Telefonica

Telefonica Europe B.V.

Interim Financial Report

June 30, 2017

Contents

INTERIM MANAGING DIRECTOR'S REPORT

The management herewith submits the Interim Financial Statements of Telefonica Europe B.V. ("the Company") for the half year ended on June 30, 2017.

Result

During the period under review, the Company recorded a **profit of EUR 1,142 thousand** (January 1, 2016 - June 30, 2016: EUR 695 thousand), which is set out in detail in the enclosed Interim Statement of Income and Expenses.

The financial margin has increased, from EUR 1,631 thousand on June 30, 2016 to EUR 1,897 thousand on June 30, 2017, mainly due to rises of about 12,3% in borrowed and on-lent volumes in average terms.

Operational expenses have decreased by EUR 326 thousand when compared to the same period of 2016, mainly due to lower legal fees (EUR 253 thousand).

Financing Activity

During the first half of 2017:

(i) On February 15, 2017, EUR 750 million were drawn by the Company from the **EUR 1,500 million credit facility agreement** dated November 28, 2016. This is the first disposal made under this credit facility.

(ii) In the short term, the Company continued with its issuing activity under **Euro Commercial Paper Programme** and during the first half of 2017 placed, among several investors, 65 ECPs for a total notional amount of EUR 4,320 million. The notional outstanding at June 30, 2017 is EUR 2,210 million (December 31, 2016: EUR 2,630 million).

Credit Facilities and liquidity

On February 15, 2017, as mentioned above, EUR 750 million were drawn by the Company from the EUR 1,500 million credit facility agreement dated November 28, 2016.

Subsequent events

No material subsequent events, affecting these Interim Financial Statements, have taken place until date of this report.

Future developments

Subject to financial market conditions, the Company will continue to seek and prospect for new markets and sources of finance for the Telefónica Group in order to extend its investor base.

Risks and uncertainties

The main risk and uncertainties the Company will face are summarized as follows:

Liquidity and credit risk:

The Company has invested the funds borrowed, in Telefónica, S.A., furthermore most of external debt and bonds issued by the Company are guaranteed by Telefónica, S.A.. In addition, the Company holds cash balances in several financial institutions.

In summary, as any substantial credit or liquidity risk would be related to credit risk of Telefónica, S.A., Telefonica Europe B.V. has not control measures by itself as they are according to the Group's liquidity risk management.

Interest rate and Foreign Exchange risk:

The Company lends money to the shareholder denominated in the same currency and, at present, such loans are denominated in the same currency as the funds it raises on the capital markets. Therefore, currently the Company implements a natural hedge. Consequently, foreign exchange fluctuation in exchange rates may have a limited impact on its financial result.

The Company may have, though, limited foreign exchange risk due to the financial margin earned in several currencies different from Euro (mainly GBP, JPY and USD), and also due to some cash positions held in foreign currencies (USD and GBP).

As of today, the Company policy is to hedge any interest rate exposure arising from funding raised, by investing on the similar terms (tenors and type of interest, whether it may be floating or fixed interest rates). Nevertheless, if that would not be eventually possible, or the Company may not consider it appropriate, the Company may look to mitigate any interest rate risk in other ways (by using derivatives or any other suitable instrument), or eventually decide not to hedge it.

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

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 monetary normalization by the central banks, including both through interest rates hikes and/or balance sheet reduction, and oil price instability, or if there is an eventual deterioration in the solvency or operating performance of Telefónica.

Worsening of the economic and political environment could negatively affect Telefonica's Group 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.

Macroeconomic perspectives in Europe have improved given that political uncertainty has decreased after the results of the general elections in some European countries and after reaching an agreement related to the Greek bailout programme. Notwithstanding, even though risks have diminished, the economic activity and the financial stability could be affected by the banking sector still under (advanced) restructuring and also due to the impact of steps taken towards an EU banking union and a capital markets union, especially regarding the monetary normalization in the Eurozone. On the other hand, the British exit process from the European Union following the vote to leave in the 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, employment and financial market volatility.

