latter, calculated in accordance with the adjustments referred to above) of certain income statement and other measures, and the contribution of each item for which we have adjusted to our reported growth:

YoY variation			Contribution to reported growth (percentage points)					
TELEFÓNICA HISPANOAMÉRICA 2016	% Reported YoY	% Organic YoY	Exchange rate effect and hyperin- flation	Restruc- turing costs	Towers sales	Spectrum acquisition	Capital Gains/losses on sale of companies	Impairments
Revenues	(12.6%)	7.5%	(20.0)	--	--	--	--	--
Other income	(21.3%)	(10.4%)	(10.7)	--	(5.0)	--	4.2	--
Supplies	(11.3%)	4.4%	(15.6)	--	--	--	--	--
Personnel expenses	(6.1%)	22.8%	(32.4)	4.2	--	--	--	--
Other expenses	(9.5%)	7.0%	(21.2)	--	--	--	--	4.8
<b>OIBDA</b>	<b>(20.2%)</b>	<b>3.9%</b>	<b>(17.5)</b>	<b>(1.6)</b>	<b>(0.4)</b>	--	<b>0.3</b>	<b>(4.9)</b>
CapEx	(14.6%)	6.5%	(19.1)	--	--	(1.2)	--	--
<b>OpCF (OIBDA- CapEx)</b>	<b>(33.3%)</b>	<b>(0.3%)</b>	<b>(13.6)</b>	<b>(5.5)</b>	<b>(1.3)</b>	<b>2.9</b>	<b>1.1</b>	<b>(16.6)</b>

## Results discussion

**Revenues** amounted to 12,579 million euros in 2016, decreasing 12.6% year-on-year in reported terms due to the foreign exchange effects and the hyperinflation in Venezuela (-20.0 p.p.). Revenues increased 7.5% year-on-year in organic terms mainly due to the growth in data revenues (mobile and fixed) and the growth of the customer base, higher data usage per customer and higher data penetration.

- **Mobile service revenues** reached 7,918 million euros in 2016 and decreased by 13.6% year-on-year in reported terms. This decrease was mainly driven by the foreign exchange effects and the hyperinflation in Venezuela (which decreased growth by 20.6 p.p. of the year-on-year variation). Excluding these effects, these revenues grew by 7.0% principally as a result of the increase of service revenues in Argentina (18.4%). Mobile service revenues performance by country was as follows:
  - In Argentina: mobile service revenues amounted to 1,628 million euros in 2016, decreasing 25.8% year-on-year in reported terms. This decrease was mainly due to the exchange rate effect, reducing growth by 44.2 p.p. Excluding this effect, revenues increased by 18.4% due to the data revenues growth leveraged on the higher 4G customer base, permitting data consumption acceleration and commercial offers adapted to the inflationary environment.
  - In Mexico: mobile service revenues reached 1,246 million euros in 2016, decreasing 19% year-on-year in reported terms. In local currency, these revenues decreased 4.9%, mainly due to lower prepaid revenues as a result of strong competition and due to the

regulatory impact, which was partially offset by a satisfactory performance in wholesale service.

- In Chile: service revenues reached 1,103 million euros in 2016, decreasing 6.3% year-on-year in reported terms mainly due to the foreign exchange effect (-3.1 p.p.). In local currency, these revenues decreased by 3.2% affected by lower prepaid revenues as well as lower interconnection rates.
- In Peru: mobile service revenues reached 1,206 million euros in 2016, decreasing 13.2% year-on-year in reported terms mainly due to the foreign exchange effect (-5 p.p.). In local currency these revenues decreased by 8.2%, affected by the reduction of prepaid and contract revenues due to higher aggressiveness in the market, resulting in lower ARPU's.
- **Data revenues** in the segment reached 3,511 million euros in 2016 and decreased 4.8% year-on-year in reported terms mainly due to foreign exchange effects and the hyperinflation in Venezuela (-24.4 p.p.). Excluding these effects, these revenues grew 19.6% year-on-year mainly due to the increase in data revenues in most of the countries of the region and by the higher data penetration which grew from 41.3% in 2015 to 46.1% during 2016.
- **Fixed business revenues** reached 3,732 million euros in 2016, and decreased 8.3% in reported terms. Excluding the foreign exchange effects and the hyperinflation in Venezuela (which decreased growth by 20.5p.p.) these revenues grew by 12.2% due to the increase in broadband and new services revenues (+21.6%). Revenues from broadband and new services, accounted for 53.7% of fixed revenues (+3.0 p.p. year-on-year). The growth was particularly notable in Argentina (44.7%), Colombia (17.4%) and Chile (11.7%) with a strong growth in broadband revenues due to the higher quality of the customer base as well as the tariff adjustment.

**OIBDA** reached 3,477 million euros in 2016, decreasing 20.2% in reported terms, negatively affected by the goodwill impairment in Mexico and Venezuela and restructuring costs in 2016 and 2015 previously mentioned, and offset by the generated capital gain from the Telefónica sale. Excluding these adjustments, exchange rate effects and hyperinflation in Venezuela, OIBDA increased 3.9% in organic terms. This growth is mainly due to the good evolution in revenues and higher commercial efficiencies that offset higher interconnection, content and network costs, up principally due to the devaluation in certain countries in the region. Energy, electricity and call center costs also increased during 2016.

Below additional information by country.

- Argentina: OIBDA reached 797 million euros in December 2016, decreasing 20.7% in reported terms. In local currency, OIBDA increased by 26.6%, mainly due to the revenue growth as well as to lower commercial costs recorded in 2016, as a result of lower commercial activity and greater commercial efficiency.
- Chile: OIBDA reached 704 million euros in December 2016, decreasing 7.4% in reported terms mainly due to the exchange rate evolution (-3 p.p.). In local currency, OIBDA decreased by 4.4%, explained by the decrease in mobile service revenues.
- Peru: OIBDA reached 782 million euros in December 2016, decreasing 17.1% in reported terms mainly due to the exchange rate evolution. In local currency, OIBDA decreased by 12.3%, as the efforts in costs savings were insufficient to compensate higher interconnection costs associated with higher traffic, and more than offset the revenue increase.
- Colombia: OIBDA reached 464 million euros in December 2016, decreasing 15% in reported terms mainly due to the exchange rate evolution. In local currency, OIBDA decreases 5.1%

year-on-year due to higher interconnection costs associated to the successful offer “Todo Destino”.

The **OIBDA margin** was 27.6% in 2016, decreasing 2.6 p.p. in reported terms. This decrease is affected by the margin reduction in Chile (-1.7 p.p.), Peru (-2.8 p.p.), Colombia (-3.3 p.p.) and Mexico (-5.0 p.p.), reflecting a higher commercial effort focused on higher value segments.

## 2015/2014 Consolidated results

In this section, we discuss changes in the Group's consolidated income statements for 2015 and 2014. The consolidated income statement data for the years ended December 31, 2015 and 2014 set forth below has been retrospectively amended, in order to cease to present our operations in the United Kingdom as a discontinued operation.

As explained above, the consolidated income statement for the year ended December 31, 2015 has been amended to retroactively show the reclassification of Telefónica United Kingdom's results as continuing operations. Therefore, the results below differ from the results previously published for such period. The segmented financial information shown below has been amended for 2015 as discussed above.

Telefónica's **total accesses** totaled 347.5 million as of December 31, 2015. Telefónica United Kingdom customers have been included in the 2014 and 2015 customer base, since we have classified Telefónica United Kingdom and its operations as continuing operations. Group accesses increased 1.9% year-on-year, as a result mainly of the additional accesses gained following the purchase of GVT by Telefónica Brazil and DTS in Telefónica Spain and the growth in accesses in Telefónica Hispanoamérica, Telefónica Germany and Telefónica United Kingdom. If we consider the accesses from GVT and DTS as of December 31, 2014 to make both years comparable, accesses would have decreased by 0.8% affected, in part, by prepaid disconnections in Telefónica Brazil (which resulted in the disconnection of 11.5 million accesses in 2015 and 1.6 million accesses in 2014). In 2015, commercial activity increased based on high value customers, resulting in growth of the contract mobile segment (smartphones and LTE), fiber and Pay TV. Accesses in Telefónica Hispanoamérica (38.7% of the Group's total as of December 31, 2015) increased by 2.3% year-on-year, Telefónica United Kingdom (7.3% of the Group's total as of December 31, 2015) increased by 2.3% year-on-year, while accesses in Telefónica Germany (13.9% of the Group's total) increased by 1.5% year-on-year.

The below table shows the evolution of accesses 2014 and 2015:

### ACCESSES

Thousands of accesses	2014	2015	%Reported YoY	%Organic YoY (1)
Fixed telephony accesses (2)	36,830.0	39,734.9	7.9%	(3.0%)
Internet and data accesses	18,151.7	21,365.3	17.7%	1.3%
Broadband (3)	17,668.5	20,971.3	18.7%	1.8%
Fiber (4)	1,755.0	6,100.3	247.6%	29.9%
Mobile accesses	274,458.0	272,103.9	(0.9%)	(0.9%)
Prepay	175,720.4	167,845.1	(4.5%)	(4.5%)
Contract	98,737.6	104,258.8	5.6%	5.6%
M2M	9,787.4	11,526.3	17.8%	17.8%
Pay TV (5)	5,087.2	8,271.6	62.6%	12.0%
<b>Final Clients Accesses</b>	<b>334,526.9</b>	<b>341,475.6</b>	<b>2.1%</b>	<b>(0.7%)</b>
<b>Wholesale Accesses</b>	<b>6,521.6</b>	<b>6,062.8</b>	<b>(7.0%)</b>	<b>(7.0%)</b>
<b>Total Accesses</b>	<b>341,048.5</b>	<b>347,538.4</b>	<b>1.9%</b>	<b>(0.8%)</b>

Notes:

- T. Ireland customers are excluded since the third quarter 2014. Accesses include E-Plus customers since the fourth quarter 2014 and GVT and DTS customers since May 1 2015.

(1) In order to calculate organic changes, we have added the accesses of DTS and GVT as of December 31, 2014 to our accesses as of such date.

(2) Includes "fixed wireless" and Voice over IP accesses.

(3) Includes DSL, satellite, optic fiber, cable modem and broadband circuits.

(4) Includes 3.25 million GVT fiber (FTTx) customers since second quarter 2015.

(5) Includes 1.1 million DTS customers.

The below table shows the contribution of each item for which we have adjusted our reported growth. With respect to each line item, the contribution to reported growth of such line item, expressed in p.p., is the result of dividing the impact of each item for which we have adjusted by the amount of such line item, on a reported basis, for the prior year.

TELEFÓNICA 2015	%Reported YoY	%Organic YoY (1)	DTS	GVT
Fixed telephony accesses	7.9%	(3.0%)	0.0 p.p.	11.2 p.p.
Internet and data accesses	17.7%	1.3%	0.0 p.p.	16.2 p.p.
Broadband	18.7%	1.8%	0.0 p.p.	16.6 p.p.
Fiber	n.m.	29.9%	0.0 p.p.	n.m.
Pay TV	62.6%	12.0%	28.3 p.p.	16.9 p.p.
<b>Final Clients Accesses</b>	<b>2.1%</b>	<b>(0.7%)</b>	<b>0.4 p.p.</b>	<b>2.4 p.p.</b>
<b>Total Accesses</b>	<b>1.9%</b>	<b>(0.8%)</b>	<b>0.4 p.p.</b>	<b>2.3 p.p.</b>

(1) In order to calculate organic changes, we have added the accesses of DTS and GVT as of December 31, 2014 to our accesses as of such date.

The table below shows the evolution of accesses by segment:

Accesses 2015	YoY variation		% Over Total Accesses	
	%Reported YoY	%Organic YoY (1)	2014	2015
Spain	1.9%	(1.6%)	12.1%	12.1%
United Kingdom	2.3%	--	7.3%	7.3%
Germany	1.5%	--	14.0%	13.9%
Brazil	1.4%	(6.4%)	28.0%	27.9%
Hispanoamérica	2.3%	--	38.6%	38.7%
Others	16.6%	--	0.1%	0.1%

(1) In order to calculate organic changes, we have added the accesses of DTS and GVT as of December 31, 2014 to our accesses as of such date.

The Group's strategy is based on capturing growth in its markets, especially on attracting high-value customers.

**Mobile accesses** totaled 272.1 million at December 31, 2015, down 0.9% compared to December 31, 2014, affected mainly by the decrease in prepay accesses (due to the disconnection of prepay accesses in Brazil (11.5 million accesses in 2015 and 1.6 million accesses in 2014)). Contract accesses, however, were up 5.6% year-on-year, continuing to increase their weight over total mobile accesses up to 38.3% (+2.3 p.p. year-on-year).

**Smartphone accesses** maintained a strong growth rate (up 48.3% year-on-year), totaling 126.2 million accesses as of December 31, 2015 and reaching a penetration rate over total accesses of 49.5% (+14.3 p.p. year-on-year), reflecting the Company's strategic focus on the growth of its data services.

**Fixed broadband accesses** stood at 21.0 million at December 31, 2015, up 18.7% year-on-year (of which 16.6 p.p. was due to the inclusion of accesses from GVT in the 2015). Fiber accesses stood at 6.1 million at December 31, 2015.

**TV accesses** totaled 8.3 million up 63% year-on-year (of which 28 p.p. was due to the inclusion of accesses from DTS and 17 p.p. was due to the inclusion of accesses from GVT in the 2015 access base).

Telefónica's customer base includes the consumer and business segments, and therefore is not affected by customer concentration risk.

Consolidated Results Millions of euros	Year ended December, 31				Percent Change	
	2014 (*)		2015(*)		2015 vs 2014	
	Total	% of revenues	Total	% of revenues	Total	%
Revenues	50,377	100.0%	54,916	100.0%	4,539	9.0%
Other income	1,707	3.4%	2,011	3.7%	304	17.8%
Supplies	(15,182)	(30.1%)	(16,547)	(30.1%)	(1,365)	9.0%
Personnel expenses	(7,098)	(14.1%)	(10,349)	(18.9%)	(3,251)	45.8%
Other expenses	(14,289)	(28.4%)	(16,802)	(30.6%)	(2,513)	17.6%
<b>OPERATING INCOME BEFORE DEPRECIATION AND AMORTIZATION (OIBDA)</b>	<b>15,515</b>	<b>30.8%</b>	<b>13,229</b>	<b>24.1%</b>	<b>(2,286)</b>	<b>(14.7%)</b>
Depreciation and amortization	(8,548)	(17.0%)	(9,704)	(17.7%)	(1,156)	13.5%
<b>OPERATING INCOME</b>	<b>6,967</b>	<b>13.8%</b>	<b>3,525</b>	<b>6.4%</b>	<b>(3,442)</b>	<b>(49.4%)</b>
Share of loss of investments accounted for by the equity method	(510)	(1.0%)	(10)	(0.0%)	500	(97.9%)
Net financial expense	(2,822)	(5.6%)	(2,609)	(4.8%)	213	(7.5%)
<b>PROFIT BEFORE TAX</b>	<b>3,635</b>	<b>7.2%</b>	<b>906</b>	<b>1.7%</b>	<b>(2,729)</b>	<b>(75.1%)</b>
Corporate income tax	(383)	(0.8%)	(155)	(0.3%)	228	(59.6%)
<b>PROFIT FOR THE YEAR</b>	<b>3,252</b>	<b>6.5%</b>	<b>751</b>	<b>1.4%</b>	<b>(2,501)</b>	<b>(76.9%)</b>
Attributable to equity holders of the Parent	3,001	6.0%	616	1.1%	(2,385)	(79.5%)
Attributable to non-controlling interests	251	0.5%	135	0.3%	(116)	46.2%

(\*) Amended data in order to cease to present Telefónica United Kingdom as discontinued operations.

### Adjustments made to calculate organic variations

As previously mentioned, year-on-year changes referred to in this document as “organic” or presented in “organic terms” intend to present year-on-year variations on a comparable basis (see Consolidated Results 2016/2015- Adjustments for the calculation of organic variations)

The adjustments made to calculate 2015/2014 organic variations are the following:

- **Foreign exchange effects and the impact of hyperinflationary adjustments in Venezuela:** We have excluded the impact of changes in exchange rates by assuming constant average foreign exchange rates in 2015 and 2014. In particular, we have used the average foreign exchange rates of 2014 for both years.

Foreign exchange rates had a negative impact on our reported 2015 results, mainly due to the depreciation of various Latin American currencies versus the euro, in particular the Brazilian real and, to a lesser extent, the Venezuelan bolívar.

We have also excluded the impact of hyperinflationary adjustments in Venezuela by reversing such adjustments.

- **Changes in the scope of consolidation:** We have excluded the impact of changes in our consolidation perimeter in 2015 and 2014. The main changes in our consolidation perimeter in such years related to the consolidation of GVT in Telefónica Brazil since May 2015, the consolidation of DTS in Telefónica Spain since May 2015, the consolidation of E-Plus in Telefónica Germany since October 2014 and the sale of Telefónica Ireland in July 2014.

In order to exclude the impact of these changes in our perimeter, we have:

- consolidated GVT's results from May 1 to December 31, 2014 in our 2014 results;
- consolidated DTS's results from May 1 to December 31, 2014 in our 2014 results;
- consolidated E-Plus's results from January 1 to September 30, 2014 in our 2014 results; and



◦ excluded Telefónica Ireland's results from January 1 to June 30, 2014 from our 2014 results.

- **Restructuring costs:** We have excluded the impact of certain restructuring costs, mainly those related to the 1st Collective Agreement of Related Companies in Telefónica Spain, restructuring processes relating to Telefónica Germany, Telefónica United Kingdom and Telefónica Brazil and the Group's simplification program.

In 2015, these restructuring costs totaled 3,217 million euros and were aimed at increasing future efficiency, representing a further step towards the transformation and simplification initiatives carried out by Telefónica. These costs were distributed by segment as follows (impacts on OIBDA): Telefónica Spain (2,896 million euros), Telefónica Germany (74 million euros), Telefónica Hispanoamérica (38 million euros), Telefónica Brazil (7 million euros), Telefónica United Kingdom (4 million euros) and other companies (197 million euros).

In 2014, these restructuring costs totaled 658 million euros and were attributable to the simplification initiatives that the Group has implemented to meet its targets. These costs were mainly distributed by segment as follows (impacts on OIBDA): Telefónica Germany (414 million euros), Telefónica Brazil (68 million euros), Telefónica Hispanoamérica (99 million euros, mainly in Peru) and other companies (77 million euros).

- **Results of tower sales:** The results attributable to the sale of towers in 2015 and 2014 have been excluded in both years.

In 2015 the results from the sale of towers totaled 65 million euros, distributed as follows: Telefónica Spain (38 million euros), Telefónica Brazil (10 million euros) and Telefónica Hispanoamérica (18 million euros, mainly in Chile). In 2014 the results from the sale of towers totaled 196 million euros in OIBDA, mainly in Telefónica Spain (191 million euros).

- **Irrevocable commitment with Fundación Telefónica:** In 2015 we have excluded the expense (325 million euros) resulting from Telefónica, S.A.'s irrevocable commitment to make a donation to Fundación Telefónica in order to provide this entity with the financing required so that it can carry out its existing or new social programs and non-profit activities in the short and medium term.
- **Adjustments to the final purchase price of E-Plus:** In 2015 we have excluded the positive result from the difference between the preliminary purchase price of E-Plus (as estimated at the end of the valuation period) and the final purchase price agreed with KPN, totaling 104 million euros (which had a 102 million euros positive impact on OIBDA, net of costs related to the acquisition).
- **Spectrum acquisition:** We have excluded the impact of spectrum acquisitions in 2015 and 2014.

In 2015, these acquisitions totaled 1,585 million euros, 1,198 million euros corresponding to Telefónica Germany, 49 million euros corresponding to Telefónica Spain and 338 million euros corresponding to Telefónica Hispanoamérica (mainly Argentina and Ecuador).

In 2014 these acquisitions totaled 1,294 million euros, 889 million euros corresponding to Telefónica Brazil and 405 million euros corresponding to Telefónica Hispanoamérica with the following distribution by country or region:

- Telefónica Argentina (168 million euros);
- Telefónica Colombia (111 million euros); and
- Telefónica Venezuela and Central America (126 million euros).

- **Real Estate Efficiency Plan:** In 2014 we have excluded the impact of certain urban assets qualification changes in Telefónica Spain and also the investment in Telefónica's Barcelona head office, which had an impact on capital expenditures (Capex) of 78 million euros.
- **Other adjustments:** We have excluded the partial adjustment of the goodwill generated in the acquisition of Telefónica Digital Inc. amounting to 104 million euros y the impact of the impairment resulting from the deterioration in certain minority participations, totaling 23 million euros in 2015. We have also excluded the impact of the 30 million euros provision recorded in 2015 in Telefónica Spain to optimize the distribution channel.

The table below shows 2015/2014 variations in reported and organic terms (the latter, calculated in accordance with the adjustments referred to above) of certain income statement and other measures:

TELEFÓNICA 2015	YoY variation	
	% Reported YoY	% Organic YoY
Revenues	9.0%	3.5%
Other income	17.8%	15.3%
Supplies	9.0%	0.3%
Personnel expenses	45.8%	4.0%
Other expenses	17.6%	8.1%
<b>OIBDA</b>	<b>(14.7%)</b>	<b>3.2%</b>
<b>Operating income (OI)</b>	<b>(49.4%)</b>	<b>4.0%</b>
CapEx	10.7%	4.9%
<b>OpCF (OIBDA-CapEx)</b>	<b>(54.4%)</b>	<b>1.3%</b>

The below table shows the contribution of each item for which we have adjusted to our reported growth. With respect to each line item, the contribution to reported growth of such line item, expressed in p.p., is the result of dividing the impact of each item for which we have adjusted by the amount of such line item, on a reported basis, for the prior year.

TELEFÓNICA 2015	Contribution to reported growth (percentage points)								
	Exchange rate effect and hyperinflation	Perimeter change	Restruc- turing costs	Towers sales	Commitment with Fundación	Adjustments to the final purchase price of E- Plus	Spectrum acquisition	Real Estate Efficiency Plan	Other adjustments
Revenues	(2.3)	7.6	-	-	-	-	-	-	-
Other income	(2.7)	7.5	-	(7.7)	-	6.1	-	-	-
Supplies	0.3	8.4	-	-	-	-	-	-	-
Personnel expenses	(1.5)	7.1	36.3	-	-	-	-	-	-
Other expenses	(4.4)	9.9	(0.1)	-	2.3	-	-	-	1.1
<b>OIBDA</b>	<b>(3.2)</b>	<b>4.8</b>	<b>(16.5)</b>	<b>(0.8)</b>	<b>(2.1)</b>	<b>0.7</b>	-	-	<b>(1.0)</b>
<b>Operating Income (OI)</b>	<b>(5.3)</b>	<b>(4.2)</b>	<b>(36.7)</b>	<b>(1.9)</b>	<b>(4.7)</b>	<b>1.5</b>	-	-	<b>(2.3)</b>
CapEx	(3.7)	7.9	-	-	-	-	2.8	(0.8)	-
<b>OpCF (OIBDA- CapEx)</b>	<b>(2.4)</b>	-	<b>(42.2)</b>	<b>(2.1)</b>	<b>(5.4)</b>	<b>1.7</b>	<b>(4.4)</b>	<b>1.3</b>	<b>(2.6)</b>

## Results Discussion

**Revenues** totaled 54,916 million euros in 2015, increasing 9.0% compared to 2014 in reported terms. This increase was mainly attributable to the consolidation of E-Plus, GVT and DTS (which accounted for 7.6 p.p. of the year-on-year increase), which was partially offset by the impact of changes in foreign exchange rates and hyperinflation in Venezuela (-2.3 p.p.). In organic terms, revenues increased 3.5% due to higher connectivity revenues, mainly in the mobile business as a consequence of the strong data revenue growth. The growing focus on our key markets was reflected in the revenue mix with Telefónica Spain, Telefónica Brazil and Telefónica Germany accounting for 57.1% of the revenues, increasing local scale and keeping at the same time the Group's differential diversification and global scale.

