TELEFONICA S A
Form 6-K
July 26, 2018

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FORM 6-K
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Report of Foreign Private Issuer

Pursuant to Rule 13a-16 or 15d-16
of the Securities Exchange Act of 1934

For the month of July, 2018

Commission File Number: 001-09531

Telefónica, S.A.
(Translation of registrant's name into English)

Distrito Telefónica, Ronda de la Comunicación s/n,
28050 Madrid, Spain
3491-482 87 00
(Address of principal executive offices)

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F:

Form 20-F X Form 40-F

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1):

Yes No X

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7):

Yes No X

Indicate by check mark whether by furnishing the information contained in this Form, the registrant is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934:

Yes No X

If “Yes” is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): N/A

Telefónica, S.A.

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Telefónica Group

Consolidated statements of financial position

| Millions of euros | Notes | 06/30/2018 | 12/31/2017 |
|---|---|---|---|
| ASSETS | | | |
| A) NON-CURRENT ASSETS | | 91,567 | 95,135 |
| Intangible assets | (Note 6) | 17,118 | 18,005 |
| Goodwill | (Note 6) | 25,527 | 26,841 |
| Property, plant and equipment | (Note 6) | 32,674 | 34,225 |
| Investments accounted for by the equity method | (Note 7) | 68 | 77 |
| Financial assets and other non-current assets | (Note 9) | 8,768 | 8,167 |
| Deferred tax assets | (Note 18) | 7,412 | 7,820 |
| B) CURRENT ASSETS | | 19,384 | 19,931 |
| Inventories | | 1,220 | 1,117 |
| Receivables and other current assets | (Note 10) | 10,816 | 10,093 |
| Tax receivables | (Note 18) | 1,092 | 1,375 |
| Other current financial assets | (Note 11) | 2,552 | 2,154 |
| Cash and cash equivalents | (Note 11) | 3,662 | 5,192 |
| Non-current assets classified as held for sale | | 42 | — |
| TOTAL ASSETS (A+B) | | 110,951 | 115,066 |

| | Notes | 06/30/2018 | 12/31/2017 |
|---|---|---|---|
| EQUITY AND LIABILITIES | | | |
| A) EQUITY | | 23,715 | 26,618 |
| Equity attributable to equity holders of the parent and other holders of equity instruments | (Note 8) | 14,821 | 16,920 |
| Equity attributable to non-controlling interests | (Note 8) | 8,894 | 9,698 |
| B) NON-CURRENT LIABILITIES | | 59,397 | 59,382 |
| Non-current financial liabilities | (Note 12) | 46,798 | 46,332 |
| Payables and other non-current liabilities | (Note 13) | 1,823 | 1,687 |
| Deferred tax liabilities | (Note 18) | 2,360 | 2,145 |
| Non-current provisions | | 8,416 | 9,218 |
| C) CURRENT LIABILITIES | | 27,839 | 29,066 |
| Current financial liabilities | (Note 12) | 7,972 | 9,414 |
| Payables and other-current liabilities | (Note 14) | 15,485 | 15,095 |
| Current tax payables | (Note 18) | 2,252 | 2,341 |
| Current provisions | | 2,130 | 2,216 |
| TOTAL EQUITY AND LIABILITIES (A+B+C) | | 110,951 | 115,066 |

Unaudited data at June 30, 2018.

The accompanying notes are an integral part of these condensed consolidated interim financial statements.

Telefónica Group
Consolidated income statements

| Millions of euros | Notes | January-June | January-June |
|---|---|---|---|
| INCOME STATEMENTS | | 2018 | 2017 |
| Revenues | (Note 4) | 24,334 | 26,091 |
| Other income | | 680 | 709 |
| Supplies | | (6,678) | (7,362) |
| Personnel expenses | | (3,125) | (3,493) |
| Other expenses | (Note 17) | (7,109) | (7,766) |
| OPERATING INCOME BEFORE DEPRECIATION AND AMORTIZATION (OIBDA) | (Note 4) | 8,102 | 8,179 |
| Depreciation and amortization | (Notes 4 and 6) | (4,405) | (4,809) |
| OPERATING INCOME | (Note 4) | 3,697 | 3,370 |
| Share of income (loss) of investments accounted for by the equity method | (Note 7) | 5 | 3 |
| Finance income | | 827 | 673 |
| Exchange gains | | 1,808 | 2,416 |
| Finance costs | | (1,321) | (1,869) |
| Exchange losses | | (1,697) | (2,417) |
| Net financial expense | | (383) | (1,197) |
| PROFIT BEFORE TAX | | 3,319 | 2,176 |
| Corporate income tax | (Note 18) | (1,298) | (520) |
| PROFIT FOR THE PERIOD | | 2,021 | 1,656 |
| Attributable to equity holders of the Parent | | 1,739 | 1,600 |
| Attributable to non-controlling interests | | 282 | 56 |
| Basic and diluted earnings per share attributable to equity holders of the parent (euros) | | 0.29 | 0.29 |

Unaudited data.
The accompanying notes are an integral part of these condensed consolidated interim financial statements.

Telefónica Group
Consolidated statements of comprehensive income

| Millions of euros | January - June 2018 | January - June 2017 |
|---|---|---|
| Profit for the period | 2,021 | 1,656 |
| Other comprehensive (loss) income | 41 | 318 |
| Gains (Losses) from financial assets measured at Fair value through comprehensive income | 7 | 42 |
| Income tax impact | (2) | 5 |
| Reclassification of losses (gains) included in the income statement | — | 32 |
| Income tax impact | — | — |
| | 5 | 79 |
| Gains (Losses) on hedges | (71) | 231 |
| Income tax impact | 22 | (55) |
| Reclassification of losses (gains) included in the income statement | 65 | 75 |
| Income tax impact | (19) | (19) |
| | (3) | 232 |
| Gains (Losses) on hedges costs | 63 | — |
| Income tax impact | (16) | — |
| Reclassification of losses (gains) included in the income statement | — | — |
| Income tax impact | — | — |
| | 47 | — |
| Share of gains (losses) recognized directly in equity of associates and others | (8) | 9 |
| Income tax impact | — | (2) |
| Reclassification of losses (gains) included in the income statement | — | — |
| Income tax impact | — | — |
| | (8) | 7 |
| Translation differences | (3,053) | (3,350) |
| Total other comprehensive (loss) income recognized in the period (Items that may be reclassified subsequently to profit or loss) | (3,012) | (3,032) |
| Actuarial gains (losses) and impact of limit on assets for defined benefit pension plans | 1 | 57 |
| Income tax impact | — | (14) |
| | 1 | 43 |
| Gains (Losses) from financial assets measured at Fair value through comprehensive income | (41) | — |
| Income tax impact | (9) | — |
| | (50) | — |
| Total other comprehensive income (loss) recognized in the period (Items that will not be reclassified subsequently to profit or loss) | (49) | 43 |
| Total comprehensive (loss) income recognized in the period | (1,040) | (1,333) |
| Attributable to: | | |
| Equity holders of the parent and other holders of equity instruments | (741) | (871) |
| Non-controlling interests | (299) | (462) |
| | (1,040) | (1,333) |

Unaudited data.
The accompanying notes are an integral part of these condensed consolidated interim financial statements.

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Telefónica Group
Consolidated statement of changes in equity

| | Attributable to equity holders of the parent and other holders of equity instruments | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Millions of euros | Share capital | Share premium | Treasury Shares | Other equity instruments | Legal reserve | Retained earnings | Fair value financial assets | Hedges | Equity of associates and others | Translation differences | Total | N i |
| Financial position at December 31, 2017 | 5,192 | 4,538 | (688) | 7,518 | 987 | 18,225 | 74 | 384 | 37 | (19,347) | 16,920 | 9 |
| Adjustment on initial application of new reporting standards (Note 8) | — | — | — | — | — | 823 | (292) | — | — | — | 531 | 6 |
| Financial position at January 1, 2018 | 5,192 | 4,538 | (688) | 7,518 | 987 | 19,048 | (218) | 384 | 37 | (19,347) | 17,451 | 9 |
| Profit for the year | — | — | — | — | — | 1,739 | — | — | — | — | 1,739 | 2 |
| Other comprehensive income (loss) for the year | — | — | — | — | — | 6 | (44) | (3) | 45 | (2,484) | (2,480) | ( |
| Total comprehensive income (loss) for the year | — | — | — | — | — | 1,745 | (44) | (3) | 45 | (2,484) | (741) | ( |
| Dividends and distribution of profit (Note 8) | — | — | — | — | 51 | (2,102) | — | — | — | — | (2,051) | ( |
| Net movement in treasury shares | — | — | 1 | — | — | (1) | — | — | — | — | — | – |
| Acquisitions and disposals of non-controlling interests and business combinations | — | — | — | — | — | — | — | — | — | — | — | – |
| Undated Deeply Subordinated | — | — | — | 451 | — | (277) | — | — | — | — | 174 | ( |

| | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Securities (Note 8) | | | | | | | | | | | | |
| Other movements | — | — | — | — | — | (12 ) | — | — | — | — | (12 ) | 1 |
| Financial position at June 30, 2018 | 5,192 | 4,538 | (687 ) | 7,969 | 1,038 | 18,401 | (262 ) | 381 | 82 | (21,831 ) | 14,821 | 8 |

Unaudited data.

The accompanying notes are an integral part of these condensed consolidated interim financial statements.

Telefónica Group

Consolidated statements of changes in equity

| Millions of euros | Attributable to equity holders of the parent and other holders of equity instruments | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Share capital | Share premium | Treasury Shares | Other equity instruments | Legal reserve | Retained earnings (1) | Available-for-sale investments | Hedges | Equity of associates and others | Translation differences | To |
| Financial position at December 31, 2016 | 5,038 | 3,227 | (1,480) | 7,803 | 985 | 17,093 | 9 | 191 | 31 | (14,740) | 18 |
| Profit for the year | — | — | — | — | — | 1,600 | — | — | — | — | 1,6 |
| Other comprehensive income (loss) for the year | — | — | — | — | — | 39 | 79 | 231 | 6 | (2,826) | (2, |
| Total comprehensive income (loss) for the year | — | — | — | — | — | 1,639 | 79 | 231 | 6 | (2,826) | (8 |
| Dividends and distribution of profit (Note 8) (1) | — | — | — | — | 2 | (1,990) | — | — | — | — | (1, |
| Net movement in treasury shares | — | — | 1 | — | — | — | — | — | — | — | 1 |
| Acquisitions and disposals of non-controlling interests and business combinations (Note 5) | — | — | 754 | — | — | (83) | — | — | — | — | 67 |
| Undated Deeply Subordinated Securities (Note 8) | — | — | — | — | — | (100) | — | — | — | — | (10 |
| Other movements | — | — | — | — | — | 13 | — | — | — | — | 13 |
| Financial position at June 30, 2017 | 5,038 | 3,227 | (725) | 7,803 | 987 | 16,572 | 88 | 422 | 37 | (17,566) | 15 |

Unaudited data.

The accompanying notes are an integral part of these condensed consolidated interim financial statements.

(1) The amount in "Dividends and distribution of profit" was modified, including the second tranche of the dividend approved by the 2017 General Shareholders' Meeting, which was paid in December 2017 (see Note 8).

