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IFRS 16 & Finance Session

Telefónica Group
13 March 2019, London

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Agenda

Pablo Eguirón
Global Head of Investor Relations



Key Objectives

Laura Abasolo
Chief Financial and Control Officer



Key Objectives

IFRS 16

- Implications of IFRS 16
 - Changes in lessor/lessee accounting
 - Disclosure in financial statements

Capital Structure

- Solid investment grade credit rating
- Guarantee solvency and liquidity
- Optimizing financing costs while managing key trade-offs:
 - Average maturity; Floating vs Fixed; FX mix

IFRS 16

Marta Soto
Head of Accounting Policies



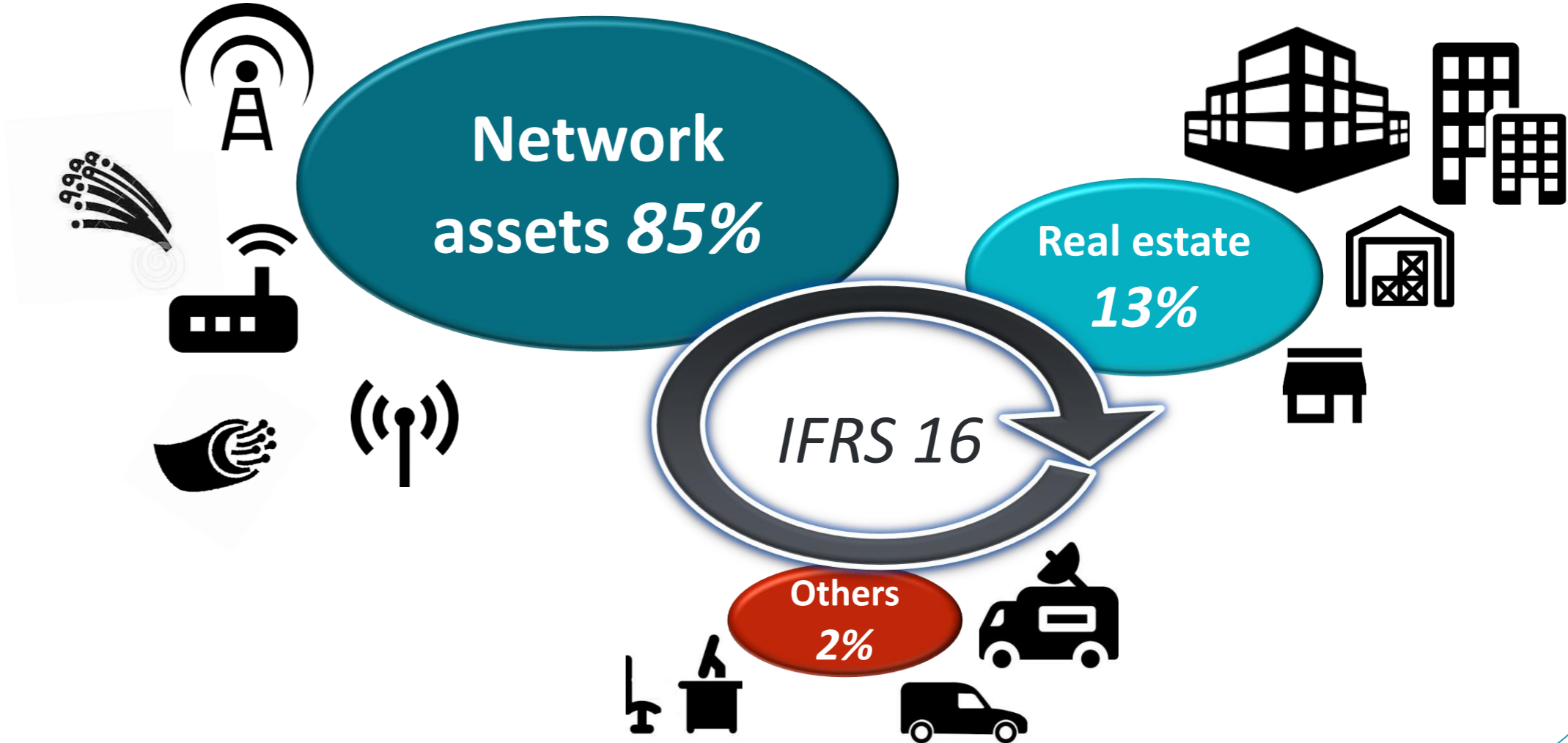
MAJOR CHANGES FOR LESSEES STARTING 1 JAN 2019

Changes in lease accounting



- Lessees are required to account for leases in the balance sheet under a single accounting model with limited exceptions
- No change on lessor side
- Additional disclosure requirements in financial statements




Main lease activities at TEF



IFRS 16 AT A GLANCE | BALANCE SHEET: ROU ASSETS AND LEASE LIABILITIES

Lessees initially recognize:

- ✓ a lease liability for the NPV of future lease payments
- ✓ a right-of-use asset for the right to use the underlying asset throughout the lease term

	BEFORE		NOW
	IAS 17		IFRS 16
	Finance	Operating	All leases(*)
Assets		---	
Liabilities	€€	---	€€€€€€
Off-balance	---	 €€€€€	---

↑ ROU assets

↑ Lease liabilities

(*) Optional for low-value assets and short-term leases   

IFRS 16 AT A GLANCE | P&L: FROM OPEX TO DEPRECIATION AND INTEREST

Impact in P&L due to change in the nature of expenses

Lease costs replaced by:


- ✓ depreciation of right-of-use assets
- ✓ interest on lease liabilities

	BEFORE		NOW
	IAS 17		IFRS 16
	Finance	Operating	All leases (*)
Income			
OpEx	---	Lease expense	---
OIBDA			↑↑
Depreciation	Depreciation	---	ROU Depreciation
Operating result			↑
Financial expense	Interests	---	Interest of lease liability
Profit before tax			

↑↑ OIBDA

↑ Depreciation

↑ Interest expense

(*) Optional for low-value assets and short-term leases   

IFRS 16 AT A GLANCE | CASH FLOW STATEMENT: NO IMPACT ON NET CASH

Impact in cash flow statement

✓ Shift from cash flows from operating activities to cash flows from financing activities

	BEFORE	NOW
	IAS 17	IFRS 16
	Operating	All leases (*)
Cash paid from operations	Lease payments	
Net payments of interest		Payment of interest
Net cash from operating activities		↑
Net cash from investing activities		---
Net cash from financing activities		Payment of principal ↓
Other		
Net cash flows		↔

↑ Operating cash flow

↓ Financing cash flow

(*) Optional for low-value assets and short-term leases   

USE OF JUDGEMENT AND ACCOUNTING POLICY ELECTIONS

CERTAIN ASSUMPTIONS ARE KEY IN THE MEASUREMENT OF ROU ASSETS AND LEASE LIABILITIES

- Lease term and renewal/early termination options
- Discount rate
- Variable lease payments
- Lease vs service

RECOGNITION EXEMPTIONS

SHORT-TERM
LEASES

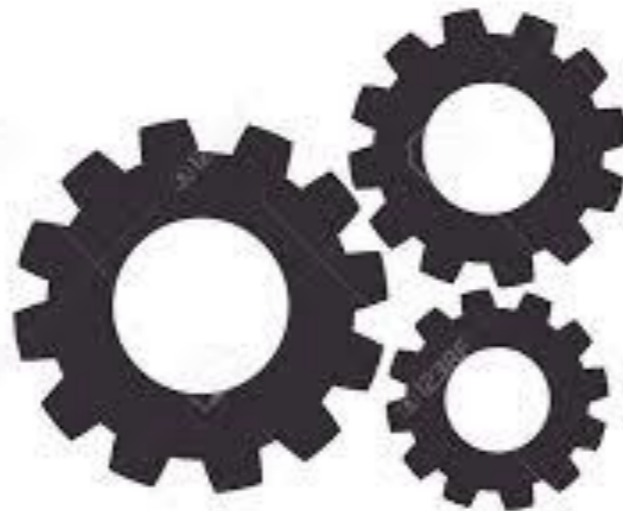


All contracts
<12 months

LOW VALUE
ASSETS



Leases of
office
equipment



INTANGIBLE ASSETS

Out of scope



**PRACTICAL EXPEDIENT:
SEPARATION OF NON-LEASE COMPONENTS**

Applied where non-lease
components are considered
not significant

TRANSITION IMPACTS | LINKED TO OPERATING LEASE COMMITMENTS 2018

Modified retrospective approach

No restatement of 2018 and earlier periods

Practical expedients 1/1/19

- Grandfathering of existing lease contracts
- Discount rates: portfolio approach
- Initial direct costs excluded from ROU asset measurement
- Leases expiring in 2019: exempt
- ROU asset = lease liability adjusted by the amount of any prepaid or accrued lease payments

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First-time adoption impacts

Bn €

Incremental Lease Liability [range]

[7.4 – 8.1]

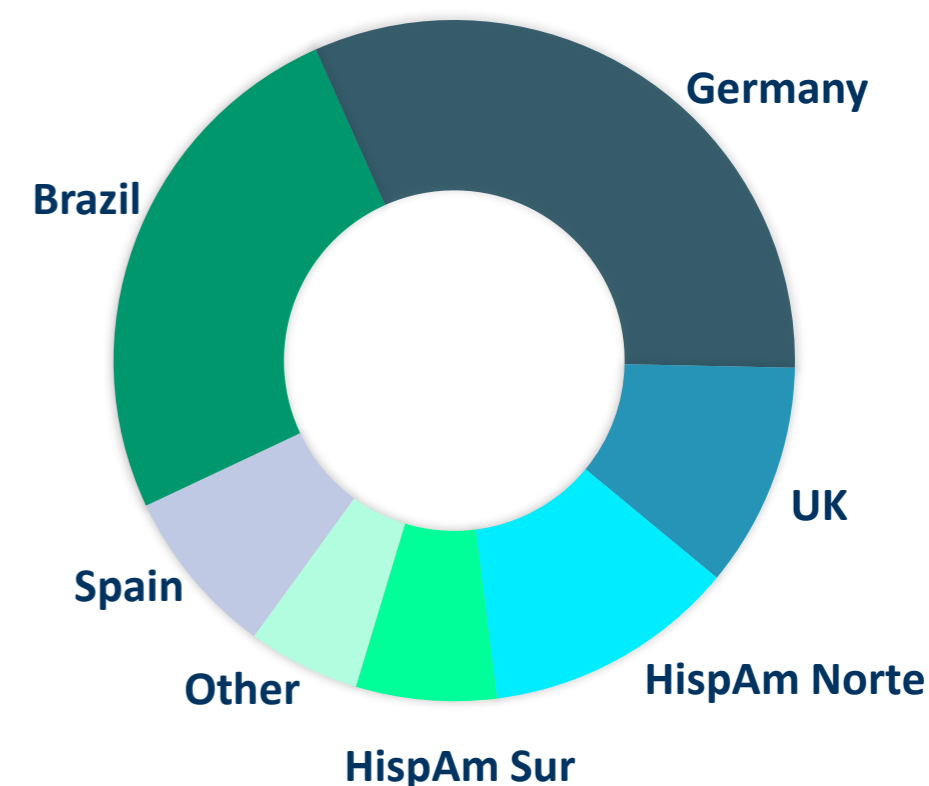
Net Debt / OIBDA*

≈ 0.2x

Operating lease commitments 2018

7.2

Incremental liability by segment



* Assuming the population of lease contracts at transition date remains unchanged in 2019

