

TELEFONICA S A
Form 6-K
February 21, 2019

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 February, 2019

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 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

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

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

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.

TABLE OF CONTENTS

Item	Sequential Page Number
1. Telefónica – 2018 Annual Accounts	
• Account Auditor's Report, Annual Financial Statements and Management Report of Telefónica, S.A., all for the Fiscal Year 2018.	
• Account Auditor's Report, Annual Financial Statements and Management Report of the Consolidated Group of Companies, all for the Fiscal Year 2018.	

2018

TELEFÓNICA, S.A.

Annual financial statements and management report for the year ended December 31, 2018

Index	
<u>Balance sheet at December 31</u>	<u>4</u>
<u>Income statements for the years ended December 31</u>	<u>6</u>
<u>Statements of changes in equity for the years ended December 31</u>	<u>7</u>
<u>Cash flow statements for the years ended December 31</u>	<u>8</u>
<u>Note 1. Introduction and general information</u>	<u>9</u>
<u>Note 2. Basis of presentation</u>	<u>10</u>
<u>Note 3. Proposed appropriation of profit</u>	<u>12</u>
<u>Note 4. Recognition and measurement accounting policies</u>	<u>13</u>
<u>Note 5. Intangible assets</u>	<u>16</u>
<u>Note 6. Property, plant and equipment</u>	<u>17</u>
<u>Note 7. Investment properties</u>	<u>19</u>
<u>Note 8. Investments in group companies and associates</u>	<u>21</u>
<u>Note 9. Financial investments</u>	<u>29</u>
<u>Note 10. Trade and other receivables</u>	<u>33</u>
<u>Note 11. Equity</u>	<u>34</u>
<u>Note 12. Financial liabilities</u>	<u>39</u>
<u>Note 13. Bonds and other marketable debt securities</u>	<u>41</u>
<u>Note 14. Interest-bearing debt and derivatives</u>	<u>43</u>
<u>Note 15. Payable to group companies and associates</u>	<u>46</u>
<u>Note 16. Derivative financial instruments and risk management policies</u>	<u>48</u>
<u>Note 17. Income tax</u>	<u>60</u>
<u>Note 18. Trade, other payables and provisions</u>	<u>65</u>
<u>Note 19. Revenue and expenses</u>	<u>67</u>
<u>Note 20. Other information</u>	<u>75</u>
<u>Note 21. Cash flow analysis</u>	<u>82</u>
<u>Note 22. Events after the reporting period</u>	<u>85</u>
<u>Note 23. Additional note for English translation</u>	<u>87</u>
<u>Appendix I: Details of subsidiaries and associates at December 31, 2018</u>	<u>88</u>
<u>Appendix II: Board and Senior Management Compensation</u>	<u>92</u>
<u>Management report 2018</u>	<u>99</u>
<u>Business Model</u>	<u>99</u>
<u>Economic results of Telefónica, S.A.</u>	<u>102</u>
<u>Investment activity</u>	<u>103</u>
<u>Share price performance</u>	<u>106</u>
<u>Research, development and innovation</u>	<u>107</u>
<u>Environment, human resources and managing diversity</u>	<u>112</u>
<u>Liquidity and capital resources</u>	<u>120</u>
<u>Financing</u>	<u>120</u>
<u>Treasury shares</u>	<u>122</u>
<u>Risks factors associated with the issuer</u>	<u>124</u>
<u>Trend evolution</u>	<u>143</u>

<u>Events after the reporting period</u>	<u>144</u>
<u>Annual Corporate Governance Report for Listed Companies</u>	<u>146</u>

Financial Statements

Telefónica, S.A.

Balance sheet at December 31

Millions of euros

ASSETS	Notes	2018	2017
NON-CURRENT ASSETS		75,034	76,400
Intangible assets	5	20	17
Software		8	8
Other intangible assets		12	9
Property, plant and equipment	6	177	210
Land and buildings		123	126
Plant and other PP&E items		48	48
Property, plant and equipment under construction and prepayments		6	36
Investment property	7	404	389
Land		100	94
Buildings		304	295
Non-current investments in Group companies and associates	8	68,040	69,166
Equity instruments		66,530	67,025
Loans to Group companies and associates		1,503	2,141
Other financial assets		7	—
Financial investments	9	3,415	3,761
Equity instruments		298	340
Derivatives	16	2,421	2,509
Other financial assets	9	696	912
Deferred tax assets	17	2,978	2,857
CURRENT ASSETS		10,810	8,465
Net assets held for sale	8	69	—
Trade and other receivables	10	388	575
Current investments in Group companies and associates	8	4,510	3,460
Loans to Group companies and associates		4,473	3,426
Derivatives	16	8	10
Other financial assets		29	24
Investments	9	1,821	1,557
Loans to companies		972	759
Derivatives	16	842	793
Other financial assets		7	5
Accruals		11	5
Cash and cash equivalents		4,011	2,868
TOTAL ASSETS		85,844	84,865

The accompanying Notes 1 to 23 and Appendices I and II are an integral part of these balance sheets

Telefónica, S.A. 4

Financial Statements

Millions of euros

EQUITY AND LIABILITIES	Notes	2018	2017
EQUITY		20,949	19,865
CAPITAL AND RESERVES		21,497	20,520
Share capital	11	5,192	5,192
Share premium	11	4,538	4,538
Reserves	11	9,439	10,924
Legal & Statutory		1,111	1,066
Other reserves		8,328	9,858
Treasury shares and own equity instruments	11	(686)	(688)
Profit for the year	3	3,014	554
UNREALIZED GAINS (LOSSES) RESERVE	11	(548)	(655)
Available-for-sale financial assets		(49)	42
Hedging instruments		(499)	(697)
NON-CURRENT LIABILITIES		46,371	48,874
Non-current provisions	18	494	459
Non-current borrowings	12	4,408	7,314
Bank borrowings	14	2,033	4,186
Derivatives	16	2,207	2,796
Other debts		168	332
Non-current borrowings from Group companies and associates	15	41,154	40,642
Deferred tax liabilities	17	291	427
Long term deferred revenues		24	32
CURRENT LIABILITIES		18,524	16,126
Current provisions	18	93	123
Current borrowings	12	2,483	1,352
Bonds and other marketable debt securities	13	181	204
Bank borrowings	14	2,094	896
Derivatives	16	208	252
Current borrowings from Group companies and associates	15	15,578	14,101
Trade and other payables	18	362	539
Accruals		8	11
TOTAL EQUITY AND LIABILITIES		85,844	84,865

The accompanying Notes 1 to 23 and Appendices I and II are an integral part of these balance sheets

Financial Statements

Telefónica, S.A.

Income statements for the years ended December 31

Millions of euros	Notes	2018	2017
Revenue	19	4,921	3,715
Rendering of services to Group companies and associates		517	558
Rendering of services to non-group companies		21	35
Dividends from Group companies and associates		4,259	3,027
Interest income on loans to Group companies and associates		124	95
Impairment and gains (losses) on disposal of financial instruments	8	(412)	(1,130)
Impairment losses and other losses		(587)	(1,443)
Gains (losses) on disposal and other gains and losses		175	313
Other operating income	19	68	42
Non-core and other current operating revenue - Group companies and associates		46	26
Non-core and other current operating revenue - non-group companies		22	16
Employees benefits expense	19	(143)	(174)
Wages, salaries and others		(118)	(149)
Social security costs		(25)	(25)
Other operational expense		(316)	(412)
External services - Group companies and associates	19	(102)	(113)
External services - non-group companies	19	(198)	(287)
Taxes other than income tax		(16)	(12)
Depreciation and amortization	5, 6 and 7	(32)	(36)
Gains (losses) on disposal of fixed assets		—	2
OPERATING PROFIT		4,086	2,007
Finance revenue	19	359	411
Finance costs	19	(2,230)	(2,299)
Change in fair value of financial instruments		—	(30)
Gain (loss) on available-for-sale financial assets recognized in the period	9 and 11	—	(30)
Exchange rate gains (losses)	19	49	185
NET FINANCIAL EXPENSE		(1,822)	(1,733)
PROFIT BEFORE TAX	21	2,264	274
Income tax	17	750	280
PROFIT FOR THE YEAR		3,014	554

The accompanying Notes 1 to 23 and Appendices I and II are an integral part of these income statements

Telefónica, S.A. 6

Financial Statements

Telefónica, S.A.

Statements of changes in equity for the years ended December 31

A) Statement of recognized income and expense

Millions of euros	Notes	2018	2017
Profit of the period		3,014	554
Total income and expense recognized directly in equity	11	652	(139)
From valuation of available-for-sale financial assets		(91)	2
From cash flow hedges		991	(191)
Income tax impact		(248)	50
Total amounts transferred to income statement	11	(545)	150
From valuation of available-for-sale financial assets		—	30
From cash flow hedges		(727)	161
Income tax impact		182	(41)
TOTAL RECOGNIZED INCOME AND EXPENSE		3,121	565

The accompanying Notes 1 to 23 and Appendices I and II are an integral part of these statements of changes in equity.