Condensed consolidated interim financial statements 2018

Telefónica Group
Consolidated statements of cash flows

| Millions of euros | January - June 2018 | January - June 2017 |
|---|---|---|
| Cash received from operations | 29,760 | 32,024 |
| Cash paid from operations | (22,317) | (24,557) |
| Net payments of interest and other financial expenses net of dividends received | (986) | (976) |
| Taxes paid | (356) | (537) |
| Net cash flow provided by operating activities | 6,101 | 5,954 |
| (Payments on investments)/proceeds from the sale in property, plant and equipment and intangible assets, net | (4,582) | (4,405) |
| Proceeds on disposals of companies, net of cash and cash equivalents disposed | 1 | 30 |
| Payments on investments in companies, net of cash and cash equivalents acquired | (2) | (6) |
| Proceeds on financial investments not included under cash equivalents | 480 | 155 |
| Payments on financial investments not included under cash equivalents | (586) | (544) |
| (Payments)/proceeds on placements of cash surpluses not included under cash equivalents | (604) | (1,112) |
| Government grants received | 37 | — |
| Net cash flow used in investing activities | (5,256) | (5,882) |
| Dividends paid | (1,433) | (1,136) |
| Proceeds from share capital increase | — | 3 |
| Proceeds/(payments) of treasury shares and other operations with shareholders and with minority interests | — | — |
| Operations with other equity holders | 68 | (135) |
| Proceeds on issue of debentures and bonds, and other debts | 2,672 | 6,789 |
| Proceeds on loans, borrowings and promissory notes | 2,284 | 2,823 |
| Repayments of debentures and bonds, and other debts | (3,760) | (2,534) |
| Repayments of loans, borrowings and promissory notes | (1,744) | (2,439) |
| Financed operating payments and investments in property, plant and equipment and intangible assets payments (Note 12) | (230) | (841) |
| Net cash used in financing activities | (2,143) | 2,530 |
| Effect of changes in exchange rates | (232) | (292) |
| Effect of changes in consolidation methods and others | — | — |
| Net increase (decrease) in cash and cash equivalents during the period | (1,530) | 2,310 |
| CASH AND CASH EQUIVALENTS AT JANUARY 1 | 5,192 | 3,736 |
| CASH AND CASH EQUIVALENTS AT JUNE 30 | 3,662 | 6,046 |
| RECONCILIATION OF CASH AND CASH EQUIVALENTS WITH THE STATEMENT OF FINANCIAL POSITION | | |
| BALANCE AT JANUARY 1 | 5,192 | 3,736 |
| Cash on hand and at banks | 3,990 | 2,077 |
| Other cash equivalents | 1,202 | 1,659 |
| BALANCE AT JUNE 30 | 3,662 | 6,046 |
| Cash on hand and at banks | 2,609 | 3,745 |
| Other cash equivalents | 1,053 | 2,301 |

Unaudited data.
The accompanying notes are an integral part of these condensed consolidated interim financial statements.

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Telefónica, S.A. and subsidiaries composing the Telefónica Group

Notes to the condensed consolidated interim financial statements for the six-months ended June 30, 2018

Note 1. Background and general information

Telefónica, S.A. and its subsidiaries and investees ("Telefónica", "the Company", the "Telefónica Group" or "the Group") make up an integrated and diversified telecommunications group operating mainly in Europe and Latin America. The Group's activity is centered around services of wireline and wireless telephony, broadband, internet, data traffic, Pay TV and other digital services.

The parent company of the Group is Telefónica, S.A., a public limited company incorporated on April 19, 1924 for an indefinite period. Its registered office is at calle Gran Vía 28, Madrid (Spain).

As a multinational telecommunications company which operates in regulated markets, the Group is subject to different laws and regulations in each of the jurisdictions in which it operates, pursuant to which permits, concessions or licenses must be obtained in certain circumstances to provide the various services.

In addition, certain wireline and wireless telephony services are provided under regulated rate and price systems.

Note 2. Basis of presentation of the consolidated financial statements

The condensed consolidated interim financial statements for the six-month period ended June 30, 2018 (hereinafter, the "interim financial statements") have been prepared in accordance with International Accounting Standard (IAS) 34 Interim Financial Reporting and Article 12 of Royal Decree 1362/2007, of October 19. Therefore, they do not contain all the information and disclosures required in complete annual consolidated financial statements and, for adequate interpretation, should be read in conjunction with the consolidated financial statements (Consolidated annual accounts) for the year ended December 31, 2017.

The accompanying interim financial statements were approved by the Company's Board of Directors at its meeting of July 25, 2018.

The figures in these interim financial statements are expressed in millions of euros, unless otherwise indicated, and may therefore be rounded.

Comparison of information

Comparisons in the accompanying interim financial statements refer to the six-month periods ended June 30, 2018 and 2017, except in the consolidated statement of financial position, which compares information at June 30, 2018 and at December 31, 2017.

No significant changes took place in the scope of consolidation of the Group in the six months ended June 30, 2018.

With respect to seasonality, the historical performance of consolidated results does not indicate that the operations of the Group, taken as a whole, are subject to significant variations between the first and second halves of the year.

Impact of adopting new accounting standards in 2018

On January 1, 2018 the new IFRS 9 Financial Instruments and IFRS 15 Revenue from Contracts with Customers became effective, resulting in changes in the accounting policies applied in prior periods.

IFRS 15 Revenues from Contracts with Customers

IFRS 15 sets out the requirements for recognising revenue from contracts with customers. The Group has adopted IFRS 15 using one of the two transition methods allowed: the modified retrospective method, with the cumulative effect from initial application recognised as an adjustment to the opening balance of retained earnings at the date of initial application, January 1, 2018 (see Note 8). Accordingly, the 2017 information presented for comparative purposes has not been restated - i.e. it is prepared and presented in accordance with the accounting standards effective at that moment: under IAS 18 Revenue, IAS 11 Construction Contracts and related interpretations.

Under the provisions in IFRS 15, it is possible to elect to apply certain practical expedients to reduce complexity in the application of the new requirements. The main practical expedients applied by the Group are:

- Completed contracts: not to apply the standard retrospectively to contracts that are completed contracts at January 1, 2018.
- Portfolio approach: the Group will apply the requirements of the standard to groups of contracts with similar characteristics (residential customers and small and medium-sized entities, where standard offers are marketed), since, for the cluster identified, the effects do not differ significantly from an application on a contract by contract basis.

The details of the new significant accounting policies and the nature of the main changes to previous accounting policies in relation to revenue recognition under the new model in IFRS 15 are set out in Note 3. The most significant impacts relate to the first-time recognition of contract assets, that, under IFRS 15, lead to the earlier recognition of revenue from the sale of goods, and the acceleration and deferral of the incremental costs of obtaining contracts, that under IFRS 15, result in the later recognition of customer acquisition costs.

The impacts of adopting IFRS 15 on the Group's interim financial statements for the six-month period ended June 30, 2018 are set out below:

| Millions of euros | 06/30/2018 | 06/30/2018 | 06/30/2018 |
|---|---|---|---|
| ASSETS | IFRS 15 | IAS 18 | IFRS 15 Impact |
| A) NON-CURRENT ASSETS | 91,567 | 91,267 | 300 |
| Intangible assets | 17,118 | 17,118 | — |
| Goodwill | 25,527 | 25,527 | — |
| Property, plant and equipment | 32,674 | 32,674 | — |
| Investments accounted for by the equity method | 68 | 68 | — |
| Financial assets and other non-current assets | 8,768 | 8,438 | 330 |
| Deferred tax assets | 7,412 | 7,442 | (30) |
| B) CURRENT ASSETS | 19,384 | 18,533 | 851 |
| Inventories | 1,220 | 1,220 | — |
| Receivables and other current assets | 10,816 | 9,976 | 840 |
| Tax receivables | 1,092 | 1,081 | 11 |
| Other current financial assets | 2,552 | 2,552 | — |
| Cash and cash equivalents | 3,662 | 3,662 | — |
| Non-current assets classified as held for sale | 42 | 42 | — |
| TOTAL ASSETS (A+B) | 110,951 | 109,800 | 1,151 |

Condensed consolidated interim financial statements 2018

| EQUITY AND LIABILITIES | 06/30/2018 IFRS 15 | 06/30/2018 IAS 18 | 06/30/2018 IFRS 15 Impact |
|---|---|---|---|
| A) EQUITY | 23,715 | 22,955 | 760 |
| Equity attributable to equity holders of the parent and other holders of equity instruments | 14,821 | 14,157 | 664 |
| Equity attributable to non-controlling interests | 8,894 | 8,798 | 96 |
| B) NON-CURRENT LIABILITIES | 59,397 | 59,158 | 239 |
| Non-current financial liabilities | 46,798 | 46,798 | — |
| Payables and other non-current liabilities | 1,823 | 1,748 | 75 |
| Deferred tax liabilities | 2,360 | 2,196 | 164 |
| Non-current provisions | 8,416 | 8,416 | — |
| C) CURRENT LIABILITIES | 27,839 | 27,687 | 152 |
| Current financial liabilities | 7,972 | 7,972 | — |
| Payables and other-current liabilities | 15,485 | 15,422 | 63 |
| Current tax payables | 2,252 | 2,163 | 89 |
| Current provisions | 2,130 | 2,130 | — |
| TOTAL EQUITY AND LIABILITIES (A+B+C) | 110,951 | 109,800 | 1,151 |

| Millions of euros | January - June 2018 | January - June 2018 | January - June 2018 |
|---|---|---|---|
| INCOME STATEMENTS | IFRS 15 | IAS 18 | IFRS 15 Impact |
| Revenues | 24,334 | 24,361 | (27) |
| OPERATING INCOME BEFORE DEPRECIATION AND AMORTIZATION (OIBDA) | 8,102 | 8,081 | 21 |
| Depreciation and amortization | (4,405) | (4,405) | — |
| OPERATING INCOME | 3,697 | 3,676 | 21 |
| Share of profit (loss) of investments accounted for by the equity method | 5 | 5 | — |
| Net financial expense | (383) | (378) | (5) |
| PROFIT BEFORE TAX | 3,319 | 3,303 | 16 |
| Corporate income tax | (1,298) | (1,297) | (1) |
| PROFIT FOR THE PERIOD | 2,021 | 2,006 | 15 |
| Attributable to equity holders of the Parent | 1,739 | 1,732 | 7 |
| Attributable to non-controlling interests | 282 | 274 | 8 |
| Basic and diluted earnings per share attributable to equity holders of the parent (euros) | 0.29 | 0.28 | 0.01 |

IFRS 9 Financial Instruments

IFRS 9 sets out a new accounting framework for the recognition, classification, measurement and derecognition of financial instruments, impairment losses on financial assets and hedge accounting. The details of the new significant accounting policies and the nature of the main changes to previous accounting policies in relation to financial instruments under the new standard IFRS 9 are set out in Note 3.

Pursuant to the transition provisions in IFRS 9, the Group has elected the exemption not to restate comparative periods to be presented in the year of initial application (i.e. 2017 information presented for comparative purposes is prepared and presented in accordance with the accounting standards effective at that moment: under IAS 39 Financial Instruments: Recognition and Measurement, and related interpretations). The difference

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in the carrying amounts of financial assets and financial liabilities resulting from the adoption of the new requirements is recognised in retained earnings as at January 1, 2018 (see Note 8)

The main impact of adopting IFRS 9 on the Group's interim financial statements resulted in an increase amounting to 204 million euros over the bad debt provision balance and fair value adjustments on customer receivables. In addition to this, financial assets have changed to the new measurement categories under IFRS 9 (see Note 11).

Translation of Telefónica Venezolana's financial statements

Venezuela has been considered a hyperinflationary economy since 2009. We review on a regular basis the economic conditions in Venezuela and the specific circumstances of our Venezuelan operations. Assessment of the exchange rate that better reflects the economics of Telefónica's business activities in Venezuela relies on several factors and is performed considering all the information available at each closing date.

