

Rating object	Rating information	
Telefónica S.A. Creditreform ID: 12436 Incorporation: 1924 Based in: Madrid, Spain (Main) Industry: Telecommunication CEO: José María Álvarez-Pallete López, CEO <u>Rating objects:</u> Long-term Corporate Issuer Rating: Telefónica S.A. Long-term Corporate Issuer Rating: Telefónica Emisiones S.A.U. Long-term Corporate Issuer Rating: Telefónica Europe B.V. Long-term Local Currency (LT LC) Senior Unsecured Issues	Corporate Issuer Rating:	Type: Update unsolicited
	BBB- / stable	
	LT Senior Unsecured Issues, LC:	Other: n.r.
	Rating date: 29 November 2019 Monitoring until: withdrawal of the rating Initial rating: 18.04.2018 Rating methodology: CRA "Corporate Ratings" CRA "Non-Financial Corporate Issue Ratings" CRA "Rating Criteria and Definitions"	Rating history: www.creditreform-rating.de

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Summary

Company

Telefónica, S.A. (hereinafter also called Telefónica or the Company), with its consolidated subsidiaries comprising the Telefónica Group, is a leading multinational telecommunications service provider headquartered in Madrid, Spain. The Company offers a broad range of fixed and mobile telecommunications services with 356.2 million accesses in 17 countries, mainly in Europe and Latin America. Telefónica is active in the following businesses: wireless and wireline telephony, broadband, internet, data traffic, pay TV and other digital services, and operates under its main brand names Telefónica, Movistar, O2, and Vivo.

In 2018 the Group, with an average of 121,853 employees, achieved revenues amounting to EUR 48,693 million (2017: EUR 52,008 million), an EBITDA of EUR 15,848 million (2017: EUR 16,278 million), and an EAT of EUR 3,950 million (2017: EUR 3,378 million).

Rating result

The current rating of BBB- attests a highly satisfactory level of creditworthiness to Telefónica, S.A., which represents a low to medium default risk.

The rating result of Telefónica, S.A. is based on its large scale, high degree of diversification, and its solid and leading position in many of its key markets. Despite unfavorable market conditions adversely affecting revenues and EBITDA, the Company has improved its net profit, and has continued to reduce debt as planned in 2016, which is noticeable in the relevant key figures, especially in the improvement in the ratio of interest expenses to total debt. We see that the investments of Telefónica in the past years and its focus on digitalization has brought about diversification and lead to more efficiency, increasing its competitiveness and achieving organic growth.

Our assessment is, however, partially offset by political and economic instability in Latin America, increased currency and interest rate risks, and the Company's still high payout ratio in line with its improvable capital structure. In addition, uncertainty in the UK due to Brexit has had an adverse impact on the Company, albeit to a much lesser extent. The Company displayed an

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adequate volume of investment in the past, which has helped to set up at a technologically appropriate level. Even though this fast-paced industry is capital-intensive and requires constant innovation.

Telefónica continually needs to invest in its infrastructure and spectrum, which could put pressure on Telefónica's financials. As one of the leading telecommunications companies in its core markets, we believe the Group is, financially and structurally, in the position to handle the operational and financial challenges that arise, especially those linked to 5G network expansion. Any regulatory changes or breaches of material contracts could severely impact the Company's businesses.

Outlook

The outlook of the Company is stable. This outlook is based on our expectations that the Company will continue to grow, focusing on its high-value customers and improving operating performance thanks to its digitalization and simplification strategy as well as securing a competitive position as 5G-network operator. It remains to be seen, if the Company will be able to continue its deleveraging path in the short and medium term due to the high investment requirements which we expect for example in line with 5G investments. Higher investments could dampen the rating, but we would also consider it as a measure to ensure competitiveness.

Relevant rating factors

Table 1: Financials of Telefónica S.A. (Group) | Source: Telefónica S.A. annual report 2018, standardized by CRA

Excerpts from the financial key figures analysis 2018

- + Reduction of interest costs
- + EAT
- + Return on investment
- + Improved capital structure (deleveraging)
- + Level of cash flows
- + Satisfactory net-debt/EBITDA

- Equity ratio
- Decrease in revenues
- Capital intensity
- Asset coverage ratio

Telefónica S.A. Selected key figures of the financial statement analysis Basis: Annual accounts and report of 31.12. (IFRS, Group)	CRA standardized figures ¹	
	2017	2018
Sales (million EUR)	52,008	48,693
EBITDA (million EUR)	16,278	15,848
EBIT (million EUR)	6,882	6,799
EAT (million EUR)	3,378	3,950
EAT after transfer (million EUR)	3,132	3,331
Total assets (million EUR)	99,515	98,772
Equity ratio (%)	13.28	14.56
Capital lock-up period (days)	56.35	64.05
Short-term capital lock-up (%)	31.96	36.95
Net total debt / EBITDA adj. (factor)	4.64	4.67
Ratio of interest expenses to total debt (%)	3.90	3.19
Return on Investment (%)	5.70	5.25