B) Statements of total changes in equity for the years ended December 31

Millions of euros	Share capital	Share premium and Reserves	Treasury shares	Profit for the year	Other net equity instruments	Net unrealized gains (losses) reserve	Total
Balance at December 31, 2016	5,038	16,155	(1,480)	24	1,206	(666)	20,277
Total recognized income and expense	—	—	—	554	—	11	565
Transactions with shareholders and owners	—	(2,019)	792	—	—	—	(1,227)
Dividends paid (Note 11)	—	(2,019)	—	—	—	—	(2,019)
Other transactions with shareholders and owners	—	—	792	—	—	—	792
Other movements	154	1,302	—	—	(1,206)	—	250
Appropriation of prior year profit (loss)	—	24	—	(24)	—	—	—
Balance at December 31, 2017	5,192	15,462	(688)	554	—	(655)	19,865
Total recognized income and expense	—	—	—	3,014	—	107	3,121
Transactions with shareholders and owners	—	(2,039)	2	—	—	—	(2,037)
Dividends paid (Note 11)	—	(2,051)	—	—	—	—	(2,051)
Other transactions with shareholders and owners	—	12	2	—	—	—	14
	—	554	—	(554)	—	—	—

Appropriation of prior
year profit (loss)

Balance at December 31, 2018	5,192	13,977	(686)3,014	—	(548)20,949
---------------------------------	-------	--------	------	--------	---	------	---------

The accompanying Notes 1 to 23 and Appendices I and II are an integral part of these statements of changes in equity.

Telefónica, S.A. 7

Financial Statements

Telefónica, S.A.

Cash flow statements for the years ended December 31

Millions of euros	Notes	2018	2017
A) CASH FLOWS FROM OPERATING ACTIVITIES		2,364	1,424
Profit before tax		2,264	274
Adjustments to profit:		(2,117)	(153)
Depreciation and amortization	5,6 and 7	32	36
Impairment of investments in Group companies and associates	8	587	1,443
Change in long term provisions		—	73
Gains on the sale of financial assets		(175)	(313)
Losses on disposal of property, plant and equipment		—	(3)
Dividends from Group companies and associates	19	(4,259)	(3,027)
Interest income on loans to Group companies and associates	19	(124)	(95)
Net financial expense		1,822	1,733
Change in working capital		(272)	(71)
Trade and other receivables		51	(15)
Other current assets		(134)	(76)
Trade and other payables		(189)	20
Other cash flows from operating activities	21	2,489	1,374
Net interest paid		(1,618)	(1,505)
Dividends received and other		3,518	2,931
Income tax receipts		589	(52)
B) CASH FLOWS (USED IN)/FROM INVESTING ACTIVITIES	21	(64)	(2,829)
Payments on investments		(2,139)	(6,441)
Proceeds from disposals		2,075	3,612
C) CASH FLOWS USED IN FINANCING ACTIVITIES		(1,130)	3,426
Proceeds from financial liabilities	21	918	5,330
Debt issues		9,983	14,687
Repayment and redemption of debt		(9,065)	(9,357)
Dividends paid	21	(2,048)	(1,904)
D) NET FOREIGN EXCHANGE DIFFERENCE		(27)	36
E) NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS		1,143	2,057
Cash and cash equivalents at January 1		2,868	811
Cash and cash equivalents at December 31		4,011	2,868

Notes 1 to 23 and Appendices I and II are an integral part of these cash flow statements.

Telefónica, S.A. 8

Financial Statements

TELEFÓNICA, S.A.

Annual financial statements for the ended December 31, 2018

Note 1. Introduction and general information

Telefónica, S.A. (“Telefónica” or “the Company”) is a public limited company incorporated for an indefinite period on April 19, 1924, under the corporate name of Compañía Telefónica Nacional de España, S.A. It adopted its present name in April 1998.

The Company’s registered office is at Gran Vía 28, Madrid (Spain) and its Employer Identification Number (CIF) is A-28/015865.

Telefónica’s basic corporate purpose, pursuant to Article 4 of its Bylaws, is the provision of all manner of public or private telecommunications services, including ancillary or complementary telecommunications services or related services. All the business activities that constitute this stated corporate purpose may be performed either in Spain or abroad and wholly or partially by the Company, either through shareholdings or equity interests in other companies or legal entities with an identical or a similar corporate purpose.

In keeping with the above, Telefónica is currently the parent company of a group that offers both fix and mobile telecommunications with the aim to turn the challenges of the new digital business into reality and being one of the most important players. The objective of the Telefónica Group is positioning as a Company with an active role in the digital business taking advantage of the opportunities of its size and industrial and strategic alliances.

The Company is taxed under the general tax regime established by the Spanish State, the Spanish Autonomous Communities and local governments, and files consolidated tax returns with most of the Spanish subsidiaries of its Group under the consolidated tax regime applicable to corporate groups.

Telefónica, S.A. 9

Financial Statements

Note 2. Basis of presentation

a) True and fair view

These financial statements have been prepared from Telefónica, S.A.'s accounting records by the Company's Directors in accordance with the accounting principles and standards contained in the Spanish GAAP in force approved by Royal Decree 1514/2007, on November 16 (PGC 2007), modified by Royal Decree 602/2016, dated December 2, 2016 and other prevailing legislation at the date of these financial statements, to give a true and fair view of the Company's equity, financial position, results of operations and of the cash flows obtained and applied in 2018.

The accompanying financial statements for the year ended December 31, 2018 were prepared by the Company's Board of Directors at its meeting on February 20, 2019 for submission for approval at the General Shareholders' Meeting, which is expected to occur without modification.

The figures in these financial statements are expressed in millions of euros, unless indicated otherwise, and therefore may be rounded. The euro is the Company's functional currency.

b) Comparison of information

In 2018 and 2017 there have not been significant transactions that should be taken into account in order to ensure the comparison of information included in the Annual Financial Statements of both years.

c) Materiality

These financial statements do not include any information or disclosures that, not requiring presentation due to their qualitative significance, have been determined as immaterial or of no relevance pursuant to the concepts of materiality or relevance defined in the PGC 2007 conceptual framework.

d) Use of estimates

The financial statements have been prepared using estimates based on historical experience and other factors considered reasonable under the circumstances. The carrying value of assets and liabilities, which is not readily apparent from other sources, was established on the basis of these estimates. The Company periodically reviews these estimates.

A significant change in the facts and circumstances on which these estimates are based could have an impact on the Company's results and financial position.

Key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date that have a significant risk of causing a material adjustment to the financial statements of the following year are discussed below.

Provisions for impairment of investments in Group companies and associates

Investments in group companies, joint ventures and associates are tested for impairment at each year end to determine whether an impairment loss must be recognized in the income statement or a previously recognized impairment loss be reversed. The decision to recognize an impairment loss (or a reversal) involves estimates of the reasons for the potential impairment (or recovery), as well as the timing and amount. In Note 8.2 it is assessed the impairment of these investments.

There is a significant element of judgment involved in the estimates required to determine recoverable amount and the assumptions regarding the performance of these investments, since the timing and scope of future changes in the business are difficult to predict.

Financial Statements

Deferred taxes

The Company assesses the recoverability of deferred tax assets based on estimates of future earnings, and of all the options available to achieve an outcome, it considers the most efficient one in terms of tax within the legal framework the Company is subject to. The ability to recover these taxes depends ultimately on the Company's ability to generate taxable earnings over the period for which the deferred tax assets remain deductible. This analysis is based on the estimated schedule for reversing deferred tax liabilities, as well as estimates of taxable earnings, which are sourced from internal projections and are continuously updated to reflect the latest trends.

The appropriate valuation of tax assets and liabilities depends on a series of factors, including estimates as to the timing and realization of deferred tax assets and the projected tax payment schedule. Actual income tax receipts and payments could differ from the estimates made by the Company as a result of changes in tax legislation, the outcome of ongoing tax proceedings or unforeseen future transactions that could affect tax balances. The information about deferred tax assets and unused tax credits for loss carryforwards, whose effect has been registered when necessary in balance, is included in Note 17.

Telefónica, S.A. 11

Financial Statements

Note 3. Proposed appropriation of profit

Telefónica, S.A. obtained 3,014 million euros of profit in 2018.

Accordingly, the Company's Board of Directors will submit the following proposed appropriation of 2018 profit for approval at the Shareholders' Meeting:

Millions of euros

Proposed appropriation:

Profit for the year 3,014

Distribution to:

Legal reserve

Unrestricted reserves 3,014

Telefónica, S.A. 12

Financial Statements

Note 4. Recognition and measurement accounting policies

As stated in Note 2, the Company's financial statements have been prepared in accordance with the accounting principles and standards contained in the Código de Comercio, which are further developed in the Plan General de Contabilidad currently in force (PGC 2007), as well as any commercial regulation in force at the reporting date. Accordingly, only the most significant accounting policies used in preparing the accompanying financial statements are set out below, in light of the nature of the Company's activities as a holding.

a) Intangible assets

Intangible assets are stated at acquisition or production cost, less any accumulated amortization or any accumulated impairment losses.

Intangible assets are amortized on a straight-line basis over their useful lives. The most significant items included in this caption are computer software licenses, which are generally amortized on a straight-line basis over three years.

b) Property, plant and equipment and investment property

Property, plant and equipment is stated at cost, net of accumulated depreciation and any accumulated impairment in value.

The Company depreciates its property, plant and equipment once the assets are in full working conditions using the straight-line method based on the assets' estimated useful lives, calculated in accordance with technical studies which are revised periodically based on technological advances and the rate of dismantling, as follows:

Estimated useful life	Years
Buildings	40
Plant and machinery	3 - 25
Other plant or equipment, furniture and office equipment	10
Other items of property, plant and equipment	4 - 10

Investment property is measured and depreciated using the same criteria described for land and buildings for own use.

c) Impairment of non-current assets

Non-current assets are assessed at each reporting date for indicators of impairment. Where such indicators exist, or in the case of assets which are subject to an annual impairment test, the Company estimates the asset's recoverable amount as the higher of its fair value less costs to sell and its value in use. In assessing value in use, the estimated future post-tax cash flows deriving from the use of the asset or its cash generating unit, as applicable, are discounted to their present value, using a post-tax discount rate reflecting current market assessments of the time value of money and the risks specific to the asset, whenever the result obtained is the same that would be obtained by discounting pre-tax cash flows at a pre-tax discount rate.