In light of the economic environment and in the absence of official rates that are representative of the situation in Venezuela, in the first half of 2018 the Group maintained its policy to estimate an exchange rate that matches the progression of inflation in Venezuela and contributes to reflect the economic and financial position of the Group's Venezuelan operations within its consolidated financial statements in a more accurate way (hereinafter, synthetic exchange rate). Thus, the exchange rate used to translate the financial statements of the Venezuelan subsidiaries as of June 30, 2018 amounts to 2,369,815 VEF/USD (36,115 VEF/USD as of December 31, 2017 and 3,547 VEF/USD as of June 30, 2017). The inflation rates applied by the Group to Venezuela are 6,461.8% and 192.1% for the six-month period ended June 30, 2018 and 2017, respectively (2,874.1% for the year 2017).

The exchange rate resulting from the last auction of the exchange mechanism introduced in January 2018 (Exchange Agreement No. 39) is 134,262.5 VEF/EUR.

The following table presents the contribution of Telefónica Venezolana to certain items of the consolidated income statement, the statement of cash flows and statement of financial position of the Telefónica Group for the first half of 2018, applying the synthetic exchange rate:

| Millions of euros | |
|---|---|
| Contribution of Telefónica Venezolana to the consolidated financial statements of the Telefónica Group | |
| Revenues | 13 |
| Operating income before depreciation and amortization (OIBDA) | 1 |
| Depreciation and amortization | (41 ) |
| Financial result [1] | 106 |
| Profit before tax | 65 |
| Income tax [2] | (91 ) |
| Result for the period | (26 ) |
| Other comprehensive income (movement of translation differences) | (10 ) |
| Net cash flow provided by operating activities | 5 |
| Capital expenditures (CapEx) | 1 |
| Non-current assets | 261 |

(1) The financial result resulting from the hyperinflation adjustment to the net monetary position and from the exchange differences arising from foreign currency items held by Telefónica Venezolana amounted to 106 million euros in the six-month period ended June 30, 2018 (loss of 20 million euros in the six-month period ended June 30, 2017).

(2) Deferred tax recognized for the inflation adjustments of the net assets, which are not deductible according to the present tax regime in Venezuela.

Alternative measures not defined in IFRS

The Management of the Group uses a series of measures in its decision-making, in addition to those expressly defined in the IFRS, because they provide additional information useful to assess the Group's performance, solvency and liquidity. These measures should not be viewed in isolation or as a substitute for the measures presented according to the IFRS.

Operating income before depreciation and amortization (OIBDA)

Operating income before depreciation and amortization (OIBDA) is calculated by excluding solely depreciation and amortization from operating income. OIBDA is used to track the performance of the business and to establish operating and strategic targets of the Telefónica Group companies. OIBDA is a commonly reported measure and is widely used among analysts, investors and other interested parties in the telecommunications industry, although not a measure explicitly defined in IFRS, and therefore, may not be comparable to similar indicators used by other companies. OIBDA should not be considered as a substitute for operating income.

The following table presents the reconciliation of OIBDA to operating income for the Telefónica Group for the six-months periods ended June 30, 2018 and 2017:

| Millions of euros | January - June 2018 | January - June 2017 |
|---|---|---|
| Operating Income Before Depreciation and Amortization (OIBDA) | 8,102 | 8,179 |
| Depreciation and amortization | (4,405) | (4,809) |
| Operating income | 3,697 | 3,370 |

The following table presents the reconciliation of OIBDA to operating income for each business segment for the six-months periods ended June 30, 2018 and 2017:

January - June 2018

| Millions of euros | Telefónica Spain | Telefónica United Kingdom | Telefónica Germany | Telefónica Brazil | Telefónica Hispam Norte | Telefónica Hispam Sur | Other companies and eliminations | Total Group |
|---|---|---|---|---|---|---|---|---|
| Operating Income Before Depreciation and Amortization (OIBDA) | 2,507 | 879 | 882 | 2,257 | 434 | 1,024 | 119 | 8,102 |
| Depreciation and amortization | (816) | (491) | (980) | (992) | (456) | (537) | (133) | (4,405) |
| Operating income | 1,691 | 388 | (98) | 1,265 | (22) | 487 | (14) | 3,697 |

January - June 2017 (revised, see Note 4)

| Millions of euros | Telefónica Spain | Telefónica United Kingdom | Telefónica Germany | Telefónica Brazil | Telefónica Hispam Norte | Telefónica Hispam Sur | Other companies and eliminations | Total Group |
|---|---|---|---|---|---|---|---|---|
| Operating Income Before Depreciation and Amortization (OIBDA) | 2,425 | 849 | 861 | 2,138 | 613 | 1,183 | 110 | 8,179 |
| Depreciation and amortization | (850) | (523) | (1,006) | (1,156) | (497) | (630) | (147) | (4,809) |
| Operating income | 1,575 | 326 | (145) | 982 | 116 | 553 | (37) | 3,370 |

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Debt indicators

As calculated by us, net financial debt includes: (i) current and non-current financial liabilities in our consolidated statement of financial position (which includes the negative mark-to-market value of derivatives) and (ii) other payables included in “Payables and other non-current liabilities” and "Payables and other current liabilities" (mainly corresponding to payables for deferred payment of radio spectrum that have a financial component). From these liabilities, the following are subtracted: i) cash and cash equivalents, ii) current financial assets (which include short-term derivatives), iii) the positive mark-to-market value of derivatives with a maturity beyond one year, and iv) other interest-bearing assets (components of “Receivables and other current assets” and “Financial assets and other non-current assets” in our consolidated statement of financial position). The accounts included in the net financial debt calculation recorded in "Payables and other non-current liabilities" or "Financial assets and other non-current assets" have a maturity beyond one year and a financial component. In "Receivables and other current assets" we include the customer financing of terminal sales classified as short term, and "Financial assets and other non-current assets" includes derivatives, installments for the long term sales of terminals to customers and other long term financial assets (which at June 30, 2018 includes the credit related to the judicial decision in favor of Telefónica Brasil about PIS/COFINS, see Note 9).

We calculate net financial debt plus commitments by adding gross commitments related to employee benefits to net financial debt, and deducting the value of long-term assets associated with those commitments and the tax benefits arising from the future payments of those commitments.

We believe that net financial debt and net financial debt plus commitments are meaningful for investors and analysts because they provide an analysis of our solvency using the same measures used by our Management. We use net financial debt and net financial debt plus commitments to calculate internally certain solvency and leverage ratios used by Management. Nevertheless, neither net financial debt nor net financial debt plus commitments as calculated by us should be considered as a substitute for gross financial debt as presented in the consolidated statement of financial position.

The following table presents a reconciliation of net financial debt and net financial debt plus commitments as of June 30, 2018 and December 31, 2017 to the Telefónica Group’s gross financial debt as indicated in the consolidated statement of financial position:

| Millions of euros | 06/30/2018 | 12/31/2017 |
|---|---|---|
| Non-current financial liabilities | 46,798 | 46,332 |
| Current financial liabilities | 7,972 | 9,414 |
| Gross financial debt (Note 12) | 54,770 | 55,746 |
| Cash and cash equivalents | (3,662) | (5,192) |
| Other current financial assets | (2,552) | (2,154) |
| Positive mark-to-market value of long-term derivative instruments (Note 9) | (2,854) | (2,812) |
| Other liabilities included in "Payables and other non-current liabilities" | 652 | 708 |
| Other liabilities included in "Payables and other current liabilities" | 114 | 111 |
| Other assets included in "Financial assets and other non-current assets" | (2,141) | (1,516) |
| Other assets included in "Receivables and other current assets" | (734) | (661) |
| Net financial debt | 43,593 | 44,230 |
| Gross commitments related to employee benefits | 6,130 | 6,578 |
| Value of associated long-term assets | (784) | (749) |
| Tax benefits | (1,422) | (1,533) |
| Net commitments related to employee benefits | 3,924 | 4,296 |
| Net financial debt plus commitments | 47,517 | 48,526 |

Free Cash Flow

The Group’s free cash flow is calculated starting from “Net cash flow provided by operating activities” as indicated in the consolidated statement of cash flows; deducting (Payments on investments)/Proceeds from the sale of investments in property, plant and equipment and intangible assets, net, adding the cash received form government grants and deducting dividends paid to minority interests. The cash used to cancel commitments related to employee benefits (originally included in the Net cash flow provided by operating activities) is added as it represents the payments of principal of the debt incurred with those employees.

The definition of free cash flow was revised in 2017, so that the cash received from the sale of real estate (which in the first six-month period of 2017 amounted to 5 million euros) is no longer excluded from the cash flow proceeding from the operations. Cash received from the sale of real estate is included in the "(Payments on investments)/Proceeds from the sale of investments in property, plant and equipment and intangible assets, net" figure within the free cash flow.

We believe that free cash flow is a meaningful measure for investors and analysts because it provides an analysis of the cash flow available to protect solvency levels and to remunerate the parent company’s shareholders and other equity holders. The same measure is used internally by our management. Nevertheless, free cash flow as calculated by us should not be considered as a substitute for the various flows of cash as presented in the consolidated statements of cash flows.

The following table presents the reconciliation between Telefónica Group's Net cash flow provided by operating activities as indicated in the consolidated statement of cash flows and the free cash flow for the six-months periods ended June 30, 2018 and 2017:

| Millions of euros | January - June 2018 | January - June 2017 |
|---|---|---|
| Net cash flow provided by operating activities | 6,101 | 5,954 |
| (Payments on investments)/Proceeds from the sale of property, plant and equipment and intangible assets, net | (4,582) | (4,405) |
| Government grants received | 37 | — |
| Dividends paid to minority shareholders | (406) | (255) |
| Payments related to cancellation of commitments | 398 | 332 |
| Free cash flow | 1,548 | 1,626 |

Note 3. Accounting policies

The accounting policies applied in the preparation of the interim financial statements for the six-month period ended June 30, 2018 are consistent with those used in the preparation of the Group's consolidated annual financial statements for the year ended December 31, 2017, except for the following new standards and amendments to standards published by the International Accounting Standards Board (IASB) and endorsed by the EU for use in Europe, which are effective for annual periods beginning on or after January 1, 2018.

IFRS 15 Revenues from Contracts with Customers

IFRS 15 establishes a comprehensive framework for determining when to recognise revenue and how much revenue to recognise. The core principle is that an entity should recognise revenue to depict the transfer of promised goods or services to the customer in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The main changes introduced by the new standard are as follows:

a) Under IFRS 15, for bundled packages that combine multiple wireline, wireless, data, internet or television goods or services, the total revenue is allocated to each performance obligation based on their standalone selling prices in relation to the total consideration of the package and is recognised when (or as) the obligation is satisfied, regardless of whether there are undelivered items. This criteria differs from previous accounting where the portion of the total consideration that was contingent upon delivery of undelivered elements was not allocated to delivered elements. Consequently, when bundles include a discount on equipment, the adoption of these new requirements results in an increase of revenues recognised from the sale of handsets and other equipment, generally recognised upon delivery to the end customer, in detriment of ongoing service revenue over subsequent periods. The difference between the revenue from the sale of equipment and the consideration received from the customer upfront is recognised as a contract asset on the statement of financial position.

b) IFRS 15 requires the recognition of an asset for those incremental costs (sales commissions and other third party acquisition costs) directly related with obtaining a contract and that are expected to be recovered. These are subsequently amortised over the same period as the revenue associated with such asset. Costs to obtain a contract are expensed when incurred if the Group estimates that their amortisation period is one year or less.

c) IFRS 15 sets out more detailed requirements on how to account for contract modifications. Certain changes must be accounted for as a retrospective change (i.e. as a continuation of the original contract), while other modifications must be accounted for prospectively as separate contracts, like the end of the original contract and the creation of a new one.

d) The Group does not adjust the transaction price for a significant financing component where the period between the transfer of goods or services to the customer and payment by the customer is not expected to exceed one year.

Information on the impact of initially applying this standard is disclosed in Note 2.