The **structure of revenues** reflects Telefónica's business diversification. Despite the adverse impact of exchange rates and hyperinflation in Venezuela, the segment with the largest contribution to our revenues in 2015 was Telefónica Hispanoamérica, representing 26.2% (+0.1 p.p. compared to 2014), followed by Telefónica Spain, representing 22.6% (-1.3 p.p. compared to 2014), Telefónica Brazil, representing 20.1% (-2.2 p.p. compared to 2014), Telefónica Germany, which increased its contribution with respect to 2014 to 14.4% (+3.4 p.p. year-on-year), and Telefónica United Kingdom representing 14.3% (+0.3 p.p. compared to 2014).

**Mobile business revenues** totaled 35,540 million euros in 2015 (of which 30,289 million euros corresponded to service revenues and 4,984 million euros corresponded to handset revenues) up 8.2% year-on-year in reported terms. This increase was mainly attributable to the consolidation of E-Plus (which accounted for 6.1 p.p. of the year-on-year increase), which was partially offset by the impact of changes in foreign exchange rates and hyperinflation in Venezuela (-1.6 p.p.). Excluding these impacts, year-on-year growth was 3.5% due to higher mobile revenues in Telefónica Hispanoamérica and Telefónica Brazil as a result mainly of the increase in the customer base and data adoption.

**Mobile service revenues** totaled 30,289 million euros in 2015, up 6.6% year-on-year in reported terms. This increase was mainly attributable to the consolidation of E-Plus (which accounted for 6.0 p.p. of the year-on-year increase), which was partially offset by the impact of changes in foreign exchange rates and hyperinflation in Venezuela (-2.2 p.p.). Excluding these impacts, year-on-year growth was 2.6% due mainly to the higher customer base and higher data consumption.

**Mobile data revenues** totaled 13,869 million euros in 2015, up 18.9% in reported terms. This increase was mainly attributable to the consolidation of E-Plus (which accounted for 7.9 p.p. of the year-on-year increase) and the higher consumption of data of our customers, which was partially offset by the impact of changes in foreign exchange rates and hyperinflation in Venezuela (-2.2 p.p.). Excluding these impacts, mobile data revenues increased by 12.2% due mainly to the increased revenues of non-SMS data (up 20.4%) and higher use of data per customer. Mobile data revenues accounted for 45.5% of mobile service revenues in 2015, up 4.8 p.p. compared to 2014 in reported terms.

**Fixed revenues** totaled 17,854 million euros in 2015, up 9.5% year-on-year in reported terms. This increase was mainly attributable to the consolidation of GVT and DTS (which accounted for +10.9 p.p. of the year-on-year increase), which was partially offset by the impact of changes in foreign exchange rates and hyperinflation in Venezuela (-3.9 p.p.). Excluding these impacts, fixed revenues increased 2.2%. This increase was mainly due to higher broad band connection revenues and Pay-TV revenues as a result of the commercial actions carried out by the Company in order to increase our value proposition and the higher customer base in Pay-TV.

**Other income** in 2015 mainly included own work capitalized in our fixed assets, profit from the sale of other assets, and the sale of towers by Telefónica Spain, Telefónica Brazil and Telefónica Hispanoamérica.

In 2015, other income totaled 2,011 million euros, up 17.8% year-on-year in reported terms. In 2015, other income was positively affected by the consolidation of E-Plus, GVT and DTS, the positive result from the E-Plus price adjustment (104 million euros), the positive impact from the expired payment obligation (98 million euros) in Telefónica Brazil, the spectrum swap with AT&T in Telefónica Mexico carried out in December 2015 (79 million euros), the sale of real estate in Telefónica Spain (78 million euros) and the result from the sale of towers amounting to 65 million euros.

In 2014, the sale of towers had a positive impact of 196 million euros. Other income also included an extraordinary sale of real estate in Telefónica Spain (63 million euros).

**Total expenses** (which include supply costs, personnel costs and other expenses (principally external services and taxes) but do not include amortization and depreciation expenses), were 43,698 million euros in 2015, up year-on-year 19.5% in reported terms. This increase was mainly attributable to the consolidation of E-Plus, GVT and DTS (which accounted for 8.7 p.p. of the year-on-year increase) and higher restructuring costs amounting to 3,217 million euros (which accounted for 7.0 p.p. of the year-on-year increase), which was partially offset by the impact of changes in foreign exchange rates and hyperinflation in Venezuela (-1.9 p.p.). The costs are explained in detail below:

- **Supplies** amounted to 16,547 million euros in 2015, up 9.0% year-on-year in reported terms mainly as a result of the consolidation of E-Plus, GVT and DTS (which accounted for 8.4 p.p. of the year-on-year increase). In organic terms, supplies expenses grew by 0.3% year-on-year, due to increased commercial activity in high-end devices and higher TV content costs, which more than offset the decrease in mobile interconnection costs.
- **Personnel expenses** amounted to 10,349 million euros in 2015, up 45.8% in reported terms year-on-year compared to 2014. This increase was mainly attributable to higher restructuring costs of 3,146 million euros (which accounted for +36.3 p.p. of the year-on-year increase), the consolidation of E-Plus, GVT and DTS (which accounted for 7.1 p.p. of the year-on-year increase), and was partially offset by the impact of changes in foreign exchange rates and hyperinflation in Venezuela (-1.5 p.p.). In organic terms, personnel costs increased 4.0% year-on-year mainly affected by inflationary pressures in some Latin American countries.

The average headcount was 133,569 employees in 2015, up 10.8% compared to 2014 (-2.1% excluding the impact of changes in the scope of consolidation).

- **Other expenses** amounted to 16,802 million euros in 2015, up 17.6% in reported terms. This increase was mainly attributable to the consolidation of E-Plus, GVT and DTS (which accounted for 9.9 p.p. of the year-on-year increase), the provision of 325 million euros related to the irrevocable agreement between Telefónica, S.A. and Fundación Telefónica for its short-and mid-term financing (+2.3 p.p.) and to a lesser extent, the impairment resulting from the deterioration in certain minority participations, the goodwill value adjustment in Telefónica Digital Inc. (+1.1 p.p.) and the decrease in other expenses related to restructuring processes (-0.1 p.p.), which was partially offset by the impact of changes in foreign exchange rates and hyperinflation in Venezuela (-4.4 p.p.). In organic terms, other expenses increased by 8.1% compared to 2014, mainly as a result of increased network costs, higher IT costs and a higher commercial activity. Increased inflation in some Latin American countries offset in part the savings resulting from the simplification measures carried out by the Company.

**OIBDA** was 13,229 million euros in 2015, down 14.7% in reported terms. This decrease was mainly attributable to the higher restructuring costs (which accounted for 16.5 p.p. of the year-on-year decrease and included a restructuring costs provision of 3,217 million euros), the impact of changes in foreign exchange rates and hyperinflation in Venezuela (-3.2 p.p.), the provision of 325 million euros related to the agreement between Telefónica S.A. and Fundación Telefónica for its short and mid-term financing (-2.1 p.p.) and, to a lesser extent, the decreased results from the sale of towers (-0.8 p.p.), the provision recorded in connection with the optimization of the distribution channel in Spain of 30 million euros (-0.2 p.p.) and the impairment resulting from the deterioration in certain minority participations (-0.8 p.p.), which was partially offset by the impact of the consolidation of E-Plus, GVT and DTS (+4.8 p.p.) and the adjustments made to the final acquisition price of E-Plus (+0.7 p.p.).

In organic terms, OIBDA grew 3.2% due to the positive evolution of Telefónica Germany (+20.9% year-on-year), reflecting increased synergies, the better performance of Telefónica Brazil (+2.9% year-on-year) and the results from Telefónica Hispanoamérica (+7.2% year-on-year).

**OIBDA margin** stood at 24.1% in 2015, down 6.7 p.p. compared to 2014 in reported terms due mainly to the restructuring costs provision of 3,217 million euros in 2015.

By segments, Telefónica Hispanoamérica was the main contributor to Group OIBDA with 32.9% (+6.7 p.p. compared to 2014), Telefónica Brazil contributed 27.0% (+4.2 p.p. compared to 2014), Telefónica Germany contributed 14.0% (+9.3 p.p. compared to 2014) and Telefónica United Kingdom contributed 14.6% (+3.3 p.p. compared to 2014). Telefónica Spain contributed 17.7% to Group OIBDA, down 18.9 p.p. compared to 2014, mainly as a result of the restructuring cost provision of 2,896 million euros in 2015.

**Depreciation and amortization** amounted to 9,704 million euros in 2015, up 13.5% year-on-year in reported terms, mainly due to the consolidation of E-Plus, GVT and DTS. The total depreciation and amortization charges arising from purchase price allocation processes amounted to 894 million euros in 2015, up 26.3% year-on-year.

**Operating income (OI)** in 2015 totaled 3,525 million euros, down 49.4% compared to 2014 for the reasons set forth above for OIBDA. In organic terms, operating income grew 4.0% year-on-year as a result of higher revenues and costs savings.

The **share of loss of investments accounted for by the equity method** for 2015 was a loss of 10 million euros (compared to a loss of 510 million euros in 2014). The loss recorded in 2014 was mainly due to the valuation adjustment of Telco, S.p.A. at Telecom Italia, S.p.A. amounting to 464 million euros.

**Net financial expense** amounted to 2,609 million euros in 2015, 7.5% lower than the previous year. Excluding exchange rate differences, costs improved by 21.2% (536 million euros) to 1,993 million euros. Negative foreign exchange differences amounted to 616 million euros (excluding monetary correction), primarily due to adoption of the SIMADI exchange rate for the Venezuelan bolivar. The lower cost of debt in euros explains 146 million euros of this improvement, due to lower fixed rate debt and capture of the

reduction in short-term rates. The divestment of the entire holding in Telecom Italia, S.p.A. generated a positive variation of 404 million euros. Other effects resulted in losses of 13 million euros. These included the monetary correction for inflation in Venezuela, net of higher expenses in Latin America currencies, costs for updating contingencies, and other gains and losses on equities. The effective cost of debt over 2015, excluding exchange rate differences and the positive impact of the divestment of Telecom Italia, S.p.A., stood at 4.82%, down 52 basis points year-on-year.

**Corporate income tax** totaled 155 million euros in 2015, compared to 383 million euros in 2014, mainly due to the temporary difference recorded related to a restructuring provision the activation of tax credit in Spain. Considering a pre-tax income of 906 million euros, the effective tax rate was 17.1% in 2015, 6.5 p.p. higher than in 2014.

**Profit attributable to non-controlling interest** reduced the profit for the year attributable to equity holder of the parent by 135 million euros, 116 million euros less than in 2014, mainly due to the lower profit attributable to minority interests in Telefónica Brazil and Colombia Telecomunicaciones.

As a result of the foregoing, **profit for the year attributable to equity holders of the parent** for 2015 was 616 million euros, down by 79.5% year on year compared to 2014.

## 2015/2014 Segment results

### TELEFÓNICA SPAIN

The below table shows the evolution of accesses in Telefónica Spain over the past two years as of December 31 of such years:

#### ACCESSES

Thousands of accesses	2014	2015	%Reported YoY	%Organic YoY (1)
Fixed telephony accesses (2)	10,447.8	10,005.6	(4.2%)	(4.2%)
Internet and data accesses	5,928.7	6,000.0	1.2%	1.2%
Broadband (3)	5,885.9	5,962.0	1.3%	1.3%
Fiber	1,316.8	2,223.0	68.8%	68.8%
Mobile accesses	17,575.4	17,258.5	(1.8%)	(1.8%)
Prepay	3,328.1	2,777.1	(16.6%)	(16.6%)
Contract	14,247.3	14,481.4	1.6%	1.6%
M2M	1,612.4	1,778.8	10.3%	10.3%
Pay TV	1,884.7	3,671.5	94.8%	10.5%
<b>Final Clients Accesses</b>	<b>35,836.7</b>	<b>36,935.6</b>	<b>3.1%</b>	<b>(0.9%)</b>
<b>Wholesale Accesses</b>	<b>5,366.0</b>	<b>5,037.7</b>	<b>(6.1%)</b>	<b>(6.1%)</b>
<b>Total Accesses</b>	<b>41,202.7</b>	<b>41,973.3</b>	<b>1.9%</b>	<b>(1.6%)</b>

Notes:

(1) In order to calculate organic changes, we have added the accesses of DTS as of December 31, 2014 to our accesses as of such date.

(2) PSTN (including Public Use Telephony) x1; ISDN Basic access x1; ISDN Primary access; 2/6 Digital Access x30. Company's accesses for internal use included. Includes VoIP and Naked ADSL.

(3) Includes ADSL, satellite, optical fiber, cable modem and broadband circuits.

The below table shows the contribution of each item for which we have adjusted to our reported growth. With respect to each line item, the contribution to reported growth of such line item, expressed in p.p., is the result of dividing the impact of each item for which we have adjusted by the amount of such line item, on a reported basis, for the prior year:

TELEFÓNICA SPAIN 2015	%Reported YoY	%Organic YoY (1)	DTS
Pay TV	94.8%	10.5%	76.3 p.p.
<b>Final Clients Accesses</b>	<b>3.1%</b>	<b>(0.9%)</b>	<b>4.0 p.p.</b>
<b>Total Accesses</b>	<b>1.9%</b>	<b>(1.6%)</b>	<b>3.5 p.p.</b>

(1) In order to calculate organic changes, we have added the accesses of DTS as of December 31, 2014 to our accesses as of such date.

In 2015 the commercial activity was leveraged on the differentiated assets of the Company and, in the second half of 2015 was strengthened by the convergent offer "Movistar Fusión+" launched in July 2015 as well as the promotion that included all "TV Premium Extra" content from 9.90 euros/month, launched in August 2015. This promotion was subscribed by almost 700 thousand customers, reflecting the attractiveness of the offer (new TV contents and ultra-speed fiber in an economic environment where private consumption continues to improve).

Churn evolution has been positive in 2015, especially taking into account the elimination of "Fusión" long-term contracts on August 1, 2015. This fact, together with the good evolution in adds since the launching of "Movistar Fusión+" has resulted in a positive performance of commercial activity. In 2015, broadband net adds duplicated year-on-year, fiber net adds grew by 25.3%, mobile contract net adds resumed growth (+0.2 million customers) and in fixed telephony the net loss of accesses decreased by 31.1% year-on-year.

The results of Telefónica Spain in 2015 showed a lower decrease in revenues compared to the year-on-year results of 2014-2013, as a result of the transformation strategy implemented in recent years which relies on a high value offer based on the differentiated assets of Telefónica Spain, a more rational market in competition terms and a more favorable macroeconomic context, with improvement in private consumption.

Telefónica Spain had 42.0 million accesses at the end of December 2015, up 1.9% year-on-year, after the consolidation of the DTS satellite TV accesses (0.9 million accesses at December 2015). The organic variation was down by 1.6%, explained by the decrease in mobile accesses and fixed telephony accesses, although it is important to highlight that retail accesses grew by 3.1% year-on-year.

"Movistar Fusión", with a customer base of 4.2 million with 1.5 million additional wireless lines to the base offer as of December 31, 2015, maintained a solid year-on-year growth (+13% and +8% respectively compared to December 2014) and contributed 81% of the fixed retail broadband customer base and 63% of the wireless contract customer base. There was significant growth in the penetration of the high value services of "Movistar Fusión", with 31.8% of the customer base already using 100 Mb or 300 Mb ultra-fast broadband (+10.9 p.p. year-on-year) and 62.4% of the customer base with Pay-TV as of December 31, 2015 (+17.7 p.p. year-on-year).

**Fixed accesses** decreased 4.2% year-on-year, with a net loss of 442 thousand accesses in the year 2015. This decrease was mainly due to a lower fixed access market growth.

**Retail broadband accesses** totaled 6.0 million and grew 1.3% year-on-year, with net adds of 76 thousand accesses, due to the good evolution of fiber adds (+37.1% year-on-year) and lower churn (1.4% in 2015, -0.1 p.p. year-on-year).

**Fiber accesses** posted a new record in terms of net adds (0.9 million new accesses in 2015), reaching 2.2 million customers (1.7 times compared to December 31, 2014), representing 37.3% of total broadband customers (+14.9 p.p. year-on-year). Two thirds of fiber accesses are benefiting from the new speeds (30 and 300 Mb) launched in May 2015.

Ultra-speed fiber accesses, with 100 or 300 Mb (with additional ARPU of 12 euros, including VAT) reached 1.5 million accesses (68.6% of total fiber accesses), after the new record of 0.5 million accesses in 2015, triggered by the higher level of adds (+25.9% year-on-year) and contained churn (0.9%, +0.1 p.p. year-on-year).

At December 31, 2015 our fiber deployment reached 14.3 million premises, 4 million more than at December 31, 2014.

Total **mobile accesses** stood at 17.3 million, down 1.8% compared with year-end 2014 as a result of the decrease in prepay accesses. The contract access base accelerated its growth during 2015, growing by 1.6% year-on-year. The positive evolution of contract portability (-162 thousand customers at December 31, 2015, compared to -508 thousand customers at December 31, 2014), resulted in a positive contract net adds base (excluding M2M) (+68 thousand customers at December 31, 2015, compared to -113 thousand customers at December 31, 2014). Smartphone penetration stood at 66.3% of the mobile voice base (+5.7 p.p. compared to year-end 2014) and significantly boosted data traffic growth to 86.8% year-on-year in 2015 due to the higher number of customers with the renewed portfolio containing superior data packages.



LTE network rollout continued to progress well and coverage reached (based on our estimates) approximately 75% of the population at the end of 2015, up 17 p.p. compared to December 31, 2014, due to the deployment of the 800 MHz. As a result, the LTE customer base reached 3.3 million customers at December 31, 2015, doubling the customer base at December 31, 2014, while the penetration reached 21% (+10 p.p. year-on-year).

**Pay-TV accesses** reached 3.7 million, up by 94.8% in reported terms compared to December 31, 2014 as a result of the acquisition of DTS (+10.5% in organic terms), including 926 thousand satellite TV accesses from DTS.

The table below shows the evolution of Telefónica Spain's results over the past two years:

Millions of euros

TELEFÓNICA SPAIN	2014	2015	%Reported YoY	%Organic YoY (1)
Revenues	12,023	12,402	3.2%	(2.1%)
<b>Mobile Business</b>	<b>4,556</b>	<b>4,337</b>	<b>(4.8%)</b>	<b>(4.8%)</b>
Mobile service revenues	3,888	3,677	(5.4%)	(5.4%)
<b>Fixed Business</b>	<b>8,543</b>	<b>9,359</b>	<b>9.6%</b>	<b>1.9%</b>
Other income	635	516	(18.7%)	7.0%
Supplies	(2,592)	(2,996)	15.6%	(2.7%)
Personnel expenses	(2,139)	(5,173)	141.8%	4.0%
Other expenses	(2,256)	(2,413)	7.0%	(0.2%)
<b>OIBDA</b>	<b>5,671</b>	<b>2,336</b>	<b>(58.8%)</b>	<b>(4.3%)</b>
OIBDA Margin	47.2%	18.8%	(28.3 p.p.)	(1.0 p.p.)
Depreciation and amortization	(1,805)	(1,898)	5.2%	2.4%
<b>Operating Income (OI)</b>	<b>3,866</b>	<b>438</b>	<b>(88.7%)</b>	<b>(7.8%)</b>
CapEx	1,732	1,827	5.5%	4.5%
OpCF (OIBDA-CapEx)	3,939	509	(87.1%)	(8.3%)

(1) See adjustments made to calculate organic variation below.

Adjustments made to calculate organic variations

As explained above, year-on-year changes referred to in this document as "organic" or presented in "organic terms" intend to present year-on-year variations on a comparable basis.

With respect to Telefónica Spain, we have made the following adjustments in order to calculate 2015/2014 variations in organic terms:

- **Changes in the scope of consolidation:** We have excluded the impact of changes in our consolidation perimeter in 2015 and 2014. The only change to our Telefónica Spain consolidation perimeter in such years is related to the consolidation of DTS in Telefónica Spain since May 1, 2015. In order to exclude the impact of such change in our perimeter, we have consolidated DTS's results from May 1 to December 31, 2014 in our 2014 results.
- **Restructuring costs:** We have excluded the impact of the 2,896 million euros of restructuring costs in 2015, mainly those related to the Voluntary Suspension Plan in Spain. The restructuring process is aimed at increasing future efficiency, representing a further step towards the transformation and simplification initiatives carried out by Telefónica.

No restructuring costs were excluded from our 2014 results to calculate organic variations.

- **Results of tower sales:** The results attributable to the sale of towers in 2015 and 2014 have been excluded in both years. In 2015, the results from the sale of towers totaled 38 million euros. In 2014, the results from the sale of towers totaled 191 million euros.
- **Spectrum acquisition:** We have excluded the impact of spectrum acquisitions in 2015, which totaled 49 million euros.
- **Real Estate Efficiency Plan:** We have excluded the impact of certain urban assets qualification changes in Telefónica Spain in 2014, totaling 49 million euros.
- **Spain distribution channel:** We have excluded the impact of the 30 million euros provision recorded in 2015 in Telefónica Spain to optimize the distribution network.

The table below shows 2015/2014 variations in reported and organic terms (the latter, calculated in accordance with the adjustments referred to above) of certain income statement and other measures, and the contribution of each item for which we have adjusted to our reported growth:

TELEFÓNICA SPAIN 2015	YoY variation		Contribution to reported growth (percentage points)					
	%Reported YoY	%Organic YoY	Perimeter change (DTS)	Restructuring costs	Towers sales	Spectrum acquisition	Real Estate Efficiency Plan	Spain distribution channel
Revenues	3.2%	(2.1%)	5.4	--	--	--	--	--
Other income	(18.7%)	7.0%	0.9	--	(24.5)	--	--	--
Supplies	15.6%	(2.7%)	18.7	--	--	--	--	--
Personnel expenses	141.8%	4.0%	2.4	135.4	--	--	--	--
Other expenses	7.0%	(0.2%)	5.9	--	(0.1)	--	--	1.3
<b>OIBDA</b>	<b>(58.8%)</b>	<b>(4.3%)</b>	<b>(0.4)</b>	<b>(51.1)</b>	<b>(2.7)</b>	--	--	<b>(0.5)</b>
CapEx	5.5%	4.5%	1.1	--	--	2.8	(2.8)	--
<b>OpCF (OIBDA- CapEx)</b>	<b>(87.1%)</b>	<b>(8.3%)</b>	<b>(1.0)</b>	<b>(73.5)</b>	<b>(3.9)</b>	<b>(1.2)</b>	<b>1.3</b>	<b>(0.8)</b>

## Results Discussion

**Revenues** in Telefónica Spain in 2015 were 12,402 million euros, up 3.2% year-on-year in reported terms mainly as a result of the consolidation of DTS since May 1, 2015 (which accounted for +5.4 p.p. of the year-on-year increase). In organic terms, revenues were down by 2.1% due to lower mobile service revenues in the mobile business and lower access and voice revenues in the fixed business.