¹ For analytical purposes, CRA adjusted the original values in the financial statements in the context of its financial ratio analysis. For example, when calculating the analytical equity ratio, deferred tax assets, goodwill (entirely or partly), and internally-generated intangible assets are subtracted from the original equity, whilst deferred tax liabilities are added. Net total debt takes all balance sheet liabilities into account. Therefore, the key financial figures shown often deviate from the original values of the company.

Please note:

General rating factors summarize the key issues that – according to the analysts as per the date of the rating – have a significant or long-term impact on the rating, positive (+) as well as negative (-).

General rating factors

- + Strong market position in Europe and Latin America (market leader or one of the top providers in several countries) and high geographical diversification
- + Leading global integrated broadband and telecommunications provider with a full range of services – adequate business mix
- + State-of-the-art use of technology (fiber roll-outs, TV contents, bundled offers, and improved networks)
- + Significant size and scale; scalable and sustainable business model
- + Entry barriers in the market (licenses, concessions and permits)
- + Proven access to debt capital markets
- Dependency on economic trends
- Highly competitive markets (also fostered by regulators)
- Capital-intensive business with high ongoing investments (infrastructure and spectrum)
- Country risks: exposure to developing countries with unstable economies
- Foreign exchange risk: high exposure to currency fluctuations
- Interest rate risks
- Partly reduced customer loyalty
- Regulatory risk exposure in every jurisdiction where the Group is active

Current rating factors (rating 2019)

- + Business development in line with objectives
- + Organic growth in revenues and reported growth in net profit
- + Costs reductions, synergies leading to increased operating cash flow
- + Growth on high value segment
- + Ongoing deleveraging thanks to growing cash flow generation and in Central America
- + Improved competitiveness thanks to investments in network, content, and bundled products
- + Acquisition of spectrum bands to ensure competitiveness at 5G
- Still high leverage accompanied by uncertainties regarding to expansion of 5G
- Still high payout ratio leaving little room to deleverage rapidly (organic)
- Depreciation of currencies on numerous markets
- Exceptional effects on the income statement (currency movements, restructuring costs especially in Spain, legal affairs, sale of operators in Central America)
- Competitive regulatory and commercial cost pressures in Latin America
- Decrease in prepay and fixed telephony

Prospective rating factors

- + Cost reductions, synergies leading to increased operating cash flow
- + Profitable sales growth
- + Stabilization of the economic situation in Venezuela and Argentina
- + Timely implementation/ launching of 5G in comparison with its competitors
- + Extension of its fiber network and further improvement of its network quality
- Deterioration of operating performance due to increased competition

Current rating factors are the key factors which, in addition to the underlying rating factors, have an impact on the current rating.

Prospective rating factors are factors and possible events that – according to the analysts as per the date of the rating – would most likely have a stabilizing or positive effect (+) and a weakening or negative effect (-) on future ratings, if they occurred. This is not a full list of possible future events with potential relevance for future ratings. Circumstances can arise that are not included in the list of prospective factors whose effects are impossible to assess at the time of the rating, either because these effects are uncertain or because the underlying events are deemed unlikely to occur.

- Worsening of the economic situation and political instability in Latin America
- Unexpected increase in capex/leveraging, in particular due to 5G investments (spectrum and infrastructure)
- Possible hard Brexit with further depreciation effects and weakening domestic economy
- Weakening economic activity in Europe
- Complications/delay in the launching of 5G

Best-case scenario

In our best-case scenario for one year, we assume a rating of BBB. This could be the case if the Company generates improved and strong operating results in combination with higher revenues and cash flows under current regulatory environments, as well as better cost efficiency. Also, a higher analytical equity ratio of over 20%, ceteris paribus, could lead to a rating upgrade.

Worst-case scenario

In our worst-case scenario for one year, we assume a rating of BB+. This could be the case if key financials deteriorate following an increase of debt due to disproportionately high investments in 5G frequencies, and the rollout of the mobile network in line with higher leverage, or as a consequence of weak operating results. Any unfavorable regulatory changes or poor economic conditions in Telefónica's key markets would significantly affect the profitability of the Company, having an adverse impact on the rating.