KPIs | WHAT TO EXPECT IN 2019

2019 is a transition year

No restatement of 2018

2019 adjusted figures will be provided for comparative purposes

Net Debt adjusted by MTM cash flow hedging activities related to debt

2018 Organic OIBDA

≈

2019 Organic OIBDA

excludes IFRS 16 effects

2018 Reported Net Debt

≈

2019 Net Debt

excluding lease liabilities

	2018	2019	Basis for comparison 2019 vs 2018
Organic OIBDA	✓	✓	
Net Debt excluding lease liabilities	✓	✓	
Net Debt + lease liabilities	✗	✓	⚠ Not comparable
FCF including leases	✓	✓	
FCF excluding leases	✗	✓	⚠ Not comparable

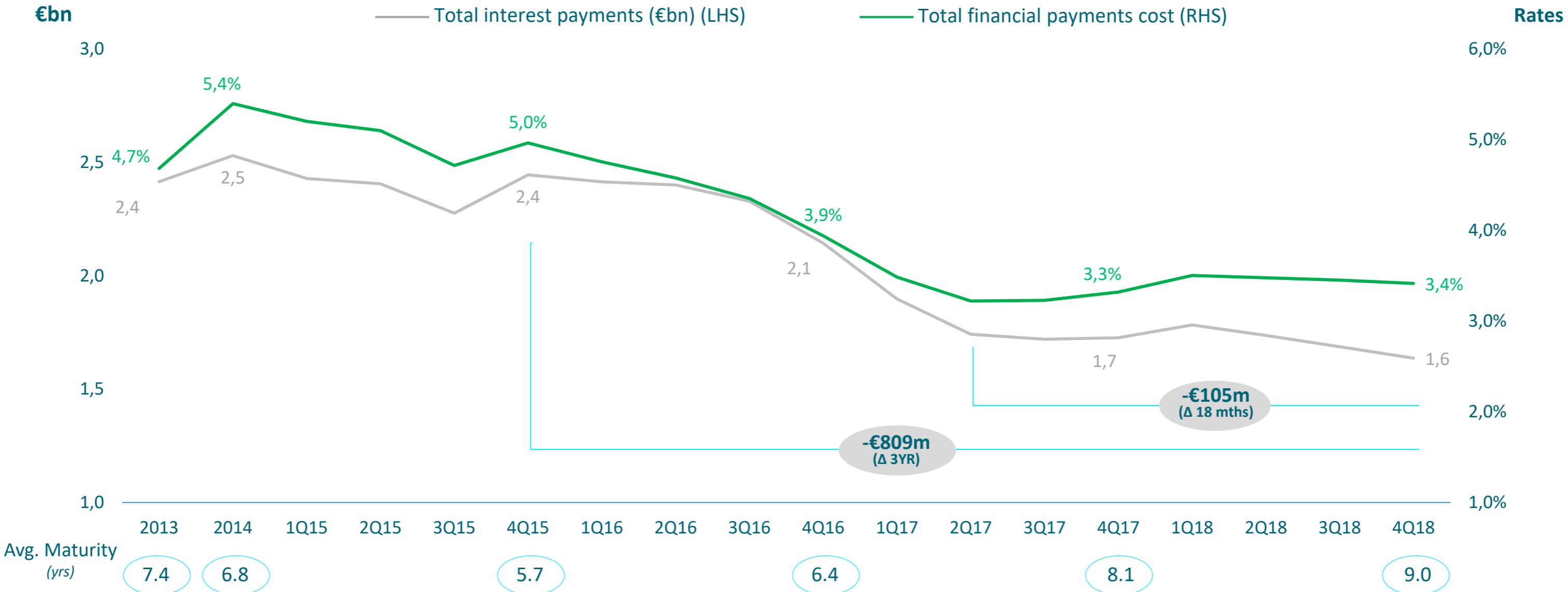
$$\text{Leverage Ratio}_{2019} = \frac{\text{Net Debt excluding lease liabilities}}{\text{Adjusted OIBDA 12m rolling excluding IFRS 16 effects}}$$