Signing of the interim financial statements

The members of the Management Board have signed these interim financial statements pursuant to their statutory obligations under art. 5:25d(2) Financial Markets Supervision Act. To the best of their knowledge, the financial statements give a true and fair value of the assets, liabilities, financial position and profit or loss of the company in accordance with Title 9 Book 2 of the Dutch Civil Code, and the management board's report gives a true and fair view of the position and performance of the business of the company, and reflects the significant risks related to the business.

Amsterdam, July 26, 2017

/s/
C.D. Maroto Sobrado

/s/
M.C. van der Sluijs-Plantz

/s/
E.J. Álvarez Gómez

/s/
J.M. Hernández Rabbat

INTERIM BALANCE SHEET
AS AT 30 JUNE 2017
(before appropriation of result)

ASSETS

Unaudited figures (Euros in thousands)

	Note	30/06/2017	31/12/2016
Fixed Assets			
Tangible fixed assets	1	3	4
Financial fixed assets	2	8,452,828	7,815,176
Total Fixed Assets		8,452,831	7,815,180
Current Assets			
Loans receivable	3	2,210,875	2,630,234
Interest receivable		219,353	184,291
Other current assets		1,691	96
Cash at bank	4	5,656	5,923
Total Current Assets		2,437,575	2,820,544
TOTAL ASSETS		**10,890,406**	**10,635,724**

SHAREHOLDER'S EQUITY AND LIABILITIES

	Note	30/06/2017	31/12/2016
Shareholder's Equity	5		
Issued share capital		46	46
Retained earnings		6,732	4,700
Result for the period		1,142	2,032
Total Shareholder´s Equity		7,920	6,778
Long Term Liabilities			
Bonds and loans	6	8,452,943	7,815,219
Current Liabilities			
Short term loans and bonds	7	2,210,875	2,630,234
Interest payable		218,019	183,063
Taxes payable		240	309
Other debts and accrued liabilities		409	121
Total Current Liabilities		2,429,543	2,813,727
TOTAL EQUITY & LIABILITIES		**10,890,406**	**10,635,724**

INTERIM STATEMENT OF INCOME AND EXPENSES
FOR THE PERIOD ENDED 30 JUNE 2017

Unaudited figures (Euros in thousands)

	Note	01/01/17-30/06/17	01/01/16-30/06/16
Financial Income and Expenses			
Interest Income		240,478	219,766
Interest Expense		(238,576)	(218,129)
Currency Exchange result		(5)	(6)
Net financial result	8	1,897	1,631
Operational Income and Expenses			
Personnel expenses		(88)	(85)
Administrative expenses		(297)	(626)
Result from ordinary activities before taxation		1,512	920
Taxation	9	(370)	(225)
Result after taxation		**1,142**	**695**

NOTES TO THE INTERIM FINANCIAL STATEMENTS
FOR THE PERIOD ENDED 30 JUNE 2017

General Information and Principal Activities

Telefónica Europe B.V. ("the Company"), having its statutory seat and registered office in Amsterdam, The Netherlands, is engaged in holding and financing activities for related companies. The main office of the Company is located in Zuidplein 112, 1077XV, Amsterdam (The Netherlands). The Company was incorporated on October 31, 1996.

The authorized share capital of the Company consists of 100 shares with a par value of EUR 460 each (EUR 46,000). On June 30, 2017 and December 31, 2016, the issued capital of the Company consists of 100 shares, which have been fully paid and which represent a total paid up capital in the amount of EUR 46,000.

Group Affiliation

The Company is a wholly-owned subsidiary of Telefónica, S.A., located in Madrid, Spain. Direct or indirect subsidiaries of Telefónica, S.A. are referred to as related companies.

Basis of Presentation

The interim financial information should be read in conjunction with the Annual Report for the year ended December 31, 2016. The Annual Report and the Interim Financial Report were prepared in accordance with Title 9, Book 2, of the Dutch Civil Code.

The functional currency as well as the reporting currency of Telefonica Europe B.V, is the Euro (€). These financial statements are presented in Euro.

Comparison with prior period

In line with more common practice in The Netherlands the balance sheet of last year end is taken up as the comparative balance sheet, rather than the balance sheet as at the interim date of the previous year.