Telefónica bases the calculation of impairment on the business plans of the various companies approved by the Board of Directors' of Telefónica, S.A. to which the assets are allocated. The projected cash flows, based on strategic business plans, cover a period of five years not including the present year when the analysis is calculated. Starting with the sixth year, an expected constant growth rate is applied.

Financial Statements

d) Financial assets and liabilities

Financial investments

All regular way purchases and sales of financial assets are recognized on the trade date, i.e. the date that the Company commits to purchase or sell the asset.

“Investments in group companies, joint ventures and associates” are classified into a category of the same name and are shown at cost less any impairment loss (see Note 4.c). Group companies are those over which the Company exercises control, either by exercising effective control or by virtue of agreements with the other shareholders. Joint ventures are companies which are jointly controlled with third parties. Associates are companies in which there is significant influence, but not control or joint control with third parties. Telefónica assesses the existence of significant influence not only in terms of percentage ownership but also in qualitative terms such as presence on the board of directors, involvement in decision-making, the exchange of management personnel, and access to technical information. Financial investments which the Company intends to hold for an unspecified period of time and could be sold at any time to meet specific liquidity requirements or in response to interest rate movements and which have not been included in the other categories of financial assets defined in the PGC 2007 are classified as available-for-sale. These investments are recorded under “Non-current assets,” unless it is probable and feasible that they will be sold within 12 months.

Derivative financial instruments and hedge accounting

When Telefónica chooses not to apply hedge accounting criteria but economic hedging, gains or losses resulting from changes in the fair value of derivatives are taken directly to the income statement.

e) Revenue and expenses

Revenue and expenses are recognized on the income statement based on an accruals basis; i.e. when the goods or services represented by them take place, regardless of when actual payment or collection occurs.

The income obtained by the Company in dividends received from Group companies and associates, and from the interest accrued on loans and credits given to them, are included in revenue in compliance with the provisions of consultation No. 2 of BOICAC 79, published on September 30, 2009.

f) Related party transactions

In mergers and spin-offs of businesses involving the parent company and its direct or indirect subsidiary, in cases of non-monetary contributions of businesses between Group companies, and in cases of dividends, the contributed assets are valued, in general, at their pre-transaction carrying amount in the individual financial statements, given that the Telefónica Group does not prepare its consolidated financial statements in accordance with the Standards on Preparing Consolidated Financial Statements (Spanish “NOFCAC”).

In these same operations, companies may also opt to use the consolidated values under International Financial Reporting Standards (IFRS) as adopted by the European Union, providing that the consolidated figures do not differ from those obtained under the NOFCAC. Lastly, the Company may also opt to use the values resulting from a reconciliation to the NOFCAC. Any accounting difference is recognized in reserves.

g) Financial guarantees

The Company has provided guarantees to a number of subsidiaries to secure their transactions with third parties (see Note 20.a). Where financial guarantees provided have a counter-guarantee on the Company’s balance sheet, the value of the counter-guarantee is estimated to be equal to the guarantee given, with no additional liability recognized as a result.

Guarantees provided for which there is no item on the Company’s balance sheet acting as a counter-guarantee are initially measured at fair value which, unless there is evidence to the contrary, is the same as the premium

Financial Statements

received plus the present value of any premiums receivable. After initial recognition, these are subsequently measured at the higher of:

i) The amount resulting from the application of the rules for measuring provisions and contingencies.

ii) The amount initially recognized less, when applicable, any amounts taken to the income statement corresponding to accrued income.

h) Consolidated data

As required under prevailing legislation, the Company has prepared separate consolidated annual financial statements, drawn up in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union.

The balances of the main headings of the Telefónica Group's consolidated financial statements for 2018 and 2017 are as follows:

Millions of euros

Item	2018	2017
Total assets	114,047	115,066
Equity:		
Attributable to equity holders of the parent	17,947	16,920
Attributable to minority interests	9,033	9,698
Revenue from operations	48,693	52,008
Profit for the year:		
Attributable to equity holders of the parent	3,331	3,132
Attributable to minority interests	619	246

Telefónica, S.A. 15

Financial Statements

Note 5. Intangible assets

The movements in the items composing intangible assets and the related accumulated amortization in 2018 and 2017 are as follows:

2018

Millions of euros	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance	
INTANGIBLE ASSETS, GROSS	236	10	(1	)3	248
Software	146	3	—	4	153	
Other intangible assets	90	7	(1	)(1	)95
ACCUMULATED AMORTIZATION	(219)(10)1	—	(228)
Software	(138)(7)—	—	(145)
Other intangible assets	(81)(3)1	—	(83)
NET CARRYING AMOUNT	17	—	—	3	20	

2017

Millions of euros	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance	
INTANGIBLE ASSETS, GROSS	230	4	—	2	236	
Software	140	2	—	4	146	
Other intangible assets	90	2	—	(2	)90
ACCUMULATED AMORTIZATION	(207)(12)—	—	(219)
Software	(131)(7)—	—	(138)
Other intangible assets	(76)(5)—	—	(81)
NET CARRYING AMOUNT	23	(8	)—	2	17

At December 31, 2018 and 2017 commitments to acquire intangible assets are 0.9 and 0.5 million euros, respectively. At December 31, 2018 and 2017, the Company had 189 million euros and 182 million euros, respectively, of fully amortized intangible assets.

After the merger of Terra Networks, S.A. with Telefónica, S.A., in 2006 the Company registered a goodwill, which was amortized on an annual basis until the entry into force of PGC 2007. As of December 31, 2007 that asset had a net carrying amount of 33.9 million euros. Subsequently, Telefónica, S.A. tested for impairment that asset every year, which did not disclose any need to recognise a write-down. The Company has set aside 1.6 million euros annually (5% of the net carrying amount of the asset) of its net profit to a non-distributable reserve for goodwill amortization. The balance of this reserve at December 31, 2015 was 12 million euros.

After the publication of Royal Decree 602/2016, on December, 2, 2016, modifying certain aspects in PGC 2007 such as the indefinite useful life of goodwill, among others, which was made definite again, the Company amortized the aforementioned goodwill in a retrospective way as it had not been amortized since PGC 2007 entered into force. Since December 31, 2017 these assets are fully amortized.

Financial Statements

Note 6. Property, plant and equipment

The movements in the items composing property, plant and equipment and the related accumulated depreciation in 2018 and 2017 are as follows:

2018

Millions of euros	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
PROPERTY, PLANT AND EQUIPMENT, GROSS	588	7	—	(31)	)564
Land and buildings	223	3	—	(5)	)221
Plant and other PP&E items	329	4	—	4	337
Property, plant and equipment under construction and prepayments	36	—	—	(30)	)6
ACCUMULATED DEPRECIATION	(378)	)(9	)—	—	(387)
Buildings	(97)	)(1	)—	—	(98)
Plant and other PP&E items	(281)	)(8	)—	—	(289)
NET CARRYING AMOUNT	210	(2	)—	(31)	)177

2017

Millions of euros	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
PROPERTY, PLANT AND EQUIPMENT, GROSS	569	22	(1)	)(2	)588
Land and buildings	223	—	(1)	)1	223
Plant and other PP&E items	325	1	—	3	329
Property, plant and equipment under construction and prepayments	21	21	—	(6)	)36
ACCUMULATED DEPRECIATION	(364)	)(14	)—	—	(378)
Buildings	(92)	)(5	)—	—	(97)
Plant and other PP&E items	(272)	)(9	)—	—	(281)
NET CARRYING AMOUNT	205	8	(1)	)(2	)210

Firm commitments to acquire property, plant and equipment at December 31, 2018 and 2017 amounted to 0.5 million euros and 2 million euros, respectively. At December 31, 2018 and 2017, the Company had 241 and 225 million euros, respectively, of fully depreciated items of property, plant and equipment.

Telefónica, S.A. has taken on insurance policies with appropriate limits to cover the potential risks which could affect its property, plant and equipment.

“Property, plant and equipment” includes the net carrying amount of the land and buildings occupied by Telefónica, S.A. at its Distrito Telefónica headquarters, amounting to 68 and 69 million euros at 2018 and 2017 year-ends, respectively. It also includes the net carrying amount of the remaining assets in this site (mainly property, plant and equipment items) of 10 and 20 million euros at December 31, 2018 and 2017, respectively.

Telefónica, S.A. 17

Financial Statements

During 2018 a new parking for employees located in the Distrito Telefónica complex has been completed. The 78% of its area has been estimated to be rented to other Group Companies. The remaining area, 22% of the total, has been included as Additions of Land and Buildings in the 2018 chart of movements.

The land and buildings rented to other Group Companies have been included as “Investment properties” in Note 7.