Capital Structure Strategy Update

Jesús Romero
Deputy Chief Financial Officer



Historical trend in financial payments and key management trade-offs



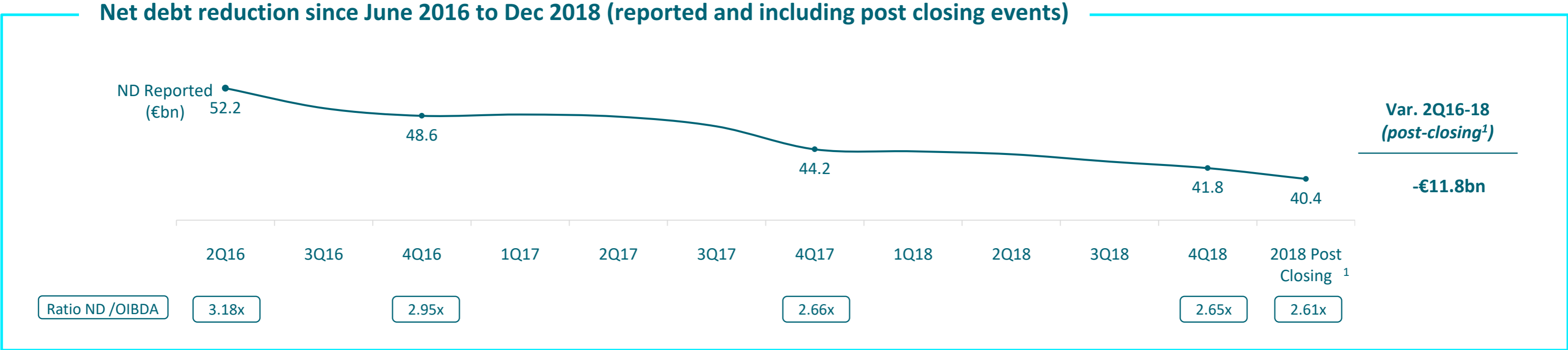
1 AVERAGE MATURITY:
 low maturities = lower cost
 ▪ 2018: 9.0 YR
 ▪ 2015: 5.7 YR

2 FLOATING vs. FIXED RATES¹:
 floating = lower cost
 ▪ 2018: 74% fixed
 ▪ 2015: 48% fixed } +26 p.p.

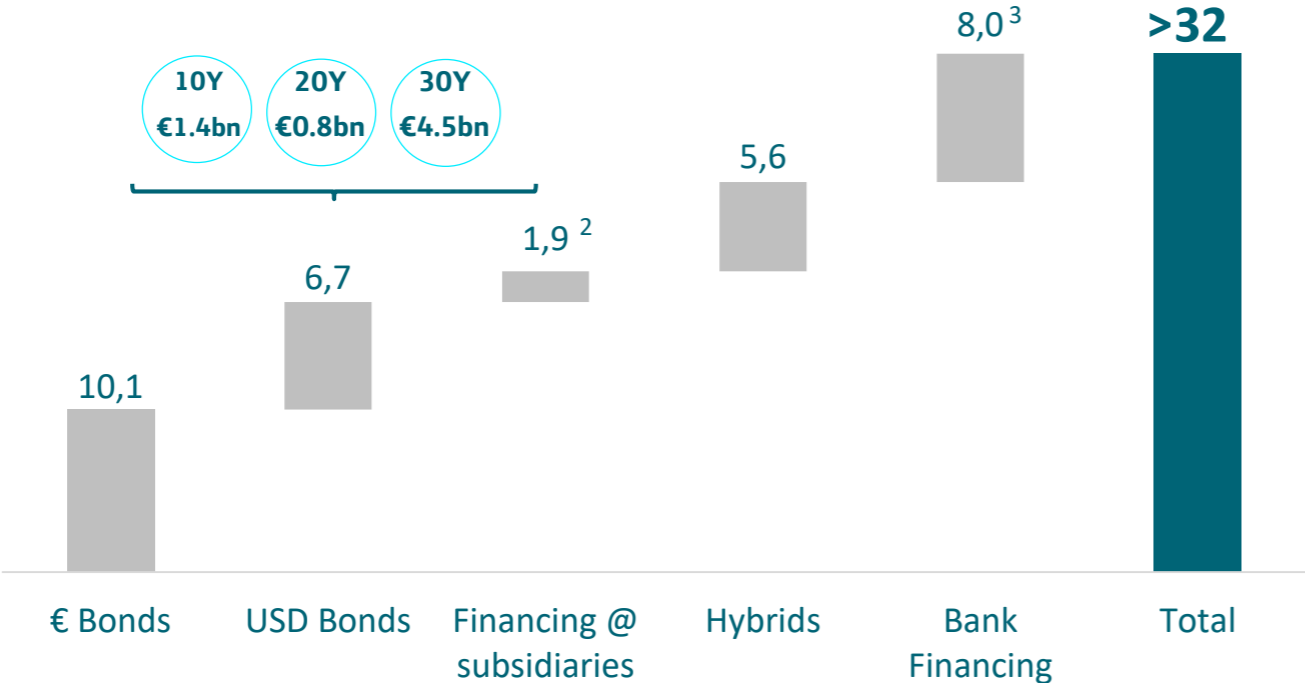
3 FX MIX²: cost in euros are lower than in Latam currencies
 ▪ 2018³: 79% EUR / 11% Latam
 ▪ 2015⁴: 67% EUR / 17% Latam

1. Calculated over end of period net debt + commitments. 2. Calculated over average gross debt + commitments. 3. 2018: 7% in GBP and 3% in USD. 4. 2017: 10% in GBP and 6% in USD

A stronger balance sheet: lower absolute debt and longer maturity at lower rates



TEF: clear focus of long-term financing in last quarters (from June 16 to 2019 YTD in €bn)