IFRS 9 Financial Instruments

IFRS 9 sets out the requirements for recognising and measuring financial assets and financial liabilities. This new standard includes:

a) a model for classifying financial assets that is driven by an asset's cash flow characteristics and the business model in which it is held. IFRS 9 simplifies the previous measurement model for financial assets and establishes three main categories: amortised cost, fair value through profit or loss and fair value through Other Comprehensive Income (OCI).

b) a model for classifying financial liabilities, where there are no significant changes from the criteria applied in prior periods, except for the recognition in other comprehensive income, rather than in profit or loss of changes in own credit risk for those financial liabilities measured at fair value through profit or loss.

c) a new model for impairment losses on financial assets not measured at fair value through profit or loss, i.e. the expected credit loss model, which replaces the incurred loss model applied previously. Under this new impairment model entities are required to account for expected credit losses from when the financial assets are first recognized. The Group applies the IFRS 9 simplified approach to measure loss allowances for trade receivables and contract assets based on lifetime expected credit losses.

d) a new hedge accounting model, less restrictive, that more closely aligns the accounting treatment with the entity's risk management activities, requiring an economic relationship between the hedged item and the hedging instrument and requiring that the coverage ratio be the same as that applied by the entity for its risk management. The new standard modifies the criteria for documentation of hedging relationships and includes enhanced disclosure requirements about risk management activity.

Information on the impact of initially applying this standard is disclosed in Note 2.

Classification and Measurement of Share-based Payment Transactions (Amendments to IFRS 2)

These amendments contain requirements on the accounting for:

a) the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments;

b) the classification of a share-based payment transaction with a net settlement feature for withholding tax obligations; and

c) accounting where a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled.

The application of these amendments did not have a significant impact on the Group's interim consolidated financial position or results.

Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (Amendments to IFRS 4)

These amendments provide a number of options to addresses concerns arising from the different effective dates of IFRS 9 and IFRS 17 Insurance Contracts, whose effective date is 1 January 2021. The modifications are not relevant for the Group as it has not used any of the exemptions included within the amendments.

Transfers of Investment Property (Amendments to IAS 40)

This amendment clarifies when an entity should transfer property, including property under construction or development into, or out of investment property. The amendments state that a change in use occurs when the property meets, or ceases to meet, the definition of investment property and there is evidence of the change in use. A mere change in management's intentions for the use of a property does not provide evidence of a change in use. The application of these amendments did not have a significant impact on the Group's interim consolidated financial position or results.

Annual Improvements to IFRS Standards 2014-2016 Cycle

The annual improvements projects provide a vehicle for making non-urgent but necessary amendments to IFRSs, with the aim of removing inconsistencies and clarifying wording. The amendment relating to the measurement of an associate or joint venture at fair value clarifies that entities that elect to measure investments in joint ventures and associates at fair value through profit or loss may make this election separately for each associate or joint venture. The application of these amendments did not have a significant impact on the Group's interim consolidated financial position or results.

IFRIC 22 Foreign Currency Transactions and Advance Consideration

This new interpretation clarifies that, in determining the spot exchange rate to use on initial recognition of the related asset, expense or income (or part of it) on the derecognition of a non-monetary asset or non-monetary liability relating to advance consideration in a foreign currency, the date of the transaction is the date on which an entity initially recognises the non-monetary asset or non-monetary liability arising from the advance consideration. If there are multiple payments or receipts in advance, then the entity must determine a date of the transactions for each payment or receipt of advance consideration. The application of this interpretation did not have a significant impact on the Group's interim consolidated financial position or results.

New standards and amendments to standards issued but not effective as of June 30, 2018

At the date of preparation of the interim consolidated financial statements, the following IFRSs and amendments had been published, but their application was not mandatory:

| Standards and amendments | | Mandatory application: annual periods beginning on or after |
|---|---|---|
| IFRS 16 | Leases | January 1, 2019 |
| IFRIC 23 | Uncertainty over Income Tax Treatments | January 1, 2019 |
| Amendments to IFRS 9 | Prepayment Features with Negative Compensation | January 1, 2019 |
| Amendments to IAS 19 | Plan Amendment, Curtailment or Settlement | January 1, 2019 |
| Amendments to IAS 28 | Long-term Interests in Associates and Joint Ventures | January 1, 2019 |
| Improvements to IFRS Standards 2015-2017 Cycle | | January 1, 2019 |
| IFRS 17 | Insurance Contracts | January 1, 2021 |

Based on the analyses made to date, the Group estimates that the adoption of the new standard on lease contracts, IFRS 16 Leases, issued but not yet effective, might have a significant impact on the consolidated financial statements at the time of its adoption and prospectively. Regarding the rest of the standards, amendments and interpretations issued but not yet effective, based on the analyses undertaken to date the

Group estimates that they will not have a significant impact on the consolidated financial statements in the initial period of application.

IFRS 16 Leases

IFRS 16 requires lessees to recognise assets and liabilities arising from all leases (except for short-term leases and leases of low-value assets) in the statement of financial position.

The Group acts as a lessee on a very significant number of lease agreements over different assets, such as third-party towers, circuits, office buildings and stores and land where the towers are located, mainly. A significant portion of these contracts is accounted for as operating lease under the current lease standard, with lease payments being recognised generally on a straight-line basis over the contract term.

The Group is currently in the process of estimating the impact of this new standard on such contracts. This analysis includes the estimation of the lease term, based on the non-cancellable period and the periods covered by options to extend the lease, when the exercise depends only on Telefónica and where such exercise is reasonably certain. This will depend, to a large extent, on the specific facts and circumstances by class of assets in the telecom industry (technology, regulation, competition, business model, among others). In addition to this, the Group will make assumptions to calculate the discount rate, which will mainly be based on the incremental borrowing rate of interest for the estimated term. On the other hand, the Group will not separately recognise non-lease components from lease components for those classes of assets in which non-lease components are not material with respect to the total value of the lease.

Moreover, the standard allows for two transition methods: retrospectively for all periods presented, or using a modified retrospective approach where the cumulative effect of adoption is recognised at the date of initial application. The Group has decided to adopt the latter transition method; therefore, the cumulative effect of initial application shall be recognised as an adjustment to retained earnings in the year of initial application of IFRS 16. Also, certain practical expedients are available on first-time application in connection with the right of use asset measurement, discount rates, impairment, leases that finish within the twelve months subsequent to the date of first application, initial direct costs, and term of the lease. The Group is evaluating which of these practical expedients will be adopted. In this regard, the Group shall apply the practical expedient that allows not to reassess whether a contract is or contains a lease on the date of initial application of IFRS 16 but to directly apply the new requirements to all those contracts which under current accounting were identified as leases.

Due to the different alternatives available, together with the complexity of the estimations and the significant number of lease contracts, the Group has not yet completed the implementation process, so at present it is not possible to make a reasonable estimation of the impact of initial application of the new requirements. However, based on the volume of contracts affected, as well as the magnitude of the future lease commitments, as disclosed in the Group's Consolidated Annual Financial Statements, the Group expects that the changes introduced by IFRS 16 would have a significant impact on its financial statements from the date of adoption, including the recognition on the balance sheet of right of use assets and their corresponding lease obligations in connection with the majority of contracts that are classified as operating leases under the current lease standard. Also, amortization of the right of use assets and recognition of interest costs on the lease obligation on the statements of income will replace amounts recognised as lease expense under the current lease standard. Classification of lease payments in the statement of cash flows will also be affected by the requirements of the new lease standard. On the other side, the Group's Financial Statements will include broader disclosures with relevant information regarding lease contracts.

## Note 4. Segment information

The organizational structure approved by the Board of Directors of Telefónica, S.A. on February 26, 2014 was made up of the following segments: Telefónica Spain, Telefónica United Kingdom, Telefónica Germany, Telefónica Brazil and Telefónica Hispanoamérica (formed by the Group's operators in Argentina, Chile, Peru, Colombia, Mexico, Venezuela, Central America, Ecuador and Uruguay).

On January 31, 2018, the Board of Directors of Telefónica also resolved to adopt a new organisational structure in order to make the Group more agile, simple and focused on management, customer service, growth, efficiency and profitability.

In this context, Telefónica Hispanoamérica was split into two new segments in order to more effectively manage the different market situations: Telefónica Hispam Sur, encompassing operations in Argentina, Chile, Peru and Uruguay, and Telefónica Hispam Norte, encompassing the operations in Colombia, Mexico, Central America, Ecuador and Venezuela.

The comparative results of the segments of the Group for the first half of 2017 and the comparative segmentation of assets, liabilities and investments accounted for by the equity method as of December 31, 2017 have been restated to reflect this new organization. These changes in the segments have had no impact on the consolidated results of the Group.

These segments include the information related to wireline, wireless, cable, data, internet, television businesses and other digital services provided in each country or countries. Any services not specifically included in these segments are part of "Other companies and eliminations", which includes, in particular, Telxius (as further explained below), the companies belonging to the cross-sectional areas, other Group companies as well as eliminations in the consolidation process. Inter-segment transactions are carried out at market prices.

Telxius' financials are reported under "Other companies and eliminations". Revenues of Telxius in the first half of 2018 amounted to 366 million euros (370 million euros in the first half of 2017), of which 223 million euros correspond to inter-segment revenues (229 million euros in the first half of 2017). OIBDA of Telxius in the first half of 2018 amounted to 173 million euros (179 million euros in the first half of 2017). The capital expenditures in the first half of 2018 in Telxius amounted to 98 million euros (56 million euros in the first half of 2017).

The Group manages borrowing activities centrally. Also, Telefónica, S.A. is the head of the Telefónica tax group in Spain. Therefore, a significant part of the related assets and liabilities is included under "Other companies and eliminations" and the results of the segments are disclosed up to operating income. Revenue and expenses arising from intra-group invoicing for the use of the trademark and management services have been eliminated from the operating results of each Group segment. These adjustments have no impact on the Group's consolidated results.

Segment reporting takes into account the impact of the purchase price allocation to the assets acquired and the liabilities assumed for the companies included in each segment. The assets and liabilities presented in each segment are those managed by the heads of each segment, irrespective of their legal structure.