Euro Medium Term Note Debt Programme

In 1996, the Company entered into a USD 1,500 million EMTN Debt Issuance Programme, arranged by Morgan Stanley & Co. International Limited, irrevocably guaranteed by Telefónica, S.A. Under the Programme, the Company may from time to time issue instruments in different currencies up to a maximum aggregate principal amount of USD 1,500 million. The total maximum aggregate principal amount was increased in 1998 to USD 2,000 million. In 2000, the total maximum aggregate principal amount was increased to EUR 8,000 million and finally, in July 2003, the maximum aggregate principal amount was increased again to EUR 10,000 million. The notes are listed on the London Stock Exchange. The Company has not issued any notes under this programme since 2003. The proceeds of the notes issued are lent on to the parent company or to other related companies within the group of the parent company (Telefónica, S.A.).

As at June 30, 2017, the EMTN Debt Issuance Programme includes:

Euro Notes due 2033	EUR	500,000,000

Global bonds

On September 21, 2000, Telefónica Europe B.V. issued notes with an application to be listed on the Luxembourg Stock Exchange for the notional amounts and coupons of USD 1,250,000,000 7.35% and EUR 1,000,000,000 6.125% due and repaid in 2005, USD 2,500,000,000 7.75% due and repaid 2010 and USD 1,250,000,000 8.25% due 2030. These bonds are irrevocably guaranteed by the parent company.

As at June 30, 2017 there is only one outstanding note under the programme (USD 1,250 million maturing on 2030).

Euro Commercial Paper Programme

On June 29, 2000, the Company entered into a Euro Commercial Paper Programme with a maximum aggregate principal amount of EUR 2,000,000,000 or its equivalent in alternative currencies. The Programme was updated in May 2005 and in May 2012, when its maximum aggregate principal amount outstanding was raised from EUR 2,000,000,000 to EUR 3,000,000,000 or its equivalent in alternative currencies. On April 22, 2016 the limit of the Programme was increased from EUR 3,000,000,000 to EUR 5,000,000,000 or its equivalent in alternative currencies.

The Euro Commercial Paper issues are unconditionally and irrevocably guaranteed by the parent company. Notes may have any denomination, subject to compliance with any applicable legal and regulatory requirements. The minimum denominations are EUR 500,000, USD 500,000, JPY 100,000,000, and GBP100,000. The tenor of the notes shall be not less than one nor more than 365 days.

The notional outstanding amount as at June 30, 2017 is EUR 2,210 million. In the balance sheet the outstanding ECP issues are stated at their discounted notional amounts and were accounted for EUR 2,211 million at half year end.

JPY Dual Currency Loan

The Company borrowed a total of JPY 15,000 million in three loans from a Japanese investor with a maturity on July 2037. Under this agreement interests are payable in USD on a semi-annual basis at a fix annual rate of 4.75%.

Perpetual Hybrid Bonds in EUR and in GBP

On September 18, 2013, the Company issued two tranches of perpetual hybrid securities of EUR 1,125,000 thousand and EUR 625,000 thousand respectively. A third issue of GBP 600,000 thousand was completed on November 26, 2013. On March 31, 2014 the Company issued two additional tranches of perpetual hybrid securities of EUR 750,000 thousand and EUR 1,000,000 thousand. On December 4, 2014 the Company issued a new tranche of perpetual hybrid securities for EUR 850,000 thousand. On September 15, 2016, the Company issued a new tranche of perpetual hybrid securities for EUR 1,000,000 thousand.

All perpetual hybrid securities were fully outstanding at June 30, 2017, amounting to a total equivalent of EUR 6,032,835 thousand (FX rate for GBP is the closing rate as of June 30). All perpetual hybrid securities issued by the Company are listed for trading on the London Stock Exchange.