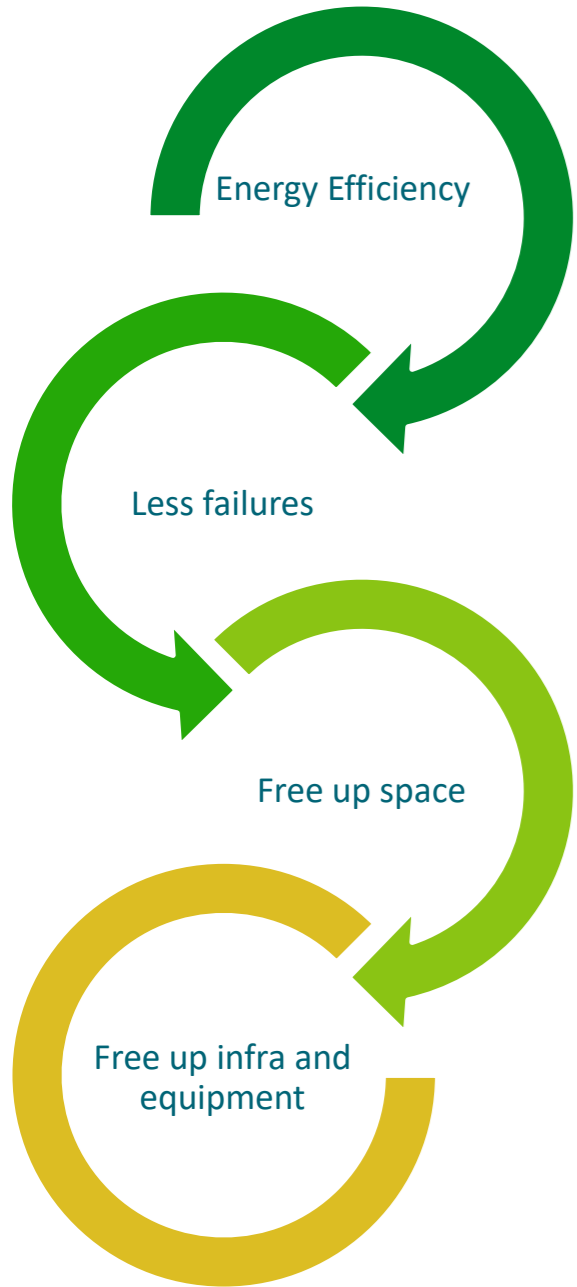


- Year to date issues reach €4.4bn with liquidity covering the next 2.5 years of debt maturities
- Since June 2016, net debt declined by €12bn and total refinancing exceeded €32bn
- During the same period, average debt life almost doubled to ~10 years at 2019 YTD

1. Post Closing Events include the sale of TEF CAM and Antares 2.€0.25bn from TEF Germany (Promissory Notes) and €1.66bn in Latam 3.Including €5.5bn of Syndicated Facility Extension

In January 2019 we issued first Green Bond in the telecoms sector globally

Fiber is our carrier for the next 30-50 years



Optical fiber is significantly more efficient than copper

- More than 7 times less energy per costumer (>85%). ≈ -40GWh/year
- 50% (-500K failures in 9 months)
- 1000 times more capacity with same cable section
- 85% less space in switch sites
- 4x distance capacity => decommissioning of technical buildings
- Recycling legacy equipment and copper wires

Optical Fiber transformation How we do it

TECHNICAL BUILDINGS SWITCHED OFF

NETWORK DOWNSIZE

DISMANTLING AND RECYCLING

Key Results (until 2018)

SWITCHED OFF

255 switch sites

300K elements

69% legacy network

SAVED (2016-2018)

208 GWh*

56.5 KtCO2**

avoided (2016-2018)

1st Green Bond issued in the Telco sector globally

- €1bn 5Y term
- Coupon: 1.069%
- Book 5x oversubscribed
- ~50% of green investors

*Accumulated figure. **Calculated according to GHG Protocol location method. Electricity emission factor from CNMV

Hybrids LM of €3.5bn extended average years to call and saved €75mn/year in coupons

Hybrids Pre-LM (Mar 2018)

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

Hybrids Post-LM³ (Mar 2019)

1 st Call Date (Crncy)	NOTIONAL (€m)	Years to Call	COUPON (%)
Nov-20 (GBP) ⁴	200	1.70	6.75%
Sep-21 (EUR)	293	2.51	7.625%
Mar-22 (EUR)	1,000	3.00	3.75%
Jun-23 (EUR)	1,000	4.23	2.625%
Dec-23 (EUR)	1,250	4.72	3.00%
Mar-24 (EUR)	1,000	5.04	5.875%
Mar-25 (EUR)	1,300	6.00	4.375%
Sep-26 (EUR)	1,000	7.52	3.875%
TOTAL TEF Holding	7,043	4.91	4.14%
Mar-20 ⁵ (USD)	438	1.04	8.5%

1. FX: 0.88 GBP/EUR

2. COLTEL Hybrid FX: 1.20 USD/EUR

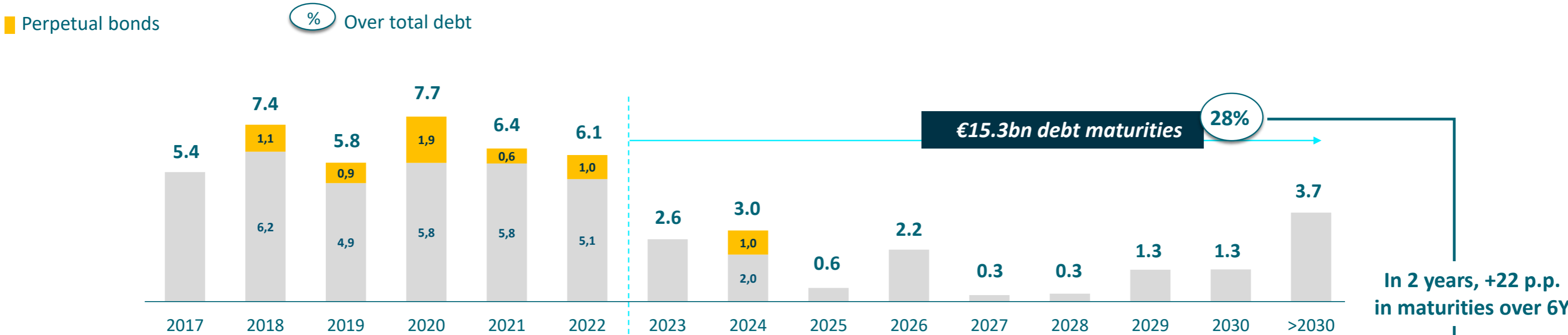
3. Assuming exercise at first call dates (Dec'19 and Mar'20)