We consider revenue breakdown to be increasingly less relevant given the high penetration level of our convergent offer, by which we mean the offer of more than a single service for a single price. However, we continue to report revenue separately for information purposes. Fixed business revenues were up by 9.6% year-on-year in 2015, due to the consolidation of DTS, the repositioning of tariffs, higher retail broadband revenues and new services, mainly related to TV and IT services. Excluding the impact of DTS, fixed revenues increased by 1.9%. Mobile business revenues fell 4.8% year-on-year in 2015 due to the decline in mobile accesses and the 3.6% drop in ARPU.

**Mobile ARPU** was 15.3 euros in 2015, down by 3.6% year-on-year. Mobile ARPU is becoming less representative of the Group's business performance, owing to its high dependence on the allocation of revenue in convergent offers.

TELEFÓNICA SPAIN	2014	2015	%YoY
Voice Traffic (millions of minutes)	35,600	36,368	2.2%
<b>ARPU (EUR)</b>	<b>15.9</b>	<b>15.3</b>	<b>(3.6%)</b>
Prepay	6.2	5.7	(8.2%)
Contract (1)	20.6	19.5	(5.3%)
<b>Data ARPU (EUR)</b>	<b>7.0</b>	<b>7.8</b>	<b>11.0%</b>
% non-SMS over data revenues	95.0%	95.5%	0.5 p.p.

Notes:

(1) Excludes M2M.

**OIBDA** amounted to 2,336 million euros in 2015, down 58.8% year-on-year in reported terms, mainly due to provisions recorded in 2015 totaling 2,926 million euros (relating to restructuring cost accounted for 51.1 p.p. of the year-on-year decrease and 0.5 p.p. of the year-on-year decrease in distribution channel restructuring) and, to a lesser extent, the lower proceeds (38 million euros in 2015 compared to 191 million euros in 2014) from the sale of towers (-2.7 p.p.). This decrease was partially offset by the sale of real estate assets amounting to 73 million euros (net of costs).

In organic terms OIBDA decreased 4.3% year-on-year, mainly due to the lower revenues, higher personnel costs and higher content costs. The higher personnel costs, up by 4.0% year-on-year in organic terms, were primarily due to the resumption of the Company's contribution to its pension plan in July 2014, and to a lesser extent, the acquisition of DTS. Telefónica Spain had 32,171 employees at the end of December 2015, up 7.2% year-on-year, due mainly to the acquisition of DTS.

**OIBDA margin** was 18.8% in 2015, down 28.3 p.p. year-on-year.

## TELEFÓNICA UNITED KINGDOM

As explained above, the consolidated income statement for the year ended December 31, 2015 has been amended to retroactively show the reclassification of Telefónica United Kingdom's results as continuing operations. Therefore, the results below differ from the results previously published for such period. The segmented financial information shown below has been amended for 2015 as discussed above.

The table below shows the evolution of accesses in Telefónica United Kingdom over the past two years as of December 31 of such years:

## ACCESSES

Thousands of accesses	2014	2015	% Reported YoY
Fixed telephony accesses (1)	228.0	247.1	8.4%
Internet and data accesses	19.2	21.0	9.4%
Broadband	19.2	21.0	9.4%
Mobile accesses	24,479.1	25,018.8	2.2%
Prepay	10,761.2	10,561.4	(1.9%)
Contract	13,717.9	14,457.4	5.4%
M2M	2,192.0	2,383.9	8.8%
<b>Final Clients Accesses</b>	<b>24,726.4</b>	<b>25,286.9</b>	<b>2.3%</b>
<b>Total Accesses</b>	<b>24,726.4</b>	<b>25,286.9</b>	<b>2.3%</b>

Notes

(1) Includes "fixed wireless" and Voice over IP accesses

In 2015, Telefónica United Kingdom maintained market momentum, as a result of O2's brand recognition, the success of commercial proposal success and customer loyalty. These factors have allowed the company to keep growing in a competitive market.

The **total access** base grew 2.3% year-on-year and stood at 25.3 million at December 31, 2015, mainly driven by a 2.2% increase in the mobile base.

The contract **mobile customer base** grew 5.4% year-on-year and reached 14.5 million accesses, with a broadly stable 57.8% share over the total mobile base. Net adds reached 539 thousand accesses due to the solid contribution of postpay accesses. Smartphone penetration reached 60% of the total mobile accesses base, up 15.4 p.p. year-on-year, driven by the continued growth of LTE customers (+85.8% year-on-year reaching 7.6 million at December 31, 2015). LTE penetration reached 35% of the total mobile access base.

The prepay access base decreased 1.9% year-on-year to 10.6 million at December 31, 2015.

The table below shows the evolution of Telefónica United Kingdom's results over the past two years:

Millions of euros

TELEFÓNICA UNITED KINGDOM	2014	2015	%Reported YoY	%Organic YoY (1)
Revenues	<b>7,062</b>	<b>7,837</b>	<b>11.0%</b>	<b>(0.1%)</b>
Mobile service revenues	5,397	5,778	7.1%	(3.6%)
Other income	184	170	(7.5%)	(16.7%)
Supplies	(3,520)	(3,769)	7.1%	(3.6%)
Personnel expenses	(460)	(549)	19.5%	6.8%
Other expenses	(1,522)	(1,760)	15.7%	4.1%
<b>OIBDA</b>	<b>1,744</b>	<b>1,929</b>	<b>10.6%</b>	<b>(0.2%)</b>
OIBDA Margin	24.7%	24.6%	(0.1 p.p.)	(0.0 p.p.)
Depreciation and amortization	(1,121)	(1,196)	6.7%	(3.9%)
<b>Operating Income (OI)</b>	<b>623</b>	<b>733</b>	<b>17.6%</b>	<b>6.5%</b>
CapEx	755	883	17.0%	5.3%
OpCF (OIBDA-CapEx)	989	1,046	5.7%	(4.4%)

(1) See adjustments made to calculate organic variation below.

Adjustments made to calculate organic variations

As explained above, year-on-year changes referred to in this document as "organic" or presented in "organic terms" intend to present year-on-year variations on a comparable basis.

To calculate the organic growth for 2015 of Telefónica United Kingdom, we have made the following adjustments:

- **Exchange rate effect:** we have excluded the impact of changes in exchange rates by assuming constant average foreign exchange rates for 2014 and 2015. In particular, we have used the average foreign exchange rates of 2014 for both years.
- **Restructuring costs:** we have excluded the impact from 2015 of restructuring costs, associated with certain simplification processes implemented in Telefónica United Kingdom amounting to 4 million euros. There were not restructuring costs in Telefónica United Kingdom results in 2014.

The table below shows 2015/2014 variations in reported and organic terms (the latter, calculated in accordance with the adjustments referred to above) of certain income statement measures, and the contribution of each item for which we have adjusted to our reported growth:

TELEFÓNICA UNITED KINGDOM 2015	YoY variation		Contribution to reported growth (percentage points)	
	% Reported YoY	% Organic YoY	Exchange rate effect	Restructuring costs
Revenues	11.0%	(0.1%)	11.0	-
Other income	(7.5%)	(16.7%)	9.2	-
Supplies	7.1%	(3.6%)	10.7	-
Personnel expenses	19.5%	6.8%	11.8	0.8
Other expenses	15.7%	4.1%	11.5	-
<b>OIBDA</b>	<b>10.6%</b>	<b>(0.2%)</b>	<b>11</b>	<b>(0.2)</b>
CapEx	17.0%	5.3%	11.6	-
<b>OpCF (OIBDA-CapEx)</b>	<b>5.7%</b>	<b>(4.4%)</b>	<b>10.5</b>	<b>(0.4)</b>

### Results Discussion

Total **revenues** were 7,837 million euros in 2015, up 11.0% year-on-year in reported terms due mainly to the appreciation of the pound sterling (which accounted for 11 p.p. of the year-on-year increase). In organic terms, revenues decreased by 0.1% year-on-year due mainly to lower handset sales, down by 13.9%.

- **Mobile service revenues** totaled 5,778 million euros in 2015, up 7.1% year-on-year in reported terms due mainly to the appreciation of the pound sterling (which accounted for 10.7 p.p. of the year-on-year increase). Excluding this impact, mobile service revenues decreased by 3.6% due to the "Refresh" commercial model as well as the low interconnection fares. Under the Refresh commercial model, certain revenues related to handset are not considered as mobile service revenues, but as handset revenues.

Mobile **ARPU** increased by 2.9% year-on-year in reported terms due mainly to the appreciation of the pound sterling. In organic terms, ARPU went down by 7.3% adversely affected by the "Refresh" commercial model, as well as a decrease in data ARPU of 5.7%. Revenues under the "Refresh" commercial model, are not considered as service revenues but as handset revenues, therefore, smartphone sales are not reflected in ARPU.

TELEFÓNICA UNITED KINGDOM	2014	2015	%YoY	%Organic YoY
Voice Traffic (millions of minutes)	49,096	50,231	2.3%	2.3%
<b>ARPU (EUR)</b>	<b>18.8</b>	<b>19.4</b>	<b>2.9%</b>	<b>(7.3%)</b>
Prepay	7.3	7.7	4.4%	(6.0%)
Contract (1)	33.1	33.5	1.4%	(8.7%)
<b>Data ARPU (EUR)</b>	<b>10.8</b>	<b>11.3</b>	<b>4.7%</b>	<b>(5.7%)</b>
% non-SMS over data revenues	57.9%	59.4%	1.5 p.p.	(1.5 p.p.)

Notes:

(1) Excludes M2M.

**OIBDA** totaled 1,929 million euros in 2015, up 10.6% year-on-year in reported terms, as a result mainly of the appreciation of the pound sterling. In organic terms, OIBDA decreased by 0.2% year-on-year due to lower service revenues, which was partially offset by expense restraint.

The **OIBDA margin** stood at 24.6% in reported terms for 2015, down 0.1 p.p. compared to 2014.

#### TELEFÓNICA GERMANY

The below table shows the evolution of accesses in Telefónica Germany over the past two years as of December 31 of such years:

#### ACCESSES

Thousands of accesses	2014	2015	% Reported YoY
Fixed telephony accesses (1)	2,036.4	1,997.8	(1.9%)
Internet and data accesses	2,387.0	2,330.6	(2.4%)
Broadband	2,143.8	2,098.0	(2.1%)
Mobile accesses	42,124.9	43,062.8	2.2%
Prepay	23,350.7	23,979.4	2.7%
Contract (2)	18,774.1	19,083.4	1.6%
M2M	414.0	632.0	52.7%
<b>Final Clients Accesses</b>	<b>46,548.3</b>	<b>47,391.2</b>	<b>1.8%</b>
<b>Wholesale Accesses</b>	<b>1,113.3</b>	<b>972.0</b>	<b>(12.7%)</b>
<b>Total Accesses</b>	<b>47,661.5</b>	<b>48,363.2</b>	<b>1.5%</b>

Notes:

(1) Includes "fixed wireless" and Voice over IP accesses.

(2) In the fourth quarter of 2014, 428 thousand E-Plus accesses were excluded before integration, due to the criteria harmonization.

In 2015, Telefónica Germany maintained market momentum, increasing slightly its estimated mobile service revenue market share.

The **total access** base grew 1.5% year-on-year and stood at 48.4 million at December 31, 2015, mainly driven by a 2.2% increase in the mobile base (which reached 43.1 million).

The contract mobile customer base grew 1.6% year-on-year and reached 19.1 million accesses, with a broadly stable 44.3% share over the total mobile base. Net adds reached 309 thousand accesses due to the solid contribution of partners (second brands). Smartphone penetration reached 54.2% of the total mobile access base, up 5.5 p.p. year-on-year driven by the continued growth of LTE customers (+154.5% year-on-year reaching 7.9 million at December 31, 2015). LTE penetration reached 18.6% of the total mobile access base.

The prepay access base increased 2.7% year-on-year to 24.0 million. Prepay posted 629 thousand net additions in 2015, 32.5% more than in 2014 due to the strong contribution from wholesale agreements (second brands). The retail broadband access loss trend continued to improve, with 46 thousand net loss in 2015, more than halving the number of 2014. VDSL was once again the main growth engine of fixed performance with 260 thousand net additions (+55% year-on-year) in 2015.

The table below shows the evolution of Telefónica Germany's results over the past two years:

Millions of euros

TELEFÓNICA GERMANY	2014	2015	%Reported YoY	%Organic YoY (1)
Revenues	5,522	7,888	42.9%	1.2%
<b>Mobile Business</b>	<b>4,375</b>	<b>6,832</b>	<b>56.2%</b>	<b>2.8%</b>
Mobile service revenues	3,580	5,532	54.5%	0.1%
<b>Fixed Business</b>	<b>1,138</b>	<b>1,043</b>	<b>(8.3%)</b>	<b>(8.3%)</b>
Other income	106	265	150.4%	14.7%
Supplies	(2,144)	(2,712)	26.5%	(3.4%)
Personnel expenses	(828)	(655)	(20.9%)	(10.1%)
Other expenses	(1,923)	(2,928)	52.2%	(1.1%)
<b>OIBDA</b>	<b>733</b>	<b>1,858</b>	<b>153.7%</b>	<b>20.9%</b>
OIBDA Margin	13.3%	23.6%	10.3 p.p.	3.8 p.p.
Depreciation and amortization	(1,426)	(2,128)	49.3%	(3.8%)
<b>Operating Income (OI)</b>	<b>(693)</b>	<b>(270)</b>	<b>(61.0%)</b>	<b>(57.2%)</b>
CapEx	849	2,230	162.8%	(11.1%)
OpCF (OIBDA-CapEx)	(116)	(372)	n.m.	126.2%

(1) See adjustments made to calculate organic variation below.

Adjustments made to calculate organic variations

With respect to Telefónica Germany, we have made the following adjustments in order to calculate 2015/2014 variations in organic terms:

- **Changes in the scope of consolidation:** We have excluded the impact of changes in our consolidation perimeter in 2015 and 2014. The only change to our Telefónica Germany consolidation perimeter in such years related to the consolidation of E-Plus in Telefónica Germany since October 1, 2014. In order to exclude the impact of this change in our perimeter, we have consolidated E-Plus's results from January 1 to September 30, 2014 in our 2014 results.
- **Restructuring costs:** We have excluded the impact of restructuring costs associated with certain simplification processes implemented in Germany. In 2015, restructuring costs had a 74 million euros impact on OIBDA. In 2014, restructuring costs had a 414 million euros impact on OIBDA.
- **Spectrum acquisition:** We have excluded the impact of spectrum acquisitions in 2015, amounting to 1,198 million euros. There were no spectrum acquisitions in 2014.
- **Adjustments to the final purchase price of E-Plus:** In 2015 we have excluded the result from the difference between the preliminary purchase price of E-Plus (as estimated at the end of the valuation period) and the final purchase price agreed with KPN, totaling 104 million euros (which had a 102 million euros positive impact on OIBDA net of costs related to the acquisition).

The table below shows 2015/2014 variations in reported and organic terms (the latter, calculated in accordance with the adjustments referred to above) of certain income statement and other measures, and the contribution of each item for which we have adjusted to our reported growth:



TELEFÓNICA GERMANY 2015	YoY variation		Contribution to reported growth (percentage points)			
	%Reported YoY	%Organic YoY	Perimeter change (E-Plus)	Restructuring Costs	Spectrum acquisition	Adjustments to the final purchase Price of E-Plus
Revenues	42.9%	1.2%	41.1	--	--	--
Other income	150.4%	14.7%	32.3	--	--	98.6
Supplies	26.5%	(3.4%)	30.9	--	--	--
Personnel expenses	(20.9%)	(10.1%)	26.9	(39.0)	--	--
Other expenses	52.2%	(1.1%)	54.7	(0.9)	--	0.1
<b>OIBDA</b>	<b>153.7%</b>	<b>20.9%</b>	<b>50.2</b>	<b>46.5</b>	--	<b>13.9</b>
CapEx	162.8%	(11.1%)	36.8	--	141.2	--
<b>OpCF (OIBDA-CapEx)</b>	<b>n.m.</b>	<b>126.2%</b>	<b>(47.1)</b>	<b>(293.2)</b>	<b>1,031.3</b>	<b>(87.7)</b>

## Results Discussion

Total **revenues** were 7,888 million euros in 2015, up 42.9% year-on-year in reported terms due mainly to the consolidation of E-Plus since October 1, 2014 (which accounted for 41.1 p.p. of the year-on-year increase). In organic terms, revenues increased by 1.2% due mainly to higher handset sales arising from Christmas campaigns.

**Mobile service revenues** totaled 5,532 million euros in 2015, up 54.5% year-on-year in reported terms, due mainly to the consolidation of E-Plus since October 1, 2014 and to a lesser extent, the increasing share of the partner segment (second brands) within the customer base. Telefónica Germany continued to focus on data revenues, which increased by 58.4% and accounted for 51.3% of mobile service revenues in 2015. Non-P2P SMS data revenues amounted to 2,034 million euros (increasing 4.9% year-on-year), accounting for 71.6% of the total data revenues (+0.4 p.p. year-on-year).

**Fixed revenues** were 1,043 million euros in 2015, down 8.3% year-on-year, due to continued decrease in accesses.

**Mobile ARPU** was 10.7 euros in 2015, down 8.9% year-on-year, while contract ARPU stood at 17.2 euros down 6.5% year-on-year, as a result of the higher share of wholesale customers in the customer base. Data ARPU was 5.5 euros, down 6.8% year-on-year, mainly as a result of the continued decline of SMS volumes.

TELEFÓNICA GERMANY	2014	2015	%YoY
Voice Traffic (millions of minutes)	41,186	62,696	52.2%
ARPU (EUR)	11.8	10.7	(8.9%)
Prepay	5.4	5.8	8.2%
Contract (1)	18.4	17.2	(6.5%)
Data ARPU (EUR)	5.9	5.5	(6.8%)
% non-SMS over data revenues	71.2%	71.6%	0.4 p.p.

Notes:

(1) Excludes M2M.

**OIBDA** totaled 1,858 million euros in 2015, up 153.7% year-on-year in reported terms, as a result mainly of the consolidation of E-Plus (which accounted for 50.2 p.p. of the increase), the lower restructuring costs recorded in 2015 (+46.5 p.p.) and the positive result from the E-Plus preliminary acquisition price and the final acquisition price agreed on with KPN (+13.9 p.p.). In organic terms, OIBDA increased by 20.9% year-on-year, driven by the increased synergies, which mainly affected personnel expenses and supplies.

The **OIBDA margin** stood at 23.6% in reported terms for 2015, up 10.3 p.p. compared to 2014.

## TELEFÓNICA BRAZIL

The below table shows the evolution of accesses in Telefónica Brazil over the past two years as of December 31 of such years:

### ACCESSES

Thousands of accesses	2014	2015	%Reported YoY	%Organic YoY (1)
Fixed telephony accesses (2)	10,743.4	14,654.5	36.4%	(1.6%)
Internet and data accesses	4,082.6	7,195.5	76.2%	2.5%
Broadband	3,939.8	7,129.5	81.0%	3.6%
Fiber	374.6	3,779.9	n.m.	14.0%
Mobile accesses	79,932.1	73,261.3	(8.3%)	(8.3%)
Prepay	51,582.4	42,194.4	(18.2%)	(18.2%)
Contract	28,349.7	31,066.9	9.6%	9.6%
M2M	3,506.9	4,234.7	20.8%	20.8%
Pay TV	770.6	1,787.9	132.0%	9.7%
<b>Final Clients Accesses</b>	<b>95,528.6</b>	<b>96,899.3</b>	<b>1.4%</b>	<b>(6.4%)</b>
<b>Wholesale Accesses</b>	<b>25.9</b>	<b>22.3</b>	<b>(14.0%)</b>	<b>(14.0%)</b>
<b>Total Accesses</b>	<b>95,554.5</b>	<b>96,921.5</b>	<b>1.4%</b>	<b>(6.4%)</b>

Notes:

(1) In order to calculate organic changes, we have added the accesses of GVT as of December 31, 2014 to our accesses as of such date.

(2) Includes "fixed wireless" and Voice over IP accesses.

The below table shows the contribution of each item for which we have adjusted to our reported growth. With respect to each line item, the contribution to reported growth of such line item, expressed in p.p., is the result of dividing the impact of each item for which we have adjusted by the amount of such line item, on a reported basis, for the prior year:

TELEFÓNICA BRAZIL 2015	%Reported YoY	%Organic YoY (1)	GVT
Fixed telephony accesses	36.4%	(1.6%)	38.6 p.p.
Internet and data accesses	76.2%	2.5%	72.0 p.p.
Broadband	81.0%	3.6%	74.6 p.p.
Fiber	n.m.	14.0%	785.0 p.p.
Pay TV	132.0%	9.7%	111.5 p.p.
<b>Final Clients Accesses</b>	<b>1.4%</b>	<b>(6.4%)</b>	<b>8.3 p.p.</b>
<b>Total Accesses</b>	<b>1.4%</b>	<b>(6.4%)</b>	<b>8.3 p.p.</b>

Notes:

(1) In order to calculate organic changes, we have added the accesses of GVT as of December 31, 2014 to our accesses as of such date.

Telefónica Brazil closed the year 2015 improving its competitive position in the mobile as well as in the fixed market. In the mobile business, Telefónica Brazil kept its leadership in the higher value segments, which permitted the operator to capture mobile market revenue growth in 2015. In the fixed business, the transformation towards fiber and Pay-TV was strengthened by the GVT consolidation in May 2015, adding as of December 31, 2015, 8.5 million customers to the Group.

Revenues and OIBDA evolution were positively supported by the acceleration of mobile data and the good evolution of fixed broadband and Pay-TV. Additionally, Telefónica Brazil carried out costs control measures aimed at offsetting the adverse macroeconomic situation.

However, results in 2015 were adversely affected by the interconnection tariff reduction in the mobile business (-33.0%) and in the retail fixed-mobile tariff (-23.3%) since February 24, 2015.

Telefónica Brazil reached 96.9 million **accesses** at December 31, 2015, up 1.4% due mainly to the consolidation of GVT. Excluding the impact of such consolidation, accesses were down 6.4%, due to the disconnection of prepay accesses.

In the **mobile business**, the strategic focus remained on gaining and retaining high value customers, reaching a market share of 42.4% in the contract segment as of December 31, 2015 (Source: ANATEL). Telefónica Brazil maintained its market leadership in terms of total accesses with a market share of 29.5% as of December 2015 (source: ANATEL). The commercial offer in the contract segment included a higher data volume, more minutes of voice traffic and innovative products such as "Vivo Bis" (pursuant to which the data not consumed in a month is automatically added to data available for the following month). The contract growth was partially offset by the disconnection of 11.5 million prepay accesses.