Telefónica, S.A. 18

Financial Statements

Note 7. Investment properties

The movements in the items composing investment properties in 2018 and 2017 and the related accumulated depreciation are as follows:

Millions of euros	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
2018					
INVESTMENT PROPERTIES, GROSS	495	—	—	28	523
Land	94	—	—	6	100
Buildings	401	—	—	22	423
ACCUMULATED DEPRECIATION	(106)	(13)	—	—	(119)
Buildings	(106)	(13)	—	—	(119)
NET CARRYING AMOUNT	389	(13)	—	28	404
2017					
INVESTMENT PROPERTIES, GROSS	495	—	—	—	495
Land	94	—	—	—	94
Buildings	401	—	—	—	401
ACCUMULATED DEPRECIATION	(96)	(10)	—	—	(106)
Buildings	(96)	(10)	—	—	(106)
NET CARRYING AMOUNT	399	(10)	—	—	389

“Investment properties” mainly includes the value of land and buildings leased by Telefónica, S.A. to other Group companies at Distrito Telefónica, headquarters in Madrid and the building of its head offices in Barcelona, known as “Diagonal 00”.

After the opening of the new parking mentioned in the previous note, the value of the area rented to other Group companies that was registered under the "Property, plant and equipment under construction" caption in 2017 has been transferred to final assets (amounting to 22 million euros) and has started its amortization. Moreover, the 78% of the value of the land where the parking is located has been transferred to investment properties in 2018 amounting to 6 million euros.

In 2018, the Company has buildings with a total area of 356,171 square meters leased to several Telefónica Group companies, equivalent to an occupancy rate of 90.29% of the buildings it has earmarked for lease. In 2017, it had a total of 310,389 square meters leased, equivalent to an occupancy rate of 91.22% of the buildings earmarked for lease. Total income from leased buildings in 2018 (see Note 19.1.a.) amounted to 43 million euros (45 million euros in 2017). Future minimum rentals receivable under non-cancellable leases are as follows:

Financial Statements

	2018	2017
Millions of euros	Future minimum recoveries	Future minimum recoveries
Up to one year	40	40
Between two and five years	2	1
Over 5 years	1	—
Total	43	41

The most significant lease contracts held with subsidiaries occupying Distrito Telefónica have been renewed in 2018 for a non-cancellable period of 12 months. The numbers also include non-cancellable lease revenues from Diagonal 00, whose contracts have an expiration date in December 2019.

The main operating leases in which Telefónica, S.A. acts as lessee and there is no sub-lease are described in Note 19.5.

Telefónica, S.A. 20

Financial Statements

Note 8. Investments in group companies and associates

8.1. The movements in the items composing investments in Group companies and associates in 2018 and 2017 are as follows:

2018

Millions of euros	Opening balance	Additions	Disposals	Transfers	Exchange losses	Dividends	Net investment hedges	Closing balance	Fair value
Equity instruments (Net) (1)	67,025	113	(209)	)(69	)—	(281	)(49	)66,530	122,108
Equity instruments (Cost)	92,717	700	(209)	)(69	)—	(281	)(49	)92,809	
Impairment losses	(25,692	)(587	)—	—	—	—	—	(26,279)
Loans to Group companies and associates	2,141	73	(186	)(550	)25	—	—	1,503	1,492
Other financial assets	—	7	—	—	—	—	—	7	7
Total non-current investment in Group companies and associates	69,166	193	(395	)(619	)25	(281	)(49	)68,040	123,600
Loans to Group companies and associates	3,426	4,845	(4,326	)550	(22	)—	—	4,473	3,967
Derivatives	10	8	(10	)—	—	—	—	8	8
Other financial assets	24	29	(24	)—	—	—	—	29	29
Total current investments in Group companies and associates	3,460	4,882	(4,360	)550	(22	)—	—	4,510	4,004

(1) Fair value at December 31, 2018 of Group companies and associates quoted in an active market (Telefônica Brasil, S.A.) was calculated taking the listing of the investments on the last day of the year; the rest of the shareholdings are stated at the value of discounted cash flows based on those entities' business plans.

2017

Millions of euros	Opening balance	Additions	Disposals	Transfers	Exchange losses	Dividends	Net investment hedges	Closing balance	Fair value
Equity instruments (Net) (1)	65,249	2,864	(965	)(22	)—	—	(101	)67,025	122,904
Equity instruments (Cost)	91,178	4,307	(980	)(1,687	)—	—	(101	)92,717	
Impairment losses	(25,929	)(1,443	)15	1,665	—	—	—	(25,692)
Loans to Group companies and	2,950	44	(361	)(406	)(86	)—	—	2,141	2,172

Edgar Filing: TELEFONICA S A - Form 6-K

associates									
Other financial assets	12	5	—	(17)—	—	—	—	—
Total non-current investment in Group companies and associates	68,211	2,913	(1,326	)(445	)(86	)—	(101	)69,166	125,076
Loans to Group companies and associates	3,167	3,750	(3,856	)406	(41	)—	—	3,426	3,020
Derivatives	30	10	(30	)—	—	—	—	10	10
Other financial assets	30	9	(32	)17	—	—	—	24	24
Total current investments in Group companies and associates	3,227	3,769	(3,918	)423	(41	)—	—	3,460	3,054

(1) Fair value at December 31, 2017 of Group companies and associates quoted in an active market (Telefônica Brasil, S.A.) was calculated taking the listing of the investments on the last day of the year; the rest of the shareholdings are stated at the value of discounted cash flows based on those entities' business plans.

Telefónica, S.A. 21

Financial Statements

The most significant transactions occurred in 2018 and 2017 as well as their accounting impacts are described below:
2018

On July 13 2018, a new company named Reginatorium Participaciones, S.L.U. was incorporated by Telefónica, S.A. On July 26, 2018 Telefónica made a non-monetary contribution to this new subsidiary equivalent to the net carrying value of its stake in Telxius Telecom, S.A. ("Telxius") corresponding to 60% of Telxius' share capital.

On July 27, 2018 the company was renamed Pontel Participaciones, S.L. ("Pontel") and on the same date, Telefónica sold 16.65% of it to the Pontegadea Group amounting to 378,8 million euros (a valuation of 15.2 euros per share of Telxius). An investment of 16.65% in Pontel is equivalent to a 9.99% indirect ownership in Telxius. The transaction has generated a revenue of 175 million euros in the profit and loss account of 2018.

On November 8, 2018 Telefónica reached an agreement with Catalana Occidente Group for the sale of its total stake in Seguros de Vida y Pensiones Antares, S.A., the insurance company in Spain, amounting to 161 million euros. As of December 31, 2018 the net carrying value of the investment has been transferred to "Long Term assets held for sale" totaling 69 million euros and shown as Transfers in the 2018 chart of movements. The closing of this transaction has taken place on February 14, 2019 after the pertinent regulatory authorizations were obtained.

2017

On February 10, 2017 Telefónica and Taurus Bidco S.à.r.l. (hereinafter "KKR", an entity managed by Kohlberg Kravis Roberts & Co. L.P.) reached an agreement for the sale of up to 40% of the share capital of Telxius Telecom, S.A. in exchange for an aggregate amount of 1,275 million euros (12.75 euros per share).

The agreement envisaged a sale of 62 million shares of Telxius Telecom, S.A. (representing 24.8% of its share capital) for an amount of 790.5 million euros as well as a call option over additional 38 million shares (representing 15.2% of its total share capital) for a minimum price of 484.5 million euros.

On October 24, 2017, Telefónica announced that, after obtaining all the relevant regulatory approvals, it has transferred to KKR 62 million shares of Telxius with a profit of 191 million euros. On December 13, 2017 KKR exercised the call option foreseen in the agreement over 38 million shares of Telxius Telecom, S.A. in exchange for 484.5 million euros resulting in an income on the "Gain on disposals" caption of the 2017 income statement amounting to 120 million euros.

The Group is carrying out a simplification process of corporate structure and pursuant to this process several mergers by absorption have been completed in 2017. The net book value of the absorbed companies has been accounted for in the surviving company as an increase in its investment cost. Therefore the cost and the impairment provision of the absorbed investments have been reversed. This movement is shown as "Tranfers" in 2017 chart of movements.

The merger transactions affecting 2017 investments were the following:

• In September 2017 Telefónica Latinoamérica Holding, S.L. carried out a merge by absorption of Telefónica Datacorp, S.A. and Ecuador Cellular Holding, S.L., which were both direct subsidiaries of Telefónica, S.A.

• On the same date, Telefónica Digital Holding, S.L.U. was merged and absorbed by Telefónica Digital España, S.L.U., and after this transaction the latter company becomes a direct affiliate of Telefónica, S.A.

• In November, 2017 Telefónica Móviles Argentina Holding, S.A. was merged to Telefónica Móviles Argentina, S.A. After this transaction the Company increased its direct ownership from 21.1% to 73.2%.

Financial Statements

In December 2017, Telefónica International Wholesale Services II, S.L. carried out a merge by absorption of Telefónica International Wholesale Services, S.L., which was a direct affiliate of Telefónica, S.A.

Other movements

In 2018 the column “Dividends” includes distributions of reserves made by Telxius Telecom, S.A. amounting to 217 million euros and by Pontel Participaciones, S.L. amounting to 64 million euros.

Movement in “Transfers” in “Loans to Group Companies and Associates” both 2018 and 2017 includes the reclassification between long-term and current loans in accordance with the loan maturity schedule as well as the accrued interests rendered by those loans, outstanding at year end.

The transfers in the caption of “Impairment losses” in 2017 corresponded to the reversal of the negative carrying amount of certain investments from the non-current provisions caption (see Note 18) amounting to -22 million euros.