Best-case scenario BBB

Worst case scenario: BB+

Please note:

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

Business development and outlook

During the business year 2018, revenues decreased to 48,693 million (2017: 52,008), a drop of -6.8% in comparison with the previous year, mainly as a result of exchange rates devaluations of several countries in Latin America, where the Group generates 43% of its revenues. The Group was particularly affected by the hyperinflation in Argentina and the depreciation of the Brazilian real. Excluding these currency effects, amongst others, the Company achieved a revenue growth of 2.4% in organic terms.

Table 2: The development of business of Telefónica S.A.. Source: Consolidated annual reports 2016 - 2018

Telefónica S.A.				
In million EUR	2015	2016	2017	2018
Sales	54,916	52,036	52,008	48,693
EBITDA	12,961	15,605	16,278	15,848
EBIT	3,257	5,956	6,882	6,799
EBT	906	3,245	4,597	5,571
EAT	751	2,3993	3,378	3,950

Revenues were generated in its core geographical areas: Spain (26.1%), Brazil (20.8%), Germany (15.0%), UK (13.9%), the countries corresponding to the territory of Telefónica Hispam Sur² (13.7%), Hispam Norte (8.4%), and others (2.1%). Each country recorded a growth in revenues except Brazil and the countries belonging to Telefónica Hispam Sur and Hispam Norte.

As shown in table three, the total accesses of Telefónica decreased slightly to 356.2 million as of 31 December 2018 (2017: 358.1 million), mainly due to a decrease in its prepaid and fixed voice customers, in particular in Latin America and Germany. Nevertheless, the adverse development of -5.6% in prepay was absorbed by the increase of 6.8% in mobile contracts accesses. Overall, the number of high-value customers (postpaid and ultra-broadband (UBB) increased, resulting in growth for the mobile segment, fiber and Pay-TV. Mobile business revenues represented 63.2% of total revenues, while fixed revenues accounted for 34.4% in 2018.

Table 3: The development of the accesses in each business segment 2018 | Source: Consolidated annual report of 2018

In million EUR	2017	2018	%
Fixed telephony accesses	36,898.6	34,941.4	-5.3%
Internet and Data accesses (total)	21,864.6	22,087.5	1.0
<i>Broadband</i>	21,417.5	21,645.2	1.1
<i>FTTx³/Cable</i>	10,961.6	13,213.1	20.5
Mobile accesses (total):	271,766.9	270,814.9	-0.4
<i>Prepay</i>	155,868.5	147,062.0	-5.6
<i>Contract</i>	115,898.4	123,752.9	6.8
<i>M2M⁴</i>	16,137.2	19,483	20.7
Pay TV	8,467.7	8,875.4	4.8
Final Clients Accesses	338,997.9	336,719.3	-0.7
Wholesale Accesses:	19,124.9	19,520.0	2.1
<i>Fixed wholesale accesses</i>	4,460.2	3,951.5	-11.4
<i>Mobile wholesale accesses</i>	14,664.7	15,568.5	6.2
Total Accesses	358,122.8	356,239.4	-0.5

In 2018, expenses benefited from special items; particularly the above-mentioned depreciation and hyperinflation effects, a favorable legal decision in Brazil related to taxes (EUR 789 million), and the adoption of IRFS 15. Other incomes were achieved due to the sale of other assets. The analytical EBITDA amounted to EUR 15,848 million (2017: EUR 16,278 million), i.e. a decrease of -2.6%, caused by the decline in revenues, restructuring costs of (EUR 461 million) (in particular the individual suspension plan in Spain from 2016⁵), an impairment on goodwill (EUR 350 million), and certain provisions (EUR 215 million). However, the Group achieved a net income (EAT)

² Telefónica differentiates between the segments Telefónica Hispam Norte and Hispam Sur. To Hispam Norte belong the countries Colombia, Mexico, Venezuela, Ecuador and before 2019 Central America and to Hispam Sur Argentina, Chile, Peru and Uruguay.

³ FTTx: term for broadband network architecture, which uses optical fiber, replacing copper.

⁴ M2M: Machine to machine; technologies that enable communication between mobile and wired systems and other devices.