In the **fixed business**, Telefónica Brazil maintained its strategic focus on fiber deployment, with 16.6 million premises passed with FTTx at December 31, 2015 and 3.8 million homes connected, and also on increasing Pay-TV accesses (up 10% year-on-year). Fixed telephony accesses stood at 14.7 million in 2015, up 36.4% in reported terms due mainly to the consolidation of GVT. In organic terms, these accesses were down by 1.6% year-on-year. Retail broadband customers totaled 7.1 million customers as of December 31, 2015, up 81.0% year-on-year due mainly to the consolidation of GVT (up 3.6% year-on-year in organic terms due to the increase of fiber accesses). Of the 7.1 million customers at the end of 2015, 53.0% were connected with FTTC. Pay TV customers stood at 1.8 million as of December 31, 2015, up 132.0% in reported terms due mainly to the consolidation of GVT, increasing by 9.7% year-on-year in organic terms due to a higher penetration of high value and IPTV clients. IPTV accesses increased their relevance, representing 9.6% of total Pay-TV accesses.

The table below shows the evolution of Telefónica Brazil's results over the past two years:

Millions of euros

TELEFÓNICA BRAZIL	2014	2015	%Reported YoY	%Organic YoY (1)
Revenues	11,231	11,060	(1.5%)	4.5%
<b>Mobile Business</b>	<b>7,618</b>	<b>6,906</b>	<b>(9.3%)</b>	<b>6.2%</b>
Mobile service revenues	7,228	6,495	(10.1%)	5.3%
<b>Fixed Business</b>	<b>3,613</b>	<b>4,154</b>	<b>15.0%</b>	<b>1.9%</b>
Other income	261	416	59.3%	35.4%
Supplies	(2,680)	(2,568)	(4.2%)	4.4%
Personnel expenses	(976)	(1,042)	6.8%	3.5%
Other expenses	(4,293)	(4,293)	(0.0%)	8.6%
<b>OIBDA</b>	<b>3,543</b>	<b>3,573</b>	<b>0.9%</b>	<b>2.9%</b>
OIBDA Margin	31.5%	32.3%	0.8 p.p.	(0.5 p.p.)
Depreciation and amortization	(1,762)	(1,916)	8.7%	12.9%
<b>Operating Income (OI)</b>	<b>1,781</b>	<b>1,657</b>	<b>(6.9%)</b>	<b>(6.7%)</b>
CapEx	2,933	2,105	(28.2%)	(1.1%)
OpCF (OIBDA-CapEx)	610	1,468	140.8%	9.3%

(1) See adjustments made to calculate organic variation below.

Adjustments made to calculate organic variations

As explained above, year-on-year changes referred to in this document as "organic" or presented in "organic terms" intend to present year-on-year variations on a comparable basis. With respect to Telefónica Brazil, we have made the following adjustments in order to calculate 2015/2014 variations in organic terms:

- **Foreign exchange effects:** We have excluded the impact of changes in exchange rates by assuming constant average foreign exchange rates in 2015 and 2014. In particular, we have used the average foreign exchange rate of 2014 for both years. Foreign exchange rates had a negative impact on our reported 2015 Telefónica Brazil results as a result of the depreciation of the Brazilian real.
- **Changes in the scope of consolidation:** We have excluded the impact of changes in our consolidation perimeter in 2015 and 2014. The only change to our Telefónica Brazil consolidation perimeter in such years related to the consolidation of GVT since May 1, 2015. In order to exclude the impact of this change in our perimeter, we have consolidated GVT's results from May 1 to December 31, 2014 in our 2014 results.
- **Restructuring costs:** We have excluded the impact of certain restructuring costs associated with certain simplification processes implemented in Telefónica Brazil. In 2015, these restructuring costs totaled 7 million euros. In 2014, these restructuring costs totaled 68 million euros.
- **Spectrum acquisition:** We have excluded the impact of spectrum acquisitions in 2014 amounting to 889 million euros (related to a LTE block in the 700 MHz band) while there were no spectrum acquisitions in 2015.
- **Results of tower sales:** The results attributable to the sale of towers in 2015 and 2014 have been excluded in both years. The results from the sale of towers totaled 10 million euros and 1 million euros in 2015 and 2014, respectively.

The table below shows 2015/2014 variations in reported and organic terms (the latter, calculated in accordance with the adjustments referred to above) of certain income statement and other measures, and the contribution of each item for which we have adjusted to our reported growth:

	YoY variation		Contribution to reported growth (percentage points)				
TELEFÓNICA BRAZIL 2015	%Reported YoY	%Organic YoY	Exchange rate effect	Perimeter change (GVT)	Restructuring Costs	Spectrum acquisition	Towers sales
Revenues	(1.5%)	4.5%	(16.6)	10.1	--	--	--
Other income	59.3%	35.4%	(26.9)	34.5	--	--	4.1
Supplies	(4.2%)	4.4%	(16.2)	7.2	--	--	--
Personnel expenses	6.8%	3.5%	(18.1)	26.8	(6.2)	--	--
Other expenses	(0.0%)	8.6%	(16.9)	7.6	--	--	--
<b>OIBDA</b>	<b>0.9%</b>	<b>2.9%</b>	<b>(17.0)</b>	<b>12.5</b>	<b>1.7</b>	<b>--</b>	<b>0.3</b>
CapEx	(28.2%)	(1.1%)	(12.1)	15.1	--	(30.3)	--
<b>OpCF (OIBDA-CapEx)</b>	<b>140.8%</b>	<b>9.3%</b>	<b>40.7</b>	<b>0.2</b>	<b>9.9</b>	<b>145.8</b>	<b>1.7</b>

## Results Discussion

**Revenues** totaled 11,060 million euros in 2015, down 1.5% in reported terms, mainly due to the depreciation of the Brazilian real (which accounted for -16.6 p.p. of the evolution) and partially offset by the impact of the consolidation of GVT (+10.1 p.p.). In organic terms, the year-on-year variation was 4.5%, principally due to the good evolution in the mobile business (+6.2% year-on-year) as well as the fixed business (+1.9% year-on-year), which was partially offset by the impact of the regulatory interconnection tariff reduction (-2.7 p.p. of the year-on-year variation).

- **Revenues from the mobile business** totaled 6,906 million euros in 2015, down 9.3% in reported terms due mainly to the depreciation of the Brazilian real (which accounted for -15.3 p.p. of the evolution). Excluding this impact, revenues from the mobile business increased by 6.2% due to the positive evolution of service revenues (+5.3% year-on-year) as a result of the good performance of outbound revenues, which increased as a result of an increase in the contract customer base and the higher data penetration. This trend was partially offset by lower inbound revenues affected by lower interconnection tariffs. Handset revenues were up by 5.1% in reported terms, due to higher proportion of contract add and higher smartphones and LTE handset sales.
- **Fixed telephony revenues** totaled 4,154 million euros, up by 15.0% in reported terms due mainly to the consolidation of GVT (+31.9 p.p.) and were partially offset by the impact of depreciation of the Brazilian real (which accounted for -19.4 p.p. of the evolution). Excluding these effects, revenues were up by 1.9%, mainly due to the increase in fixed broadband revenues, which were up by 9.3% supported by the increase of fiber and the growth of Pay TV accesses with higher ARPU, in spite of the lower retail fixed-mobile tariff (-2.5 p.p.).

The **mobile ARPU** decreased 13.2% year-on-year in reported terms due mainly to depreciation of the Brazilian real. In organic terms, it increased 1.6% year-on-year as a consequence of the higher data ARPU which more than offset the negative impact of the reduction in the mobile termination rates. We believe the high quality of the customer base is reflected in an increase in the outbound ARPU and the 31.5% growth in the data ARPU.

TELEFÓNICA BRAZIL	2014	2015	%YoY	%Local Currency YoY
Voice Traffic (millions of minutes)	127,412	131,029	2.8%	2.8%
<b>ARPU (EUR)</b>	<b>7.3</b>	<b>6.3</b>	<b>(13.2%)</b>	<b>1.6%</b>
Prepay	3.9	3.2	(18.5%)	(4.7%)
Contract (1)	15.7	13.3	(15.0%)	(0.7%)
<b>Data ARPU (EUR)</b>	<b>2.6</b>	<b>2.9</b>	<b>12.5%</b>	<b>31.5%</b>
% non-SMS over data revenues	77.4%	82.9%	5.5 p.p.	5.5 p.p.

Notes:

(1) Excludes M2M.

**OIBDA** stood at 3,573 million euros in 2015, up 0.9% in reported terms due mainly to the consolidation of GVT (which accounted for +12.5 p.p. of the evolution) and, to a lesser extent, the lower restructuring costs incurred in 2015 compared to 2014 (+1.7 p.p.), and the higher results from the sale of towers compared to 2014 (+0.3 p.p.), all of which was partially offset by the negative impact of the depreciation of the Brazilian real (-17.0 p.p.). In organic terms, the year-on-year increase was 2.9% due to revenue growth and cost efficiency offsetting a worse macro scenario with higher inflation, high devaluation and a higher rate of bad debt. Personnel expenses totaled 1,042 million euros in 2015, up 6.8% in reported terms as result mainly of the consolidation of GVT, which was partially offset by the depreciation of the Brazilian real. In organic terms, personnel expenses increased by 3.5% year-on-year due to higher social benefits and the internalization of the work of certain network contractors which more than offset the savings resulting from restructuring plans in 2014. In addition, network costs grew due to higher energy costs and the deployment and improvement of fixed- and mobile networks, legal contingencies and higher content costs. OIBDA was also positively impacted by the expiration of a payment obligation (98 million euros).

**The OIBDA margin** stood at 32.3% in reported terms for 2015, up 0.8 p.p. compared to 2014.

## TELEFÓNICA HISPANOAMÉRICA

The below table shows the evolution of accesses in Telefónica Hispanoamérica over the past two years as of December 31 of such years:

### ACCESSES

Thousands of accesses	2014	2015	% Reported YoY
Fixed telephony accesses (1) (2)	13,374.4	12,829.8	(4.1%)
Internet and data accesses	5,433.8	5,667.8	4.3%
Broadband	5,379.4	5,610.4	4.3%
Mobile accesses	110,346.5	113,302.7	2.7%
Prepay (3)	86,698.0	88,332.8	1.9%
Contract	23,648.5	24,969.8	5.6%
M2M	2,062.2	2,296.9	11.4%
Pay TV	2,431.9	2,812.2	15.6%
<b>Final Clients Accesses</b>	<b>131,586.6</b>	<b>134,612.4</b>	<b>2.3%</b>
<b>Wholesale Accesses</b>	<b>16.4</b>	<b>30.9</b>	<b>87.8%</b>
<b>Total Accesses T. Hispanoamérica</b>	<b>131,603.0</b>	<b>134,643.3</b>	<b>2.3%</b>

Notes:

(1) Includes "fixed wireless" and Voice over IP accesses.

(2) Includes 50 thousand "fixed wireless" additional customers in Peru, in the second quarter of 2014.

(3) In the fourth quarter of 2014, 1.8 millions of inactive customers were disconnected in Central America.

Total accesses in Telefónica Hispanoamérica reached 134.6 million accesses at December 31, 2015 (+2.3% year-on-year).

**Mobile accesses** totaled 113.3 million (+2.7% year-on-year) due to positive net adds of 3.0 million accesses.

- There was strong contract segment growth, which expanded by 5.6% year-on-year. Growth was particularly strong in Peru (+12.9% year-on-year), Mexico (+22.3% year-on-year) and Chile (+4.2% year-on-year). Annual net adds reached 1.3 million accesses, primarily due to Peru (+659 thousand net adds) which benefitted from a successful migration strategy (from prepay to contract). Mexico also showed positive net adds (+327 thousand accesses) due to higher commercial activity.
- In the prepay segment (+1.9% year-on-year), with net adds of 1.6 million customers, growth was driven mainly by Mexico (+2.9 million customers) while Venezuela and Central America closed with 1.2 million net adds, partially compensating the net loss in Chile (-0.9 million customers) and Peru (-0.7 million customers) where we have faced a fierce competition and we have concentrated on high value customers migrating the best prepaid customers to contract and not following competition offers that would damage the quality of our networks due to intense traffic.
- There was growth in smartphones (+43.7% year-on-year) to 40.2 million accesses as of December 31, 2015, with a penetration over mobile accesses of 36.7% (+10.4 p.p. year-on-year), related mainly to Mexico, Argentina, Peru and Colombia. 4G handsets also continued to grow, reaching 8.3 million accesses as of December 31, 2015 (corresponding to a penetration of 7.4%).

Traditional **fixed business accesses** stood at 12.8 million at December 31, 2015 (-4.1% year-on-year), with negative net adds of 545 thousand customers, affected by the erosion of traditional fixed business in the region, including Chile (-5.9% year-on-year), Peru (-4.4% year-on-year), Colombia (-2.1% year-on-year) and Argentina (-1.9% year-on-year).

**Broadband accesses** totaled 5.6 million at December 31, 2015 (+4.3% year-on-year), after reaching net adds of 0.2 million accesses during 2015 due mainly to access growth in Peru (+8.0%), Chile (+5.8%) and Colombia (+4.0%). The penetration of fixed broadband accesses over traditional fixed business accesses was 43.7% at December 31, 2015 (+3.5 p.p. year-on-year). There was progressive migration towards data plans with higher speeds, with 53.4% of broadband accesses having a speed over 4Mb at December 31, 2015 (+4 p.p. year-on-year).

Pay **TV accesses** totaled 2.8 million (+15.6% year-on-year), with net adds of 0.4 million accesses as a result of an improvement in all countries in the region that offer the service. Growth was particularly positive in Peru (+26.7% year-on-year), Colombia (+17.5%) and Chile (+7.2%).

The table below shows the evolution of Telefónica Hispanoamérica's results over the past two years:

Millions of euros

TELEFÓNICA HISPANOAMÉRICA	2014	2015	%Reported YoY	%Organic YoY (1)
Revenues	13,155	14,387	9.4%	10.1%
<b>Mobile Business</b>	<b>9,578</b>	<b>10,347</b>	<b>8.0%</b>	<b>10.2%</b>
Mobile service revenues	8,454	9,160	8.4%	10.6%
<b>Fixed Business</b>	<b>3,604</b>	<b>4,070</b>	<b>12.9%</b>	<b>10.0%</b>
Other income	254	347	36.5%	29.6%
Supplies	(3,841)	(4,176)	8.7%	7.2%
Personnel expenses	(1,525)	(1,686)	10.6%	16.0%
Other expenses	(3,975)	(4,516)	13.6%	15.1%
<b>OIBDA</b>	<b>4,068</b>	<b>4,356</b>	<b>7.1%</b>	<b>7.2%</b>
OIBDA Margin	30.9%	30.3%	(0.6 p.p.)	(0.8 p.p.)
Depreciation and amortization	(2,034)	(2,241)	10.2%	7.8%
<b>Operating Income (OI)</b>	<b>2,034</b>	<b>2,115</b>	<b>4.0%</b>	<b>6.7%</b>
CapEx	2,842	3,060	7.7%	17.2%
OpCF (OIBDA-CapEx)	1,226	1,296	5.7%	(7.0%)

(1) See adjustments made to calculate organic variation below.

Adjustments made to calculate organic variations

As explained above, year-on-year changes referred to in this document as "organic" or presented in "organic terms" intend to present year-on-year variations on a comparable basis.

With respect to Telefónica Hispanoamérica, we have made the following adjustments in order to calculate 2015/2014 variations in organic terms:

- **Foreign exchange effects and the impact of hyperinflationary adjustments in Venezuela:** We have excluded the impact of changes in exchange rates by assuming constant average foreign exchange rates in 2015 and 2014. In particular, we have used the average foreign exchange rates of 2014 for both years.

We have also excluded the impact of hyperinflationary adjustments in Venezuela.

- **Restructuring costs:** We have excluded the impact of certain restructuring costs associated with certain simplification processes implemented in Telefónica Hispanoamérica. In 2015, restructuring costs totaled 38 million euros. In 2014, restructuring costs totaled 99 million euros.
- **Results of tower sales:** The results attributable to the sale of towers in 2015 and 2014 have been excluded, which totaled 18 million euros (mainly in Chile) in 2015 and 4 million euros in 2014.



- **Spectrum acquisition:** We have excluded the impact of spectrum acquisitions in 2015 and 2014. In 2015, these acquisitions totaled 338 million euros and related to Telefónica Argentina (196 million euros), Telefónica Ecuador (127 million euros), Telefónica Chile (6 million euros) and Telefónica México (8 million euros). In 2014, these acquisitions totaled 405 million euros and related to Telefónica Argentina (168 million euros), Telefónica Colombia (111 million euros) and Telefónica Venezuela and Central America (126 million euros).

The table below shows 2015/2014 variations in reported and organic terms (the latter, calculated in accordance with the adjustments referred to above) of certain income statement and other measures, and the contribution of each item for which we have adjusted to our reported growth:

TELEFÓNICA HISPANOAMÉRICA 2015	YoY variation		Contribution to reported growth (percentage points)			
	%Reported YoY	%Organic YoY	Exchange rate effect and Hyperinflation	Towers sales	Restruc turing Costs	Spectrum acquisition
Revenues	9.4%	10.1%	(0.6)	--	--	--
Other income	36.5%	29.6%	2.1	5.1	--	--
Supplies	8.7%	7.2%	1.5	--	--	--
Personnel expenses	10.6%	16.0%	--	--	(4.1)	--
Other expenses	13.6%	15.1%	(1.4)	--	--	--
<b>OIBDA</b>	<b>7.1%</b>	<b>7.2%</b>	<b>(2.0)</b>	<b>0.3</b>	<b>1.5</b>	<b>--</b>
CapEx	7.7%	17.2%	(3.6)	--	--	(3.3)
<b>OpCF (OIBDA-CapEx)</b>	<b>5.7%</b>	<b>(7.0%)</b>	<b>1.5</b>	<b>1.0</b>	<b>5.1</b>	<b>7.7</b>

## Results Discussion

**Revenues** amounted to 14,387 million euros in 2015, increasing 9.4% year-on-year in reported terms mainly due to the good results of data revenues (fixed as well as mobile) and voice revenues, in both cases due to a higher customer base, increased consumption and higher data penetration. This increase was partially offset by foreign exchange effects and hyperinflation in Venezuela and the decrease in mobile termination rates. In organic terms, revenues increased 10.1% year-on-year.

- Mobile service revenues reached 9,160 million euros in 2015, up 8.4% year-on-year in reported terms mainly due to increased revenues in Argentina, Peru, Mexico and Chile, as explained in greater detail below, which was partially offset by the foreign exchange effects and the hyperinflation in Venezuela (which accounted for -2.2 p.p. of the year-on-year variation). Mobile service revenues performance by country was as follows:
  - In Argentina, mobile service revenues reached 2,194 million euros in 2015 and grew by 29.2% year-on-year in reported terms mainly due to the good performance of consumption and data penetration and, to a lesser extent, the growth of the voice business and the foreign exchange effect (which increased growth by 6.4 p.p.). In local currency, these revenues grew by 22.9%.
  - In Mexico, mobile service revenues reached 1,539 million euros in 2015, increasing by 8.9% in reported terms mainly due to a higher customer base and the positive performance of the data business. In local currency these revenues grew by 8.4%, accounting the foreign exchange effect for 0.5 p.p. of the year-on-year reported increase.
  - In Chile, mobile service revenues reached 1,177 million euros in 2015, up 5.8% in reported terms year-on-year mainly due to the foreign exchange effect (which accounted for 4.6 p.p. of the increase) and the increase in data revenues, which more

than compensated the fall in the traditional voice business and the lower mobile termination rates. In local currency these revenues grew by 1.2%.

- In Peru, mobile service revenues reached 1,390 million euros in 2015, up 11.2% in reported terms mainly due to the foreign exchange effect (which accounted for 7.0 p.p. of the increase) and the higher contract customer base, the data boom and higher inbound revenues.
- In Venezuela and Central America, mobile service revenues reached 1,261 million euros in 2015, down 3.5% in reported terms mainly due to the foreign exchange effect and hyperinflation in Venezuela (which decreased growth in 35.1 p.p.). Excluding these effects, these revenues increased by 31.7% mainly due to the higher tariffs in all services in order to try to compensate the high inflation in Venezuela and the higher non-SMS data revenues (+83% in 2015), which represented 83.4% of total data revenues (+11.4 p.p. year-on-year).
- Data revenues in the segment were up by 19.5% in reported terms in 2015, reaching 3,198 million euros mainly due to the increase in penetration of data which increased from 31.7% to 34.9% in 2015 and higher data usage. This increase was partially offset by foreign exchange effects and hyperinflation in Venezuela (which decreased growth by 4.2 p.p.). Excluding these effects, these revenues grew by 23.6% as a result of the aforementioned increase in penetration of data.
- Fixed business revenues reached 4,070 million euros in 2015, up 12.9% in reported terms mainly due to the increase in broadband and new services revenues (+20.5%). Revenues from broadband and new services, accounted for 64.7% of fixed revenues (+4.9 p.p. year-on-year). The growth was mainly related to Argentina which experienced a substantial increase in voice and broadband revenues, as well as Chile and Peru, which had increased broad band revenues. Excluding the foreign exchange effect and hyperinflation in Venezuela (which decreased growth by 2.9 p.p.) these revenues grew by 10.0%.

**ARPU** was up by 6.1% in 2015, due to the data ARPU increase (+19.9% year-on-year) due to the increase of smartphone penetration and higher average consumption, which offset voice ARPU decrease. The lower ARPU was mainly due to lower interconnection costs and the devaluation of certain Latin American currencies against the U.S. dollar, which more than offset the increase in outgoing voice ARPU (up 7.0% year-on-year).

**OIBDA** reached 4,356 million euros in 2015, up 7.1% in reported terms (+7.2% in organic terms), being Telefónica Argentina, Telefónica Peru and Telefónica Chile the main contributors to this growth, as higher revenues offset higher costs. OIBDA was positively affected by a spectrum swap in Mexico with AT&T in December 2015 (which contributed 79 million euros). The higher costs were mainly attributable to:

- higher commercial costs, due to higher handset costs as a result of higher high-end handset sales (which more than offset lower interconnection costs resulting from the mobile termination rates reductions in Chile, Colombia, Peru and Mexico);
- higher personnel costs driven by increases in inflation in some countries of the region;
- higher costs related to commercial campaigns, higher network costs due to higher voice and data traffic; and
- higher costs resulting from the devaluation of certain Latin American currencies against the U.S. dollar.

Additional information by country is provided below:

- Argentina: OIBDA reached 1,006 million euros, up by 25.4% in reported terms mainly due to the exchange rate effect and higher service revenues, more than offsetting the higher costs resulting from the overall prices increase, although Telefónica continued to carry out cost containment plans in order to offset the inflation effect. In local currency, the year-on-year variation was 19.2%.
- Chile: OIBDA reached 760 million euros, up 7.4% in reported terms mainly due to the exchange rate effect and higher service revenues, lower supply costs due to regulatory changes (lower interconnection costs resulting from the mobile termination rates reduction) and efficiency measures that helped to offset the commercial effort made to gain higher value customers. In local currency, the year-on-year variation was 2.7%.
- Peru: OIBDA reached 943 million euros, up by 11.8% in reported terms mainly due to the exchange rate effect and higher service revenues, which more than offset higher commercial costs resulting from higher competitive pressure in the Peruvian market. In local currency OIBDA decreased by 4.7% year-on-year.
- Venezuela and Central America: OIBDA reached 342 million euros, down by 26.1% in reported terms mainly due to the exchange rate effect and hyperinflation in Venezuela. Excluding these impacts, OIBDA grew 15.8% mainly driven by higher service revenues, which compensated the overall rise in prices, and higher purchases in dollars for services and equipment purchases, which were affected by the currency devaluation in Venezuela.