In 2018 and 2017, Telefónica, S.A. bought and sold the following shareholdings:

a) Acquisitions of investments and capital increases (Additions):

Millions of euros

Companies	2018	2017
Telefónica Latinoamérica Holding, S.L.	—	3,838
Telefónica Digital España, S.L.U.	194	—
Telefónica Digital Holding, S.L.U. (absorbed by Telefónica Digital España, S.L.U.)	—	220
Telefónica Móviles México, S.A. de C.V.	460	129
Lotca Servicios Integrales, S.L.	—	85
Telefónica Ingeniería de Seguridad, S.A.U.	32	—
Other companies	14	35
Total Group companies and associates	700	4,307

2018

On January 11, 2018, with the aim of achieving a positive equity figure, Telefónica Digital España, S.L.U. has made a capital increase of 194 million euros fully subscribed and paid by the Company.

On March 22, 2018 Telefónica Móviles México S.A. de C.V. has completed a capital increase of 4,000 million Mexican pesos, equivalent to 176 million euros. On December 17, 2018 an additional capital increase of 6,550 million Mexican pesos, equivalent to 284 million euros was launched. Both transactions have been fully subscribed and paid by Telefónica, S.A.

On July 17, 2018, the Company has decided to capitalize a credit granted to its subsidiary Telefónica Ingeniería de Seguridad, S.A.U. amounting to 26.4 million euros. In addition, on December 27, 2018 a capital increase was made by the subsidiary totaling 5.2 million euros, fully subscribed and paid by Telefónica, S.A.

2017

On January 26, 2017 Telefónica Latinoamérica Holding, S.L. made a capital increase totaling 747 million euros fully subscribed and paid by Telefónica, S.A. Additionally, on December 21, 2017, Telefónica Latinoamérica

Telefónica, S.A. 23

Financial Statements

Holding, S.L. increased its share capital in 3,091 million euros. The transaction was been fully subscribed and paid by the Company.

On January 12, 2017, with the aim of achieving a positive equity figure, Telefónica Digital Holding, S.L.U. (absorbed by Telefónica Digital España, S.L.U.) made a capital increase of 220 million euros fully subscribed and paid by the Company.

On January 12, 2017 Telefónica Móviles México, S.A. de C.V. completed a capital increase of 3,000 million Mexican pesos, equivalent to 129 million euros. The transaction was fully subscribed and paid by Telefónica, S.A.

On May 4, 2017 the Company decided to capitalize the credits granted in previous years to Lotca Servicios Integrales, S.L. amounting to 85 million euros.

b) Disposals of investments and capital decreases:

Millions of euros

Companies	2018	2017
Telxius Telecom, S.A.	—	960
Pontel Participaciones, S.L.	204	—
Others	5	20
Total Group companies and associates	209	980

2018

The disposal of Pontel Participaciones, S.L. reflects the sale of shares to the Pontegadea Group, as fully described at the beginning of this note.

2017

The disposal of Telxius Telecom, S.A. refers to the sale of shares to KKR, as fully described at the beginning of this note.

8.2. Assessment of impairment of investments in group companies, joint ventures and associates

At each year end, the Company re-estimates the future cash flows derived from its investments in Group companies and associates. The estimate is based on the expected cash flows to be received from each subsidiary in its functional currency, discounted using the appropriate rate, net of the liabilities associated with each investment (mainly net debt), considering the percentage of ownership in each subsidiary and translated to euros at the official closing rate of each currency at December 31. Moreover, and only for the companies where discounted cash flow analysis is not available, due to the specific nature of their businesses, the impairment is calculated by comparing their Equity figure as of the end of the period and the net book value of those investments.

As a result of these estimations and the effect of the net investment hedge in 2018, an impairment provision of 587 million euros was recognized (write down of 1,443 million euros in 2017). This amount derives mainly from the following companies:

a. a write down of 1,038 million euros for Telefônica Brasil, S.A. (write down amounting to 510 million euros in 2017) and 243 million euros for Sao Paulo Telecomunicações, Ltda (113 million euros in 2017);

b. a write down reversal, net of hedges, of 4,062 million euros for Telefónica Europe, plc (an impairment of 460 million euros, net of hedges, was registered in 2017);

Telefónica, S.A. 24

Financial Statements

- c. write down of 2 million euros for Telefónica Contenidos, S.A.U. (177 million euros in 2017);
 d. write down of 219 million euros for Telefónica Digital España, S.L.U. (141 million euros in 2017) and
 e. a write down by 1,075 million euros for Telefónica México, S.A. de C.V. (write down reversal by 96 million euros
 in 2017);

In 2017 no write down was recorded for the investment of Telefónica Latinoamérica Holding, S.L.U. In 2018 an
 f. impairment of 1,962 million euros has been recorded. The write down is mainly originated by the write down of
 Telefônica Brasil, S.A. as indicated in section a).

Main hypothesis used for the calculation of the discounted cash flows of investments

Brazil has faced a complex macro-economic scenario in 2018. Several adverse effects have caused, on the one hand, a growth rate lower than its target (1.4% versus target of 2% at the beginning of the year) and on the other hand, an exchange rate depreciation of the Brazilian Real by 17% and a 30 basic points (b.p.) increase in the country risk. For 2019, the macroeconomic scenario envisages a slight growth in the Gross Domestic Product (GDP) up to 2.5% and in domestic consumption. The Operating Income before Depreciation and Amortization (OIBDA) margin for Brazil is 42%, within the range of analysts' long-term forecasts (between 37% and 43%). Over the term of the strategic plan, the operator will invest a percentage in line with the investment needs identified by analysts (18%). The perpetuity growth rate is in line with the Brazilian Central Bank's medium-term inflation target (4%, within a range of ± 1.5 p.p.) and is aligned with the analyst consensus for the Strategic Plan horizon (below 4.5%) yet below the forecast nominal GDP growth rate (which oscillates around 6.5%).

Mexican economy in 2018 has grown around 2%, 1 b.p. below the average growth rate since 2010. Uncertainty arising from the presidential and parliament elections in July as well as the lack of agreement regarding the new Mexico, United States and Canada commercial treaty are the answers for the under performance of the economy. The Mexican peso versus US dollar exchange rate reflects this uncertainty: Its quotation for the most part of the year has been historically high, preventing inflation rate from dropping and allowing an improvement domestic rent for Mexican families. Interest rate increase in the United States has a harmful effect in Mexico as the investment in the country becomes less profitable from investors' point of view. In the mid term, the key is the government commitment to structural changes in-force several years ago, specially related to the efficiency in the oil sector, tax administration and public sector. In this context, the WACC has increased to 10.6% (9.6% in 2017). Mexican economy is estimated to accelerate during the strategic plan horizon with an inflation rate below 4% from 2019. However, the cell phone market is expected to decrease due to a strong competition with AMX who has a 72% market share in 2018, 5 b.p. bigger than the previous year. AMX and AT&T are using aggressive commercial campaigns aimed to reduce prepaid cell phone tariffs to a minimum price within the region. Telefónica Móviles México has not launched new price promotions for this segment since the beginning of 2018. As a consequence of these two reasons the revenues of Telefónica Móviles México have been reduced in 2018.

With respect to the United Kingdom, domestic consumption was shown a more dynamic trend (growing above 1%) thanks to the improvement in the families' rent. Their income has been benefited from the increase in salaries, the drop of the inflation rate and the positive behaviour of the labour market, with an unemployment rate at its lowest. On the other hand, if the expectation of a more favourable end of the BrExit process is finally confirmed, the stability of the pound sterling exchange rate will extend the positive scenario to the following years ahead. The Strategic Plan includes a hypothesis of soft BrExit in the net results of the company. O2 UK is estimating to keep their market share of revenues based on the quality of services, adapting the range of products to the customer demands and improvement in B2B and IoT (Internet of Things). The increase in the OIBDA figure is achieved through an efficiency plan to keep the growth in expenses below the inflation rate, network sharing scheme with Vodafone and spectrum optimum usage). The long-term OIBDA margin is in line with analysts' forecasts over a three-year horizon, 26%. Regarding the ratio of CapEx over revenues, over the term of the strategic plan, the valuations consider the opinions of analysts with regard to investment needs (around 12%).

Financial Statements

8.3. The detail of subsidiaries and associates is shown in Appendix I.

8.4. Transactions protected for tax purposes

The transaction carried out in 2018 that qualify for special tax treatment, as defined in Articles 76 and 87, as applicable, of Chapter VII of Title VII of Legislative Royal Decree 27/2014 of November 27 approving the Spanish Corporate Income Tax Law, is described in the following paragraph. Transactions qualified for special tax treatment carried out in prior years are disclosed in the financial statements for those years.

On September 26, 2018, Telefónica Digital España, S.L.U., the sole stockholder of Synergic Partners, S.L. approved the merger by absorption of the latter and the transfer en bloc of its assets and liabilities to Telefónica Digital España, S.L.U. which also acquires all its rights and obligations by universal succession. The merger was filed in the Madrid Companies Register on November 6, 2018.