The following table presents income and CapEx information (capital expenditures in intangible assets and property, plant and equipment, see Note 6) regarding the Group's operating segments:

January - June 2018

| Millions of euros | Telefónica Spain | Telefónica United Kingdom | Telefónica Germany | Telefónica Brazil | Telefónica Hispam Norte | Telefónica Hispam Sur | Other companies and eliminations | Total Group |
|---|---|---|---|---|---|---|---|---|
| Revenues | 6,265 | 3,223 | 3,525 | 5,227 | 1,998 | 3,631 | 465 | 24,334 |
| External revenues | 6,144 | 3,204 | 3,510 | 5,217 | 1,953 | 3,607 | 699 | 24,334 |
| Inter-segment revenues | 121 | 19 | 15 | 10 | 45 | 24 | (234) | — |
| Other operating income and expenses | (3,758) | (2,344) | (2,643) | (2,970) | (1,564) | (2,607) | (346) | (16,232) |
| OIBDA | 2,507 | 879 | 882 | 2,257 | 434 | 1,024 | 119 | 8,102 |
| Depreciation and amortization | (816) | (491) | (980) | (992) | (456) | (537) | (133) | (4,405) |
| Operating income | 1,691 | 388 | (98) | 1,265 | (22) | 487 | (14) | 3,697 |
| Capital expenditures (CapEx) | 778 | 987 | 424 | 892 | 165 | 553 | 133 | 3,932 |

January - June 2017 (revised)

| Millions of euros | Telefónica Spain | Telefónica United Kingdom | Telefónica Germany | Telefónica Brazil | Telefónica Hispam Norte | Telefónica Hispam Sur | Other companies and eliminations | Total Group |
|---|---|---|---|---|---|---|---|---|
| Revenues | 6,226 | 3,208 | 3,542 | 6,193 | 2,212 | 4,207 | 503 | 26,091 |
| External revenues | 6,083 | 3,190 | 3,523 | 6,180 | 2,150 | 4,188 | 777 | 26,091 |
| Inter-segment revenues | 143 | 18 | 19 | 13 | 62 | 19 | (274) | — |
| Other operating income and expenses | (3,801) | (2,359) | (2,681) | (4,055) | (1,599) | (3,024) | (393) | (17,912) |
| OIBDA | 2,425 | 849 | 861 | 2,138 | 613 | 1,183 | 110 | 8,179 |
| Depreciation and amortization | (850) | (523) | (1,006) | (1,156) | (497) | (630) | (147) | (4,809) |
| Operating income | 1,575 | 326 | (145) | 982 | 116 | 553 | (37) | 3,370 |
| Capital expenditures (CapEx) | 704 | 434 | 435 | 915 | 277 | 645 | 97 | 3,507 |

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The following table presents assets and liabilities by segment:

June 2018

| Millions of euros | Telefónica Spain | Telefónica United Kingdom | Telefónica Germany | Telefónica Brazil | Telefónica Hispam Norte | Telefónica Hispam Sur | Other companies and eliminations | Total Group |
|---|---|---|---|---|---|---|---|---|
| Fixed assets | 15,244 | 9,719 | 14,059 | 20,960 | 5,873 | 7,280 | 2,184 | 75,319 |
| Investments accounted for by the equity method | 2 | 8 | — | 2 | 1 | — | 55 | 68 |
| Total allocated assets | 24,277 | 12,916 | 16,759 | 27,397 | 8,898 | 10,406 | 10,298 | 110,951 |
| Total allocated liabilities | 13,801 | 4,790 | 6,042 | 7,538 | 5,004 | 5,230 | 44,831 | 87,236 |

December 2017 (revised)

| Millions of euros | Telefónica Spain | Telefónica United Kingdom | Telefónica Germany | Telefónica Brazil | Telefónica Hispam Norte | Telefónica Hispam Sur | Other companies and eliminations | Total Group |
|---|---|---|---|---|---|---|---|---|
| Fixed assets | 15,288 | 9,198 | 14,611 | 23,845 | 6,075 | 7,840 | 2,214 | 79,071 |
| Investments accounted for by the equity method | 2 | 7 | — | 2 | 1 | — | 65 | 77 |
| Total allocated assets | 22,722 | 11,610 | 17,225 | 30,229 | 9,194 | 11,009 | 13,077 | 115,066 |
| Total allocated liabilities | 13,391 | 4,063 | 5,889 | 8,130 | 5,118 | 5,611 | 46,246 | 88,448 |

The composition of segment revenues is as follows:

| Millions of euros | January - June 2018 | | | | January - June 2017 | | | |
|---|---|---|---|---|---|---|---|---|
| Segments | Fixed | Mobile | Other and elims. | Total | Fixed | Mobile | Other and elims. | Total |
| Spain (*) | | | | 6,265 | | | | 6,226 |
| United Kingdom | — | 3,032 | 191 | 3,223 | — | 3,048 | 160 | 3,208 |
| Germany | 391 | 3,127 | 7 | 3,525 | 440 | 3,092 | 10 | 3,542 |
| Brazil | 1,943 | 3,285 | (1) | 5,227 | 2,411 | 3,781 | 1 | 6,193 |
| Hispam Norte | 356 | 1,641 | 1 | 1,998 | 386 | 1,826 | — | 2,212 |
| Hispam Sur | 1,423 | 2,209 | (1) | 3,631 | 1,639 | 2,568 | — | 4,207 |
| Other and inter-segment eliminations | — | — | 465 | 465 | — | — | 503 | 503 |
| Total Group | — | — | — | 24,334 | — | — | — | 26,091 |

Note: In the countries of the Telefónica Hispam Norte and Telefónica Hispam Sur segments with separate fixed and mobile operating companies, the intercompany revenues have not been considered.
(*) The detail of revenues for Telefónica Spain is shown in the table below.

Given the convergence reached at Telefónica Spain due to the high penetration of the convergent offers in Telefónica Spain, the revenue breakdown by fixed and mobile is less relevant in this segment. For this reason, the following revenue breakdown is shown, which Management believes is more meaningful.

| Millions of euros | | |
|---|---|---|
| Telefónica Spain | January - June 2018 | January - June 2017 |
| Mobile handset sale | 179 | 165 |
| Ex-Mobile handset sale | 6,086 | 6,061 |
| Consumer | 3,336 | 3,273 |
| Corporate | 1,715 | 1,710 |
| Others (*) | 1,035 | 1,078 |
| Total | 6,265 | 6,226 |

(*) Other includes wholesale, subsidiaries and other revenues.

Note 5. Business combinations and acquisitions of non-controlling interests

Business combinations

No material business combinations were finalized within the Group in the six months ended June 30, 2018 and 2017.

Acquisition by Coltel of control over Telebucaramanga, Metrotel and Optecom

On September 30, 2017, as part of the early termination agreement regarding the contract with PARAPAT, Colombia Telecomunicaciones, S.A. ESP (Coltel) acquired control of the Colombian companies Empresa de Telecomunicaciones de Telebucaramanga S.A. ESP (“Telebucaramanga”), operating in the city of Bucaramanga; Metropolitana de Telecomunicaciones S.A. ESP (“Metrotel”); and Operaciones Tecnológicas y Comerciales S.A.S. (“Optecom”), operating in the city of Barranquilla, for an overall price of 509,975 million Colombian pesos (approximately 147 million euros on the transaction date). These companies primarily provide fixed telephony, data, pay TV, installation and maintenance services.

As of the date when the present interim financial statements were drawn up, the process for allocating the purchase price is provisional. This analysis should conclude in the coming months, yet will not last longer than twelve months from the acquisition date stipulated in the standard.

Transactions with non-controlling interests

Share swap with KPN

In March 2017 Telefónica entered into a swap agreement with Koninklijke KPN NV (hereinafter, KPN) to deliver 72.0 million of its treasury shares (representing 1.43% of its share capital) in exchange for 178.5 million shares of its subsidiary Telefónica Deutschland Holding AG, representing 6.0% of the share capital of the latter (see Note 8). The exchange ratio was determined based on the average of the volume weighted average price of the respective shares over the last five trading sessions. As a result of this agreement, Telefónica increased from 63.2% to 69.2% its shareholding in Telefonica Deutschland.

Note 6. Intangible assets, property, plant and equipment and goodwill

The movements in "Intangibles assets" and "Property, plant and equipment" in the first half of 2018 are as follows:

| Millions of euros | Intangibles assets | Property, plant and equipment | Total |
|---|---|---|---|
| Balance at 12/31/2017 | 18,005 | 34,225 | 52,230 |
| Additions | 1,171 | 2,761 | 3,932 |
| Depreciation and amortization | (1,647) | (2,758) | (4,405) |
| Disposals | (2) | (21) | (23) |
| Translation differences and hyperinflation adjustments | (635) | (1,290) | (1,925) |
| Transfers and others | 226 | (243) | (17) |
| Balance at 06/30/2018 | 17,118 | 32,674 | 49,792 |

As a result of its participation in the Principal Stage of the spectrum auction conducted in the United Kingdom, Telefónica UK Limited (O2 UK) was granted four blocks of 10 MHz in the 2.3 GHz spectrum band and eight blocks of 5 MHz in the 3.4 GHz band. The investment for these new frequencies by O2 UK was 524 million pounds sterling (approximately 588 million euros).

The additions by segment are detailed in Note 4.

The movement in "Goodwill" in the first half of 2018 is as follows:

| Millions of euros | Goodwill |
|---|---|
| Balance at 12/31/2017 | 26,841 |
| Translation differences | (1,206 ) |
| Write-offs | (108 ) |
| Balance at 06/30/2018 | 25,527 |

The movement of translation differences is mainly related to the depreciation of the Brazilian real.

The Group carries out periodically a sensitivity analysis of the goodwill impairment test, by considering reasonable changes in the main assumptions used in such test.

As indicated in the consolidated financial statements for 2017, the goodwill allocated to Telefónica Móviles México could be impaired by variations in the discount rate (WACC) and the perpetuity growth rate. During the first half of 2018, changes in the macroeconomic and financial conditions were revealed, reflected in the risk premiums that are computed in the cost of capital. In this context, the estimated WACC increased to 10.0% (from 9.5% used at the end of 2017) and the estimated perpetuity growth rate decreased 0.4 p.p.

As a consequence of the update of the assumptions used in calculating the value in use, and the carrying value of the company at June 30, 2018, a partial write-off of the goodwill allocated to Telefónica Móviles México was recognized, amounting to 108 million euros (see Note 17).

Regarding the sensitivity of the calculation, an additional 50 b.p. increase in the WACC could result in an additional impairment amounting to 134 million euros, while with an additional 25 b.p. decrease in the perpetuity growth rate the impact would be 56 million euros. On the other hand, a decrease of 1 p.p. in the long-term OIBDA margin could result in a negative impact of 125 million euros and with an increase of 0.5 p.p. in the long-term CapEx ratio the negative impact would be 63 million euros.

## Note 7. Related parties

### Significant shareholders

The significant shareholders of the Company are Banco Bilbao Vizcaya Argentaria, S.A. (BBVA), Caja de Ahorros y Pensiones de Barcelona (“la Caixa”) and Blackrock, Inc., with stakes in Telefónica, S.A. of 5.17%, 5.01% and 4.989%, respectively.

During the first six months of 2018 and 2017 the Group did not carry out any significant transactions with Blackrock, Inc., other than the dividends paid corresponding to its stake.

A summary of significant transactions between the Telefónica Group and the companies of BBVA and those of la Caixa, carried out at market prices, is as follows:

Condensed consolidated interim financial statements 2018

| Millions of euros | January-June 2018 | January-June 2017 |
|---|---|---|
| Finance costs | 25 | 26 |
| Receipt of services | 13 | 7 |
| Purchase of goods and other expenses | 27 | 34 |
| Total costs | 65 | 67 |
| Finance income | 23 | 11 |
| Dividends received(1) | 5 | 8 |
| Services rendered | 36 | 50 |
| Sale of goods | 28 | 25 |
| Total revenue | 92 | 94 |
| Finance arrangements: loans and capital contributions (borrower) | 759 | 888 |
| Guarantees | 260 | 274 |
| Commitments | 88 | 80 |
| Finance arrangements: loans and capital contributions (lessee) | 1,175 | 1,865 |
| Dividends paid | 116 | 120 |
| Factoring operations | 637 | 250 |
| Other transactions | 12 | 11 |

(1) At June 30, 2018, Telefónica holds a 0.66% stake (0.66% at June 30, 2017) in the share capital of Banco Bilbao Vizcaya Argentaria, S.A.

In addition, the nominal value of outstanding derivatives held with BBVA and la Caixa in the first half of 2018 amounted to 20,318 and 546 million euros, respectively (21,480 million euros held with BBVA and 385 million euros held with la Caixa in the first half of 2017). This figure is inflated by the use in some cases of several levels of derivatives applied to the nominal value of a single underlying. The net fair value of these same derivatives in the statement of financial position as of June 30, 2018 is 371 and -20 million euros, respectively (748 and -32 million euros, as of June 30, 2017).

Additionally, at June 30,2018 there were collateral guarantees net on derivatives with BBVA amounting to 100 million euros. In the same period of the previous year there was no amount related to this concept.

Other related parties

Certain Telefónica Group subsidiaries performed during the first half of 2018 transactions with Global Dominion Access Group, related to the Group´s ordinary course of business (mainly in Telefónica Spain amounting to 30 million euros).