The main terms of the six tranches issued are the following:

i. EUR 1,125,000 thousand issued on September 18, 2013 and with a first call date on September 18, 2018 with an annual coupon of 6.50% (ISIN: XS0972570351);

ii. EUR 625,000 thousand issued on September 18, 2013 and with a first call date on September 18, 2021 with an annual coupon of 7.625% (ISIN: XS0972588643);

iii. GBP 600,000 thousand issued on November 26, 2013 and with a first call date on November 26, 2020 with an annual coupon of 6.75% (ISIN: XS0997326441);

iv. EUR 750,000 thousand issued on March 31, 2014 and with a first call date on March 31, 2020 with an annual coupon of 5.00% (ISIN: XS1050460739);

v. EUR 1,000,000 thousand issued on March 31, 2014 and with a first call date on Mach 31, 2024 with an annual coupon of 5.875% (ISIN: XS1050461034);

vi. EUR 850,000 thousand issued on December 4, 2014 and with a first call date on December 4, 2019 with an annual coupon of 4.20% (ISIN: XS1148359356) and

vii. EUR 1,000,000 thousand issued on September 15, 2016 and with a first call date on March 15, 2022 with an annual coupon of 3.75% (ISIN: XS1490960942).

EUR 1,500 million Facility Agreement

A facility agreement of EUR 1,500 million with an international financial institution and guaranteed by Telefónica, S.A. was entered into November 28, 2016. The facility matures on November 28, 2024. The proceeds of the facility agreement are to be on lent to the parent company for the ultimate purpose of financing the Group's procurement of telecommunications equipment and related services.
EUR 750 million were drawn in February 15, 2017. As of June 30, 2017, a total amount of EUR 750 million have been drawn and are outstanding under the Facility .

Investments of the Company

Substantially all the net proceeds from the principal or notional amounts obtained or borrowed by the Company under its financing activities have been lent on to the parent company or to companies belonging to Telefónica Group.

Cash flow statement

No cash flow statement is presented in this interim financial report as the ultimate parent company provides all the capital of the Company and the financial statements of the ultimate parent company, containing a cash flow statement, are available at the Company's office in The Netherlands.

ACCOUNTING POLICIES

General

These interim financial statements have been prepared in accordance with Title 9, book 2 of The Netherlands Civil Code.

The accounting principles of the Company are summarized below. These accounting principles have all been applied consistently throughout the year and the preceding year.

Assets and liabilities are stated at cost value, unless indicated otherwise.

The fair value of the financial fixed assets, loans receivables, bond and loans and short term loans and bonds are not presented. The terms and conditions of these financial assets and financial liabilities are similar in all material aspects and therefore the difference between the carrying amount and the fair value is of limited importance. The fair value of the other financial assets and liabilities approximates the carrying amount due to the short term nature of these assets and liabilities.

Foreign currencies

Assets and liabilities, denominated in foreign currencies are translated into the reporting currency at exchange rates prevailing at the Balance Sheet date. Any resulting exchange differences are recorded in the Statement of Income and Expenses.

Revenues and expenses in the year under review, which are denominated in foreign currencies, are translated into the reporting currency at exchange rates in effect on the transaction date.

Tangible fixed assets

Tangible fixed assets are stated at their historical cost less accumulated depreciation. Depreciation is provided over the expected useful life of the related asset under the straight line method. The estimated useful lives are:

Furniture and office equipment: 3 to 5 years.

Long term receivables from related companies

Long term receivables from related companies are carried at amortised cost using the effective interest rate method, except where otherwise stated in these notes. Gains and losses are recognised in the income statement when the loans are derecognized or impaired, as well as through the amortisation process.

Current loans receivables and payables

Current loans receivables and payables are carried at amortised cost using the effective interest rate method, except where otherwise stated in these notes.

Bonds and loans

Bonds and loans are carried at amortised cost using the effective interest rate method, except where otherwise stated in these notes. Gains and losses are recognized in the income statement when the liabilities are derecognised as well as through the amortisation process.

Accounting policies in respect of result determination

Interest income and expense

Interest income and expense are recognized in profit or loss using the effective interest rate method. The effective interest rate include all fees and points paid or received that are an integral part of the effective interest rate. This includes transaction costs that are directly attributable to the acquisition or issue of financial assets or liabilities.