8.5. The breakdown and maturity of loans to Group companies and associates in 2018 and 2017 are follows:

2018

Millions of euros

Company	2019	2020	2021	2022	2023	2024 and subsequent years	Final balance, current and non-current
Telefónica Móviles España, S.A.U.	756	—	—	—	—	—	756
Telefónica Móviles México, S.A. de C.V.	—	860	—	—	—	—	860
Telfisa Global, B.V.	700	—	—	—	—	—	700
Telefónica de España, S.A.U.	2,352	—	—	—	—	—	2,352
Telxius Telecom, S.A.	—	—	—	280	—	280	560
Telefônica de Brasil, S.A.	258	—	—	—	—	—	258
Telefónica Latinoamérica Holding, S.L.U.	89	—	—	—	—	8	97
Other companies	318	—	35	—	16	24	393
Total	4,473	860	35	280	16	312	5,976

Financial Statements

2017

Millions of euros

Company	2018	2019	2020	2021	2022	2023 and subsequent years	Final balance, current and non-current
Telefónica Móviles España, S.A.U.	861	—	—	—	—	—	861
Telefónica Móviles México, S.A. de C.V.	—	773	—	—	—	—	773
Telefónica de Contenidos, S.A.U.	733	—	—	—	—	—	733
Telefónica de España, S.A.U.	987	550	—	—	—	—	1,537
Telxius Telecom, S.A.	—	—	—	140	280	280	700
Telefónica Latinoamérica Holding, S.L.U.	484	—	—	—	—	8	492
Other companies	361	23	52	—	15	20	471
Total	3,426	1,346	52	140	295	308	5,567

The main loans granted to Group and associated companies are described below:

The financing extended to Telefónica Móviles España, S.A.U. in 2018 includes dividends distributed and unpaid in December 2018 amounting to 552 million euros. The loan of 400 million euros outstanding in 2017 has been cancelled at maturity date.

Moreover, 204 million euros of taxes are receivable from this subsidiary for its tax expense declared in the consolidated tax return (155 million euros in 2017).

At December 31, 2018 and 2017, the account receivable with Telefónica Móviles México, S.A. de C.V. amounts to 11,697 million Mexican pesos, equivalent to 520 and 496 million euros, respectively. This asset is recognised as non-current pursuant to the expected collection date at the reporting date. At December 31, 2018, accrued interest receivable totals 340 million euros (277 million euros in 2017), which forms part of the non-current balance receivable.

In December 2018, Telfisa Global, B.V. has distributed dividends totaling 700 million euros which are unpaid as of the date of these financial statements.

The 2018 balance of Telefónica de España, S.A.U. consists of:

a 550 million euros credit facility granted and drawn down in full in November 2014 and maturing in 2019. dividends distributed and unpaid in December 2018 amounting to 1,574 million euros.

Additionally, there is also a balance of 227 million euros comprising tax receivables from the subsidiary for its tax expense declared in the consolidated tax return (323 million euros in 2017) and accrued interest of 1 million euros.

On May 27, 2016, with the aim of enabling the necessary funds for restructuring the infrastructure business line of the Group as described at the beginning of this note, the Company granted its subsidiary, Telxius Telecom, S.A. with a credit of 280 million euros at a fix interest rate and maturity in 2022, a credit of 280 million euros at a fix interest rate and maturity in 2026 and a credit of 140 million euros and an interest rate referred to euribor maturing 2021. This last credit has been cancelled prior to its maturity in 2018.

Telefónica, S.A. 27

Financial Statements

The balance totaling 258 million euros shown in 2018 with Telefônica Brasil, S.A. entirely corresponds to dividends agreed by the subsidiary and unpaid at year end.

The balance of unpaid dividends from Telefónica Latinoamérica Holding, S.L.U. in 2017 amounting to 391 million euros has been collected in 2018.

Moreover, 97 million euros of taxes are receivable from this subsidiary for its tax expense declared in the consolidated tax return (101 million euros in 2017).

The Company has also extended 589 million euros (686 million euros in 2017) of loans in connection with the taxation of Telefónica, S.A. as the head of the tax group pursuant to the consolidated tax regime applicable to corporate groups (see Note 17). The most significant amounts have already been disclosed through this note. All these amounts fall due in the short term.

Disposals of current loans to group companies and associates includes the cancellation of balances receivable from subsidiaries on account of their membership of Telefónica, S.A.'s tax group totaling 686 million euros (446 million euros in 2017).

Total accrued interest receivable at December 31, 2018 and 2017 included under "Current loans to group companies and associates" amount to 2 million euros.

8.6. Other financial assets with Group companies and associates

This includes rights to collect amounts from other Group companies related to share-based payment plans involving Telefónica, S.A. shares offered by subsidiaries to their employees.

Invoices of share plans that were already vested and are outstanding at year end are shown as other current financial assets. Amounts derived from the new share plan scheme launched in 2018 with a maturity date in 2020 are included as other non-current financial assets (see Note 19.3).

Financial Statements

Note 9. Financial investments

9.1. The breakdown of “Financial investments” at December 31, 2018 and 2017 is as follows:
2018

Millions of euros	Assets at fair value			Measurement hierarchy		Assets at amortized cost						
	Available-for-sale financial assets for trading	Hedges	Subtotal assets at fair value	Level 1: quoted prices observable market inputs	Level 2: other directly observable market inputs	Level 3: Estimates based on not observable market data	Loans and receivables	Other financial assets	Subtotal assets at amortized cost	Fair value	Total carrying amount	Total fair value
Non-current financial investments	298	1,595	2,719	298	2,421	—	—	696	696	696	3,415	3,415
Equity instruments	298	—	298	298	—	—	—	—	—	—	298	298
Derivatives (Note 16)	—	826	1,595	—	2,421	—	—	—	—	—	2,421	2,421
Loans to third parties and other financial assets	—	—	—	—	—	—	—	696	696	696	696	696
Current financial investments	—	322	520	842	842	—	972	7	979	980	1,821	1,822
Loans to third parties and other financial assets	—	—	—	—	—	—	972	7	979	980	979	980
Derivatives (Note 16)	—	322	520	842	842	—	—	—	—	—	842	842
Total financial investments	298	1,148	2,115	3,561	298	3,263	—	972	703	1,675	1,676	5,237

Telefónica, S.A. 29

Financial Statements

2017

Millions of euros	Assets at fair value				Assets at amortized cost								
	Available-for-sale financial assets for trading	Held Hedges	Subtotal assets at fair value	Measurement hierarchy			Loans and receivables	Other financial assets	Subtotal assets at amortized cost	Fair value	Total carrying amount	Total fair value	
				Level 1: quoted prices observable market inputs	Level 2: Estimates based on directly observable market inputs	Level 3: Estimates not based on observable market data							
Non-current financial investments	340	1,087	1,422	2,849	340	2,509	—	—	912	912	902	3,761	3,751
Equity instruments	340	—	—	340	340	—	—	—	—	—	—	340	340
Derivatives (Note 16)	—	1,087	1,422	2,509	—	2,509	—	—	—	—	—	2,509	2,509
Loans to third parties and other financial assets	—	—	—	—	—	—	—	—	912	912	902	912	902
Current financial investments	—	132	661	793	—	793	—	759	5	764	764	1,557	1,557
Loans to third parties and other financial assets	—	—	—	—	—	—	—	759	5	764	764	764	764
Derivatives (Note 16)	—	132	661	793	—	793	—	—	—	—	—	793	793
Total financial investments	340	1,219	2,083	3,642	340	3,302	—	759	917	1,676	1,666	5,318	5,308

Derivatives are measured using the valuation techniques and models normally used in the market, based on money-market curves and volatility prices available in the market. Additionally, on this valuation, the credit valuation adjustment or CVA net for counterparty (CVA + DVA), which is the methodology used to measure the credit risk of the counterparties and of Telefónica itself is calculated to adjust the fair value determination of the derivatives. This adjustment reflects the possibility of insolvency or deterioration of the credit quality of the counterparty and Telefónica.

Financial Statements

9.2 Held-for-trading financial assets and hedges

These two categories include the fair value of outstanding derivative financial instruments at December 31, 2018 and 2017 (see Note 16).

9.3 Available-for-sale financial assets.

This category mainly includes the fair value of investments in listed companies (equity instruments) over which the Company does not have significant control or influence. The movement of items composing this category at December 31, 2018 and 2017 are as follows:

December 31, 2018

Millions of euros	Opening balance	Additions	Disposals	Other movements	Fair value adjustments	Closing balance
Banco Bilbao Vizcaya Argentaria, S.A.	313	—	—	—	(108)	)205
Promotora de Informaciones, S.A. (PRISA)	27	49	—	—	17	93
Total	340	49	—	—	(91)	)298

December 31, 2017

Millions of euros	Opening balance	Additions	Disposals	Other movements	Fair value adjustments	Closing balance
Banco Bilbao Vizcaya Argentaria, S.A.	283	—	—	—	30	313
Promotora de Informaciones, S.A. (PRISA)	56	—	(30)	)—	1	27
Total	339	—	(30)	)—	31	340

In accordance with the change introduced in 2017 by the article 21 of Income Tax Law 27/2014 with respect to the non-deductible nature of the net losses generated by the sale of some investments with certain characteristics, the Company is not accruing the tax impacts of the fair value adjustments in its available-for-sale investments.

Banco Bilbao Vizcaya Argentaria, S.A.

The impacts shown in the column "Fair value adjustments" on both years include the fair value adjustment of Banco Bilbao Vizcaya Argentaria, S.A. (BBVA). These impacts are registered in the Equity of the Company (Note 11.2.).

At December 31, 2018 Telefónica, S.A.'s investment in BBVA represents 0.66% of that company's share capital.

Promotora de Informaciones, S.A. (Prisa)

On February 16, 2018 the company launches a capital increase. Telefónica subscribed and acquired 42.2 million new shares and the rest of the preferred subscription rights were sold. The net amount of the transaction is reflected as Additions in the 2018 chart of movements.

In 2017 a write down of the investment in Prisa amounting to 30 million euros was recorded under the "Losses on available-for-sale investments" caption. In 2018 no additional impairments for this stake have been recorded.