4. FX: 0.858 GBP/EUR as of 28/2/19

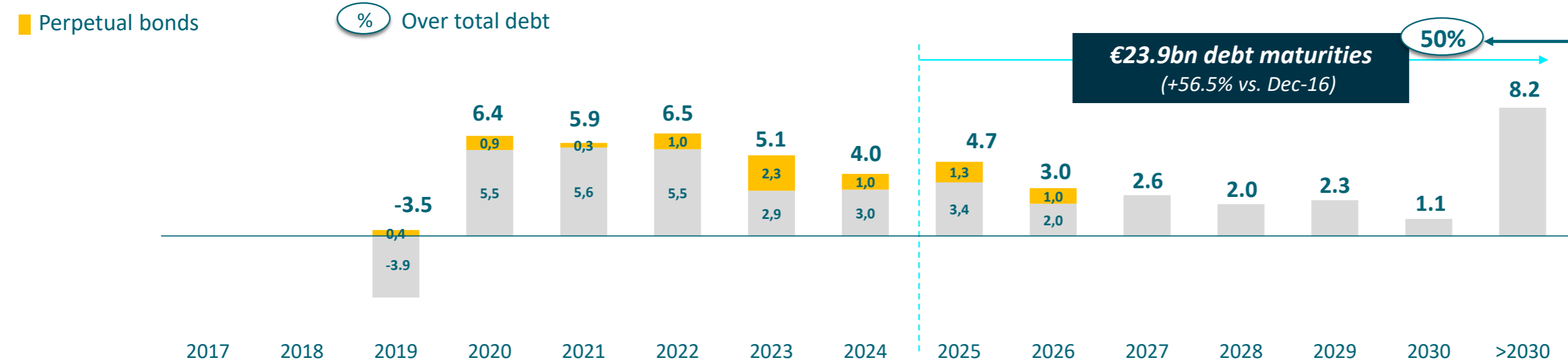
5. COLTEL Hybrid FX: 1.141 USD/EUR as of 28/2/19

Trade offs (1) – increased average debt life, from 6.4Y to ~10Y considering YTD issues

December 2016 (Liquidity¹: €21.3 bn)



March 2019 Pro-Forma (Liquidity¹: ~€24bn)



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

Trade offs (2) – increased fixed rate debt to 74% limiting exposure to higher rates

	<u>2013</u>	<u>2014</u>		<u>2015</u>		<u>2016</u>		<u>2017</u>		<u>2018</u>
Total financial payments cost (%)	4.68%	5.40%		4.96%		3.94%		3.32%		3.41%
% of Debt in Fixed Rates	71%	70%	----- Δ -22 p.p. ----->	48%	----- Δ +3 p.p. ----->	51%	----- Δ +20 p.p. ----->	71%	----- Δ +3 p.p. ----->	74%
Total financial payments (€m)	2,415	2,530		2,445		2,143		1,726		1,636

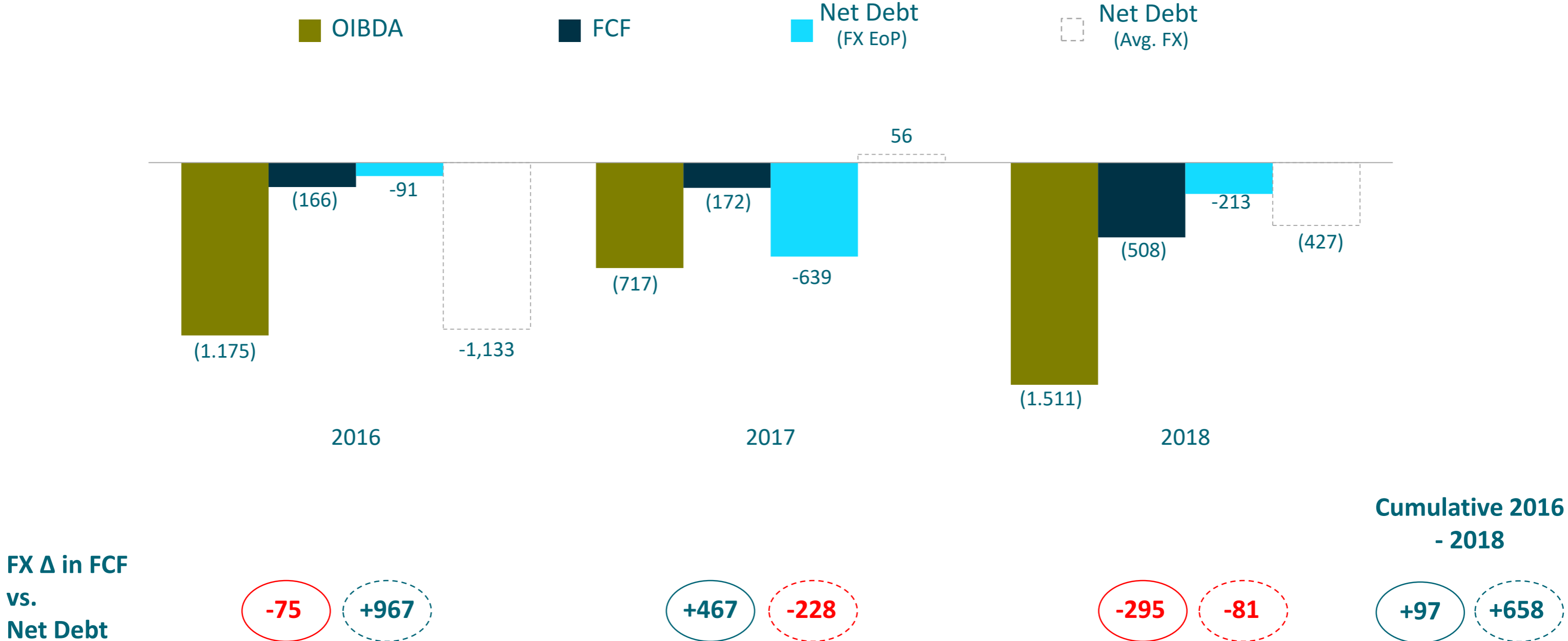
Sensitivity to +100 bps in interest rates