**OIBDA margin** reached 30.3% in 2015, with a year-on-year decrease of 0.6 p.p. in reported terms. This margin decrease was driven by lower margins in all countries in the segment except Mexico (which benefitted from higher commercial efforts focused on higher value segments), especially in Argentina and Colombia.

## Liquidity and Capital Resources

### Financing

In 2016, Telefónica's financing activity amounted approximately to 10,542 million euros, excluding euro commercial paper and short term banking loans, 9.5% of which were treated as equity (hybrid) and the remaining amount as financial debt. The activity focused mainly on strengthening the liquidity position, refinancing the debt maturities in an environment of very low interest rates, and extending the debt maturities.

The main financing transactions carried out in the bond market in 2016 are as follows:

Item	Date	Maturity Date	Nominal (millions)			Coupon
			Currency	Euros	Currency of issuance	
Telefónica Emisiones, S.A.U.						
EMTN Bond	04/13/16	04/13/22	1,400	1,400	EUR	0.75%
	04/13/16	04/13/26	1,350	1,350	EUR	1.46%
	10/17/16	10/17/20	1,250	1,250	EUR	0.318%
	10/17/16	10/17/31	750	750	EUR	1.93%
	12/28/16	12/28/51	150	150	EUR	4.00%
Telefónica Participaciones, S.A.U.						
Cash-settled equity-link bonds non-dilutive (*)	03/09/16	03/09/21	600	600	EUR	0%
Telefónica Móviles Chile, S.A.						
Bond	09/28/16	09/13/21	94,410	134	CLP	4.90%
(*) Referenced to the trading price of Telefónica, S.A.						

(\*) Referenced to the trading price of Telefónica, S.A.

The main financing transactions carried out in the bank market in 2016 are as follows:

Group Company/Description	Limit	Currency	Outstanding balance (millions of euros)	Arrangement Date	Maturity date
Telefónica, S.A.					
Bilateral loan	100	EUR	100	02/23/16	02/23/19
Bilateral loan	100	EUR	100	02/23/16	02/23/21
Loan	300	EUR	300	03/08/16	03/08/21
Bilateral loan	300	EUR	300	10/24/16	03/19/19
Telefónica Móviles Chile, S.A.					
Syndicated	150	USD	135	04/15/16	04/15/21
Telefónica Germany GmbH & Co. OHG					
Syndicated	750	EUR	50	03/22/16	03/22/21
EIB Financing <sup>(1)</sup>	450	EUR	250	06/13/16	06/13/25
Telefónica Europe, B.V.					
Structured financing <sup>(*)</sup>	1.500	EUR	-	11/28/16	11/28/24

(\*) Facility with amortization schedule.

(1) This financing is split in 5 tranches with a maturity to as late as 2025.

### Availability of funds

As of December 31, 2016, Telefónica's liquidity, amounting to 21,274 million euros, includes: undrawn committed credit facilities arranged with banks for an amount of 14,627 million euros (of which 13,491 million euros maturing in more than 12 months); and cash equivalents and current financial assets other than those in Venezuela.

Additional information on sources of liquidity and undrawn lines of credit available to the Company, on liquidity risk management, on the Company's debt levels, and on capital management is provided in Notes 12, 13 and 16 to the consolidated financial statements.

### Contractual commitments

Note 18 to the consolidated financial statements provides information on firm commitments giving rise to future cash outflows and associated with purchases and services received in relation to the Company's principal activity, and any operating leases for buildings and assets related to the Company's activity, primarily.

### Credit risk management

The Telefónica Group considers credit risk management as a key element to achieve its business and customer base growth targets in a manner that is both sustainable and consistent with Telefónica Corporate Risk Management Policy. This management approach relies on the active monitoring of the risk-reward balance within the commercial operations and on the adequate separation between the risk ownership and risk management functions.

Formal delegation of authority procedures and management practices are implemented in all Group companies, taking into account benchmark risk management techniques but adapted to the local characteristics of each market. Debtors that may cause a relevant impact on the Telefónica Group consolidated financial statements and increased risk profile products – due to customer target, term, channels or other commercial characteristics - are subject to specific management practices in order to mitigate the exposure to credit risk. These procedures include:

- Statistical and expert models for customer acquisition that are used to forecast and to manage the expected probability of default of the transactions.
- Decision tools allowing the implementation of tailored credit strategies by product, channel, geography and type of customer.
- Continuous monitoring of the payment behavior and solvency of the customer portfolio.
- Internal and external collection processes designed to increase recovery through differentiated actions by debt age and customer profile.
- Ongoing controls over the credit risk exposure performed by specific committees.

The commercial credit risk management strategy is embedded in the day-to-day operational processes guiding both the product and services available for the different customer profile and the management practices all through the customer life-cycle.

### Credit rating

At December 31, 2016, Telefónica, S.A.'s long-term issuer default rating is "BBB stable outlook" from Fitch, "Baa3 stable outlook" from Moody's and "BBB stable outlook" from Standard & Poor's. During 2016, there have been changes in the credit ratings by the three agencies. Moody's downgraded the rating to "Baa3 stable" from "Baa2 negative" on November 7, 2016, Fitch downgraded the rating to "BBB

stable" from "BBB+ stable" on September 5, 2016 and Standards and Poor's revised the outlook to "stable" from "positive" on May 17, 2016.

European Commission's decision to block the proposed sale of O2 U.K. to Hutchison's Three U.K. had an impact on Telefónica's credit ratings and outlooks by Moody's and Standards and Poor's, as they considered that such decision would delay the Company's deleveraging process. In 2016, among the measures taken to protect the credit rating, it is noteworthy the change in the shareholder remuneration policy (see dividend policy below), together with the announcement of the commitment to maintain a solid investment grade credit rating. Additionally, it is worth highlighting the strong financing activity undertaken during 2016 together with the maintenance of an appropriate level of liquidity, an active portfolio management through the announced intention to continue analyzing best strategic alternatives for O2 UK and Telxius, the executed sale of Telefé and the partial disposal of China Unicom, as well as the issuance of undated deeply subordinated securities as a solvency protection measure to mitigate negative impacts on our consolidated financial statements.

### Dividend policy

Telefónica, S.A.'s dividend policy is revised yearly based on the Group's earnings, cash generation, solvency, liquidity, flexibility to make strategic investments, and shareholder and investor expectations. In 2016, the Annual General Meeting approved to pay a dividend, via scrip dividend of approximately 0.35 euros per share to be paid in November 2016.

On October 27, 2016, the Board of Directors of Telefónica, S.A. decided to modify the dividend policy for the years 2016 and 2017, announcing for the year 2016 the payment of 0.55 euros per share, adding to the scrip approved by the Annual Shareholders Meeting, the payment of 0.20 euros in cash in the second quarter of 2017. Relating to 2017, it was announced that the dividend would amount to 0.40 euros per share: 0.20 euros in the fourth quarter of 2017 and 0.20 euros in the second quarter of 2018. Both tranches would be paid in cash.

On November 2016, Telefónica launched a scrip dividend issue to allow shareholders to choose to receive new shares in place of a cash dividend (which may be replaced by selling the associated subscription rights to the Company at a pre-established price), while enabling the Company to reduce its debt, depending on the take-up rate of the conversion.

## Share price performance

European equity markets posted a volatile performance in 2016, a year characterized by various political events. The first months of the year were affected by doubts around economic growth in China, which negatively affected the performance of emerging countries. In June, the United Kingdom voted in a referendum not to continue in the European Union, which triggered sharp drops in the markets, reaching annual lows. In November, the elections in the United States once again generated an increase of volatility in the markets. With regard to monetary policy, the ECB expanded its debt repurchasing program and lowered interest rates to 0% with the aim of generating higher economic activity and increasing inflation levels. The Federal Reserve, in turn, delayed the expected interest rate increase until December.

In this context, the main European indexes closed 2016 with a mixed performance (EStoxx-50 +0.7%); highlighting the positive performance of the FTSE-100 (+14.4%), which was driven by the high weight of mining companies and the depreciation of the sterling pound, which favored exporters and multinational companies with limited exposure to the domestic market; DAX (+6.9%), CAC-40 (+4.9%). The Ibex-35 (-2.0%) along with the FTSEMIB (-10.2%) were the only indexes closing the year with losses as a result of their exposure to emerging markets and, in the case of the Italian index, uncertainty regarding the banking sector.

Among sectors included in the European DJ Stoxx-600 (-1.2%), basic resources (+61.9%), oil & gas (+22.9%) and construction & materials (+9.2%), led positive performances, whereas health care (-10.2%), travel & leisure (-11.1%) and telecommunications (-15.8%) posted losses. The relative worse performance of the telecommunications sector during the year is due to the cancellation of certain corporate transactions, adverse regulatory news, weak revenue growth trends, and concerns over capex increases, along with rotation towards more cyclical sectors following the elections in the United States.

Telefónica share closed 2016 at 8.82 euros per share, with a total shareholder return of -6.3%, reflecting the evolution of the share price (-13.8%) and dividends distributed in the year (0.40 euros in cash and 0.35 euros in scrip). The profitability is higher than that of the sector in Europe, which showed a total shareholder return after dividends of -11.7%.

Telefónica closed the 2016 financial year with a market capitalization of 44,433 million euros, ranking as the eleventh company in the telecommunications sector worldwide. The daily traded volume in the Spanish stock exchange amounted to 24.6 million shares.

## Treasury shares

Telefónica has performed, and may consider performing, transactions with treasury shares and financial instruments or contracts that confer the right to acquire treasury shares or assets whose underlying is Company shares.

Treasury share transactions will always be for legitimate purposes, including:

- Undertaking treasury share acquisitions approved by the Board of Directors or pursuant to General Shareholders' Meeting resolutions.
- Honoring previous legitimate commitments assumed.
- Covering requirements for shares to allocate to employees and management under stock option plans.
- Other purposes in accordance with prevailing legislation. In the past, treasury shares purchased on the stock market were exchanged for other shares-securities (as in the case of preferred capital securities), swapped for stakes in other companies (e.g. China Unicom, Telco S.p.A., or Telefônica Brasil, S.A.) acquired to reduce the number of shares in circulation (by redeeming the shares acquired), thereby boosting earnings per share.

Treasury share transactions will not be performed in any event based on privileged information or in order to intervene in free price formation. In particular, any of the conduct referred to in Articles 83.ter.1 of the Spanish Securities Market Law and 2 of Royal Decree 1333/2005 of November 11 implementing the Spanish Securities Market Law, with regards to market abuse will be avoided.

At December 31, 2016, 2015 and 2014, Telefónica, S.A. held the following treasury shares:

	Number of shares	Euros per share		Market value(*)	%
		Acquisition price	Trading price		
Treasury shares at 12/31/16	141,229,134	10.48	8.82	1,246	2.80339%
Treasury shares at 12/31/15	141,639,159	11.69	10.24	1,450	2.84690%
Treasury shares at 12/31/14	128,227,971	11.68	11.92	1,528	2.75332%

(\*) Millions of euros

In 2016, 2015 and 2014 the following transactions involving treasury shares were carried out:



	Number of shares
<b>Treasury shares at 12/31/13</b>	<b>29,411,832</b>
Acquisitions	100,723,415
Disposals	(129,177)
Employee share option plan	(1,778,099)
<b>Treasury shares at 12/31/14</b>	<b>128,227,971</b>
Acquisitions	138,036,450
Disposals	(47,824,300)
Employee share option plan	(2,724,699)
Capital reduction	(74,076,263)
<b>Treasury shares at 12/31/15</b>	<b>141,639,159</b>
Acquisitions	77,087,297
Employee share option plan	(2,869,334)
Capital reduction	(74,627,988)
<b>Treasury shares at 12/31/16</b>	<b>141,229,134</b>

Treasury shares purchases in 2016 amounted to 668 million euros (1,654 million euros and 1,176 million euros in 2015 and 2014, respectively).

Treasury shares sold, including share plan redemptions, in 2016, 2015 and 2014 amounted to 26 million euros, 593 million euros and 1 million euros, respectively.

The main sale of treasury shares in 2015 was the exchange with Vivendi, S.A. of 46 million of Telefónica, S.A.'s treasury shares, for 58.4 million preferred shares of Telefónica Brasil, S.A., amounting to 555 million euros (see Note 5).

On June 30, 2016, the third phase of the Telefónica, S.A. long-term incentive plan called "Performance and Investment Plan 2013-2016" ("PIP 2013-2016") ended, which did not entail the delivery of any shares to Telefónica Group managers.

On June 30, 2015, the second phase of the Telefónica, S.A. long-term incentive plan called "Performance and Investment Plan 2012-2015" ("PIP 2012-2015") ended. According to the level of "Total Shareholder Return" (TSR) achieved, 77%, 2,724,699 shares were delivered (see Note 19).

On October 13, 2016, pursuant to the resolutions adopted in the General Shareholders' Meeting of May 12, 2016, capital was reduced by redeeming 74,627,988 treasury shares, thereby reducing this caption by 813 million euros.

On July 24, 2015, pursuant to the resolutions adopted in the General Shareholders' Meeting of June 12, 2015, capital was reduced by redeeming 74,076,263 treasury shares, thereby reducing this caption by 886 million euros.

The Company maintain a derivative financial instrument subject to net settlement on a notional equivalent to 35.2 million of Telefónica shares in 2016 (33.8 million equivalent shares 2015), recognized under "Current interest-bearing debt" in the balance attached for both exercises.

## Responsible business and fiscal responsibility

### Responsible business

The future of Telefónica is based on promoting a responsible business model that is able to generate trust in our customers, investors, employees, shareholders, and society. In order to promote this, we have the global Responsible Business Plan, approved and followed by the Board's Committee for Regulation and Institutional Affairs.

This Plan sets out priorities through year 2020 in three areas: compliance and risk management, responsible productivity and sustainability as leverage for growth to improve our business and the world.

Currently, it is focused on **Customer Promise and Digital Trust; Supply Chain; Talent and Diversity; Environmental Management and Sustainable Innovation**, with their corresponding goals and KPIs. These take form in different local plans in the countries where we are present.

The Customer Promise and Digital Trust project arises from the need to continually reinforce the relationship of trust that we have with the customer, not only in the commercial field by complying with standards of transparency and honesty, but also in the field of privacy and security. The Responsible Management of our Supply Chain is key if we want to guarantee compliance of ethical, social, and environmental standards throughout our value chain. We demand compliance of these standards from all our providers, and we perform awareness and verification actions to manage the risks, and control and implement improvement actions. The directed management of our human resources with the goal of attracting and retaining the best talent, including the management of diversity, are key aspects for the success of the company's strategy. Telefónica promotes an ambitious and very effective environmental strategy with the goal of not only managing possible risks and minimizing the impacts of the company's activities on the environment, but also of assuming its responsibility in the mitigation of climate change. Finally, Sustainable Innovation is the project with which Telefónica contributes to generate positive social and environmental impacts through commercial proposals that, within a context of global growth trends, will generate new models of sustainable business.

In 2016, in addition to the Global Responsible Business Plan, the plans for Spain, Germany, Brazil, Colombia, Ecuador, Mexico, Peru, Argentina and Chile were approved.

During the year:

- A Responsible Business Advisory Panel and an extended consulting group were put together to collect stakeholders' expectations.
- A Chief Data Officer was named, we performed training and audits on privacy and cyber security and we worked to give back citizens control over their digital lives.
- The Privacy Center, which informs our stakeholders about our privacy and publicity policies, was published.
- Telefónica's first Report on Transparency in Communications was published.
- The Chief Compliance Officer was appointed, thus reinforcing our commitment with compliance issues.
- Assessments of critical providers were increased through EcoVadis and we joined the JAC (Joint Audit Cooperation) sector initiative to audit their factories.
- The Telefónica Global Diversity Council was established to promote diversity among employees.

- New energy and climate change goals were announced for the 2015-2030 period for the purpose of contributing to the Paris Agreement.
- Telefónica brought to Latin America the Eco Rating, a seal for the environmental and social impact of mobiles.
- For the third consecutive year, Telefónica was on the CDP "A-List": we are one of nine Telcos to figure in this ranking at a global level, and the only Spanish one.
- Movistar+ 5S was launched, a pioneering proposal to bring television to people with sensory disabilities.
- Telefónica, with "La Caixa", presented the ProFuturo Project to promote digital education for children in developing countries.
- In 2016, Telefónica was one of the top nine leading companies in the world in terms of sustainability, according to the DJSI.

Some of these advances influence the Sustainable Development Objective (SDO), in which Telcos play a prominent role since the Internet and digital solutions are fundamental to being able to reach more than half of the proposed goals, with connectivity as the foundation.

### **Fiscal Responsibility**

According to the Principle of Responsible Business, Telefónica is committed to acting with honesty, transparency and respect for the law when managing our financial issues.

The Company is adhered to the Good Tax Practices Code and committed to that established in the "OECD Guidelines for Multinational Enterprises" regarding taxation. Consequently, Telefónica does not use company structures in order to cover or reduce the transparency of our activities before the tax authorities, or any other interested party. Nor is the Company present in any of the jurisdictions included in the list of tax havens established in Spanish regulations.

To calculate the **total tax contribution** (the list of countries can be consulted on the web) Telefónica follows the PwC CTT methodology, according to which the distributed value of a company is made up of the sum of the following elements: value for the shareholder (for example: dividends, reserves, etc.) wages and salaries (net of tax levied on employees), net interests and tax (input and levied).

## Research, Development and Innovation

Telefónica remains committed to technological innovation as a fundamental tool for being one of the main actors in the new digital universe, with the capacity to help to create a more sustainable world while achieving competitive advantages and distinctive products. By introducing new technologies and developing business solutions and processes, we aim to become a more effective, efficient and customer-oriented Group.

Telefónica bases its innovation strategy on the balance between two main models:

- Promoting our **internal research, development and innovation (R&D&i) capabilities**, for which we have developed our own innovation model, which allows us to promote the application of technical research in developing commercial products and services using the knowledge developed in research centers, technological institutes and universities, among other sources;
- Promoting the creation of **open innovation ecosystems**, in which the “**Open Future**” initiative stands out as a global program designed to connect entrepreneurs, start-ups, investors, venture capital funds and public and private organizations around the world which promote innovation in collaboration with other actors.

In parallel with these two models, Telefónica seeks to promote the development of sustainable solutions that generate a positive impact on the economic, social and technological progress of the regions in which we operate. To this effect, in addition to the investment made in promoting sustainable innovation projects and in the activities that are developed to guarantee the accessibility of our solutions to all groups, a new subsidiary has been created that is focused on product innovation and the development of disruptive technologies.

Telefónica firmly believes that competitive advantage can not be based solely on acquired technology, and so has always considered the promotion of internal innovation, research and development activities as a strategic axis, in an effort to achieve this differentiation and move forward in other activities which guarantee the sustainability of our business.

To this effect, the Telefónica Group's internal innovation policy focuses on contributing with solutions that guarantee Telefónica's commitment to developing a responsible business under the criteria of economic, social and environmental sustainability, by:

- Developing new products and services that enable growth and competition in an increasingly global environment, while being adapted to the diversity and local needs of each market;
- Encouraging the return of innovation through open innovation and creating value from the technology generated;
- Increasing our customers' loyalty and satisfaction;
- Increasing the revenues, profits and value of the Company;
- Increasing the quality of our infrastructure and services, as well as our relationship with our technology providers and solutions;
- Improving business processes and operations with the aim of optimizing resources, increasing efficiency and reducing environmental impact;

During 2016 we carried out numerous technological innovation projects focused on sustainability, process efficiency, the creation of new sources of revenue, customer satisfaction, the consolidation of our presence in new markets and technological leadership.

We also initiated projects to promote an increase in the access to information technology, new services focused on new Internet business models, advanced user interfaces, distribution of TV and multimedia contents and other value added services, taking advantage of the potential of the new infrastructures. These projects, among others, were undertaken based on our objective to quickly identify emerging technologies that may have a relevant impact on our business, and to test these technologies on pilots related to new platform services, applications and prototypes.

A significant part of the innovation activities and projects are carried out by Telefónica Investigación y Desarrollo S.A.U. (Telefónica I+D), a wholly owned subsidiary gives support mainly to our business lines. Telefónica I+D receives support from other companies and universities in the execution of its functions. The mission of the company is focused on improving our competitiveness through technological innovation and product development. Telefónica I+D is also responsible for experimental and applied research and for the development of products to increase our range of services and reduce operating costs.

The technological innovation activities of Telefónica I+D focus on three main areas:

1. The development of new networks, mainly carried out in collaboration with Telefónica's Global Resources area. These activities are related to new radio and fibre optic access technologies (technologies on the virtualization of network functions, in line with the technological trend known as SDN or defined networks via software) and on topics related to network optimization and *zero touch*, which enable us to have a much more flexible and adaptable network that is dynamically adaptable to the new requirements of digital services and customers.
2. The development of new products and services which are carried out within the framework of the digital services strategy. The following stand out among these activities:
  - Interpersonal communication of the future with natural access, taking advantage of the possibilities of the Internet and smartphones;
  - Services related to Big Data, regarding the concept of the Fourth Platform, whose vision is to return the value associated with the data it generates to the customer;
  - Video and multimedia services (combining text, audio, images and video) with a user experience on all connected devices;
  - Advanced solutions in emerging ICT businesses, such as *cloud computing* cloud or security;
  - Management of Internet of Things (IoT) services, related to enriched mobility, energy efficiency and smart retail;
  - Using users' communication profiles to obtain opportunities to exploit different products and business models (marketing campaigns, targeted advertising, contextual services, churn reduction, cross-selling, etc.).
3. Experimental and applied research: With a medium and long-term outlook, Telefónica also has "Scientific Groups" whose mission is to investigate the possibilities of new networks and services and to solve the technological, social and environmental challenges that arise.

It should be noted that in 2016 Telefónica I+D Chile, a 100% subsidiary of Telefónica Chile, which was launched in 2014 in collaboration with the Chilean government, for the development of the first products and the generation of the first patents in "enriched mobility", Smart Industry and Smart Agro.

As of December 31, 2016, Telefónica I+D had 612 employees (654 employees in 2015).

The total I+D expense in the Group for 2016 amounted to 906 million euros, 14.1% less than the 1,055 million euros incurred in 2015 (1,111 million euros in 2014). This expense represents 1.7%, 1.9% and 2.2% of the Group's consolidated revenue for 2016, 2015 and 2014, respectively. These figures were calculated using guidelines of the Organization for Economic Co-operation and Development (OECD).

During 2016, Telefónica registered 27 new patent applications, including three through the American office (USPTO), two through the Chilean office (INAPI) and 22 through the Spanish patent and trademark office (OEPM), seven of which were international (PCT) and 15 European applications. Moreover, one utility model was registered in the Spanish patent and trademark office, also through the OEPM.

Regarding the development of open innovation in Telefónica, the company has the Open Future\_ unit, which includes an open, global program designed to connect entrepreneurs, startups, investors, and public and private organizations from around the world.

The main objective of Open Future\_ is to detect, develop and enhance the talent and technological entrepreneurship in all its phases, for that which drives and accelerates the growth of ideas, projects, initiatives and companies. The integral character of Telefónica Open Future enables innovation to be developed in different stages. It is structured around seven initiatives, the objectives of which are as follows:

- **Drive** (Think Big and Talentum Startups).
- **Accelerate** (Crowdworking and Wayra).
- **Invest** (Telefónica Ventures, Amérigo and CIP Telefónica).