Interest is recognised in profit and loss on an accrual basis.
Costs and revenues are recognised in the year to which they refer regardless of when paid or received, in accordance with the accrual basis. Differences between amounts received and paid and the corresponding revenue and costs are recognised under the correspondent caption of financial assets or financial liabilities.

Operating expenses

Expenses are based on the historical cost convention and attributed to the financial year to which they pertain.

Taxation

Taxation is calculated on the reported pre-tax result, at the prevailing tax rates, taking account of any losses carried forward from previous financial years and tax-exempt items and non-deductible expenses and using tax facilities.

Temporary differences between taxation on the result as shown in the Statement of Income and Expense and the taxation on the fiscal result are added or deducted from the provision for deferred taxation.

Financial Instruments

General

The information included in the notes for financial instruments is useful to estimate the extent of risks relating to on-balance sheet financial instruments. The Company's primary financial instruments, not being derivatives, serve to finance the Telefonica's Group operating activities. The principal risks, arising from the Company's financing operations are, liquidity, credit, interest and foreign exchange risks. These risks to mitigate are set out in detail below:

i. *Liquidity and credit risk*

The Company has invested the funds borrowed, in Telefónica, S.A., furthermore most of external debt and bonds issued by the Company are guaranteed by Telefónica, S.A. In addition, the Company holds cash balances in several financial institutions.

In summary, as any substantial credit or liquidity risk would be related to credit risk of Telefónica, S.A., Telefonica Europe B.V. has not control measures by itself as they are according to the Group's liquidity risk management.

ii. Interest rate and Foreign Exchange risk

The Company lends money to the shareholder and, at present, such loans are denominated in the same currency as the funds it raises on the funding markets. Therefore, currently the Company implements a natural hedge. Consequently, foreign exchange fluctuation in exchange rates may have a very limited impact on its result.

The Company may have, though, limited foreign exchange risk due to the financial margin earned in several currencies different from Euro (mainly GBP, USD and JPY), and also due to some cash positions held in foreign currencies (GBP and USD).

Currently, the Company's policy is to hedge any interest rate exposure arising from funding raised, by investing on the similar terms (tenors and type of interest, whether it may be floating or fixed interest rates). Nevertheless, if that would not be eventually possible, or the Company may not consider it appropriate, the Company may look to mitigate any interest rate risk in other ways (by using derivatives or any other suitable instrument), or eventually decide not to hedge it.

1. Tangible Fixed Assets

The tangible fixed assets are comprised as follows:

	Unaudited figures (Euros in thousands)	
	30/06/2017	31/12/2016
Tangible fixed assets	3	4

The movement in the tangible fixed assets is as follows:

	Unaudited figures (Euros in thousands)	
	01/01/2017-30/06/2017	01/01/2016-31/12/2016
Carrying value		
Balance January 1	93	93
Balance	93	93
Accumulated depreciation		
Balance January 1	(89)	(87)
Change for the period	(1)	(2)
Balance	(90)	(89)
Net book value	**3**	**4**

2. Financial fixed assets

	Unaudited figures (Euros in thousands)	
	30/06/2017	31/12/2016
Long term receivables from related companies	8,452,828	7,815,176
Financial Fixed assets	**8,452,828**	**7,815,176**

Long term receivables from related companies

The long term receivables from related companies represent loans to the shareholder and total EUR 8,452,828 thousand at June 30, 2017 (EUR 7,815,176 thousand at December 31, 2016).

The movement in the financial fixed assets is as follows:

	Unaudited figures (Euros in thousands)	
	01/01/2017-30/06/2017	01/01/2016-31/12/2016
Balance January 1	7,815,176	6,886,842
Deferred Commissions amortization	(373)	6,566
New Loans	750,000	992,366
Foreign Exchange result	(111,975)	(70,598)
Balance	**8,452,828**	**7,815,176**

3. Loans receivable

The loans receivable comprise short term loans due by the shareholder and other related companies and amounted **EUR 2,210,875 thousand** at June 30, 2017 (EUR 2,630,234 thousand at December 31, 2016).