⁵ Telefónica has extended the plan, which concerns voluntary early termination in line with its simplification process to reduce costs, until 2018.

amounting to EUR 3,950 million (2017: EUR 3,378 million), i.e. a growth of 15.5% due to an improved financial result. The improvement by around 1 billion in reference to our analytical financial result is based on a non-recurring effect of interest due to the above-mentioned favorable ruling in Brazil (EUR 665 million), and on lower financing costs, a decrease of EUR 673 million due to debt reduction

In the first three quarters of 2019, the Group recorded a further decrease in access. The total access amounted as of September 2019 345.8 million (September 2018: 356.6 million). The decline in accesses was almost result of the sale of Telefónica Panamá, Telefónica Nicaragua, Telefónica Guatemala and Antares, reducing the total access by 10.8 million. Despite the sale of these operative unities and the further impairing depreciation of the Brazilian real and the Argentine peso against the EURO, as well as hyperinflation adjustment in Argentina, revenues increased slightly by 0.7% in the first nine month and considering the third quarter, by 1.7%, focusing on high value customer. It remains to be seen if this will mark a sustainable turnaround. The reported EBITDA decreased by -31.9%, mainly based on the restructuring costs (EUR 1,876 million), more than offsetting the positive impact of the gain on sale of fixed assets (EUR 391 million). To a lesser extent, higher operative expenses also affected adversely the results. Despite the adoption of IRFS 16 Telefónica reports, that the Group could still reduce interest costs by 17.5%. However, financial expenses increased to EUR 1.191 million in the first nine month (9M) of 2019 (9M 2018: EUR 575 million). Adversely affected by higher expenses, in particular due to special items/in particular due to restructuring costs, the reported profit for the period amounted to EUR 1,787 million in the first nine month of 2019 (9M 2018: EUR 3,212 million), a down of -44.4%.

Between December 2018 and September 2019, the Company reached a -6.8% net debt reduction excluding operating leases due to free cash flow generation and the disinvestments in Central America. Telefónica has withdrawn from all its operations in Central America, generating capital gains of EUR 467 million so far. (For the closing of the sale of Telefónica Costa Rica the Company is waiting the regulatory approval).

In the 5G mobile spectrum auction in June 2019 Telefónica Germany acquired 90 MHz for a price of EUR 1,425 million, ranking the third place behind Deutsche Telekom and Vodafone . Due to spectrum investments in total of EUR 1,465 million among others, capex increased by 17.2%, amounting EUR 6,657 million. Further investments are to expect in the coming year due to the 5G spectrum auctions on its main markets and especially for the rollout of the mobile network.

At the end of November 2019 Telefónica presented a strategic plan based on five decisions, which will modify its business structure. The Company will focus its investments on its main markets Spain, Brazil, the UK and Germany, as these markets offer the most sustainable growth potential from the Company's point of view. Due to adverse impacts (competition, currency etc.), Telefónica will spin off the businesses in Hispanoamérica into a single unit to create, amongst others, better consolidation and corporate transaction options. In addition, it will launch two new divisions: Telefónica Tech, focusing on digital business (cybersecurity; IoT/Big Data and cloud), and Telefónica Infra, focusing on assets (towers, data centers, submarine cables etc.). The latter is the advancement of its operating business model with the objective of increasing agility and service. With these strategic measures, the Company in particular has planned to generate more than EUR 2 billion of additional revenues and an increase of 2 percentage points in operating cashflow margin by 2022.

Table 4: Reported figures of current financial year | Source: Consolidated January-September report 2019

Telefónica S.A. 9 month figures (9M)		
In million EUR	9M 2018	9M 2019
Total Accesses	356,603.8	345,820.6
Sales	35,776	36,023
EBITDA	12,035	11,450
EBIT	5,454	3,622
EBT	4,881	2,441
EAT	3,212	1,787
EAT after transfer	2,721	1,344

The strategy of Telefónica is to increase connectivity for its customers by offering UBB services, integrating its product range while ensuring the necessary client confidence, privacy and security. The Company seeks to be the leader in convergent markets, mobility, and to adapt to the technological change, offering new sales opportunities. For seven years, Telefónica has been working to make advances in digitalization and new technology through its platform strategy, as well as to maximize group synergies.

The main goals of Telefónica for the coming years are still revenue growth, and margin expansion, along with further debt reduction. The Group met its financial targets in 2018 as well as in 2019.

Structural risk

Telefónica, S.A. is located in Madrid (Spain) and registered under the number C.I.F. A28015865. The Group was created in 1924 under the name Compañía Telefónica Nacional de España.

Telefónica operates the following geographical segments: Telefónica Spain, Telefónica United Kingdom, Telefónica Germany, Telefónica Brazil, Telefónica Hispanoamérica Norte (Colombia, Mexico, Venezuela and Ecuador), and Sur (Argentina, Chile, Peru and Uruguay). Each segment reports the information relating to wireline, wireless, cable, data, and internet as well as TV businesses and other digital services.

The Company's Board of Directors is composed of 13 members and is supported by several committees responsible for examining and monitoring key areas. The executive team of the Group is composed of 17 members. As of 31 December 2018, the average number of employees was 121,853 (2017: 125,371).