Financial Statements

9.4 Other financial assets and loans to third parties

The breakdown of investments included in this category at December 31, 2018 and 2017 is as follows:

Millions of euros	2018	2017
Other non-current financial assets:		
Deposits related to investment properties	9	10
Collateral guarantees	687	902
Other current financial assets:		
Loans to third parties	972	759
Other current financial assets	7	5
Total	1,675	1,676

Collaterals included in both years under the caption "Other non-current financial assets" are classified in accordance with the maturity of the underlying derivative instruments which they relate to.

In relation with these collateral contracts, there is an additional guarantee of 120,000 bonds issued by Telefónica Emisiones, S.A.U. deposited in a securities account owned by Telefónica, S.A. with a notional of 105 million euros.

9.4.1 Loans to third parties

In 2018 Telefónica, S.A. has set up bank deposit contracts with a maturity period between 3 and 12 months totaling 972 million euros (700 million euros in 2017).

Additionally, in 2017 this caption also included third party option premium which were due and still unpaid at year-end amounting to 57 million euros. In 2018 no amounts have been recognized under this caption.

Outstanding interest revenues amount to 0.2 million euros in 2018 (2 million euros in 2017), are registered as other current financial assets.

Financial Statements

Note 10. Trade and other receivables

The breakdown of “Trade and other receivables” at December 31, 2018 and 2017 is as follows:

Millions of euros	2018	2017
Trade receivables	13	1
Trade receivables from Group companies and associates	193	263
Other receivables	2	—
Employee benefits receivable	1	1
Tax receivables (Note 17)	179	310
Total	388	575

“Trade receivables from Group companies and associates” mainly includes amounts receivable from subsidiaries for the impact of the rights to use the Telefónica brand and the monthly office rental fees (see Note 7).

“Trade receivables” and “Trade receivables from Group companies and associates” in 2018 and 2017 include balances in foreign currency equivalent to 86 million and 100 million euros, respectively.

In 2018 and 2017 these amounts relate to receivables in US dollars and Venezuelan bolivars. The balance in Venezuelan bolivars arose in 2017 by the change in the brand fee contract, which is being invoiced in that currency since March 31, 2017.

These balances give rise to exchange rate losses in the income statement of 4 million euros in 2018 (15 million euros of exchange rate losses in 2017).

Telefónica, S.A. 33

Financial Statements

Note 11. Equity

11.1 Capital and reserves

a) Share capital

2018

At December 31, 2018 Telefónica, S.A.'s share capital amounted to 5,192,131,686 euros and consisted of 5,192,131,686 fully paid ordinary shares of a single series, par value of 1 euro, all recorded by the book-entry system and traded on the Spanish electronic trading system ("Continuous Market"), where they form part of the "Ibex 35" Index, on the four Spanish Stock Exchanges (Madrid, Barcelona, Valencia and Bilbao) and listed on the London and Buenos Aires Stock Exchanges, and on the New York and Lima Stock Exchanges, through American Depositary Shares ('ADSs').

2017

On September 20, 2017, the public deed evidencing the conversion of bonds, share capital increase and amortization of bonds was registered, on which were issued 154,326,696 new ordinary shares, of a nominal value of 1 euro each, within the framework of the conversion of the bonds mandatorily convertible into shares of Telefónica, S.A. that were issued by its wholly owned subsidiary, Telefónica Participaciones, S.A.U. on September 24, 2014, guaranteed by Telefónica, S.A. As a result of the aforementioned conversion and the referred capital increase, the share capital of Telefónica, S.A. was set at 5,192,131,686 euros, divided into 5,192,131,686 ordinary shares of the same class and series, with a nominal value of 1 euro each of them.

At December 31, 2017, Telefónica, S.A.'s share capital amounted to 5,192,131,686 euros and consisted of 5,192,131,686 fully paid ordinary shares of a single series, par value of 1 euro.

Authorizations by Shareholders' Meeting

With respect to share capital-related authorizations, on June 12, 2015, authorization was given at the Annual Shareholders' Meeting of Telefónica, S.A. for the Board of Directors, at its discretion and in accordance with the Company's needs, to increase the Company's capital, once or several times, within a maximum five years period from that date, up to a maximum nominal increase of 2,469,208,757 euros, equivalent to half of Telefónica, S.A.'s share capital at that date, by issuing and placing new shares, with or without a share premium, and, in all cases, in exchange for cash, expressly considering the possibility that the new shares may not be fully subscribed. The Board of Directors was also empowered to exclude, partially or fully, pre-emptive subscription rights under the terms of article 506 of the Spanish Corporate Enterprises Act. However, the power to exclude pre-emptive rights is limited to 20% of the Company's share capital on the date of adoption of this resolution. Pursuant to the aforementioned authorizations, as of December 31, 2018, the Board of Directors may increase the share capital up to the maximum nominal amount of 2,469,208,757 euros.

In addition, at the June 9, 2017 Shareholders' Meeting of Telefónica, S.A., authorization was given for the Board of Directors to issue debentures, bonds, promissory notes and other fixed-income securities and hybrid instruments, including preferred shares, in all cases be they simple, tradable, and/or convertible and/or granting the holders thereof a share in the earnings of the company, as well as warrants, with the power to exclude the pre-emptive rights of shareholders. The issuance of the aforementioned securities may be conducted at one or several times, at any time, within a maximum five-year period from that date. These securities may be in the form of debentures, bonds, promissory notes or any other kind of fixed-income security, or debt instruments of similar category or hybrid instruments in any legally admitted form (including yet not restricted to preferred shares), plain or, in the case of debentures, bonds and hybrid instruments convertible into shares of the Company and/or exchangeable for shares of any of the Group companies, or any other company and/or giving the holders thereof a share in the earnings of the Company. This delegation also includes warrants or other similar securities that might give the right to directly or indirectly subscribe or acquire shares, whether newly issued or outstanding, and which may be paid for by physical delivery or by offset. The aggregated amount of the

Financial Statements

issuance(s) of securities approved under this delegation of powers may not exceed the sum of 25,000 million euros or the equivalent in another currency at any time. For promissory notes, the outstanding balance of promissory notes issued under this authorization will be calculated for the purpose of the aforementioned limit. Likewise, for the sake of the aforementioned limit, in the case of warrants, the sum of the premiums and exercise prices of the warrants for each issuance approved under this delegation shall be taken into account.

Furthermore, on June 8, 2018, shareholders voted to authorize the acquisition by the Board of Directors of Telefónica, S.A. treasury shares, up to the limits and pursuant to the terms and conditions established at the Shareholders' Meeting, within a maximum five-year period from that date. However, it specified that in no circumstances could the par value of the shares acquired, added to that of the treasury shares already held by Telefónica, S.A. and by any of its controlled subsidiaries, exceed the maximum legal percentage at any time (currently 10% of Telefónica, S.A.'s share capital).

At December 31, 2018 and 2017, Telefónica, S.A. held the following treasury shares:

	Euros per share			Market	
	Number of shares	Acquisition price	Trading price	value	%
				(1)	
Treasury shares at 12/31/18	65,496,120	10.48	7.34	481	1.26145 %
Treasury shares at 12/31/17	65,687,859	10.48	8.13	534	1.26514 %

(1) Millions of euros

The movement in treasury shares of Telefónica, S.A. during the years 2018 and 2017 is as follows:

	Number of shares
Treasury shares at 12/31/16	141,229,134
Employee share option plan (see Note 19.3)	(3,518,795)
Other movements	(72,022,480)
Treasury shares at 12/31/17	65,687,859
Employee share option plan	(191,739)
Treasury shares at 12/31/18	65,496,120
Acquisitions	

There have been no acquisitions of treasury shares in 2018 and 2017.

Share redemption and disposals

In 2018 and 2017 there have been no share redemption or disposals of treasury shares.

Employee share option plan

Treasury shares sold, including share plans redemptions, in 2018 and 2017 amount to 2 million euros and 37 million euros, respectively.

On September 30, 2018 the second phase of the "Performance and Investment Plan 2014-2019" ("PIP 2014-2019") as well as the second phase of the "Talent for the future Share Plan" (TFSP2) ended. No share have been delivered to Telefónica Group executives or managers (see Note 19).

On July 31, 2017 the third phase of the Global Employee Share Plan ("the GESP") matured and 3,187,055 treasury shares were delivered to Group employees who met the established requirements.

Financial Statements

On September 30, 2017 the first phase of the “Performance and Investment Plan 2014-2019” (“PIP 2014-2019”) and the first phase of the “Talent for the Future Share Plan” (TFSP1) ended. No shares were delivered to Telefónica Group executives or managers (see Note 19).

