

Rating object

Telefónica S.A.
Telefónica Emisiones S.A.U.
Telefónica Europe B.V.
Long Term Local Currency Senior unsecured issues

Rating incl.

BBB- / negative
BBB- / negative
BBB- / negative
BBB- / negative

Date of inception / disclosure to rated entity / maximum validity:

Rating object	Date of inception	Disclosure to rated entity	Maximum validity
Telefónica S.A.	18.09.2020	21.09.2020	Withdrawal of the rating
Telefónica Emisiones S.A.U.	18.09.2020	21.09.2020	Withdrawal of the rating
Telefónica Europe B.V.	18.09.2020	21.09.2020	Withdrawal of the rating
Long Term Local Currency Senior unsecured issues	18.09.2020	21.09.2020	Withdrawal of the rating

There occurred no changes after the communication of the rating to the rating object.

Rating summary:

Creditreform Rating has confirmed the unsolicited corporate issuer rating of Telefónica S.A. at BBB- and changed the outlook from stable to negative.

Creditreform Rating has confirmed the unsolicited corporate issuer ratings of Telefónica S.A. - hereinafter also referred to as Telefónica or the Company - Telefónica Emisiones S.A.U., Telefónica Europe B.V., and the corporate issue ratings of the long-term local currency senior unsecured notes issued by Telefónica Emisiones S.A.U. and Telefónica Europe B.V. at BBB- and changed the outlook from stable to negative.¹ This change is based on a substantial decline in the Company's 2019 results and, in H1 2020, in revenues as well as in results, predominantly due to negative currency effects in Latin America, non-recurring effects and, in H1 2020, as a result of social and macroeconomic distortion due to the COVID-19 pandemic, adversely affecting the rating relevant key figures. Furthermore, the actual economic consequences are still unclear, which could dampen the business climate, especially in Latin America, causing further devaluation of domestic currencies against the euro, potentially affecting the 2021 fiscal year. The implementation of IFRS 16 reduced net income by EUR 287 million and increased liabilities by EUR 7,229 million, marginally affecting our relevant key rating figures.

Since currency effects have been impacting on the Company's operating results for several years, disposals of subsidiaries of the Hispam conglomerate are carried out from year to year. Furthermore, in November 2019 the Company announced a new action plan, which includes among others, increased focus on its key markets Spain, UK, Germany and Brazil by means of growth-enhancing investments and an operational spin-off of its Hispanoamerican subsidiaries, forming a single unit with a management team separate from the Group. The objective of this spin-off is to attract investors, in line with Telefónica's strategy to reduce capital employed and equity in Latin America (excluding Brazil). Considering that Telefónica's key markets Spain, UK and Germany recorded growth in 2019, and Brazil a slight decline by 0.09%, while Hispam Norte recorded a decrease of 6.9% and Hispam Sur of 4.4% on a reported basis in comparison with 2018, we see these measures as plausible.

Regarding the first half of 2020, every market except Germany recorded revenue decreases on a reported and on a like-for-like basis. The Latin American countries recorded the sharpest drop in revenues; Hispam by 18.6%, and Brazil even by 21.4% on a reported basis, organically by 7.9% and 3.2% in comparison with H1 2019. Telefónica estimates a revenue loss of EUR 1,176 million through FX impact and a revenue loss of EUR 806 million through COVID-19 impacts. Both external factors were also affected adversely EBITDA by an estimated negative COVID-19 impact of EUR 371 million and FX impact of EUR 448 million. The tightened lockdowns and economic downturn affected the generally robust business model due to a drop in economic activity and events, as well as in consumption and investments. Due to the current uncertainty leads to strong distortions on the financial markets, especially in emerging developing countries, the COVID-19 crisis is also responsible for the stronger currency devaluation in Latin America. Despite the recovery over the course of the last few months in its key markets, there is still significant uncertainty regarding the pandemic and economic development, with the Latin American countries currently marked by high volatility. It should also be noted that Brazil is Telefónica's second-largest key market in terms of revenue.

Consistent with their action plan of November 2019, Telefónica announced on May 2020 the merger of Telefónica UK and Virgin Media to enable a convergent platform by offering mobile and broadband. Telefonica UK will therefore be deconsolidated and a 50-50 joint venture will be established. We expect the merger to produce positive synergies and provide a decisive competitive factor in the Company's highly competitive market through increased and improved service in the long run.