The Company is a 100% listed company with approximately 1,265,875 shareholders. Its most significant shareholders are Banco Bilbao Vizcaya Argentaria, S.A. (BBVA) (5.27%), Caja de Ahorros y Pensiones de Barcelona "la Caixa" (5.01%), and Blackrock, Inc. (5.08%). The Company's shares are listed on the stock exchanges in Buenos Aires, Lima, London, Madrid, Barcelona, Valencia, Bilbao and New York (ADR program).

Internal risk management policies limit exchange rate, interest rate, share price, liquidity, country, and credit risks.

Overall, we do not see any short-term structural risk at the level of Telefónica. The Company has managed to consolidate its strong position as a telecommunications operator, maintaining a continued policy of structural optimizing through acquisitions and divestments, which could contain regulatory and integration risks.

Business risk

The telecommunications industry is marked by regulatory intervention, increasing competition, consolidation pressure, and technological change, affecting the financials and revenues of established companies. The revenues of Telefónica are based on traffic, connection fees, network usage, installation fees, interconnection revenues, sales of handsets and equipment, other digital services such as Pay TV, as well as value-added services and maintenance. These products and services are offered individually or in bundled packages.

The general business development of Telefónica mainly depends on overall macroeconomic conditions and, more particularly, on demand for connectivity and on the spending of its consumers. Any reduction of the buying power of its subscribers has a direct impact on the Company. Furthermore, the capacity of Telefónica to attract a large number of subscribers requires high marketing expenditure, particularly given the low degree of customer loyalty and the high competitive intensity. Even though competition is very high in Telefónica's key markets, we consider Telefónica as having a strong market position in the jurisdictions where the Company operates.

The Company is subject to a variety of laws and regulations, and many services provided by Telefónica (e.g. network operation, spectrum usage) require the granting of concessions, permits, and licenses by governmental authorities. In order to maintain these licenses, the Company is obligated to make certain capital intensive investments in its infrastructure or to acquire new spectrum, putting pressure on the Company's financials. Some wireline and wireless telephony services are subject to regulated rates and price systems. Any breach of a concession contract or loss of permits or licenses could negatively affect the Group's development.

In Europe, the wish to promote competition in electronic communications networks and services has resulted in new regulations on telecommunications providers (Telecoms Single Market). These regulations have focused on reducing prices and impeding industry consolidation during the past years. With the adoption of the European Electronic Communications Code (EECC) in December 2018, the EU-Commission is trying to encourage investments in new high-capacity networks (5G and new fiber networks).

The Company is also exposed to country risks such as political, economic, regulatory and currency risks, mainly due to its operations in several non-investment-grade countries. The Company is currently adversely affected by hyperinflation in Argentina and Venezuela, and the depreciation of the Brazilian real, which have led to decreasing revenues and a detrimental effect on the group's financial ratios. Telefónica has also reported that uncertainty in the UK due to Brexit has affected its performance in the UK. These country and political risks have a dampening effect on the corporate rating.

In the telecommunications business, network quality and prices are key elements to remain competitive. Furthermore, as in most European markets, there is a clear trend towards convergence (mobile, fixed, and cable TV), and the demand for new content is continuously on the increase, forcing the Company to develop new business areas (content creation).

Given the steadily growing mobile penetration and broadband uptake worldwide, we see good chances that the Company will be able to achieve further growth by means of increasing cross-selling opportunities (bundle offers with a better margin) while continuing to invest in its network to improve coverage and/ or broadband speeds. The introduction of 5G will offer new opportunities. However, in addition to financial risks, network rollout and extension entail execution risks. Any changes to the networks such as disruption or quality loss could affect the business and business expansion of Telefónica.

We see the Group's strategy of business diversification as plausible; however, it entails risks of financing, misinvestment, as well as integration risks. Given the high technological and financial requirements Telefónica currently faces with the implementation of 5G, we consider business risks to be slightly elevated.

Financial risks

Telefónica, S.A. prepared its consolidated annual statements as of 31 December 2018 in accordance with IFRS-EU. Telefónica Brazil, Telefónica Deutschland and Telefónica de Colombia only belong to the Group for 73.7%, 69.2% and 67.5% respectively, but are fully consolidated into Telefónica, S.A.

For analytical purposes, CRA adjusted the original values in the financial statements in the context of its financial ratio analysis. Contrary to our normal practice, we deducted the goodwill shown on the balance sheet from the equity only by 50%, suggesting a certain recoverability of the goodwill. The following descriptions and indicators are based primarily on these adjustments.

The Group is capital intensive with a fixed asset intensity of 69.37% (2017: 72.15%). This capital intensity is largely influenced by the concessions and licenses.