Associates and joint ventures

The breakdown of items related to associates and joint ventures recognized in the consolidated statements of financial position and income statements is as follows:

| Millions of euros | 06/30/2018 | 12/31/2017 |
|---|---|---|
| Investments accounted for by the equity method | 68 | 77 |
| Loans to associates and joint ventures | 16 | 16 |
| Receivables from associates and joint ventures for current operations (Note 10) | 30 | 32 |
| Financial debt, associates and joint ventures | 93 | 10 |

| | | |
|---|---|---|
| Payables to associates and joint ventures (Note 14) | 351 | 491 |

| Millions of euros | January-June 2018 | January-June 2017 |
|---|---|---|
| Share of income (loss) of investments accounted for by the equity method | 5 | 3 |
| Revenue from operations with associates and joint ventures | 112 | 107 |
| Expenses from operations with associates and joint ventures | 7 | 10 |
| Financial revenues with associates and joint ventures | 1 | — |

Directors' and Senior Executives' compensation and other information

Pursuant to the disclosure established in Circular 5/2015, of October 28, of the Comisión Nacional del Mercado de Valores (the Spanish National Securities commission, or "CNMV"), on periodic reporting by issuers, the compensation and benefits paid to members of the Company's Board of Directors in the first six months of 2018 and 2017 are as follows:

| Directors | January- June | January- June |
|---|---|---|
| Thousands of euros | 2018 | 2017 |
| Fixed remuneration | 3,373 | 2,955 |
| Variable remuneration | 4,417 | 3,430 |
| Attendance fees | 106 | 115 |
| Other | 526 | 274 |
| Total | 8,422 | 6,774 |

Note: It should be noted that, on January 31, 2018, Mr. Jordi Gual Solé was appointed Director of Telefónica, S.A.; thus, in relation to such Director, the remuneration received from that date is included in this section. Likewise, on April 25, 2018, Ms. Eva Castillo Sanz resigned to her position as Director of Telefónica, S.A.; therefore, regarding Ms. Castillo, the remuneration received until that date is included in this section. Likewise, on April 25, 2018, Ms. María Luisa García Blanco was appointed Director of Telefónica, S.A.; consequently, with respect to the aforementioned Director, the remuneration received from that date is included in this section.

| Other benefits for Directors | January- June | January- June |
|---|---|---|
| Thousands of euros | 2018 | 2017 |
| Pension funds and plans: contributions | 11 | 6 |
| Life insurance premiums | 14 | 8 |
| Total | 25 | 14 |

In addition, the total amounts paid to Senior Executives of the Company, excluding those that are also members of the Board of Directors, for all items in the first six months of 2018 and 2017 are as follows.

| Executives | January- June | January- June |
|---|---|---|
| Thousands of euros | 2018 | 2017 |
| Total compensation paid to Senior Executives (1) | 17,703 | 6,452 |

(1) The "Total compensation paid to Senior Executives" Section includes the compensation received by Mr. Ramiro Sánchez de Lerín García-Ovies, former General Secretary and Secretary to the Board of Telefónica, S.A., until his disassociation from Telefónica, S.A., including the compensation received by him as a result of his dismissal.

Note 8. Changes in equity and shareholder remuneration

Dividends

Approval was given at the General Shareholders' Meeting of June 8, 2018 to pay a gross dividend of 0.40 for each company share issued, in circulation and carrying entitlement to this distribution against unrestricted reserves, payable in two tranches. The first payment of a gross amount of 0.20 in cash per share was made on

June 15, 2018 amounting to 1,025 million euros and the second payment of a gross amount of 0.20 in cash per share will be made on December 20, 2018.

Approval was given at the General Shareholders' Meeting of June 9, 2017 to pay a gross dividend of 0.40 for each company share issued, in circulation and carrying entitlement to this distribution against unrestricted reserves, payable in two tranches. The first payment of a gross amount of 0.20 in cash per share was made on June 16, 2017 amounting to 994 million euros and the second payment of a gross amount of 0.20 in cash per share (recognized in the amount of 994 million euros in the consolidated statement of changes in equity of the first half of 2017) was made on December 14, 2017 amounting to 1,025 million euros.

Other equity instruments

In March 2018, Telefónica Europe, B.V. executed an operation to proactively manage its hybrid capital composed of: a) two new emissions per aggregate amount of 2,250 million euros; and b) a tender offer on a basket of hybrids in euros and pounds with early amortization dates between September 2018 and March 2024. The issuer accepted the purchase in cash and immediately thereafter these were amortized in advance. The operations of new issuance and repurchase were liquidated with dates March 22, 2018 and March 23, 2018 respectively.

The characteristics of the undated deeply subordinated securities are the following (millions of euros):

| Issue date | Annual Fix | Variable | Exercisable from issuer | 12/31/2017 | Tender Offer | Amount repurchased | 06/30/2018 |
|---|---|---|---|---|---|---|---|
| 03/22/2018 | 3 % | from 12/04/2023 rate SWAP + spread incremental | 2023 | — | — | — | 1,250 |
| 03/22/2018 | 3.875 % | from 09/22/2026 rate SWAP + spread incremental | 2026 | — | — | — | 1,000 |
| 12/07/2017 | 2.625 % | from 06/07/2023 rate SWAP + spread incremental | 2023 | 1,000 | — | — | 1,000 |
| 09/15/2016 | 3.750 % | from 03/15/2022 rate SWAP + spread incremental | 2022 | 1,000 | — | — | 1,000 |
| 03/30/2015(*) | 8.50 % | from 03/30/2020 rate SWAP + spread incremental | 2020 | 452 | — | — | 452 |
| 12/04/2014 | 4.20 % | from 12/04/2019 rate SWAP + spread incremental | 2019 | 850 | 850 | (145) | 705 |
| 03/31/2014 | 5 % | from 03/31/2020 rate SWAP + spread incremental | 2020 | 750 | 750 | (158) | 592 |
| 03/31/2014 | 5.875 % | from 03/31/2024 rate SWAP + spread incremental | 2024 | 1,000 | 1,000 | — | 1,000 |
| 11/26/2013(**) | 6.75 % | from 11/26/2020 rate SWAP + spread incremental | 2020 | 716 | 716 | (511) | 205 |
| 09/18/2013 | 6.5 % | from 09/18/2018 rate SWAP + spread incremental | 2018 | 1,125 | 1,125 | (652) | 473 |

| | | | | | | |
|---|---|---|---|---|---|---|
| 7.625 % | from 09/18/2021 rate SWAP + spread incremental | 2021 | 625 | 625 | (333 | )292 |
| | | | 7,518 | | | 7,969 |

(*) Issued by Colombia Telecomunicaciones, S.A. ESP (500 million US dollars).
(**) Tender offer over 600 million pounds of undated deeply subordinated securities of which were accepted 428 million pounds (equivalent to 511 million euros at the rate of exchange of the issuance).
The undated deeply subordinated securities have been issued by Telefónica Europe B.V. unless specified otherwise.
In the first half of 2018, the payment of the coupons related to the undated deeply subordinated securities issued in previous years, impacted by the tender offer, amounted to an aggregate amount, net of tax effect, of 277 million euros, with a balancing entry on “Retained earnings” in the consolidated statements of changes in equity (100 million euros in the first half of 2017).

Translation differences

In the first six months of 2018, the equity attributable to the equity holders of the parent decreased by 2,484 million euros due to the variation between the exchange rate at June 30, 2018 compared with December 31, 2017, mainly the depreciation of the Brazilian real and the Argentine peso.

The cumulative impact of the accounting restatement to adjust for the effects of hyperinflation in Venezuela is also included in the "Translation Differences" line item.

Adjustment on initial application of new reporting standards IFRS 9 and IFRS 15

The initial application of new reporting standards IFRS 9 Financial instruments and IFRS 15 Revenue from contracts with customers (see Note 2), effective as of January 1, 2018, had an impact in total equity amounting to -149 million euros and 748 million euros, respectively, with the following detail:

| Millones de euros | IFRS 9 | IFRS 15 | Total |
|---|---|---|---|
| Gross impact in equity | (204) | 1,012 | 808 |
| Tax effect | 55 | (264) | (209) |
| Impact in equity | (149) | 748 | 599 |
| Attributable to equity holders | (127) | 658 | 531 |
| Attributable to non-controlling interest | (22) | 90 | 68 |

The amount reclassified to other comprehensive income from retained earnings, related to impairment losses of previous years, was included in the adjustment on initial application (see Note 11).

Treasury shares

The following transactions involving treasury shares were carried out in the six months ended June 30, 2018 and 2017:

| | Number of shares |
|---|---|
| Treasury shares at December 31, 2017 | 65,687,859 |
| Employee share option plan | (121,047) |
| Treasury shares at June 30, 2018 | 65,566,812 |

| | Number of shares |
|---|---|
| Treasury shares at December 31, 2016 | 141,229,134 |
| Disposals | (72,007,507) |
| Employee share option plan | (71,344) |
| Treasury shares at June 30, 2017 | 69,150,283 |

During the first half of 2017, under the swap agreement with KPN, Telefónica delivered 72.0 million of its treasury shares (representing 1.43% of its share capital), in exchange for 178.5 million shares of its subsidiary Telefónica Deutschland Holding AG, representing 6.0% of the share capital of the latter for an amount of 754 million euros (see Note 5).

Treasury shares in portfolio at June 30, 2018 are directly held by Telefónica, S.A. and represent 1.26% of its share capital.

The Company has a derivative financial instrument subject to net settlement on a notional equivalent to 27 million Telefónica shares, recognized under "Current financial liabilities" in the accompanying consolidated statement of financial position.

Note 9. Financial assets and other non-current assets

The breakdown of financial assets and other non-current assets of the Telefónica Group at June 30, 2018 and December 31, 2017 is as follows:

| Millions of euros | 06/30/2018 | 12/31/2017 |
|---|---|---|
| Non-current financial assets (Note 11) | 8,109 | 7,771 |
| Investments | 662 | 650 |
| Credits and others financial assets | 2,070 | 1,183 |
| Deposits and guarantees | 2,162 | 2,625 |
| Derivative financial assets | 2,854 | 2,812 |
| Trade receivables | 503 | 638 |
| Impairment of trade receivables | (142) | (137) |
| Other non-current assets | 659 | 396 |
| Contractual assets (Note 15) | 69 | — |
| Deferred expenses (Note 15) | 185 | — |
| Prepayments | 405 | 396 |
| Total | 8,768 | 8,167 |

On March 20, 2018, the Superior Court of Justice passed a final decision in favor of Telefónica Brasil, which recognized the right to deduct the state tax on goods and services (ICMS) from the calculation basis of the Social Integration Program-PIS (Programa de Integração Social) and the Financing of Social Security-COFINS (Contribuição para Financiamento da Seguridade Social). This decision covers the period from September 2003 to July 2014, although the Company has ongoing processes until June 2017. Once the values were determined, Telefónica Brasil presented to the tax authorities a refund request for the payments of PIS/COFINS affected by the judicial decision, together with the corresponding default interest.

The total amount, recognized under "Credits and other financial assets" in the table above at June 30, 2018 was 3,842 million Brazilian reais (855 million euros at the closing exchange rate as of June 30, 2018). The impact in the consolidated income statement of the first half of 2018 was 2,005 million Brazilian reais (485 million euros at the average exchange rate for the first half of 2018) reducing "Taxes other than income tax" included in "Other expenses" (see Note 17), and 1,837 million Brazilian reais (444 million euros at the average exchange rate for the first half of 2018) in Finance income.