Telefónica Open Future, is present in 16 countries, ended 2016 as one of the main investors in the Spanish area of open innovation, positioning itself as one of the major funds in Europe and Latin America in venture capital investment.

## Human Resources

### Objectives and policies

At Telefónica people are important and are the core of the business, representing one of the Group's greatest assets. Our aim as HR department is to develop our employees' capacities to the maximum in order to fulfill the compromises agreed with our customers.

Our vision is based on four main pillars:

- Recruit, develop and keep the talented employees to ensure the Company meets its strategic goals.
- Support the business units integration and the transformation process so that the companies are aligned with the business objectives.
- Build a customer-focused organization culture.
- Become a 100% online department with high self-service options in the HR internal processes and with outsourced resources and provide an integrated human resources experience for middle management and employees based on empowerment and simplification.

In 2016 the implementation of SuccessFactors (the new digital, online, multi-gadget, cloud-based and global tool for human resources management) affected all employees, unifying the performance, successions and development, recruiting and learning processes.

The most notable aspects of the change include the implementation of the central employee module in eight countries.

### Managing talent

At Telefónica we are convinced that our professionals are the Company's main asset and we believe in fully developing their potential so they can make our customers' dreams a reality. We have therefore developed a talent-based model that will accompany the employees throughout their career, identifying key skills and abilities that will help employees handle our transformation process, a line with the Company's strategy and the program "We choose it all".

This model is used when evaluating executive talent, driving a culture of meritocracy, and facilitating the decision-making process on aspects such as development, organization and compensation, among other aspects; this allows our organization to have a management talent map, as well as a structured succession plan.

Based on this model and having detected key needs for the future, we promote global talent programs that contribute to the professional development of our teams in order to better implement the Company's strategy at the various levels and segments, from young employees to executives.

Approximately 100 young people from all areas of the Company took part in the Young Leaders Program, which focused on the development of digital and transformative capacities to better prepare this group of young talent for the future. After the 2016 edition ended in September, the selection process began for the 2017 edition, in which 86 young people from 11 countries will participate, 53% of which are women.

For the Profile for Digital Transformation project, in 2016 we also invited more than 2,300 Company leaders from different levels of the organization. This allowed us to obtain solid results at the Company, transaction and functional unit level, identifying specific development needs that are incorporated in the global learning and development offer.

Within the framework of the Profile for Digital Transformation, we have also worked on developing transformative and digital skills with executives and managers with high potential during the last quarter of the year. In collaboration with one of the leading digital education institutions, we organized the Digital Development Festival where more than 1,100 hours of online training were given and where we were able to gain insight into the view of renowned internal and external experts on digitalization and its impact on Telefónica's business through a series of on-site and online conferences that were attended by more than 1,600 Company leaders.

### **Employee training**

In 2016 the new training model was implemented throughout the Company with a new process and tool that brings together all possibilities available to both employees and managers to be able to manage the organization's training activities.

Training is divided into the Local Offer, whereby the various local entities of the Company identify, manage and plan training activities, and the Global Offer, the purpose of which is to disseminate knowledge and skills on strategy, the action principles, and our Company's values. In addition, the offer available to employees has multiplied with a series of platforms in the Telefónica Group, such as DatAcademy, Lear4Sales and Miriadax, where professionals have access to more continuous training opportunities for their own development.

Almost one million courses (930,000) were given within the framework of the new training platform (SuccessFactors), which represented the management of 2.5 million hours. The Global Offer represented 340,000 hours of training, with the main training actions focused on the action principles, criminal liability, language programs, mobile telecommunications and society. The Local Offer represented 2,160,000 hours of training, which were managed by the Company's various business units according to their training plans relating to local business targets.

Another one of the elements of the Company's training is the Social Learning platform, which we have developed through Jam, where we have a series of collaborative learning groups in which 12,000 members participate and that receives 56,000 visits. A learning group is formed by a set of micro-learning resources plus the contributions made by the various users and experts.

Universitas Telefónica operates on two levels: on-site and online. The facilities at the Barcelona campus provided on-site training for 1,915 people in the eight programs given in person, accumulating a total of 79,680 hours of training, with a rating of 4.7 out of 5; and in operations, the Telefónica On the Road program provided local training to 1,864 executives and middle managers, whereby professors from Universitas traveled to various countries in Latin America and Europe, obtaining a rating of 4.6 out of 5. In all cases it was achieved through programs focused on leadership and strategy transformation. In 2016 Universitas also began providing local training to partners of strategic alliances, such as Megafon in Russia, with a rating of 4.6 out of 5.

For the Company, managing knowledge is a priority. Therefore, in 2016 the total cost of training for the Group amounted to 40 million euros.

### **Occupational health and safety**

One of Telefónica's priorities is to offer its staff the best possible working conditions at their place of work or when they are on the move.

As per its Business Principles, Telefónica ensures staff work in a safe environment. Appropriate mechanisms are therefore in place to avoid workplace accidents, injuries and illness associated with professional activities by fully complying with prevailing regulations, implementing safe working procedures, providing training and managing occupational risks.



The Occupational Risk Management System ensures worker health and safety is at the heart of all Telefónica's processes and services; offering an end-to-end model for rolling out joint action, procedures and policies. This system enables Telefónica to identify and disseminate practices that are proven to have an impact on staff welfare and therefore on reducing accident rates.

## Managing diversity

Telefónica understands that managing diversity is key leverage for the Company's digitalization.

Diversity is seen as an opportunity, a competitive element which, through our diverse professionals, allows us to reach out to our customers who are equally diverse. We are convinced of their capacity to generate value, their commercial impact, and their impact on innovation and, in short, on our results.

In response to this vision, in 2016 significant momentum was provided by the creation of the Global Diversity Council, which started up on March 17 and is composed of members of the management committees for operations. The purpose of the Diversity Council is to support the initiatives being developed locally and, based on this idea, a company plan was drafted that provides support and monitors the countries in order to ensure they are making progress towards the targets set. The Council also serves as a space to share good practices and to be able to replicate those initiatives that are working well in other countries.

Accordingly, it is important to highlight the approval on April 26 by the Executive Committee of the Company's Policy on Appointments and Termination of Executives, which strengthens the existing policy by guaranteeing the cap company has the best talent through meritocracy, diversity and transparency.

With regard to the total headcount, the number of employees of Telefónica at December 31, 2016 was 127,323. There were 47,933 female employees (37.6% of the total), and 79,390 male employees (62.4% of the total). 20.5% of executive positions are held by women.

It should also be noted that Telefónica employs professionals from more than 24 countries (four of which are represented on the Board of Directors), representing over 100 nationalities.

Telefónica considers the diversity project to be a strategic project that is part of its Responsible Business Plan, which is presented at the Committee on Institutional Affairs chaired by Julio Linares and which reports to the Board. Within the scope of the Diversity Council, a Global Diversity Policy was developed in 2016.

Also noteworthy of mention is the career acceleration program for women (Women in Leadership) developed last year, in which 150 professional women of the Group participated in 2016.

Since 25 November, 2015, Telefónica S.A. has used a specific and verifiable Female Director Selection Policy, approved by the Board of Directors, which is aimed at ensuring that Director appointment or re-election proposals meet the Board's requirements as set out in a preliminary analysis, encouraging gender equality and diversity of knowledge and experience.

With regards to the promotion of Female Directors' presence in the Board of Directors, it is important to note that the policy expressly states that it is mandatory for Director selection procedures to encourage gender diversity, and forbids any type of underlying bias which might cause any form of discrimination. Notwithstanding the foregoing, the Nominating, Compensation and Corporate Governance Committee and the Board of Directors of the Company have taken into account this premise in all their appointment proposals, re-elections and ratifications of the directors that were presented, analyzed and approved during this year 2016, and specifically the appointment proposal of Ms. Sabina Fluxà Thienemann, approved by the General Ordinary Shareholders Meeting held on May 12, 2016.

## Environment

### Environmental policy, control of environmental risks and climate change

Telefónica has a global Environmental Strategy that arises from the Environmental Policy and Energy Policy approved by the Board of Directors which sets out the road map for the Company to advance towards a green economy, reducing the environmental impact of its facilities at the same time as developing the potential for digital services to reduce the environmental footprint of other sectors.

Currently more than 80% of the company has Environmental Management Systems (EMS) in accordance with Regulation ISO 14001, certified by an external body, which contribute to the proper management of its environmental aspects and to extending a culture of environmental responsibility across the whole supply chain. Telefónica has set itself the target of certifying 100% of operators under ISO 14001 by 2017.

Telefónica's environmental risks and climate change are controlled and managed under the Company's global risk model. The environmental aspects of the telecommunications operations are mainly focused on the risk of high geographical dispersion and energy consumption, which is controlled by means of environmental management based on uniform processes and a global energy efficiency programme.

Telefónica has a global environmental team made up of experts in environmental and energy management in each of the Group's companies.

We would like to emphasize the following news from the past year:

- We approved a Policy for sustainable energy use at a corporate level.
- We announced our energy and climate change goals for the 2015-2020 period as part of our plan to contribute to the Paris Agreement.
- We received ISO 50001 certification regarding energy management systems for our operations in Spain and Germany.
- We launched a plan for renewable energy.
- We brought the Eco Rating initiative to Latin America, a seal that communicates to our customers the environmental and social impact of mobile phones.
- For the third year in a row, we were included on the "A-List" for the Carbon Disclosure Project, the largest index for investment in climate change. We are one of the nine telcos to appear in this global ranking.
- We made progress in measuring the positive impact that our digital services have regarding adapting to and mitigating climate change.
- We received ISO 14001 certification for Telefónica Brazil and our Telxius submarine cable infrastructure in America.

### A Responsible Network

It is in our Network that we see the greatest environmental impact due to energy consumption, but also with physical elements, such as visual impact or waste. To implement and maintain the responsible Network, we apply the best practices available and we manage all environmental aspects of this from design to decommissioning.

Environmental legislation, which is abundant in almost all of the countries where Telefónica operates, applies mainly to our network infrastructures. Among these, it is worth mentioning the need to obtain

environmental permits, waste management, noise control and measuring electromagnetic fields. Telefónica has common standards for all of its companies, in harmony with the principle of caution, establishes minimum guidelines for environmental management with the aim of minimizing the impact of infrastructures, these standards go beyond existing legislation. Also, these standards extend to all of our suppliers and contractors.

Among the activities undertaken by the Group to manage the environmental aspects of its operations is the sharing, whenever possible, of our facilities' locations with other operators or communication tower management companies. This leads to a lesser visual and energy impact and a reduction in waste creation.

### **Main lines of action**

Within the Responsible Business Strategic Plan, the company has established lines of action regarding the environment. This plan is also grounded in each country in order to be able to focus on the most relevant aspects at a local level. Some of the lines of action are:

- **Energy and climate change:** by means of the Corporate Climate Change Office, the Company promotes energy efficiency and the reduction of Telefónica's carbon footprint with a plan for 100% of our electricity use to come from renewable sources in 2030. The year 2016 saw the launch of the Company's new goals regarding these topics. Between 2010 and 2015, we conducted 257 initiatives with which we managed to save 492 GWh, the equivalent energy consumption of 40,300 homes in one year, and 64 million euros in our annual electricity bill. In this way, we avoided the emission of more than 142 kT CO<sub>2</sub> equivalents. Because of all this, in 2016 Telefónica was awarded the GSMA 2016 Green Mobile Award.
- **Circular economy:** the Company is committed to promoting a circular economy, in which goods used are returned to the value chain. Thus, waste and used devices from Telefónica networks and customers, with a particular focus on electrical and electronic devices, are managed by authorized entities, in compliance with environmental legislation and prioritizing management in the following order: reduce, reuse, recycle. All companies in the group have waste management programmes and recycling and/or reuse initiatives for managing customers' devices.
- **Green Services:** in the current context where environmental challenges affect the whole of society, Telefónica is developing services based on the 'Internet of Things' (IoT), Cloud Computing and Big Data to reduce the consumption of resources and the environmental impact of our customers. These will be key in the area of reduction of and adaptation to climate change. We align our business and environmental strategy, looking for opportunities linked to the search for solutions to deal with environmental questions. We want to position ourselves as a key actor in the green economy and, thus, sustainable innovation is essential.

These actions have allowed Telefónica to extend its environmental responsibility to residential and business customers and to continuously respond to the demands of responsible environmental management from investors and shareholders.

## Human rights

In our risk management and analysis process, human rights and the impact that our activities, whether directly or indirectly, may have on said rights, are taken into consideration in an inclusive and cross-departmental manner. In line with the United Nations Guiding Principles on Business and Human Rights, we regularly perform an impact analysis in relation to our activities with the goal of identifying areas where we must work with particular diligence to safeguard those rights.

In this impact analysis, we identify the areas of our activity (internal management, supply chain management, operations, client services) and the rights that could potentially be affected, with the purpose of carrying out preventative management in those fields. The growing importance of technology and information and communication services in society, the development of new data-based services, and new activities that Telefónica has undertaken (i.e. television), have led us to expand our analysis, and require that we remain aware, not only of our traditional activities such as management of our human resources and our supply chain, but also of aspects of growing concern to society such as the right to privacy, the right to freedom of speech, or rights related to access to telecommunications services and the environmental impact of our activity.

Respect for human rights is a key element in our Responsible Business Principles and our Supply Chain Sustainability Policy. We are aware of the role that information and communication technologies can play in promoting and respecting human rights and the responsibility we must take on to minimise the negative impact and highlight our positive impact.

We have implemented the necessary processes to raise and manage company risks on this matter and we provide various communication channels (employee reporting channel, supplier channel, Responsible Business channel) to our stakeholders to enable them to confidentially and anonymously communicate or report situations that entail a violation of human rights or that could result in a lack of respect for the rights of people or the communities in which we operate.

## Risk factors associated with the issuer

The Telefónica Group's business is affected by a series of intrinsic risk factors that affect exclusively the Group, as well as a series of external factors that are common to businesses of the same sector. The main risks and uncertainties facing the Company which could affect its business, financial position, reputation, corporate image and brand and its results of operations, must be considered jointly with the information in the Consolidated Financial Statements, and are as follows:

### Group-Related Risks

#### **Worsening of the economic and political environment could negatively affect Telefónica's business.**

Telefónica's international presence enables the diversification of its activities across countries and regions, but it exposes Telefónica to various legislation, as well as to the political and economic environments of the countries in which it operates. Any adverse developments or even uncertainties in this regard, including exchange-rate or sovereign-risk fluctuations, may adversely affect the Company's business, financial position, cash flows and results of operations and/or the performance of some or all of the Group's financial indicators.

Economic conditions may adversely affect the level of demand of existing and prospective customers, as they may no longer deem critical the services offered by the Group.

Growth in Europe and financial stability may be affected by political uncertainty in some European countries due to upcoming general elections, a possible revival of the crisis in Greece, restructuring of the banking sector and due to the impact of steps taken towards an EU banking union and a capital markets union. In particular, the British exit process from the European Union following the vote to leave in the recent referendum, will require an adjustment of the economy to whatever new trade and investment relationships are put in place in the future, with the consequences in the meantime being uncertainty regarding investment, activity and financial market volatility. In 2016, the Telefónica Group obtained 24.5% of its revenues in Spain (22.6% in 2015), 14.4% in Germany (the same percentage as in 2015) and 13.2% in United Kingdom (14.3% in 2015).

In Latin America, there is an increasing exchange rate risk brought on by external factors such as increasing interest rates in the United States amid still low commodity prices and doubts about growth and imbalances in China; as well as internal factors as a consequence of the still high fiscal and external deficits in the most important Latin American countries or the low liquidity in exchange markets as it is the case in Argentina.

Some of the most significant macroeconomic risk factors in the region affect Mexico, as it is the country with the highest commercial and financial exposure to the United States. In this sense, increasing interest rates and the possible overhaul of trade agreements between both countries could imply higher restrictions on imports into the United States that would affect negatively the economic activity in Mexico.

Brazil is undertaking several measures principally focused on adjusting its public finances. A constitutional amendment limiting public spending has been approved and the government has submitted a new social security reform bill to Congress. However, the possibility of a new bout of political turmoil, which could weaken the support of the reforms, is not negligible. While signs of stabilization have emerged, economic growth continues to be negative and the unemployment rate has hit double digits, having a sizable effect on consumption spending. Moreover, despite financing external needs have decreased, internal needs are still high. All these elements have led to new downgrades to the country's credit rating during 2016, which now is below investment grade.

In countries such as Chile, Colombia and Peru, the recent uptick in commodity prices is having a positive impact on its fiscal and external accounts, but growth continues to be below its potential level due to the lower external inflows, which have affected investment and, to a lower extent, consumption.

In Argentina, the new government is focused on resolving Argentina's macroeconomic and financial imbalances and on recovering international confidence. Although reforms taking place may have positive effects in the medium term, short term risks persist, including exchange rate risk, especially due to the high inflation rate amid an economic contraction.

During 2016, Telefónica Hispanoamérica represented 24.2% of the Telefónica Group's revenues (26.2% in 2015), of which 23.8% proceeded from revenues in Argentina, 19.9% in Peru and 17.2% in Chile. During 2016, Telefónica Brazil represented 21.3% of the Telefónica's Group revenues (20.1% in 2015). In this respect, approximately 30.4% of the Group's revenues were generated in countries that do not have investment grade status (in order of importance, Brazil, Argentina, Ecuador, Nicaragua, Venezuela, Guatemala, Costa Rica and El Salvador), and other countries are only one notch away from losing this threshold.

"Country risk" factors include the following, among others:

- unexpected adverse changes in regulation or administrative policies, including changes that modify the terms and conditions of licenses and concessions and their renewal (or delay their approval);
- abrupt exchange rate movements;
- high inflation rates;
- expropriation or nationalization of assets, adverse tax decisions, or other forms of state intervention;
- economic-financial downturns, political instability and civil disturbances; and
- maximum limits on profit margins imposed in order to limit the prices of goods and services through the analysis of cost structures (for example, in Venezuela, a maximum profit margin has been introduced that is set annually by the Superintendence for Defense of Socioeconomic Rights).

Any of the foregoing may adversely affect the business, financial position, results of operations and cash flows of the Group.

**The Group's financial condition and results of operations may be adversely affected if it does not effectively manage its exposure to foreign currency exchange rates or interest rates.**

At December 31, 2016, 50.8% of the Group's net debt (in nominal terms) was pegged to fixed interest rates for over a year, while 20% was denominated in a currency other than the euro. At December 31, 2016, the net financial debt ratio in Latin American currencies was 13%.

To illustrate the sensitivity of financial expenses to a change in short-term interest rates at December 31, 2016: (i) a 100 basis points increase in interest rates in all currencies in which Telefónica has a financial position at that date would lead to an increase in financial expenses of 232 million euros for the year ended December 31, 2016, (ii) whereas a 100 basis points decrease in interest rates in all currencies (even if negative interest rates are reached), would lead to a reduction in financial expenses of 201 million euros for the year ended December 31, 2016. These calculations were made assuming a constant currency and balance position equivalent to the position at year end taking into account the derivative financial instruments arranged.

According to the Group's calculations, the impact on results arising from a 10% depreciation of Latin American currencies against the US dollar and a 10% depreciation of other global currencies against the euro, excluding the pound sterling, would result in exchange losses of 43 million euros for the year ended December 31, 2016, primarily due to the depreciation of the Venezuelan bolívar and, to a lesser extent, the Argentinean peso. These calculations were made assuming a constant currency financial position with an impact on profit or loss for the year ended December 31, 2016, including derivative instruments in place.

During 2016, Telefónica Brazil represented 24.6% (27.0% in 2015), Telefónica Hispanoamérica represented 23.0% (32.9% in 2015) and Telefónica United Kingdom represented 11.3% (14.6% in 2015) of the operating income before depreciation and amortization (OIBDA) of the Telefónica Group.

The Telefónica Group uses a variety of strategies to manage this risk, among others the use of financial derivatives, which themselves are also exposed to risk, including counterparty risk. However, the Group's risk management strategies may not achieve the desired effect, which could adversely affect the Group's business, financial condition, results of operations and cash flows.

**Existing or worsening conditions in the financial markets may limit the Group's ability to finance, and consequently, the ability to carry out its business plan.**

The performance, expansion and improvement of the Telefónica Group's networks, the development and distribution of the Telefónica Group's services and products, the implementation of Telefónica's strategic plan and new technologies, the renewal of licenses or the expansion of the Telefónica Group's business in countries where it operates, may require a substantial amount of financing.

A decrease in the liquidity of Telefónica, a difficulty in refinancing maturing debt or raising new funds as debt or equity could force Telefónica to use resources allocated to investments or other commitments to pay its financial debt, which could have a negative effect on the Group's business, financial condition, results of operations and/or cash flows.

Funding could be more difficult and costly in the event of a significant deterioration of conditions in the international or local financial markets due to the uncertainties regarding the hikes in interest rates on the part of the US Federal Reserve and the oil prices instabilities, or if there is an eventual deterioration in the solvency or operating performance of Telefónica.

At December 31, 2016, gross financial debt scheduled to mature in 2017 amounted to 13,326 million euros (which includes the net position of derivative financial instruments and certain current payables), and gross financial debt scheduled to mature in 2018 amounted to 7,195 million euros.

In accordance with its liquidity policy, Telefónica has covered its gross debt maturities over the next twelve months with cash and credit lines available at December 31, 2016. Telefónica's liquidity could be affected if market conditions make it difficult to renew existing undrawn credit lines, 8% of which, at December 31, 2016, were scheduled to mature prior to December 31, 2017.

In addition, given the interrelation between economic growth and financial stability, the materialization of any of the economic, political and exchange rate risks referred to above could lead to a negative impact on the availability and cost of Telefónica's financing and its liquidity strategy, which could have a negative effect on the Group's business, financial condition, results of operations and/or cash flows.

**Adoption of new accounting standards could affect reported results and financial position.**

Accounting Standardization Bodies and other authorities may periodically change accounting regulations that govern the preparation of the Group's consolidated financial statements. Those changes could have a significant impact on the way the Group accounts and presents its financial position and its operating income. In some instances, a modified standard or a new requirement with retroactive nature must be implemented, which requires the Group to restate previous financial statements.



See details of the implementation of new standards and interpretations issued in Note 3 of the Consolidated Financial Statements. In particular, Telefónica is required to adopt the new accounting standards IFRS15 Revenue from Contracts with Customers, effective from January 1, 2018, and IFRS 16 Leases, effective for the financial years from January 1, 2019. These standards present significant changes that could affect both the amount and moment of recognition of revenues and expenses related with certain sales transactions, as well as the accounting treatment for all lease contracts (other than short-term leases and leases of low-value assets). These changes could have a material impact on the Group's financial statements. Such impact is under analysis as of the date of this document.

### **Risks relating to the Group's Industry**

**The Group operates in a highly regulated industry which requires government concessions for the provision of a large part of its services and the use of spectrum, which is a scarce and costly resource.**

The telecommunications sector is subject to laws and sector-specific regulations in the majority of the countries where the Group provides its services. Additionally, many of the services the Group provides require the granting of a license, concession or official approval, which usually requires certain obligations and investments to be made, such as those relating to the acquisition of spectrum. Among the main risks of this nature are those related to spectrum regulation and licenses/concessions, rates, universal service regulation, regulated wholesale services over fiber networks, privacy, functional separation of businesses and network neutrality. The fact that the Group's business is highly regulated both affects its revenues and imposes costs on its operations.