				Lowest Debt in Fixed Rates				Highest Debt in Fixed Rates		
Total financial payments increase (€m)	+118	+111	----- Δ +134m ----->	+245	----- Δ -13m ----->	+232	----- Δ -141m ----->	+91	----- Δ +11m ----->	+102
Total financial payments variation (%)	5%	4%		10%		11%		5%		6%
Relative to financial payments cost (%)	21%	19%		20%		25%		30%		29%

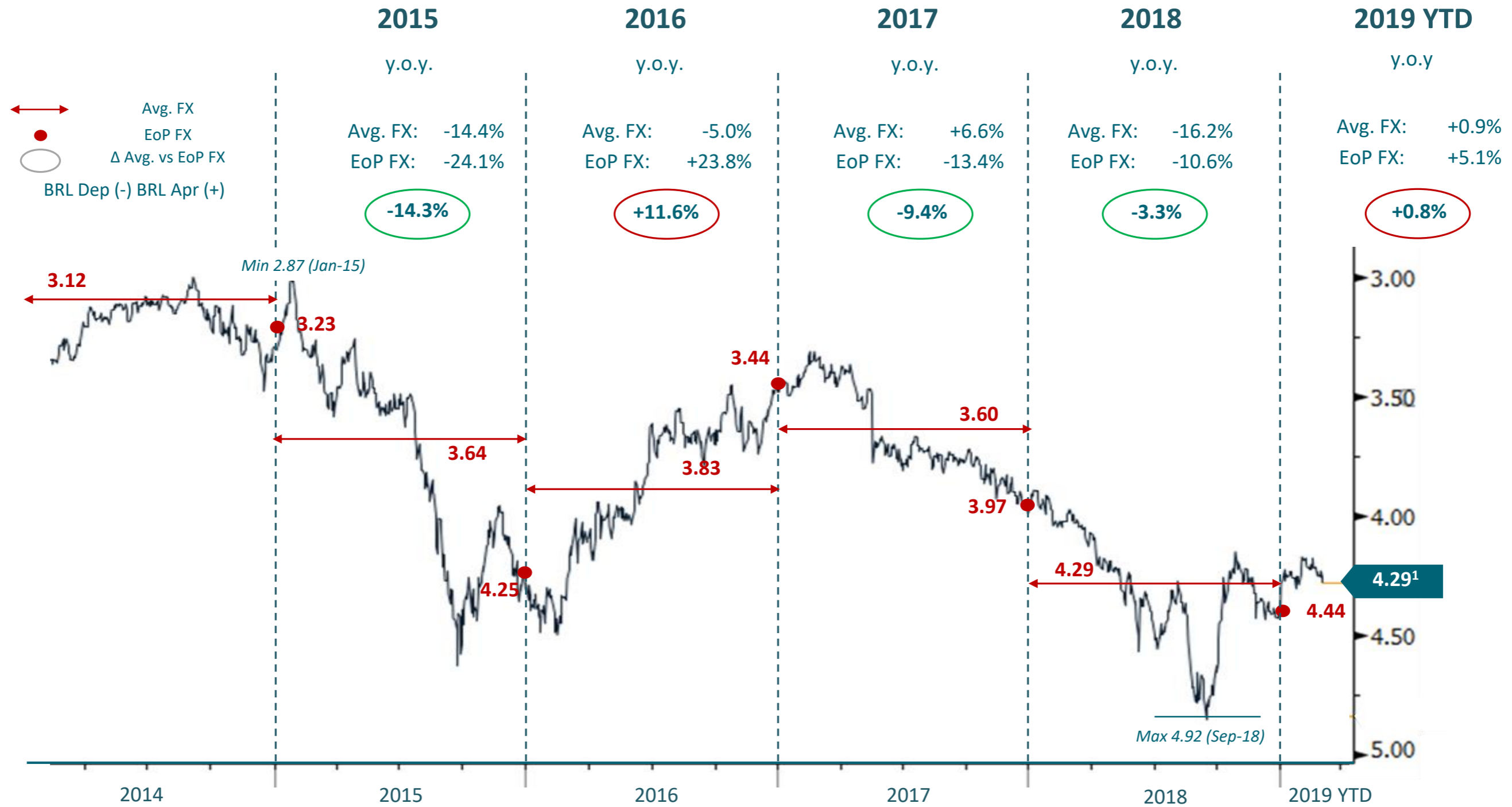
Trade offs (3) – FX hedging strategy focused on FCF vs. net debt changes