Note 10. Receivables and other current assets

The detail of receivables and other current assets of the Telefonica Group at June 30, 2018 and December 31, 2017 is as follows:

| Millions of euros | 06/30/2018 | 12/31/2017 |
|---|---|---|
| Receivables (Note 11) | 8,311 | 8,727 |
| Trade receivables billed | 7,800 | 7,876 |
| Trade receivables unbilled | 2,739 | 3,015 |
| Impairment of trade receivables | (2,710) | (2,563) |
| Receivables from associates and joint ventures (Note 7) | 30 | 32 |
| Other receivables | 452 | 367 |
| Other current assets | 2,505 | 1,366 |
| Contractual assets (Note 15) | 368 | — |
| Capitalized costs (Note 15) | 549 | — |
| Prepayments | 1,588 | 1,366 |
| Total | 10,816 | 10,093 |

Note 11. Breakdown of financial assets by category

The breakdown of financial assets of the Telefónica Group at December 31, 2017 was as follows:

December 31, 2017

| Millions of euros | Fair value through profit or loss | | | | Measurement hierarchy | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Held for trading | Fair value option | Available-for-sale | Hedges | Level 1 (Quoted prices) | Level 2 (Other directly observable market inputs) | Level 3 (Inputs not based on observable market data) | Held-to-maturity investments | Rest of financial assets at amortized cost | Total carrying amount | To fa va |
| Non-current financial assets (Note 9) | 1,074 | 250 | 1,117 | 1,738 | 822 | 3,339 | 18 | — | 3,592 | 7,771 | 7, |
| Investments | — | — | 650 | — | 567 | 83 | — | — | — | 650 | 65 |
| Credits and other financial assets | — | 250 | 467 | — | 86 | 613 | 18 | — | 466 | 1,183 | 1, |
| Deposits and guarantees | — | — | — | — | — | — | — | — | 2,625 | 2,625 | 2, |
| Derivative instruments | 1,074 | — | — | 1,738 | 169 | 2,643 | — | — | — | 2,812 | 2, |
| Trade receivables | — | — | — | — | — | — | — | — | 638 | 638 | 50 |
| Impairment of trade receivables | — | — | — | — | — | — | — | — | (137) | (137) | — |
| Current financial assets | 163 | 60 | 66 | 731 | 105 | 915 | — | 169 | 14,884 | 16,073 | 16 |
| Trade receivables (*) (Note 10) | — | — | — | — | — | — | — | — | 11,290 | 11,290 | 8, |
| Impairment of trade receivables (*) (Note 10) | — | — | — | — | — | — | — | — | (2,563) | (2,563) | — |
| | 163 | 60 | 66 | 731 | 105 | 915 | — | 169 | 965 | 2,154 | 2, |

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Other financial assets | | | | | | | | | | | |
| Cash and cash equivalents | — | — | — | — | — | — | — | — | 5,192 | 5,192 | 5, |
| Total financial assets | 1,237 | 310 | 1,183 | 2,469 | 927 | 4,254 | 18 | 169 | 18,476 | 23,844 | 2: |

(*) For comparative purposes, and considering the impact of the IFRS 9 application in the impairment of trade receivables, short-term trade receivables are included in the breakdown of financial assets by category as of December 31, 2017.

The opening balance as of January 1, 2018, after the impacts of the first application of IFRS 9 (see notes 2 and 3), are as follows:

January 1, 2018

| Millions of euros | Balance at December 31, 2017 | First application of IFRS 9 impact | Fair value through profit or loss | | Fair value through Other Comprehensive Income | | Hedges | Measurement hierarchy | | | Amortiz cost |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | Held for trading | Fair value option | Debt instruments | Equity instruments | | Level 1 (Quoted prices) | Level 2 (Other directly observable market inputs) | Level 3 (Inputs not based on observable market data) | |
| Non-current financial assets | 7,771 | (184) | 1,118 | 250 | 511 | 631 | 1,738 | 822 | 3,408 | 18 | 3,339 |
| Investments | 650 | — | 19 | — | — | 631 | — | 567 | 83 | — | — |
| Credits and other financial assets | 1,183 | — | 25 | 250 | 442 | — | — | 86 | 613 | 18 | 466 |
| Deposits and guarantees | 2,625 | — | — | — | — | — | — | — | — | — | 2,625 |
| Derivative instruments | 2,812 | — | 1,074 | — | — | — | 1,738 | 169 | 2,643 | — | — |
| Trade receivables | 638 | (191) | — | — | 69 | — | — | — | 69 | — | 378 |
| Impairment of trade receivables | (137) | 7 | — | — | — | — | — | — | — | — | (130 |
| Current financial assets | 16,073 | (20) | 805 | 60 | 488 | — | 731 | 105 | 1,979 | — | 13,969 |
| Trade receivables | 11,290 | 85 | 577 | — | 487 | — | — | — | 1,064 | — | 10,311 |
| Impairment of trade receivables | (2,563) | (105) | — | — | — | — | — | — | — | — | (2,668 |
| Other current financial assets | 2,154 | — | 228 | 60 | 1 | — | 731 | 105 | 915 | — | 1,134 |
| | 5,192 | — | — | — | — | — | — | — | — | — | 5,192 |

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Cash and cash equivalents | | | | | | | | | | | |
| Total financial assets | 23,844 | (204) | 1,923 | 310 | 999 | 631 | 2,469 | 927 | 5,387 | 18 | 17,308 |

The main impacts of the first application of IFRS 9 at January 1, 2018 are the following:

- Impact of 204 million euros (with counterpart in reserves net of tax impact) corresponding to the increase of impairment of trade receivables classified at amortized cost (183 million euros) and the decrease of the book value of trade assets classified at fair value (21 million euros).

In addition, according to the new categories introduced by IFRS 9, the following reclassifications have been recorded:

- Reclassification of trade receivables associated with portfolios whose business model is based on a combination of held to collect contractual cash flows and sell the financial asset, or only to sell, valued as financial assets at amortized cost as of December 31, 2017, to financial assets at fair value through comprehensive income and fair value through profit or loss amounting to 556 and 598 million euros respectively. The impact on the book value of these assets was a decrease of 21 million euros as of January 1, 2018, previously mentioned. On the other hand, the first application impact of non-current trade receivables amounting to

191 million euros, mainly includes the reclassification of part of trade receivables classified as financial assets at amortized cost as of December 31, 2017, to the category of financial assets at fair value through profit or loss according to the business model determined in accordance with IFRS 9 (commercial portfolio sales operations) and it is presented in the short-term at its fair value.

- Reclassification of held-to-maturity investments as of December 31, 2017 to the category of financial assets at amortized cost (169 million euros). The Group intends to hold these assets until maturity to collect the contractual cash flows, which correspond to payment of principal and interest. There has been no impact on the book value of these assets due to the application of IFRS 9.
- Reclassification of the investments, classified as available-for-sale financial assets at December 31, 2017, to the categories of financial assets at fair value through other comprehensive income, equity instruments (631 million euros) and financial assets at fair value through profit or loss (19 million euros). Impairment losses from previous years corresponding to these assets at fair value through other comprehensive income, recorded at December 31, 2017 in retained earnings, have been reclassified to other comprehensive income in equity, in the line of adjustments on initial application of new reporting standards.
- Reclassification of the rest of financial assets classified as available for sale at December 31, 2017, to financial assets at fair value through other comprehensive income, debt instruments (443 million euros) and to financial assets at fair value through profit or loss (90 million euros), without impact on the accounting valuation of these financial assets.

The breakdown of financial assets of the Telefónica Group at June 30, 2018 is as follows:

June 30, 2018

| Millions of euros | Fair value through profit or loss | | Fair value through Other Comprehensive Income | | Hedges | Measurement hierarchy | | | Amortized cost | Total carrying amount | Total fair value |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Held for trading | Fair value option | Debt instruments | Equity instruments | | Level 1 (Quoted prices) | Level 2 (Other directly observable market inputs) | Level 3 (Inputs not based on observable market data) | | | |
| Non-current financial assets (Note 9) | 982 | 282 | 496 | 640 | 1,920 | 973 | 3,327 | 20 | 3,789 | 8,109 | 8,109 |
| Investments | 22 | — | — | 640 | — | 568 | 94 | — | — | 662 | 662 |
| Credits and other financial assets | 26 | 282 | 437 | — | — | 264 | 461 | 20 | 1,325 | 2,070 | 2,070 |
| Deposits and guarantees | — | — | — | — | — | — | — | — | 2,162 | 2,162 | 2,162 |
| Derivative instruments | 934 | — | — | — | 1,920 | 141 | 2,713 | — | — | 2,854 | 2,854 |
| Trade receivables | — | — | 59 | — | — | — | 59 | — | 444 | 503 | 361 |
| Impairment of trade receivables | — | — | — | — | — | — | — | — | (142) | (142) | — |
| Current financial assets | 746 | 16 | 521 | — | 559 | 142 | 1,700 | — | 12,683 | 14,525 | 14,525 |
| Trade receivables (Note 10) | 476 | — | 520 | — | — | 3 | 993 | — | 10,025 | 11,021 | 8,311 |
| Impairment of trade receivables (Note 10) | — | — | — | — | — | — | — | — | (2,710) | (2,710) | — |
| Other current financial assets | 270 | 16 | 1 | — | 559 | 139 | 707 | — | 1,706 | 2,552 | 2,552 |

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Cash and cash equivalents | — | — | — | — | — | — | — | — | 3,662 | 3,662 | 3,662 |
| Total financial assets | 1,728 | 298 | 1,017 | 640 | 2,479 | 1,115 | 5,027 | 20 | 16,472 | 22,634 | 22,634 |

At June 30, 2018 there were deposits related to the collateral guarantees on derivatives signed by Telefonica, S.A. and its counterparts for the credit risk management of derivatives amounting to 918 million euros (495 million euros corresponding to cross currency swap).

Note 12. Financial liabilities

The composition of issues, loans and other payables, and derivative instruments, by category at June 30, 2018 and December 31, 2017 is as follows:

June 30, 2018

| | Fair value through profit or loss | | | Measurement hierarchy | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Millions of euros | Held for trading | Fair value option | Hedges | Level 1 (Quoted prices) | Level 2 (Other directly observable market inputs) | Level 3 (Inputs not based on observable market data) | Liabilities at amortized cost | Total carrying amount | Total fair value |
| Issues | — | — | — | — | — | — | 42,692 | 42,692 | 44,642 |
| Loans and other payables | — | — | — | — | — | — | 9,304 | 9,304 | 9,360 |
| Derivative instruments | 990 | — | 1,784 | 87 | 2,687 | — | — | 2,774 | 2,774 |
| Total | 990 | — | 1,784 | 87 | 2,687 | — | 51,996 | 54,770 | 56,776 |

December 31, 2017

| | Fair value through profit or loss | | | Measurement hierarchy | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Millions of euros | Held for trading | Fair value option | Hedges | Level 1 (Quoted prices) | Level 2 (Other directly observable market inputs) | Level 3 (Inputs not based on observable market data) | Liabilities at amortized cost | Total carrying amount | Total fair value |
| Issues | — | — | — | — | — | — | 43,694 | 43,694 | 47,166 |
| Loans and other payables | — | — | — | — | — | — | 8,900 | 8,900 | 9,010 |
| Derivative instruments | 1,180 | — | 1,972 | 80 | 3,072 | — | — | 3,152 | 3,152 |
| Total | 1,180 | — | 1,972 | 80 | 3,072 | — | 52,594 | 55,746 | 59,328 |

Part of the amount owed by the Telefónica Group includes restatements to amortized cost at June 30, 2018 and December 31, 2017 as a result of fair value interest rate and exchange rate hedges.

The valuation techniques and the variables used for the fair value measurement of financial instruments are the same as those used for the elaboration of the annual consolidated financial statements for 2017.