Thus, as the Group provides most of its services under licenses, authorizations or concessions, it is vulnerable to administrative bodies' decisions, such as economic fines for serious breaches in the provision of services and, potentially, revocation or failure to renew these licenses, authorizations or concessions, or the granting of new licenses to competitors for the provisions of services in a specific market.

In this regard, the Telefónica Group pursues its license renewals on the terms referred in their respective contractual conditions, though it cannot guarantee that it will always complete this process successfully or under the most beneficial terms for the Group. In many cases complying with certain obligations is required, including, among others, minimum specified quality, service and coverage standards and capital investment. Failure to comply with these obligations could result in the imposition of fines, revision of the contractual terms, or even the revocation of the license, authorization or concession.

Additionally, the Telefónica Group could be affected by regulatory actions carried out by the antitrust authorities. These authorities could prohibit certain actions, such as new acquisitions or specific practices, create obligations or lead to heavy fines. Any such measures implemented by the competition authorities could result in economic and/or reputational loss for the Group, in addition to a loss of market share and/or harm to the future growth of certain businesses. Regarding the merger of Telefónica Deutschland Holding AG and E-Plus, other providers such as United Internet and the regional cable operator Airdata lodged an appeal before the General Court against the decision of the EU which authorized such merger. Telefónica Deutschland has been accepted as an interested party of the process and it has presented its statements in both cases. United Internet has lodged a second appeal against the EC in relation to the content of the letter of commitment assumed by Telefónica Deutschland regarding the implementation of remedies for non-network operators. In December 2016, each of Mass Response Service GmbH and Multiconnect GmbH filed an appeal before the General Court against the decision of the EU that Telefónica Deutschland is not obliged to grant access to Full-Mobile Virtual Network Operators ("MVNO") under the non-MNO remedy of the commitments. Telefónica Deutschland will apply for leave to intervene as an interested party.

*Regulation of spectrum and access to new government licenses/concessions of spectrum*

On September 14, 2016, the EC adopted, among other texts, a proposed Directive for the establishment of a European Electronic Communication Code, which could have significant implications, inter alia, for access to networks, spectrum use, auction conditions, duration and renewal of licenses, universal service, consumer protection, audiovisual services and platforms. It is estimated that the approval of such regulatory framework will take place in a year and a half.

On December 14, 2016, the European Parliament and Council agreed on a decision regarding the use and availability of the 700 MHz band. This could require new cash outflows from Telefónica between 2017 and 2022 in both the United Kingdom and Spain, where it is expected that the 700 MHz band will be available between 2020-2022. In connection with spectrum auctions for 2.3 and 3.4 GHz band, in the United Kingdom, Ofcom issued a consultation document on November 21, 2016. Responses were due by January 30, 2017, and a decision is expected in the second quarter of 2017. In Germany, the regulatory agency for electricity, gas, telecommunications, post and railway ("BNetzA") initiated a proceeding for the demand-oriented allocation of new frequencies for the further rollout of digital 5G infrastructures, which include the timely allocation of the 2 GHz spectrum expiring at the end of 2020 and 2025 (so called UMTS spectrum) and further spectrum (inter alia 3.5 GHz). A decision about the allocation procedure is expected towards the end of 2017 and an auction may take place in 2018 or 2019.

In Latin America, spectrum auctions are expected to take place requiring potential cash outflows to obtain additional spectrum or to meet the coverage requirements associated with these licenses. Specifically, the procedures expected to take place in 2017-2018, in the relevant jurisdiction for the Group, are:

- Mexico: An auction spectrum in the 2500 MHz band is expected to take place between the third quarter of 2017 and the second quarter of 2018. A wholesale network tender, which will offer services in the 700 MHz band was concluded on November 17, 2016. Altán was the tender winner and the commercial operations must begin no later than March 31, 2018.
- Colombia: During 2017 the Ministry of Information Technologies and Communications published for commentaries until March 7, 2017 the project of resolution with the conditions for an auction of 70 MHz of spectrum band in 700 MHz and 5 MHz in 1900 MHz. In addition, the Ministry published a project of decree increasing the spectrum cap for lower bands to 45 MHz and 90 MHz for upper bands. The schedule for the auction has not been set yet.
- Argentina: The Government instructed the regulatory authority to issue new regulations during 2017 to ensure the reassignment of frequencies of the radio spectrum for the provision of wireless or fixed wireless services and enables the reassignment of frequencies previously granted to other provider.

However, it is likely that some of these spectrum tender procedures will not be completed, or even initiated in the mentioned dates. In addition to the above, it may be the case that certain administrations may not yet have announced their intention to release new spectrum but may do so during 2017. The above does not include processes announced via general statements by administrations, which involve bands not key to Telefónica's needs. Furthermore, Telefónica may also seek to acquire spectrum on the secondary market where opportunities might arise.

*Risks relating to concessions and licenses previously granted*

The terms of concessions and licenses granted to the Group and necessary for the provision of its services may be challenged or amended by the regulators at any time, which may materially adversely affect its business, financial condition, results of operations and cash flows.

The German regulator initiated consultations in March and July 2016 on the frequency distribution after the merger between Telefónica Deutschland and E-Plus, particularly in the 2 GHz band and on the future

spectrum allocation for 5G band. The result of such consultations could lead, among others, to proposals by the regulator reorganizing the spectrum that Telefónica Deutschland holds on the 2 GHz band.

In the United Kingdom, Telefónica has an obligation in its 800 MHz spectrum license to provide indoor coverage to 98% of the United Kingdom population (and 95% of the population of each of England, Wales, Scotland and Northern Ireland) and an obligation in its 900/1800 MHz spectrum license to provide voice and text services to 90% of the United Kingdom landmass, both by the end of 2017, to be maintained, thereafter. Inherent with these obligations is a risk of Telefónica United Kingdom not meeting the required targets. Telefónica United Kingdom is actively working towards mitigating the risk through the continuous investment in an infrastructure improvement program, upgrading its 2G and 3G Networks and continued roll-out of its 4G Network.

In the state of São Paulo, Telefônica Brasil provides local and national long-distance Fixed Switched Telephony Service ("STFC") under the so-called public regime, through a concession agreement, which is expected to remain in force until 2025. In accordance with current regulations, Telefônica Brasil informed the Brazilian regulatory authority (Agência Nacional de Telecomunicações or "ANATEL") that the net value, as of December 31, 2015, of assets assigned to the provision of STFC (which include, among others, switching and transmission equipment and public use terminals, external network equipment, energy equipment and system and operation support equipment) were estimated to total 7.8 billion Brazilian reais. At December 31, 2016, this value is estimated to total 8,813,916 Brazilian reais (this value will be updated in the second half of 2017). In principle, the assets assigned to the provision of STFC were considered reversible assets. During the last months, a bill amending the regulatory framework in Brazil has been processed, establishing, among others, that such assets will no longer be reversible under the new licenses regime in exchange for significant broadband investment commitments. Recently, the processing at the Senate of such bill has been challenged before the Federal Supreme Court. Such Court and, consequently, the Senate's governing board has decided to send the bill for voting in the plenary. With the bill being sent to the plenary, it could be understood that there is no more dispute for the Supreme Court to decide upon. In case that the bill is finally approved, ANATEL will be entitled to adopt the pertinent administrative decisions for the transformation of the respective licenses with the consequent modification of the future binding obligations to STFC providers.

In Colombia, the Ministry of Information Technologies and Communications ("ITC") issued Resolution 597 on March 27, 2014, to renew 850 MHz/1900 MHz licenses for 10 additional years. However, the reversion of assets (other than radio frequencies, which it is clear that must be returned) and its scope was widely discussed between the relevant mobile operators (including Telefónica Colombia) and the ITC in the context of the liquidation of the previous concession contract, taking into consideration the terms of the contract, and the Constitutional Court's interpretation of Law 422 of 1998 and Law 1341 of 2009. Discussions on the matter concluded on February 16, 2016, when the ITC convened an arbitration proceeding, in accordance with the terms of the relevant concession contract. The relevant concession holders (including Telefónica Colombia) filed a response to the claim prompted by the ITC. The arbitration process is still ongoing.

In Peru, Telefónica has concessions for the provision of the fixed-line service until November 2027. In December 2013, Telefónica filed a partial renewal request for these concessions for five more years. In December 2014 and June 2016, Telefónica also filed a renewal request for twenty more years in relation to a concession for the provision of local carrier service and one of the concessions to provide mobile-line services in provinces, respectively. As of the date of this document, the decision of the Ministry of Transport and Communications (Ministerio de Transportes y Comunicaciones) in all such proceedings is still pending and according to the legislation, the concessions subject of these procedures remain in force as long as the procedures are in progress.

Telefónica Móviles Chile, S.A. was awarded 2x10 MHz spectrum on the 700 MHz band in March 2014. A claim was brought by a consumer organization against the 700 MHz assignments. The decision by the Supreme Court on the appeal presented by such consumer organization is still pending.

During the year ended December 31, 2016, the Group's consolidated investment in spectrum acquisitions and renewals amounted to 345 million euros.

The Group's failure to obtain sufficient or appropriate spectrum capacity in the jurisdictions discussed above or any others in which it operates, or its inability to assume the related costs, could have an adverse impact on its ability to launch and provide new services and on Telefónica's ability to maintain the quality of existing services, which may adversely affect the Group's business, financial condition, results of operations and cash flows.

#### *Regulation of wholesale and retail charges*

The European Regulation 2015/2120 on Net Neutrality and Roaming was adopted on November 25, 2015. From June 15, 2017, operators may not charge roaming users within the EU an additional fee on their domestic prices for roaming calls, SMS and data services. However, in some circumstances, operators may apply consumption limits and additional surcharge under a "fair use policy". In January 2017, wholesale roaming caps have been agreed between the Council and the Parliament and the maximum wholesale caps have been set at the following limits: 0.01€/sms; 0.032€/minute; data services glide path: 7.7€/GB (June – December 2017); 6€/GB (2018); 4.5€/GB (2019); 3.5€/GB (2020); 3€/GB (2021) and 2.5€/GB (2022).

On September 14, 2016, the EC presented its proposal of the regulatory framework which, among other measures, intends to incorporate a European methodology and a European upper limit for the call-termination prices for landline phone/ mobile phone applicable in EU.

The decreases in wholesale mobile termination rates ("MTR") in Europe are also noteworthy. In the United Kingdom, the current rate is 0.503 ppm. A further cut to 0.495 ppm will come into effect from April 1, 2017.

In Germany, on August 30, 2016, BNetzA adopted a regulatory decision, which considers with pure long run incremental cost ("LRIC") a new cost model for the calculation of MTR. Telefónica Deutschland has appealed the decision in court, but the appeal has not yet been decided. BNetzA approved new MTR on November 30, 2016, in a provisional decision, which sets the rates to 0.011 euro/minute as of December 1, 2016, to 0.0107 euro/minute as of December 1, 2017, and to 0.0095 euro/minute as of December 1, 2018, until the end of November 2019. Before taking a final decision, the new MTR are nationally consulted and notified to the EC. There is consequently a risk that when the new MTR are approved (which will be retroactively enforceable from December 1, 2016), and with the new termination rates applicable from January 1, 2017, the rates will significantly decrease. Regarding fixed networks termination rates, BNetzA adopted at the end of January 2017 a provisional decision which establish a tariff of 0.0010 euro/minute.

In Spain, on July 1, 2016, the Spanish National Regulatory and Competition Authority (Comisión Nacional de los Mercados y la Competencia or "CNMC") initiated the process of reviewing the prices of mobile termination, with a final decision expected to be adopted during 2017.

Additionally, on January 17, 2017, the CNMC issued the analysis of the market for access and call origination on fixed networks. The CNMC maintains the obligation of Telefónica, as an operator with significant market power, to provide a wholesale interconnection offer and a wholesale line rental ("WLR"), both with cost-oriented prices regarding manufacturing costs and the adoption of a management accounting system. Telefónica is equally obliged to non-discrimination, transparency and separation of accounts. In Latin America, it is likely that MTRs will also be reduced in the short to medium term.

In Brazil, ANATEL has issued ex-ante regulations to ensure competition in the wholesale market, which includes reductions of the MTR. In this regard, the Plano Geral de Metas de Competição ("PGMC"), amended by Resolution 649/2015, established that mobile termination fees are subject to successive

yearly reductions from 2016 until 2019, when the definitive cost-oriented-model fees are expected to be in force (such Resolution has been challenged in courts without a definitive outcome). On December 5, 2016, ANATEL issued a public consultation for the revision of the PGMC, which addresses changes in the relevant wholesale markets regulated by the PGMC and also in the cost-oriented model. The mentioned public consultation is available for comments until March 22, 2017.

In Mexico, on September 23, 2016, the Instituto Federal de Telecomunicaciones ("IFT") announced that the MTRs applicable to operators different from the so-called Prevailing Economic Agent for 2017 will be 0.1906 pesos per minute, as long as the regulatory asymmetry of the Prevailing Economic Agent introduced by Mexico with the constitutional reform on 2014 and the new Federal Telecommunication Law on 2014 remains in effect.

In Colombia, the Comisión de Regulación de Comunicaciones ("CRC") published a regulatory project for public comments in November 2016. In the project the CRC proposes a symmetric termination rate of 11.17 COP per minute and 4.3 million COP per monthly capacity from 2017 for established operators and an asymmetric termination rate of 19.01 COP per minute and 7.6 million COP per monthly capacity for challenger operators in a five-year period. The CRC also proposes regulatory measures to promote the entry of mobile virtual network operators ("MVNOs"), including the regulation of prices for the access to the mobile networks. The project is still in debate.

In Peru, the Organismo Supervisor de las Telecomunicaciones ("OSIPTEL") started the process for the revision of the values on charges of interconnection for mobile termination of calls in telecommunication services networks in November 2016. The new values established by OSIPTEL will apply as of the fourth quarter of 2017.

As a result of the foregoing regulatory actions, Telefónica may receive lower prices for certain of its services, which may materially adversely affect its business, financial condition, results of operations and cash flows.

#### *Regulation of Universal Services*

The Universal Service ("US") is an economic and legal term which refers to the obligation imposed to telecommunication operators to provide a basic service to all inhabitants of a country. In general, the goal is to promote quality services availability at affordable, reasonable and fair prices, to increase the access to advances telecommunication services (such as broadband) and to move forward with the availability of such services to all customers. On its reform proposal for the regulatory framework issued on September 14, 2016, the EC seeks to modernize the Universal Services area in Europe, removing the mandatory inclusion of the traditional services (telephone boxes, directories and information services) and focusing on the provision of affordable broadband services. The EC also proposed that the US must be funded from general budgets and not from sectorial budgets. However, if this funding method does not thrive, the affordable broadband inclusion could result more expensive for the sector. In any case, it is estimated that the new regulation will not be applicable before 2020.

In Spain, the licenses of Telefónica de España and Telefónica Telecomunicaciones Públicas for the provision of USs expired on December 31, 2016. Both companies have been designated for the provision of these services from January 1, 2017.

In Brazil, on December 15, 2016, a proposal of the General Plan for Universalisation of Fixed Switched Telephony Services ("PGMU") was approved by ANATEL.

The imposition on the Telefónica Group of additional or more onerous obligations to provide US services in the jurisdictions where it operates could have a material adverse effect on its business, financial condition, results of operations and cash flows.

*Regulation of fiber networks*

On February 24, 2016, the Spanish CNMC adopted a final resolution on the wholesale broadband market regulation, which raises a geographical segmentation in competitive (66 cities, 34% of total population) and non-competitive areas. It is anticipated that this resolution will last for at least four years. Its implementation is expected to result in a moderate increase of the current regulatory obligations of Telefónica in Spain, in terms of its granting of access to other operators to its fiber network and with respect to certain aspects relating specifically to the business segment (high quality bitstream service for business customers with national coverage). This Resolution has been appealed by Telefónica España. Additionally, on January 18, 2016, the CNMC adopted a resolution which approves the reference offer of the new wholesale unbundled virtual access service to Telefónica's new broadband Ethernet service (local NEBA). The NEBA service should be operative in 12 months from the date of the resolution's adoption.

Any of such obligations and restrictions could raise costs and limit Telefónica's freedom to provide the mentioned services, which could materially adversely affect Telefónica's business, financial condition, results of operations and cash flows.

*Regulations on privacy*

An intense data protection and privacy regulation may result in limitations to offer innovative digital services such as Big Data services. In Europe the new General Data Protection Regulation ("GDPR") of April 27, 2016, will be directly applicable in all member States from May 25, 2018. The GDPR introduces administrative fines of up to 4% of an undertaking's annual global turnover for breaching the new data protection rules.

On January 10, 2017, the EC presented its proposal for a regulation on ePrivacy, which will replace the current Directive 2002/58/EC on privacy in the electronic communications sector and will complement the recently approved GDPR. The proposal also introduces administrative fines of up to 4% of an undertaking's annual global turnover for breaching new regulations.

In October 2015, the Court of Justice of the European Union declared invalid the decision of the EC as regards the "Safe Harbor Agreement" relating to the transfer of personal data from the EU to the United States. Subsequently, the EC adopted a new decision on Privacy Shield on July 12, 2016, which considers that there is an adequate level of protection of personal data transferred from the EU to US self-certified companies complying with the Privacy Shield principles. Telefónica USA, Inc. has self-certified itself as Privacy Shield compliant. The Privacy Shield has been challenged before the EU's General Court by civil-society groups, but the admission of their appeals is still pending.

In Brazil, the adoption of a Personal Data Protection Act is still pending, this could lead to further obligations and restrictions for operators in relation to the collection of personal data and its treatment.

Any of such obligations and restrictions could raise costs and limit Telefónica's ability to provide certain services, which could materially adversely affect Telefónica's business, financial condition, results of operations and cash flows.

*Regulation of network neutrality*

Under the principle of network neutrality applicable to Internet access services area, network operators could not establish technical or commercial restrictions regarding the terminals that can be connected or the services, or applications and contents that can be accessed or distributed through the Internet by the end user. It also refers to the non-discriminatory behaviour (e.g. non-anticompetitive) to be adopted by operators regarding the different types of Internet traffic circulating through their networks.

In Europe, the application of the so-called "net neutrality Regulation" (Regulation (EU) 2015/2120 of November 25, 2015) will be monitored by national regulatory authorities following guidance to be delivered by the European Regulatory Authority ("BEREC") on August 30, 2016. This guidance could

directly impact internet access service commercial practices (for example, some zero rating offers) and it may limit network management practices or increase transparency requirements on the Internet Access Service.

Telefónica operates in Latin American countries where net neutrality is being implemented, such as Chile, Colombia, Mexico and Peru, where OSIPTEL adopted regulations aimed at providing clear guidelines on the implementation of the net neutrality regime adopted in 2012 and in force since January 1, 2017. In Brazil, the President approved a net neutrality decree (regulating Marco Civil) on May 11, 2016. In Mexico, the IFT scheduled a public consultation to be carried out in August 2016 in respect of the guidelines that will be issued regarding net neutrality, which was postponed to the first quarter 2017. In Chile, on November 22, 2016, the Commission of Telecommunications submitted a bill for amending the Network Neutrality Act. The main changes are the establishment of rules more restricted to apply measures for traffic management and restrictive rules for "Zero Rating". If changes to regulation such as those described above, or otherwise, occur in the various jurisdictions where the Telefónica Group operates, it could have a material adverse effect on its business, financial condition, results of operations and cash flows.

**The Telefónica Group is exposed to risks in relation to compliance with anti-corruption laws and regulations and economic sanctions programs.**

The Telefónica Group is required to comply with the laws and regulations of various jurisdictions where it conducts operations. In particular, the Group's international operations are subject to various anti-corruption laws, including the US Foreign Corrupt Practices Act of 1977 and the United Kingdom Bribery Act of 2010, and economic sanctions programs, including those administered by the United Nations, the European Union and the United States, including the US Treasury Department's Office of Foreign Assets Control. The anti-corruption laws generally prohibit providing anything of value to government officials for the purposes of obtaining or retaining business or securing any improper business advantage. As part of the Telefónica Group's business, it may deal with entities, the employees of which are considered government officials. In addition, economic sanctions programs restrict the Group's business dealings with certain sanctioned countries, individuals and entities.

Although the Group has internal policies and procedures designed to ensure compliance with applicable anti-corruption laws and sanctions regulations, there can be no assurance that such policies and procedures will be sufficient or that the Group's employees, directors, officers, partners, agents and service providers will not take actions in violation of the Group's policies and procedures (or otherwise in violation of the relevant anti-corruption laws and sanctions regulations) for which the Group or they may be ultimately held responsible. Violations of anti-corruption laws and sanctions regulations could lead to financial penalties, exclusion from government contracts, damage to the Group's reputation and other consequences that could have a material adverse effect on the Group's business, results of operations and financial condition.

Telefónica is currently conducting internal investigations covering various countries regarding possible violations of applicable anti-corruption laws. Telefónica has been in contact with governmental authorities about these matters and intends to cooperate with those authorities as the investigations continue. It is not possible at this time to predict the scope or duration of these matters or their likely outcome.

**Customers' perceptions of services offered by the Company may put it at a disadvantage compared to competitors' offerings.**

Customers' perceptions of the assistance and services offered are critical to operating in highly-competitive markets. The ability to predict and respond to the changing needs and demands of customers affects the Company's competitive position relative to other technology sector companies, and its ability to extract the value generated during this process of transformation. Failure to do so

adequately could have an adverse impact on the Group's business, financial condition, results of operations and cash flows.

**Telefónica may not be able to adequately foresee and respond to technological changes and sector trends.**

In a sector characterized by rapid technological change, it is essential to be able to offer the products and services demanded by the market and consider the impacts of changes in the life cycle of technical assets, secure margins and select the right investments to make.

The Telefónica Group operates in markets that are highly competitive and subject to constant technological development. Therefore, as a consequence of both of these characteristics, it is subject to the effects of actions by competitors in these markets and to its ability to anticipate and adapt, in a timely manner, to constant technological changes, changes in customer preferences that are taking place in the industry, as well as economic, political and social circumstances.

Failure to do so adequately could have an adverse effect on the Group's business, financial condition, results of operations and cash flows.

New products and technologies arise constantly, and their development can render obsolete the products and services the Telefónica Group offers and the technology it uses. This means that Telefónica must invest in the development of new products, technology and services so it can continue to compete effectively with current or future competitors, which may result in the decrease of the Group's profits and revenue margins. In this respect, margins from traditional voice and data business are shrinking, while new sources of revenues are deriving from mobile Internet and connectivity services that are being launched. Research and development costs amounted to 906 million euros in 2016, representing a decrease of 14.1% from 1,055 million euros in 2015 (1,111 million euros in 2014). These expenses represented 1.7%, 1.9% and 2.2% of the Group's consolidated revenues in 2016, 2015 and 2014, respectively. These figures have been calculated using the guidelines established in the Organization for Economic Cooperation and Development ("OECD") manual. One technology that telecommunications operators, including Telefónica (in Spain and Latin America), are focused on is the new FTTx-type network, which offers broadband access using optical fiber with superior services, such as Internet speed of up to 300MB or HD television services. However, substantial investment is required to deploy these networks, which entails fully or partially substituting copper loop access with optic fiber. While an increasing demand for the capabilities offered by these new networks to end users exists, the high level of the investments requires a continuous analysis of the return on investment.