¹ We have derived the rating of Telefónica Emisiones S.A.U. and Telefónica Europe B.V. and its euro-denominated bonds from the corporate issuer rating of Telefónica S.A. The rating of the notes is therefore set equal to the corporate rating of Telefónica S.A.

In summary, we believe that these strategies could show significant positive effects in the medium to long-term, depending on cost and competitive development. Based on the Company's strong market and leading position, especially in Europe, its scalable and sustainable business model, characterized by growth options especially in digitalization, and fiberglass, good access to capital markets combined with solid liquidity, we confirm the rating of Telefónica at BBB-. We have set the outlook to negative by the end of the fiscal year 2021. In the event of significant improvement in 2021, a negative rating adjustment will not be applied.

Primary key rating drivers:

- + Strong market and leading position in its key markets in Europe and Brazil
 - + Good access to capital markets combined with solid liquidity
 - + Scalable and sustainable business model, characterized by growth options
 - + Announced new strategy with objective of improving performance by focusing on stable, growing key markets
 - + Establishing a 50-50 joint venture with Virgin Media to create synergies, enabling a better competitive position
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- In 2019 significant decline in results predominantly due to restructuring costs and negative currency effects in Latin America
 - In H1 2020 significant decline in revenues (reported as well as organic) and in results due to FX- and COVID-19 impact
 - The further development of the COVID-19 pandemic as well actual economic consequences are subject to significant uncertainty
 - Further devaluation of the Latin American currencies against the euro due to an uncertain and dampened business climate
 - Elevated restructuring costs or other nonrecurring effects, affecting operating performance

ESG-criteria:

CRA generally considers ESG factors (environment, social and governance) within its rating decisions. In the case of Telefónica S.A. we have not identified any ESG factor with significant influence.

A general valid description of Creditreform Rating AG, as well as a valid description of corporate ratings for understanding and assessing ESG factors in the context of the credit rating process, can be found here:

<https://creditreform-rating.de/en/about-us/regulatory-requirements.html?file=files/content/downloads/Externes%20Rating/Regulatorische%20Anforderungen/EN/Ratingmethodiken%20EN/The%20Impact%20of%20ESG%20Factors%20on%20Credit%20Ratings.pdf>

Rating scenarios:

Please note: The scenarios are based on information available at the time of the rating. Within the forecast horizon, circumstances may occur that could lead to a change of the rating out of the indicated range.

Best-case scenario: BBB-

In our best-case-scenario for one and a half years, we assume a rating of BBB-. In this scenario, we expect that the impact of the COVID-19 crisis as well as currency and non-recurring effects have a limited influence on the Group's operating results, and consequently on the rating relevant key figures, due to a rapid economic recovery in 2021 and successful measures by the Company, significantly improving profitability.

Worst-case scenario: BB+

In our worst-case scenario for one and a half years, we assume a rating of BB+. In this scenario, we expect the severity of the COVID-19 situation to increase, slowing economic recovery and causing a further fall in demand and further currency depreciations in Latin America. Also higher restructuring or integration costs could significantly affect the Group's operating performance as well as its cash flow and financial key figures.

Analysts / Person approving (PAC):

Name	Function	Email-Address
Christina Sauerwein	Lead analyst	C.Sauerwein@creditreform-rating.de
Christian Konieczny	Analyst	C.Konieczny@creditreform-rating.de
Rudger van Mook	PAC	R.vanMook@creditreform-rating.de

Initial rating:

Rating object	Event	Rating created	Publication date	Monitoring until	Result
Corporate Issuer Rating of Telefónica S.A., Telefónica Emisiones S.A.U. and Telefónica Europa B.V.	Initialrating	18.04.2018	27.04.2018	28.11.2019	BBB- / stable
LT LC Senior Unsecured Issues Issued of Telefónica Emisiones S.A.U. and Telefónica Europa B.V.	Initialrating	18.04.2018	27.04.2018	28.11.2019	BBB- / stable

Status of solicitation and information basis:

The present rating is an **unsolicited** rating. The rating object participated in the creation of the rating as follows:

Unsolicited Corporate Issuer / Issue Rating	
With rated entity or related third party participation	No
With access to internal documents	No
With access to management	No

Rating methodology / Version / Date of application:

Rating methodology	Version number	Date	Website
Corporate Ratings	2.3	29.05.2019	https://creditreform-rating.de/en/about-us/regulatory-requirements.html?file=files/content/downloads/Externes%20Rating/Regulatorische%20Anforderungen/EN/Ratingmethodiken%20EN/Rating%20Methodology%20Corporate%20Ratings.pdf
Non-financial Corporate Issue Ratings	1.0	October 2016	https://creditreform-rating.de/en/about-us/regulatory-requirements.html?file=files/content/downloads/Externes%20Rating/Regulatorische%20Anforderungen/EN/Ratingmethodiken%20EN/Rating%20Methodology%20Non-Financial%20Corporate%20Issue%20Ratings.pdf
Rating Criteria and Definitions	1.3	January 2018	https://creditreform-rating.de/en/about-us/regulatory-requirements.html?file=files/content/downloads/Externes%20Rating/Regulatorische%20Anforderungen/EN/Ratingmethodiken%20EN/CRAG%20Rating%20Criteria%20and%20Definitions.pdf

Regulatory requirements:

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Conflict of interests

No conflicts of interest were identified during the rating process that might influence the analyses and judgements of the rating analysts involved or any other natural person whose services are placed at the disposal or under the control of Creditreform Rating AG and who are directly involved in credit rating activities or in approving credit ratings and rating outlooks.

In the event of providing ancillary services to the rated entity, Creditreform Rating AG will disclose all ancillary services in the credit rating report.

Rules on the presentation of credit ratings and rating outlooks

The approval of credit ratings and rating outlooks follows our internal policies and procedures. In line with our "Rating Committee Policy", all credit ratings and rating outlooks are approved by a rating committee based on the principle of unanimity.

To prepare this credit rating, Creditreform Rating AG has used following substantially material sources:

Corporate issuer rating:

1. Annual and half year report
2. Website
3. Internet research

Corporate issue rating:

1. Corporate issuer rating incl. information used for the corporate issuer rating
2. Documents on issues / instruments

There are no other attributes and limitations of the credit rating or rating outlook other than those displayed on the Creditreform Rating AG website. Furthermore, Creditreform Rating AG considers as satisfactory the quality and extent of information available on the rated entity. With respect to the rated entity, Creditreform Rating AG regarded available historical data as sufficient.

Between the time of disclosure of the credit rating to the rated entity and the public disclosure, no amendments were made to the credit rating.

The Basic Data Information Card indicates the principal methodology or version of methodology that was used in determining the rating, with a reference to its comprehensive description.

In cases where the credit rating is based on more than one methodology or where reference only to the principal methodology might cause investors to overlook other important aspects of the credit rating, including any significant adjustments and deviations, Creditreform Rating AG explains this fact in the credit rating report and indicates how the different methodologies or other aspects are taken into account in the credit rating. This information is integrated in the credit rating report.

The meaning of each rating category, the definition of default or recovery and any appropriate risk warning, including a sensitivity analysis of the relevant key rating assumptions such as mathematical or correlation assumptions, accompanied by worst-case scenario credit ratings and best-case scenario credit ratings are explained.

The date at which the credit rating was initially released for distribution and the date when it was last updated, including any rating outlooks, is indicated clearly and prominently in the Basic Data Information Card as a "rating action"; initial release is indicated as "initial rating", other updates are indicated as an "update", "upgrade" or "downgrade", "not rated", "confirmed", "selective default" or "default".

In the case of a rating outlook, the time horizon is provided during which a change in the credit rating is expected. This information is available within the Basic Data Information Card.

In accordance with Article 11 (2) EU-Regulation (EC) No 1060/2009, a registered or certified credit rating agency shall make available, in a central repository established by ESMA, information on its historical performance data including the rating transition frequency and information about credit ratings issued in the past and on their changes. Requested data are available at the ESMA website: <https://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml>

An explanatory statement of the meaning of Creditreform Rating AG's default rates are available in the credit rating methodologies disclosed on the website.

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Creditreform Rating AG

Contact information

Creditreform Rating AG

Europadamm 2-6
D-41460 Neuss

Phone: +49 (0) 2131 / 109-626
Telefax: +49 (0) 2131 / 109-627

E-Mail: info@creditreform-rating.de
Web: www.creditreform-rating.de

CEO: Dr. Michael Munsch
Chairman of the Board: Prof. Dr. Helmut Rödl

HR Neuss B 10522