€0.85
Europe FCFS 2018
ex-financial
payments

Historic FX impacts on OIBDA, FCF and Net Debt (€m)



BRL / EUR averages vs. end of period (EoP) exchange rate (YoY comps)



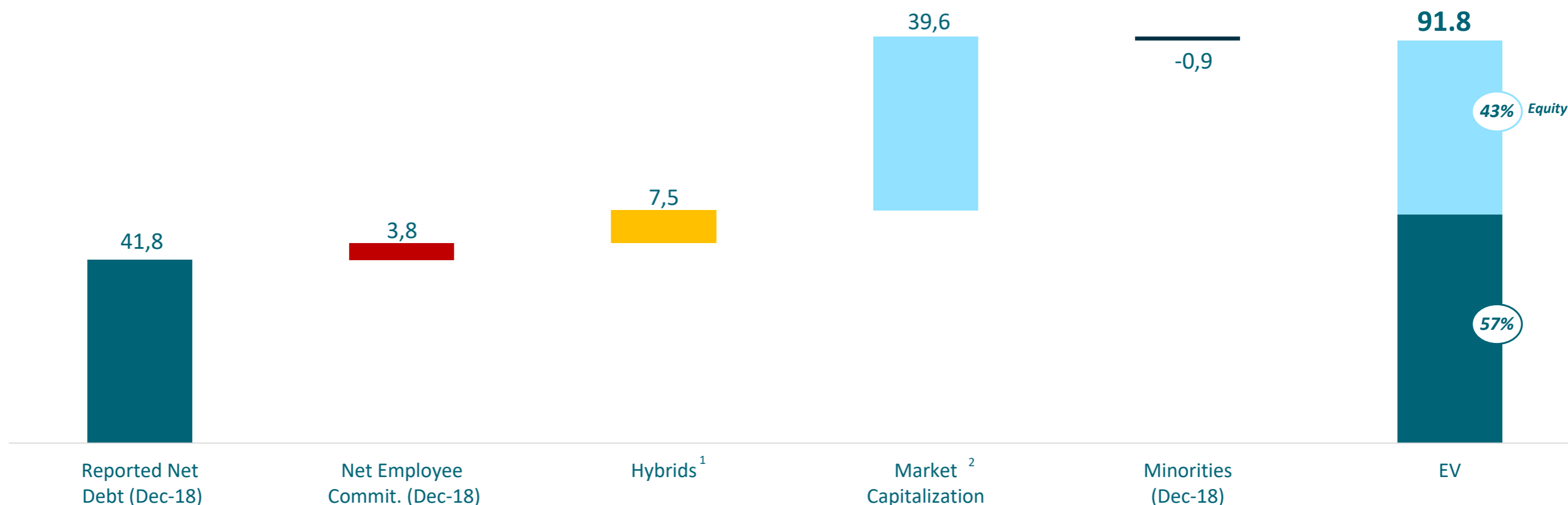
FX hedging in 2016-2018 – Potential Economic Profit (Loss)

	Reported FX Impact on net debt	Theoretical impact under benchmark		Theoretical Economic Profit (Loss)	
		Financial impact of bringing Net Debt/OIBDA to benchmark (ex-VEB)	Total theoretical Impact		
(€m)	A	B Financial Expenses ¹	C FX impact on new debt	D = A + B + C	A - D
2016	(91)	+380	+337	+626	(717) <i>(~55% coming from BRL)</i>
2017	(639)	+285	(339)	(693)	+54 <i>(~25% coming from BRL)</i>
2018	(213)	+649	(794)	(358)	+146 <i>(~45% coming from BRL)</i>

Asymmetric risks since FX depreciation (uncertain and volatile) vs. a certain cost of carry (negatively impacting FCF daily). Additionally, higher local debt lowers average debt life and % of fixed rate debt

Capital structure breakdown and pricing of debt vs. equity

€bn – 2018



Interest & Dividend outflows (€m)	1,636 ³	329 ¹	2,077 (€40c/share)	
FCF & Unlevered FCF 2018 ex spectrum (€m)			5,578	6,889 ⁴
Cash Yields (%)	Pre-tax	3.4%	4.4%	7.5% (unlevered FCF yield)
	Post-tax ⁵	2.9%	3.7%	7.1% (with Hybrids costs)
			5.2% (Div. yield) 14.1% (FCF yield)	13.2% (FCF yield with Hybrids costs)

1. Hybrids post Liability Management (March 2019)
 2. Share price of €7.63 as of 11/03/2019
 3. Total financial payments for 2018
 4. FCF 2018 (ex spectrum paid) plus financial payments net of taxes and adjusted for minorities
 5. Assuming TEF's cash tax rate of 15.5% and 2018 average net debt plus commitments

Main takeaways

1. €12bn net debt cut and €32bn refinanced in 10 Qs; committed to BBB/Baa2 rating

2. Reduced exposure to rate increases with longer debt life and higher % of fixed rate

3. FX was a major headwind in a volatile 2018

Large difference in after tax cost of debt vs. implied equity yield

Key Takeaways

Laura Abasolo
Chief Financial and Control Officer

Key Takeaways

IFRS 16

- Limited impact on leverage ratio (~0.2x)
- 2019 Guidance has been defined and will be measured pre IFRS16 (under IAS17)

Capital Structure

- Strong Net Debt reduction since June 16
- Diversified and successful financing program
- Healthier and more flexible Balance Sheet

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