CRA calculated an adjusted equity for 2018 of EUR 26,789 million (2017: EUR 26,234 million), which accounts for 14.56% of the balance sheet total (2017: 13.28%). Equity increased slightly, however the equity-ratio is in our view still low. In 2018, the Company paid dividends of EUR 2,794 million, representing a payout ratio on EAT after transfer of 83.3% (2017: 78.5%), which we do not consider to be a prudent distribution policy, especially considering the low equity ratio.

The long-term and medium-term liabilities accounted for 64.7% of the Group's total liabilities (EUR 54,638 million out of EUR 84,393 million) and 55.31% of the balance sheet total (EUR 54,638 million out of EUR 98,722 million) as of 31 December 2018. The fixed assets of the Company are therefore offset by the long- and medium-term obligations, and by equity.

The analytical liabilities amounted to EUR 84,393 million at the end of 2018 (2017: EUR 86,303 million), of which around 65% were bonds.

The analytical net total debt decreased to EUR 78,701 million as of 31 December 2018, a decrease of 2,410 million in comparison to 2017. Despite the decrease in net total debt, CRA's adjusted ratio of net total debt / EBITDA (adjusted) remained relatively stable at 4.67 as of 31 December 2018 (2017: 4.64), representing a satisfactory level, especially when considering the Group's solid cash flows. At December 31, 2018, the present value of future payments for Telefónica Group operating leases was EUR 7,229 million. Including these operate lease liabilities, the net total debt / EBITDA (adjusted) amounted to 5.10, which we see as still acceptable.

Telefónica is subject to interest rate risk (26.4% of the reported net financial debt has floating interest rates or fixed rates maturing within one year) and to foreign exchange risk (40.2% of the loans are in other currencies than EUR), which are mitigated by the use of derivatives and natural hedging. The Group disposes of extensive access to several sources of financing as well as to capital markets. Telefónica also disposes of factoring agreements. Some financing (approx. 2% of gross debt) is subject to compliance with financial covenants. As of 31 December 2018 and according to annual statements, all covenants had been met.

The Company disposes of a program for issuance of commercial paper for up to EUR 5,000 million, of which EUR 1,666 million was used as of 31 December 2018. The corporate promissory notes program of EUR 500 million, which can be increased to up to EUR 2,000 million, had an outstanding balance of EUR 181 million at the end of 2018.

The liquidity position of the Company is adequate, with cash amounts of EUR 5,692 million, current financial assets amounting to EUR 2,209 million, as well as undrawn committed credit facilities of EUR 12,219 million as of 31 December 2018.

Overall, we see no rating relevant short- or medium-term liquidity risks for Telefónica. The Group disposes of an adequate cash position, undrawn credit lines, as well as a comfortable debt maturities profile that gives the Company financial flexibility together with proven capital market access. Furthermore, Telefónica generates solid operating cash flows and disposes of diversified funding sources that should allow the Company to pursue its strategic plan while maintaining financial discipline. The Company's high payout ratio, as well as its low equity ratio, have a dampening effect on our assessment and a significant increase of net debt could have a negative or limiting impact on the rating assessment.

Issue rating

Further issuer ratings

In addition to the rating of Telefónica S.A., the following Issuers and its issues (see below), have been included in this rating report.

- Telefónica Emisiones S.A.U.
- Telefónica Europe B.V.

Telefónica S.A. is guarantor of the Group companies listed above and of the notes that have been issued under the Debt Issuance Program (DIP) of Telefónica Emisiones S.A.U., with the last base prospectus of 12.04.2019 and with the last supplement of 17.05.2019 and the Debt Issuance Program (DIP) of Telefónica Europe B.V. with the base prospectus of 19.03.2019.

Telefónica Emisiones S.A.U. and Telefónica Europe B.V. are direct wholly owned subsidiaries of Telefónica S.A. and are consolidated into the Group's annual accounts. As wholly owned direct subsidiaries and financing vehicles of Telefónica S.A. the activities of Telefónica Emisiones, S.A.U. and Telefónica Europe B.V. are directly related to the financing needs of the Company, which in turn depend on the development of the operating business and the investments in the Group. Additionally, the business development of Telefónica Emisiones S.A.U. and Telefónica Europe B.V. depends on the ability of Telefónica S.A. to service the payment obligations arising from intercompany loans granted by the subsidiary to the parent company. Overall, the future development of Telefónica Emisiones S.A.U. and Telefónica Europe B.V. will be determined by business development, strategy, and capital and investment needs of the parent company, taking into account its specific and general business risks. In this respect, we consider a consolidated

view of the business development and outlook for the rating assessment of Telefónica Emisiones S.A.U. and Telefónica Europe B.V. as appropriate. Based on these economic, financial and liability relationships between Telefónica S.A., Telefónica Emisiones S.A.U., and Telefónica Europe B.V., we have set the rating of Telefónica Emisiones S.A.U. and Telefónica Europe B.V. equal to the rating of Telefónica S.A. Hence, the rating for Telefónica Emisiones S.A.U and Telefónica Europe B.V. is **BBB- / stable**.