Net financial debt as of June 30, 2018 includes a positive value of the derivatives portfolio for a net amount of 787 million euros. In this amount, 238 million euros are due to hedges (cross currency swaps) to transfer financial debt issued in foreign currency to local currency.

The Group has entered into agreements to extend payment terms with various suppliers, or with factoring companies when such payments are discounted. The corresponding amount pending payment is recognized in “Loans and other payables” (174 million euros as of June 30, 2018 and 153 million euros as of December 31, 2017). The heading “Financed operating payments and investments in property, plant and equipment and intangible assets payments”, in the “Net cash used in financing activities” flow of the consolidated statement of cash flow amounts to 230 million euros

(841 million euros in the first half of 2017) and includes the payments related to financed spectrum licences amounting to 44 million euros (219 million euros in the same period of 2017) and payments to suppliers or with factoring companies with extended terms amounting to 186 million euros (622 million euros in the first half of 2017).
As of June 30, 2018, the Telefónica Group presented undrawn committed credit facilities arranged with banks for an amount of 12,733 million euros (of which 12,282 million euros maturing in more than twelve months).

The description of the main issues or cancellations in the first half of 2018 is as follows (in millions):

| Issuer | ISIN Code | Issue / Redemption | Type of security | Transaction date | Nominal amount (million) | Issue currency | Equivalent (millions euros) | Interest rate | Listing Market |
|---|---|---|---|---|---|---|---|---|---|
| Telefónica Emisiones, S.A.U. | XS1756296965 | Issue | Bond | 01/22/2018 | 1,000 | EUR | 1,000 | 1.447% | London |
| Telefónica Emisiones, S.A.U. | US87938WAV54 | Issue | Bond | 03/06/2018 | 750 | USD | 644 | 4.665% | New York |
| Telefónica Emisiones, S.A.U. | US87938WAW38 | Issue | Bond | 03/06/2018 | 1,250 | USD | 1,073 | 4.895% | New York |
| Telefónica Germany & Co. OHG | various | Issue | Schuldschein | 03/19/2018 | 175 | EUR | 175 | 2.506% (1) | n/a |
| Telefónica Emisiones, S.A.U. | XS0241946044 | Redemption | Bond | 02/02/2018 | (750) | GBP | (854) | 5.375% | London |
| Telefónica Emisiones, S.A.U. | XS0746276335 | Redemption | Bond | 02/21/2018 | (1,500) | EUR | (1,500) | 4.797% | London |
| Telefónica Emisiones, S.A.U. | US87938WAQ69 | Redemption | Bond | 04/27/2018 | (1,250) | USD | (1,036) | 3.192% | New York |
| Telefónica, S.A. | various | Issue | Promissory Note | various | 196 | EUR | 196 | (0.205)% | n/a |
| Telefónica, S.A. | various | Redemption | Promissory Note | various | (204) | EUR | (204) | (0.155)% | n/a |
| Telefónica Europe, B.V. | various | Issue | Commercial Paper | various | 2,988 | EUR | 2,988 | (0.280)% | n/a |
| Telefónica Europe, B.V. | various | Redemption | Commercial Paper | various | (3,100) | EUR | (3,100) | (0.228)% | n/a |

(1) Maximum coupon

Telefónica, S.A. has a full and unconditional guarantee on issues made by Telefónica Emisiones, S.A.U. and Telefónica Europe, B.V.

Interest-bearing debt arranged in the first half of 2018 includes mainly the following:

| Description | Limit 06/30/2018 (millions euros) | Currency | Outstanding balance 06/30/2018 (millions euros) | Arrangement date | Maturity date | Drawndown January-June 2018 (million euros) | Repayment January-June (million euros) |
|---|---|---|---|---|---|---|---|
| Telefónica, S.A. | | | | | | | |
| Syndicated (*) | 5,500 | EUR | - | 03/15/18 | 03/15/23 | - | - |
| Bilateral loan | 100 | EUR | 100 | 11/24/17 | 01/30/26 | 100 | - |
| Bilateral loan | 100 | EUR | 100 | 12/28/17 | 10/22/20 | 100 | - |
| Bilateral loan | 385 | EUR | 385 | 12/20/17 | 07/22/19 | 385 | - |
| Telxius Telecom, S.A. | | | | | | | |
| Syndicated facility | 300 | EUR | 289 | 12/01/17 | 12/01/22 | 289 | |

(*) On 03/15/18 Telefónica, S.A. executed a syndicated facility agreement for an aggregate amount of 5,500 million euros which unifies and replaces two existing revolving credit facilities: a revolving credit facility for 3,000 million euros with maturity in February 2021, and a credit facility of 2,500 million euros with maturity in February 2022. The facility agreement matures in 2023, with two annual extension options, at the request of Telefónica, for a maximum maturity in 2025.

Note 13. Payables and other non-current liabilities

The breakdown of "Payables and other non-current liabilities" of the Telefónica Group at June 30, 2018 and December 31, 2017 is as follows:

| Millions of euros | 06/30/2018 | 12/31/2017 |
|---|---|---|
| Payables | 714 | 900 |
| Trade payables | 86 | 86 |
| Payables to suppliers of property, plant and equipment | 11 | 5 |
| Debt for spectrum acquisition | 516 | 569 |
| Other payables | 101 | 240 |
| Other non-current liabilities | 1,109 | 787 |
| Contractual liabilities (Note 15) | 653 | — |
| Deferred revenue (see Note 15) | 320 | 774 |
| Tax payables | 136 | 13 |
| Total | 1,823 | 1,687 |

Note 14. Payables and other current liabilities

The breakdown of "Payables and other current liabilities" of the Telefónica Group at June 30, 2018 and December 31, 2017 is as follows:

| Millions of euros | 06/30/2018 | 12/31/2017 |
|---|---|---|
| Payables | 13,825 | 13,536 |
| Trade payables | 7,867 | 7,943 |
| Payables to suppliers of property, plant and equipment | 3,147 | 3,580 |
| Debt for spectrum acquisition | 131 | 172 |
| Other payables | 961 | 1,115 |
| Dividends pending payment | 1,368 | 235 |
| Payables to associates and joint ventures (Note 7) | 351 | 491 |
| Other current liabilities | 1,660 | 1,559 |
| Contractual liabilities (Note 15) | 1,232 | — |
| Deferred revenue (see Note 15) | 137 | 1,387 |
| Advances received | 291 | 172 |
| Total | 15,485 | 15,095 |

Note 15. Breakdown of contractual assets and liabilities, and capitalized costs

The movement of contractual assets and the capitalized costs in the first half of 2018 is as follows:

| Millions of euros | Balance at 12/31/2017 | First application of new IFRS impacts | Additions | Disposals | Transfers | Translation differences and hyperinflation adjustments | Balance at 06/30/2018 |
|---|---|---|---|---|---|---|---|
| Long-term contractual assets (Note 9) | — | 62 | 58 | — | (51) | — | 69 |
| Contractual assets | — | 72 | 58 | — | (51) | — | 79 |
| Impairment losses | — | (10) | — | — | — | — | (10) |
| Short-term contractual assets (Note 10) | — | 341 | 356 | (379) | 55 | (5) | 368 |
| Contractual assets | — | 356 | 360 | (380) | 55 | (6) | 385 |
| Impairment losses | — | (15) | (4) | 1 | — | 1 | (17) |
| Total | — | 403 | 414 | (379) | 4 | (5) | 437 |

| Millions of euros | Balance at 12/31/2017 | First application of new IFRS impacts | Additions | Disposals | Transfers | Translation differences and hyperinflation adjustments | Balance at 06/30/2018 |
|---|---|---|---|---|---|---|---|
| Non-current capitalized costs (Note 9) | — | 172 | 182 | — | (168) | (1) | 185 |
| Of obtaining a contract | — | 170 | 168 | — | (162) | (1) | 175 |
| Of fulfilling a contract | — | 2 | 14 | — | (6) | — | 10 |
| Impairment losses | — | — | — | — | — | — | — |
| Current capitalized costs (Note 10) | — | 544 | 211 | (370) | 168 | (4) | 549 |
| Of obtaining a contract | — | 526 | 197 | (354) | 162 | (4) | 527 |
| Of fulfilling a contract | — | 18 | 14 | (16) | 6 | — | 22 |
| Impairment losses | — | — | — | — | — | — | — |
| Total | — | 716 | 393 | (370) | — | (5) | 734 |

The movement of contractual liabilities of contracts with customers in the first half of 2018 is as follows:

| Millions of euros | Balance at 12/31/2017 | First application of new IFRS impacts | Additions | Disposals | Transfers | Translation differences and hyperinflation adjustments | Balance at 06/30/2018 |
|---|---|---|---|---|---|---|---|
| Long-term contractual liabilities | — | 105 | 292 | (138) | 393 | 1 | 653 |
| Short-term contractual liabilities | — | 99 | 4,303 | (4,345) | 1,189 | (14) | 1,232 |
| Total | — | 204 | 4,595 | (4,483) | 1,582 | (13) | 1,885 |

The “transfers” column shows amounts relating to contractual liabilities reclassified from the “Deferred revenue” (see notes 13 and 14) line item to reflect the new terminology of IFRS 15. Contract liabilities relate to unperformed performance obligations mainly referred to IRU contracts, prepaid airtime, set up fees and other prepaid services. The most significant portion of the amounts presented as non-current will be recognised as revenues within 24 months and up to 10 years.

## Note 16. Average number of Group employees

The average number of Group employees in the first six months of 2018 and 2017 is as follows:

| Average number of employees | June 2018 | June 2017 |
|---|---|---|
| Males | 76,181 | 78,760 |
| Females | 46,382 | 47,628 |
| Total | 122,563 | 126,388 |

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## Note 17. Other expenses

The breakdown of "Other expenses" is as follows:

| Millions of euros | January- June 2018 | January- June 2017 |
|---|---|---|
| Leases | 555 | 531 |
| Other external services | 5,775 | 5,884 |
| Taxes other than income tax (see Note 9) | 41 | 668 |
| Change in trade provisions and impairment of trade receivables with changes in equity | 416 | 458 |
| Losses on disposal of fixed assets and changes in provisions for fixed assets | 16 | 26 |
| Goodwill impairment (Note 6) | 108 | — |
| Other operating expenses | 198 | 199 |
| Total | 7,109 | 7,766 |

## Note 18. Income tax

The deviation in the first six months of 2018 and 2017 with respect to the income tax expense that would result from applying the statutory tax rates prevailing in each country where the Telefónica Group operates is due to the existence of tax incentives and non-deductible expenses in accordance with the rulings of the various tax authorities, and the recognition of the tax effects identified in the Group's regular evaluation of the recoverability of deferred tax assets.

Thus, in the first half of 2018, deferred tax assets for temporary differences of Telefónica Móviles Mexico amounting to 294 million euros were derecognized (with a balancing entry in Corporate income tax), mainly due to a change in the assumptions used within the existing tax framework, that affect the time horizon in which the Group expects to recover the assets.

### Tax deductibility of financial goodwill (Article 12.5)

In relation with the goodwill amortized for tax purposes corresponding to the purchase of certain companies, mainly VIVO, the Group decided to continue provisioning the amount of the goodwill amortized for tax purposes, for a total amount of 249 million euros at June 30, 2018 (215 million euros at December 31, 2017).

## Note 19. Other information

### Litigation

With regard to ongoing litigation, the main developments in litigation reported in Note 21.a) to the consolidated annual financial statements for the year ended December 31, 2017 from that date to the date of authorization for issue of these interim financial statements are as follows:

### Claim by Entel against Telefónica de Argentina, S.A.

On February 22, 2018, Entel submitted the new interest calculations required by the judge, claiming for an amount of 1,689 million of Argentine pesos (approximately 50 million euros).