4. Cash at bank

The cash at bank balances on June 30, 2017 and December 31, 2016 are comprised as follows:

Unaudited figures (Euros in thousands)

	30/06/2017	31/12/2016
Current bank account balances	5,656	5,923

5. Shareholder's equity

The movements in the Shareholder's Equity are comprised as follows:

Unaudited figures (Euros in thousands)

	Issued share capital	Retained earnings	Result for the period	Total
Balance as at January 1, 2016	46	4,700	1,467	6,213
Allocation of result	-	1,467	(1,467)	-
Result for the period	-	-	2,032	2,032
Dividend payment	-	(1,467)	-	(1,467)
Balance as at December 31, 2016	**46**	**4,700**	**2,032**	**6,778**
Balance as at January 1, 2017	46	4,700	2,032	6,778
Allocation of result	-	2,032	(2,032)	-
Result for the period	-	-	1,142	1,142
Dividend payment	-	-	-	-
Balance as at June 30, 2017	**46**	**6,732**	**1,142**	**7,920**

6. Bonds and loans

The long term bonds and loans balance is the following:

Unaudited figures (Euros in thousands)

	30/06/2017	31/12/2016
Long term bonds and loans	8,452,943	7,815,219

The movement in long term liabilities is as follows:

	Unaudited figures (Euros in thousands)	
	01/01/2017-30/06/2017	01/01/2016-31/12/2016
Balance January 1	7,815,219	6,886,866
Prepaid Commissions amortization	(299)	5,960
New loans	750,000	993,000
Foreign Exchange result	(111,977)	(70,607)
Balance	**8,452,943**	**7,815,219**

7. Short term loans and bonds

The loans receivable include short term credit facilities (with third parties and related companies) and the outstanding under the Company's European Commercial Paper Program. The balance at June 30, 2017 totals **EUR 2,210,875 thousand** (EUR 2,630,234 thousand at 31 December 31, 2016).

8. Net Financial Result

The Net Financial Result is comprised as follows:

	Unaudited figures (Euros in thousands)	
	01/01/2017-30/06/2017	01/01/2016-30/06/2016
Interest income	240,478	219,766
Interest expense	(238,576)	(218,129)
Currency exchange result	(5)	(6)
Net Financial Result	**1,897**	**1,631**

9. Taxation

The tax charge on the profit can be broken down as follows:

	Unaudited figures (Euros in thousands)	
	01/01/2017-30/06/2017	01/01/2016-30/06/2016
Corporate income tax 2017	370	-
Corporate income tax 2016	-	224
Corporate income tax 2015	-	1
Total	**370**	**225**

The effective and applicable tax rates do not differ significantly from those of previous fiscal year. The applicable tax rate for the current interim financial statements is 25% (2016: 25%) and the effective tax rate is 24.5% (2016: 24.5%)

OTHER INFORMATION

Board of directors

The Company's board of directors consists of 4 directors, who served without remuneration (2016: 4).

Auditor's report

This Interim Financial Report has not been audited by the external independent auditors of the Company.

Subsequent events

No material subsequent events affecting this interim report have occurred until the date of the interim financial statements.

Average number of employees

During the period under review the Company employed on average 2 persons (2016: 2).

Amsterdam, July 26, 2017

/s/ C.D. Maroto Sobrado	/s/ M.C. van der Sluijs-Plantz
/s/ E.J. Álvarez Gómez	/s/ J.M. Hernández Rabbat

Telefonica Europe B.V.

RESPONSIBILITY STATEMENT FOR THE INTERIM FINANCIAL REPORT

The members of the Telefónica Europe, B.V. Board of Directors hereby declare that, to the best of their knowledge, the interim financial statements for the half-year ended June 30, 2017, are prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of Telefónica Europe, B.V., and the management report includes a fair review of the development and performance of the business and the position of Telefónica Europe, B.V. and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that Telefónica Europe, B.V. faces.

Amsterdam, July 26, 2017

/s/	/s/
C.D. Maroto Sobrado	M.C. van der Sluijs-Plantz
/s/	/s/
E.J. Álvarez Gómez	J.M. Hernández Rabbat