Issue rating details

The rating objects of this issue rating are exclusively the long-term senior unsecured issues, denominated in euro, issued by Telefónica Emisiones S.A.U. and Telefónica Europe B.V. and unconditionally and irrevocably guaranteed by Telefónica S.A., which are included in the list of ECB-eligible marketable assets. The ECB list of eligible marketable assets can be found on the website of the ECB.

As mentioned above, the notes have been issued within the framework of the Debt Issuance Program (DIP), of which the latest base prospectus of Telefónica Emisiones S.A.U., dates from 12 April 2019 and of and Telefónica Europe B.V. dates from 19 March 2019. The DIP of Telefónica Emisiones S.A.U. amounts to a maximum of EUR 40 billion and the DIP of Telefónica Europe B.V. amounts to a maximum of EUR 8 billion. The notes under the DIP are senior unsecured, and rank at least pari passu among themselves and with all other present and future unsecured obligations of the issuer. Additionally, the notes benefit from a negative pledge provision and a cross default mechanism.

Corporate issue rating result

We have assigned the debt securities issued by, Telefónica Emisiones S.A.U. and Telefónica Europe B.V. a rating of **BBB- with stable outlook**. The rating is based on the corporate rating of Telefónica S.A. and its rating relevant subsidiaries listed above. Other types of debt instruments or notes by the issuers denominated in other currencies have not been rated by Creditreform Rating AG.

The following tables provide an overview of the ratings issued by Creditreform Rating AG in this context, as well as the key features of the Debt Issuance Programs of 12.04.2019 and 19.03.2019 considered here.

Overview

Table 5: Overview of CRA ratings | Source: CRA

Rating objects	Details	
	Date	Rating
Telefónica S.A. (Issuer / Guarantor)	29 November 2019	BBB- / stable
Telefónica Emisiones S.A.U. (Issuer)	29 November 2019	BBB- / stable
Telefónica Europe B.V.	29 November 2019	BBB- / stable
Long-term Local Currency (LT LC) Senior Unsecured Issues	29 November 2019	BBB- / stable
Long-term Local Currency (LT LC) Senior Unsecured Issues	29 November 2019	BBB- / stable
Other	--	n.r.

Table 6: Overview of 2018 Debt Issuance Program of Telefónica Emisiones S.A.U.: Base prospectus of 12.04.2019

Overview 2018 EMTN Programme			
Volume	EUR 40,000,000,000	Maturity	Depending on the respective bond
Issuer / Guarantor	Telefónica S.A, (Guarantor) Telefónica Emisiones S.A.U.	Coupon	Depending on the respective bond
Arrangers	BNP PARIBAS	Currency	Depending on the respective bond
Credit enhancement	--	ISIN	Depending on the respective bond

Table 7: Overview of 2018 Debt Issuance Program of Telefónica Europe B.V.: Base prospectus of 19.03.2019

Overview 2018 EMTN Programme			
Volume	EUR 8,000,000,000	Maturity	Depending on the respective bond
Issuer / Guarantor	Telefónica S.A, (Guarantor) Telefónica Europe B.V.	Coupon	Depending on the respective bond
Arrangers	--	Currency	Depending on the respective bond
Credit enhancement	--	ISIN	Depending on the respective bond

All future LT LC senior unsecured Notes issued by Telefónica S.A., that have similar conditions to the current DIPs, denominated in euro and included in the list of ECB-eligible marketable assets will, until further notice, receive the same ratings as the current LT LC senior unsecured Notes issued under the DIPs. Notes issued under the programs in any currency other than euro, or other types of debt instruments, have not yet been rated by Creditreform Rating AG. For a list of all currently valid ratings and additional information, please consult the website of Creditreform Rating AG. For the time being, other emission classes or programs (such as the Commercial Paper Program) and issues not denominated in euro will not be assessed.