The explosion of the digital market and entry of new players in the communications market, such as MVNOs, Internet companies or device manufacturers, may cause the loss of value of certain assets, and affect the Group's ability to generate income. Therefore, it is necessary to update the business model, encouraging the pursuit of incomes and additional efficiencies to those followed traditionally. Failure to do so adequately could have an adverse effect on the Group's business, financial condition, results of operations and cash flows.

In addition, the ability of the Telefónica Group's IT systems (operational and backup) to respond to Telefónica's operating requirements is a key factor to be taken into account with respect to the commercial development, customer satisfaction and business efficiency. Any failure by the Telefónica Group's IT systems to adequately respond to the Group's evolving operating requirements could have an adverse effect on the Group's business, financial condition and results of operations.

**Telefónica depends on its suppliers.**

The existence of critical suppliers in the supply chain, especially in areas such as network infrastructure, information systems or handsets, with a high concentration in a small number of suppliers, poses risks that may affect Telefónica's operations, and may cause legal contingencies or damages to its image in the event that inappropriate practices are produced by a participant in the supply chain.



As of December 31, 2016, the Telefónica Group depended on three handset suppliers and 12 network infrastructure suppliers, which together accounted for 80% of the awarded contracts for the year then ended. These suppliers may, among other things, extend delivery times, raise prices and limit supply due to their own stock shortfalls and business requirements.

If these suppliers fail to deliver products and services to the Telefónica Group on a timely basis, it could jeopardize network deployment and expansion plans, which in some cases could adversely affect the Telefónica Group's ability to satisfy its license terms and requirements, or otherwise have an adverse effect on the Group's business, financial condition, results of operations and cash flows.

**Unanticipated network interruptions can lead to quality loss or the interruption of the service.**

Unanticipated network interruptions as a result of system failures, including those due to network, hardware or software, stealing of infrastructure elements or cyber-attacks, which affect the quality of or cause an interruption in the Telefónica Group's service, could lead to customer dissatisfaction, reduced revenues and traffic, costly repairs, penalties or other measures imposed by regulatory authorities and could harm the Telefónica Group's image and reputation.

Telecommunications companies worldwide face increasing cybersecurity threats as businesses become increasingly dependent on telecommunications and computer networks and adopt cloud computing technologies. Cybersecurity threats include gaining unauthorized access to Telefónica's systems or inserting computer viruses or malicious software in its systems to misappropriate consumer data and other sensitive information, corrupt Telefónica's data or disrupt its operations. Unauthorized access may also be gained through traditional means such as the theft of laptop computers, portable data devices and mobile phones and intelligence gathering on employees with access.

Telefónica attempts to mitigate these risks through a number of measures, including backup systems and protective systems such as firewalls, virus scanners and other physical and logical security. However, these measures are not always effective. Although the Telefónica Group has insurance policies to cover these types of incidents, and the claims and loss in revenue caused by service interruptions to date have been covered by these policies, these policies may not be sufficient to cover all possible monetary losses.

**The telecommunications industry may be affected by the possible effects that electromagnetic fields, emitted by mobile devices and base stations, may have on human health.**

In some countries, there is a concern regarding potential effects of electromagnetic fields, emitted by mobile devices and base stations, on human health. This public concern has caused certain governments and administrations to take measures that have hindered the deployment of the infrastructures necessary to ensure quality of service, and affected the deployment criteria of new networks and digital services such as smart meters development.

There is a consensus between certain expert groups and public health agencies, including the World Health Organization that states that currently there are no established risks associated with exposure to low frequency signals in mobile communications. However, the scientific community is still investigating this issue especially with respect to mobile devices. Exposure limits for radio frequency suggested in the guidelines of the Protection of Non-Ionizing Radiation Protection Committee have been internationally recognized. The mobile industry has adopted these exposure limits and works to request authorities worldwide to adopt these standards.

Worries about radio frequency emissions may discourage the use of mobile devices and new digital services, which could cause the public authorities to implement measures restricting where transmitters and cell sites can be located, how they operate, the use of mobile telephones and the massive deployment of smart meters and other products using mobile technology. This could lead to Telefónica being unable to expand or improve its mobile network.

The adoption of new measures by governments or administrations or other regulatory interventions in this respect, and any future assessment on the adverse impact of electromagnetic fields on health, may adversely affect the business, financial conditions, results of operations and cash flows of the Telefónica Group.

**Possible regulatory, business, economic or political changes could lead to asset impairment.**

The Telefónica Group reviews on an annual basis, or more frequently when the circumstances require it, the value of assets and cash-generating units, to assess whether their carrying values can be supported by the future expected cash flows, including, in some cases synergies allowed for in acquisition costs. Potential changes in the regulatory, business, economic or political environment may result in the need to introduce changes to estimates made and to recognize impairments in goodwill, intangible assets or fixed assets. Although the recognition of impairments of property, plant and equipment, intangible assets and financial assets results in a non-cash charge on the income statement, it could adversely affect the results of the Telefónica Group's operations. In this respect, the Telefónica Group has experienced impairments on certain of its investments, affecting its results of operations in the year in which they were experienced. In 2016, impairment losses in goodwill were recognized amounting to 215 million euros for Telefónica operations in Venezuela (124 million euros) and Mexico (91 million euros).

**The Telefónica Group's networks carry and store large volumes of confidential, personal and corporate data, and its Internet access and hosting services may lead to claims for illegal or illicit use of the Internet.**

The Telefónica Group's networks carry and store large volumes of confidential, personal and business data, through both voice and data traffic. The Telefónica Group stores increasing quantities and types of customer data in both business and consumer segments. Despite its best efforts to prevent it, the Telefónica Group may be found liable for any loss, transfer, or inappropriate modification of the customer data or general public data stored on its servers or transmitted through its networks, any of which could involve many people and have an impact on the Group's reputation, or lead to legal claims and liabilities that are difficult to measure in advance.

In addition, the Telefónica Group's Internet access and hosting servers could lead to claims for illegal or unlawful use of the Internet. Telefónica, like other telecommunications providers, may be held liable for any loss, transfer or inappropriate modification of the customer data stored on its servers or carried by its networks.

In most countries in which the Telefónica Group operates, the provision of its Internet access and hosting services (including the operation of websites with shelf-generated content) are regulated under a limited liability regime applicable to the content that it makes available to the public as a technical service provider, particularly content protected by copyright or similar laws. However, regulatory changes have been introduced imposing additional obligations on access providers (such as blocking access to a website) as part of the struggle against some illegal or illicit uses of the Internet, notably in Europe.

Any of the foregoing could have an adverse effect on the business, financial position, results of operations and cash flows of the Group.

**Telefónica and Telefónica Group companies are party to lawsuits, tax claims, antitrust and other legal proceedings.**

Telefónica and Telefónica Group companies are party to lawsuits, tax claims, antitrust and other legal proceedings in the ordinary course of their businesses, the financial outcome of which is unpredictable. An adverse outcome or settlement in these or other proceedings could result in significant costs and may have a material adverse effect on the Group's business, financial condition, results of operations, reputation and cash flows. In particular, the Telefónica Group is party to certain judicial tax proceedings in Peru concerning the clearance of certain previous years' income tax, in respect of which a contentious-administrative appeal is currently pending and to certain tax proceedings in Brazil, primarily relating to

the ICMS (a Brazilian tax on telecommunication services) and to the Corporate Tax. Further details on these matters are provided in Notes 17 and 21 of the Consolidated Financial Statements.

## Non-Financial indicators

This is a tracking table for the Telefónica's most relevant non-financial indicators related to the way the Company manages its long-term strategy and the progress made in executing on it.

Indicators	Unit	2016
<b>ECONOMIC</b>		
<b>Impact in communities</b>		
Local suppliers	Percentage	81.9%
Average period for paying suppliers (Domestic market)	Days	45
Global tax contribution: total contribution (borne and collected)	Million euros	11,364
<b>Internal impact</b>		
No. of audits or evaluations on risk suppliers	Units	11,678
Risk suppliers with corrective action plans arising from the audits	Units	468
Standard entry level wage compared to local minimum wage (Spain)	Times	2.24
<b>Customers</b>		
Traffic managed (December 2016)	Tbytes/month	2,562,525
Customer satisfaction index at the end of the year	Points out of 10	7.46
<b>Digital Trust</b>		
Attending data protection training courses during the period	People	25,498
Number of fines confirmed for data protection issues during 2016	Units	55
<b>Internal complaint channels</b>		
Total number of complaints registered	Units	1,152
Identifications found to be justified	Units	641
Measures to terminate the employment contract taken as a result of the complaints received	Units	135
<b>Bribery and corruption</b>		
Number of confirmed cases	Units	2
Measures taken in relation to employees in the workplace as a result of confirmed cases of corruption	Units	2

Description of indicators	Unit	2016
<b>SOCIAL</b>		
<b>Internal (HHRR)</b>		
Total no. employees at the end of period	People	127,323
Voluntary turnover (1)	Percentage	6.8%
Employees under 30 yrs old (1)	People	24,331
Percentage of women on staff	Percentage	37.6%
Percentage of female directors (1)	Percentage	20.5%
No. of people with disabilities (1)	People	855
Average salary of women compared to men undifferentiated seniority: managers (Spain)	Percentage	97.3%
Average salary of women compared to men undifferentiated seniority: middle managers (Spain)	Percentage	95.9%
Employees with collective bargaining (1)	Percentage	64.7%
Global Environment and Commitment Index	Points out of 100	79.0
No. of hours of training (1)	Thousands of hours	4,946.9
Absenteeism rate (AR) (1) (2)	Units	4,284
Incident rate (IR) (1) (3)	Units	1.05
Number of discrimination cases detected	Units	0
Measures taken in relation to employees in the workplace as a result of confirmed cases of discrimination	Units	0
<b>External</b>		
Penetration of broad band in fix access	Percentage	55.4%
Mobile prepay customers	Thousands	165,663
<b>ENVIRONMENTAL (4)</b>		
<b>Energy</b>		
Total energy consumption	MWh	5,819,320
Energy from renewable sources	MWh	2,601,744
<b>Greenhouse gas emissions</b>		
Direct Emissions (scope I)	tCO2eq	137,043
Indirect Emissions (scope II location method)	tCO2eq	1,586,302
Indirect Emissions (scope II market method)	tCO2eq	811,711

Notes

<sup>(1)</sup> Data in process of external verification

<sup>(2)</sup> (Number of days lost due to absence in the period / Total number of days worked in the period)\* 200,000

<sup>(3)</sup> (Total number of accidents / Total hours worked)\* 200,000

<sup>(4)</sup> Environmental data verified by AENOR correspond to the main countries, representing up to 89% of the total revenues

## Other information

### Group companies with non-controlling interests

Non-controlling interests in the Telefónica Group companies can be divided into two groups. Firstly, subsidiaries listed in a regulated market: Telefónica Brasil and Telefónica Deutschland, where minority shareholdings are widely dispersed and in respect of which Telefónica protects minority interests by complying with the regulations of the related market. Secondly, subsidiaries with a main minority shareholder, with whom agreements are entered into in order to guarantee the protection of such shareholder's rights and, in certain cases (such as Colombia Telecomunicaciones) where there are also specific commitments resulting from corporate transactions (see Note 21.b).

### Average payment period of the Spanish companies

The Telefónica Group's Spanish companies have adapted their internal processes and payment schedules to the provisions of Law 15/2010 (amended by Law 31/2014) and Royal Decree-Law 4/2013, amending Law 3/2004, which establishes measures against late payment in commercial transactions. Engagement conditions with commercial suppliers in 2016 included payment periods of up to 60 days, according to the terms agreed between the parties.

For efficiency purposes, the Telefónica Group's companies in Spain have agreed payment schedules with suppliers, whereby payments are made on set days of each month. Payments to Spanish suppliers in 2016 surpassing the established legal limit were the result of circumstances or incidents beyond the payment policies, mainly the delay in issuing invoices (legal obligation of the supplier), the closing of agreements with suppliers over the delivery of goods or the rendering of services, or occasional processing issues. The average payment period to suppliers of the Telefónica Group's companies in Spain in 2016, calculated in accordance with the only additional provision of the Resolution of the Instituto de Contabilidad y Auditoría de Cuentas (Spanish Accounting and Audit Institute) dated January 29, 2016, amounted to 45 days (49 days in 2015).

### Governance system

The Company has a governance system, which applies to Telefónica's entire structure. Pursuant to the Company's commitment to its shareholders, the Board of Directors, supported by its Committees, manages the Company's business in accordance with the corporate governance rules laid down primarily in the Corporate By-laws, in the Regulation of the General Shareholders' Meeting, and in the Regulation of the Board of Directors.

Telefónica's Board of Directors consists of 18 directors and is responsible for overseeing and controlling the Company's activity. It has sole powers regarding general strategy and policies on corporate governance, corporate social responsibility, remuneration of the Board and senior management, shareholder remuneration, and strategic investments.

In order to strengthen the corporate governance of the Company, the Board of Directors of Telefónica, S.A. has six committees (including the Executive Commission) which are charged with examining and overseeing areas of particular relevance. Pursuant to its regulation, the Board also confers responsibility for day-to-day management of the businesses to Telefónica's executive bodies (primarily through the Executive Committee) and management team.

## Events after the reporting period

The following events regarding the Telefónica Group took place between December 31, 2016 and the date of authorization for issue of the accompanying consolidated financial statements:

### Financing

- On January 10, 2017, Telefónica, S.A. redeemed 300 million euros of its 2,500 million euros syndicated credit facility signed on February 19, 2015 and maturing in 2021.
- On January 17, 2017, Telefónica Emisiones S.A.U. issued notes under its EMTN Programme filed on September 13, 2016 in an aggregate nominal amount of 1,750 million euros. This issuance was split into two series: one series, amounting to 1,250 million euros, maturing on January 17, 2025 and an annual coupon of 1.528% and the other series, amounting to 500 million euros maturing on October 17, 2028 and with an annual coupon of 2.318%. Both series of notes are guaranteed by Telefónica, S.A.
- On January 17, 2017, Telefónica, S.A. amended the bilateral loan, signed originally on June 26, 2014 for an amount of 2,000 million euros and with an outstanding amount of 1,500 million euros, divided in two tranches with a new amortization schedule: tranche A for 500 million euros maturing on June 26, 2017 and tranche B for 1,000 million euros maturing on June 26, 2019. Later, on February 17, 2017, Telefónica, S.A. signed a new amended to its bilateral loan extending the maturity date of the tranche A for 500 million euros until June 26, 2019.
- On January 25, 2017, Telefónica Emisiones S.A.U. issued notes under its EMTN Programme filed on September 13, 2016 in an aggregate nominal amount of 150 million euros, maturing on January 25, 2019. The notes are guaranteed by Telefónica, S.A.
- On February 7, 2017, Telefónica Emisiones, S.A.U. redeemed 1,200 million euros, 100 million euros and 120 million euros of its notes, issued on February 7, 2011, March 21, 2011, February 7, 2012, respectively. The notes were guaranteed by Telefónica, S.A.
- On February 8, 2017, Telefónica Brasil, S.A. issued notes (debentures) in an aggregate notional amount of 2,000 million brazilian reais (approximately 600 million euros) maturing on February 8, 2022.
- On February 15, 2017, Telefónica Europe, B.V. drew down an aggregate principal amount of 750 million euros of its long term financing of 1,500 million euros signed on November 28, 2016 and maturing in 2024.
- On February 17, 2017, Telefónica Germany GmbH & Co. OHG agreed a 12-month extension on its 750 million euros syndicated credit facility dated on March 22, 2016 up to March 22, 2022.

**Telxius**

On February 20, 2017 Telefónica reached an agreement for the sale of up to 40% of the total share capital of Telxius Telecom, S.A.U. to Taurus Bidco S.à.r.l. (hereafter, "KKR", an entity managed by Kohlberg Kravis Roberts & Co. L.P.), for a total amount of 1,275 million euros (12.75 euros per share).

The aforementioned agreement includes a purchase agreement for the sale of 62 million shares (representing 24.8% of the share capital) of Telxius Telecom, S.A.U. for a price of 790.5 million euros, as well as options over 38 million shares (representing 15.2% of the share capital) for a price of at least 484.5 million euros.

These options correspond to a call option exercisable by KKR and to a put option exercisable by Telefónica upon maturity of the call option.

The closing is subject to obtaining the corresponding regulatory approvals. The exercise window of the options would take place during the fourth quarter of 2017, provided that regulatory approvals have been obtained on that date.

After the transaction Telefónica will continue to maintain control over Telxius.



## Definitions

Below are definitions of certain technical terms used in this report:

**"Access"** refers to a connection to any of the telecommunications services offered by Telefónica. A single fixed customer may contract for multiple services, and Telefónica believes that it is more useful to count the number of accesses a customer has contracted for, than to merely count the number of Telefónica's customers. For example, a customer that has fixed line telephony service and broadband service is counted as two accesses rather than as one customer.

**"ARPU"** is the average revenues per user per month. ARPU is calculated by dividing total gross service revenues (excluding inbound roaming revenues) from sales to customers for the preceding 12 months by the weighted average number of accesses for the same period, and then dividing by 12.

**"Bundles"** refer to combination products that combine fixed services (wirelines, broad band and television) and mobile services.

**"Churn"** is the percentage of disconnections over the average customer base in a given period.

**"Cloud computing"** is the delivery of computing as a service rather than a product, whereby shared resources, software and information are provided to computers and other devices as a utility over a network (typically the Internet).

**"Commercial activity"** includes the addition of new lines, replacement of handsets and migrations.

**"Data ARPU"** is the average data revenues per user per month. Data ARPU is calculated by dividing total data revenues from sources such as Short Message Service (SMS), Multimedia Messaging Services (MMS), other mobile data services such as mobile connectivity and mobile Internet, premium messaging, downloading ringtones and logos, mobile mail and wireless application protocol (WAP) connectivity from sales to customers for the relevant period by the weighted average number of accesses for the same period, and then dividing by the relevant period.

**"Data revenues"** include revenues from SMS, MMS, other mobile data services such as mobile connectivity and mobile Internet, premium messaging, downloading ringtones and logos, mobile mail and WAP connectivity from sales to customers.

**"Data traffic"** includes all traffic from Internet access, messaging (SMS, MMS) and connectivity services that is transported by the networks owned by Telefónica.

**"FaasT"** is a cybersecurity technology that scans an organization's system 24 hours a day, seven days a week, in order to prevent cybernetic attacks.

**"Fixed telephony accesses"** includes public switched telephone network, or PSTN, lines (including public use telephony), and integrated services digital network, or ISDN, lines and circuits. For purposes of calculating Telefónica's number of fixed line accesses, Telefónica multiplies its lines in service as follows: PSTN (x1); basic ISDN (x1); primary ISDN (x30, x20 or x10); 2/6 digital accesses (x30).

**"Fixed termination rates"** is an established fixed network tariff that applies when a customer makes a call to someone in a network operated by another operator.

**"FTTx"** is a generic term for any broadband network architecture that uses optical fiber to replace all or part of the metal local loop.

**"Gross adds"** means the gross increase in the customer base measured in terms of accesses in a period.

**"HDTV"** or "high definition TV" has at least twice the resolution of standard definition television (SDTV), allowing it to show much more detail than an analog television or digital versatile disc (DVD).

**"Interconnection revenues"** means revenues received from other operators which use Telefónica's networks to connect or to finish their calls and SMS or connect to their customers.

**"Internet and data accesses"** include broadband accesses (including retail asymmetrical digital subscriber line "ADSL," very high bit-rate digital subscriber line "VDSL", satellite, fiber optic and circuits over 2 Mbps), narrowband accesses (Internet service through the PSTN lines) and the remaining non-broadband final customer circuits. Internet and data accesses also include "Naked ADSL", which allows customers to subscribe for a broadband connection without a monthly fixed line fee.

**"IPTV" (Internet Protocol Television)** refers to distribution systems for television subscription signals or video using broadband connections over the IP protocol.

**"ISP"** means Internet service provider.

**"IT"**, or information technology, is the acquisition, processing, storage and dissemination of vocal, pictorial, textual and numerical information by a microelectronics-based combination of computing and telecommunications.

**"Latch"**, is a cybernetic application, protecting accounts and on-line services.

**"Local loop"** means the physical circuit connecting the network termination point at the subscriber's premises to the main distribution frame or equivalent facility in the fixed public telephone network.

**"LTE"** means Long Term Evolution, a 4G mobile access technology.

**"M2M"**, or machine to machine, refers to technologies that allow both mobile and wired systems to communicate with other devices of the same ability.

**"Market share"** is the percentage ratio of the number of final accesses or operator revenues over the existing total market in an operating area.

**"Metashield"** is a cybernetic product for protecting metadata (information on data) in digital documents and archives.

**"Mobile accesses"** includes accesses to the mobile network for voice and/or data services (including connectivity). Mobile accesses are categorized into contract and pre-pay accesses.

**"Mobile broadband"** includes Mobile Internet (Internet access from devices also used to make voice calls such as smartphones), and Mobile Connectivity (Internet access from devices that complement fixed

broadband, such as PC Cards/dongles, which enable large amounts of data to be downloaded on the move).

**"MTR"** means mobile termination rate, which is the charge per minute or SMS paid by a telecommunications network operator when a customer makes a call to another network operator.

**"MVNO"** means mobile virtual network operator, which is a mobile operator that is not entitled to use spectrum for the provision of mobile services. Consequently, an MVNO must subscribe to an access agreement with a mobile network operator in order to provide mobile access to their customers. An MVNO pays a determined tariff to such a mobile network operator for using the infrastructure to facilitate coverage to their customers.

**"Net adds"** means the number of new accesses in a certain period.

**"Non SMS data revenues"** means data revenues excluding SMS revenues.

**"OTT services" or "over the top services"** means services provided through the Internet (such as television).

**"P2P SMS"** means person to person short messaging service (usually sent by mobile customers).

**"Pay TV"** includes cable TV, direct to home satellite TV, or DTH, and Internet Protocol TV, or IPTV.

**"Revenues"** means net sales and revenues from rendering of services.

**"Service revenues"** means revenues less revenues from handset sales. Service revenues are mainly related to telecommunications services, especially voice revenues and data revenues (SMS and data traffic download and upload revenues) consumed by Telefónica's customers.

**"SIM"** means subscriber identity module, a removable intelligent card used in mobile handsets, USB modems, etc. to identify the user in the network.

**"Tacyt"** is a cybersecurity tool that supervises, stores, analyzes, correlates and classifies mobile applications.

**"Unbundled local loop" or "ULL"** includes accesses to both ends of the copper local loop leased to other operators to provide voice and DSL services (fully unbundled loop, fully ULL) or only DSL service (shared unbundled loop, "shared ULL").

**"VoiceTraffic"** means voice minutes used by Telefónica's customers over a given period, both outbound and inbound.

**"VoIP"** means voice over Internet protocol.

**"Wholesale accesses"** means accesses Telefónica provides to its competitors, who then sell services over such accesses to their residential and corporate clients.

**"Wholesale ADSL"** means accesses of broad band or fiber that we provide to our competitors, who then sell services over such accesses to their residential and corporate clients.