Financial ratio analysis

Table 8: Financial key ratios | Source: Telefónica S.A. consolidated annual report 2018, structured by CRA

Asset structure	2015	2016	2017	2018
Fixed asset intensity (%)	75.16	74.87	72.15	69.37
Asset turnover	0.54	0.50	0.51	0.50
Asset coverage ratio (%)	25.32	50.17	66.20	65.09
Liquid funds to total assets (%)	5.47	6.28	7.38	8.00
Capital structure				
Equity ratio (%)	10.87	12.79	13.28	14.56
Short-term-debt ratio (%)	34.16	34.14	29.99	30.12
Long-term-debt ratio (%)	8.16	24.77	31.02	31.70
Capital lock-up period (in days)	58.13	56.98	56.35	64.05
Trade-accounts-payable ratio (%)	8.44	7.63	8.07	8.65
Short-term capital lock-up (%)	39.00	44.43	31.96	36.95
Gearing	7.70	6.33	5.98	5.32
Leverage	8.40	8.44	7.68	7.19
FinancialsStability				
Cash flow margin (%)	21.86	25.03	22.58	22.30
Cash flow ROI (%)	11.79	12.43	12.00	11.18
Total debt / EBITDA adj.	7.08	5.96	5.07	5.16
Net total debt / EBITDA adj.	6.64	5.53	4.64	4.67
ROCE (%)	59.81	11.35	12.30	11.90
Total debt repayment period	19.40	-2.86	-23.58	7.86
Profitability				
Gross profit margin (%)	71.59	72.37	72.78	72.90
EBIT interest coverage	0.74	1.33	2.05	2.53
EBITDA interest coverage	2.93	3.49	4.84	5.89
Ratio of personnel costs to total costs (%)	18.53	15.31	12.98	12.79
Ratio of material costs to total costs (%)	29.62	28.81	28.41	28.30
Cost income ratio (%)	96.30	91.29	89.36	88.69
Ratio of interest expenses to total debt (%)	4.78	4.82	3.90	3.19
Return on investment (%)	2.98	4.79	5.70	5.25
Return on equity (%)	6.12	19.29	25.18	28.63
Net profit margin (%)	1.34	4.53	6.39	7.98
Operating margin (%)	5.83	11.26	13.02	13.73
Liquidity				
Cash ratio (%)	7.39	10.28	17.40	19.13
Quick ratio (%)	49.57	51.49	54.98	65.19
Current ratio (%)	72.73	73.61	92.88	101.69

Appendix

Rating history

The rating history is available under:

<https://www.creditreform-rating.de/de/ratings/published-ratings/>

Table 9: Corporate issuer Rating of Telefónica S.A., Telefónica Emisiones S.A.U and Telefónica Europe, B.V.

Event	Rating date	Publication date	Monitoring period	Result
Update	29.11.2019	www.creditreform-rating.de	Withdrawal of the rating	BBB- / stable
Initial rating	18.04.2018	27.04.2018	28.11.2019	BBB- / stable

Table 10: LT LC Senior Unsecured issues issued by Telefónica Emisiones S.A.U. and Telefónica Europe B.V.

Event	Rating date	Publication date	Monitoring period	Result
Update	29.11.2019	www.creditreform-rating.de	Withdrawal of the rating	BBB- / stable
Initial rating	18.04.2018	27.04.2018	28.11.2019	BBB- / stable

Regulatory requirements

The present rating⁶ is an unsolicited rating. Creditreform Rating AG was not commissioned by the Issuer with the preparation of the rating. The present analysis was prepared on a voluntary basis.

The rating is based on the analysis of published information and on internal evaluation factors. The rating was conducted based on Creditreform Rating AG's "Corporate Ratings" methodology, and the "Non-Financial Corporate Issue Rating" methodology, as well as on the "Rating Criteria and Definitions".

The documents submitted and information gathered were sufficient to meet the requirements of Creditreform Rating AG's rating methodologies. A complete description of Creditreform Rating AG's rating methodologies and Creditreform Rating AG's basic document "Rating Criteria and Definitions" is published on the following internet page:

www.creditreform-rating.de/en/regulatory-requirements/

This rating was carried out by analysts Christina Sauerwein (c.sauerwein@creditreform-rating.de) and Christian Konieczny (c.konieczny@creditreform-rating.de), both located in Neuss, Germany. A management meeting did not take place.

On 29 November 2019, the analysts presented the rating to the rating committee and the rating was determined. The rating result was communicated to the company on 29 November 2019. There has not been a subsequent change to the rating.

The rating will be monitored until Creditreform Rating AG withdraws the rating. The rating can be adjusted as part of the monitoring, if crucial assessment parameters change.

⁶ In these regulatory requirements the term "rating" is used in relation to all ratings issued by Creditreform Rating AG in connection to this report. This may concern several companies and their various issues.

In 2011, Creditreform Rating AG was registered within the European Union according to EU Regulation 1060/2009 (CRA-Regulation). Based on this registration, Creditreform Rating AG is allowed to issue credit ratings within the EU and is bound to comply with the provisions of the CRA-Regulation.

Please note:

This report exists in an English version only.

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.

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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 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

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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”.

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