Other movements

On March 14, 2017 Telefónica entered into a swap agreement with Koninklijke KPN NV (hereinafter, KPN) to deliver 72 million of its treasury shares in exchange for 178.5 million shares of its subsidiary Telefónica Deutschland Holding AG, representing 6.0% of the share capital of the latter. On the same date, this stake was sold at the same price to Telefónica Germany Holdings, GmbH so that, at 2017 year end, Telefónica, S.A. has no direct participation in Telefónica Deutschland Holding AG and the transfer of the stake has not had impact in the income statement. The Company also has a derivative instrument, to be settled by offset, on a nominal value equivalent to 21.7 million of Telefónica shares in 2018 (35.2 million of Telefónica shares in 2017), recognized in both years under “Current interest-bearing debt” in the accompanying balance sheet.

b) Legal reserve

According to the text of the Corporate Enterprises Act, companies must transfer 10% of profit for the year to a legal reserve until this reserve reaches at least 20% of share capital. The legal reserve can be used to increase capital by the amount exceeding 10% of the increased share capital amount. Except for this purpose, until the legal reserve exceeds the limit of 20% of share capital, it can only be used to offset losses, if there are no other reserves available. At December 31, 2017, after the capital increase carried forward in 2017, the Company needed to increase the legal reserve by 51 million euros until the legal reserve was fully constituted. The proposed appropriation of profit in 2017 included an allocation of that amount. At December 31, 2018, this reserve is fully constituted and amounts to 1,038 million euros.

c) Other reserves

“Other reserves” includes:

The “Revaluation reserve” which arose as a result of the revaluation made pursuant to Royal Decree-Law 7/1996 dated June 7. The revaluation reserve may be used, free of tax, to offset any losses incurred in the future and to increase capital. From January 1, 2007, it may be allocated to unrestricted reserves, provided that the capital gain has been realized. The capital gain will be deemed to have been realized in respect of the portion on which the depreciation has been recorded for accounting purposes or when the revalued assets have been transferred or derecognized. In this respect, at the end of 2018 and 2017, an amount of 6 million euros in both years, corresponding to revaluations reserves subsequently considered unrestricted has been reclassified to “Other reserves”. The balance of this reserve at December 31, 2018 and 2017 was 72 million euros and 78 million euros, respectively.

Reserve for cancelled share capital: In accordance with Section 335.c) of the Corporate Enterprises Act and to render null and void the right of opposition provided for in Section 334 of the same Act, whenever the Company decreases capital it records a reserve for cancelled share capital for an amount equal to the par value of the cancelled shares, which can only be used if the same requirements as those applicable to the reduction of share capital are met. The cumulative amount of the reserve for cancelled share capital at December 31, 2018 and 2017 totals 731 million euros. Pursuant to the provisions of Royal Decree 1514/2007, since 2008, after the distribution of profits for each year, the Company set aside a non-distributable reserve of 2 million euros for goodwill amortization. Pursuant to the provisions of Royal Decree 602/2016 of December 2, 2016, the goodwill amortization as of January 1, 2015, amounting to 10 million euros was registered with a counterparty in this reserve.

Financial Statements

In addition to the restricted reserves explained above, "Other reserves" includes unrestricted reserves from gains obtained by the Company in prior years.

d) Dividends

Dividend distribution in 2018

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 was made on December 20, 2018 amounting to 1,026 million euros.

Dividend distribution in 2017

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 was made on December 14, 2017 amounting to 1,025 million euros.

e) Other equity instruments

On September 24, 2014, Telefónica Participaciones, S.A.U., issued 1,500 million euros of bonds necessarily convertible into new and/or existing shares of Telefónica, S.A. at a nominal fixed interest rate of 4.9%, due on September 25, 2017, guaranteed by Telefónica, S.A. The notes could be converted at the option of the noteholders or the issuer. On the same date, Telefónica, S.A. issued bonds with the same amount and characteristics of the previously detailed bond and a derivative instrument (warrant) in order to hedge the conversion price of the bonds. These bonds were wholly acquired by Telefónica Participaciones, S.A.U.

At the issuance date, in the balance sheet of Telefónica, S.A. the present value of the coupons was recorded as debt, the warrant was accounted as long term liabilities to group companies and the remaining amount of 1,206 million euros was recorded as "other net equity instruments".

As explained in section a) of this same note, at maturity of the notes, Telefónica, S.A. on behalf of Telefónica Participaciones, S.A.U. delivered a total of 154,341,669 shares of Telefónica S.A. at a conversion price of 9.7174 euros per share (minimum conversion price after the standard adjustments included in the terms of the notes). In order to meet the conversion of the notes, Telefónica S.A. issued 154,326,696 new shares in execution of a capital increase and delivered 14,973 treasury shares.

11.2 Unrealized gains (losses) reserve

The movements in the items composing "Unrealized gains (losses) reserve" in 2018 and 2017 are as follows:

Financial Statements

2018

Millions of euros	Opening balance	Valuation at market value	Tax effect of additions	Amounts transferred to income statement	Tax effect of transfers	Closing balance
Available-for-sale financial assets (Note 9.3)	42	(91	)—	—	—	(49)
Cash flow hedges	(697	)991	(248	)727	)182	(499)
Total	(655	)900	(248	)727	)182	(548)

2017

Millions of euros	Opening balance	Valuation at market value	Tax effect of additions	Amounts transferred to income statement	Tax effect of transfers	Closing balance
Available-for-sale financial assets (Note 9.3)	8	2	2	30	—	42
Cash flow hedges	(674	)191	)48	161	(41	)697)
Total	(666	)189	)50	191	(41	)655)

In 2017, the impact of fair value hedges generated and transferred to the profit and loss account in the same period as the impacts of the hedged instruments, were reflected directly in the profit and loss account offsetting the amounts of those hedged instruments. Therefore there were no impact in the statement of recognized income and expense in Equity.

In 2018, the Company has decided to change the presentation of the concept, including them in the statement of recognized income and expense in equity, and transferring the amounts to the profit and loss account in the same period. The impacts are shown in the column "Valuation at market value" and with the opposite sign in the column "Amounts transferred to income statement" of the 2018 chart of movements. The accounting in the profit and loss account has remained unchanged.

Financial Statements

Note 12. Financial liabilities

The breakdown of “Financial liabilities” at December 31, 2018 and 2017 is as follows:

2018

Millions of euros	LIABILITIES AT FAIR VALUE						LIABILITIES AT AMORTIZED COST			
	Financial liabilities held for trading	Hedges	Subtotal financial liabilities at fair value	MEASUREMENT HIERARCHY			Trade and other payables	Trade and other payables at fair value	TOTAL CARRYING AMOUNT	TOTAL FAIR VALUE
				Level 1: quoted prices	Level 2: Estimates based on other directly observable market inputs	Level 3: Estimates not based on other directly observable market data				
Non-current financial liabilities	821	1,386	2,207	—	2,207	—	43,355	44,501	45,562	46,708
Payable to Group companies and associates	—	—	—	—	—	—	41,154	42,279	41,154	42,279
Bank borrowings	—	—	—	—	—	—	2,033	2,059	2,033	2,059
Derivatives (Note 16)	821	1,386	2,207	—	2,207	—	—	—	2,207	2,207
Other financial liabilities	—	—	—	—	—	—	168	163	168	163
Current financial liabilities	77	131	208	—	208	—	17,853	17,958	18,061	18,166
Payable to Group companies and associates	—	—	—	—	—	—	15,578	15,683	15,578	15,683
Bank borrowings	—	—	—	—	—	—	2,094	2,094	2,094	2,094
Bonds and other marketable debt securities	—	—	—	—	—	—	181	181	181	181
Derivatives (Note 16)	77	131	208	—	208	—	—	—	208	208
	898	1,517	2,415	—	2,415	—	61,208	62,459	63,623	64,874

Total
financial
liabilities

Telefónica, S.A. 39

Financial Statements

2017

Millions of euros	LIABILITIES AT FAIR VALUE						LIABILITIES AT AMORTIZED COST			
	Financial liabilities held for trading	Hedges	Subtotal financial liabilities at fair value	MEASUREMENT HIERARCHY			Trade and other payables	Trade and other payables at fair value	TOTAL CARRYING AMOUNT	TOTAL FAIR VALUE
				Level 1: quoted prices	Level 2: Estimates based on other directly observable market inputs	Level 3: Estimates not based on other directly observable market data				
Non-current financial liabilities	1,038	1,758	2,796	—	2,796	—	45,160	48,409	47,956	51,205
Payable to Group companies and associates	—	—	—	—	—	—	40,642	43,821	40,642	43,821
Bank borrowings	—	—	—	—	—	—	4,186	4,244	4,186	4,244
Derivatives (Note 16)	1,038	1,758	2,796	—	2,796	—	—	—	2,796	2,796
Other financial liabilities	—	—	—	—	—	—	332	344	332	344
Current financial liabilities	119	133	252	—	252	—	15,201	15,226	15,453	15,478
Payable to Group companies and associates	—	—	—	—	—	—	14,101	14,128	14,101	14,128
Bank borrowings	—	—	—	—	—	—	896	894	896	894
Bonds and other marketable debt securities	—	—	—	—	—	—	204	204	204	204
Derivatives (Note 16)	119	133	252	—	252	—	—	—	252	252
Total financial liabilities	1,157	1,891	3,048	—	3,048	—	60,361	63,635	63,409	66,683

Derivatives are measured using the valuation techniques and models normally used in the market, based on money-market curves and volatility prices available in the market. Additionally, on this valuation, the credit valuation adjustment or CVA net for counterparty (CVA + DVA), which is the methodology used to measure the credit risk of the counterparties and of Telefónica itself is calculated to adjust the fair value determination of the derivatives. This adjustment reflects the possibility of insolvency or deterioration of the credit quality of the counterparty and Telefónica.

The calculation of the fair values of the Company's financial debt instruments required an estimate for each currency of a credit spread curve using the prices of the Company's bonds and credit derivatives.

Telefónica, S.A. 40

Financial Statements

Note 13. Bonds and other marketable debt securities

13.1 The balances and movements in issues of debentures, bonds and commercial paper at December 31, 2018 and 2017 are as follows:

2018			
Millions of euros	Non-convertible debentures and bonds	Other marketable debt securities	Total
Opening balance	—	204	204
Additions	—	348	348
Disposals	—	(371)	(371)
Revaluation and other movements	—	—	—
Closing balance	—	181	181
Details of maturities:			
Non-current	—	—	—
Current	—	181	181
2017			
Millions of euros	Non-convertible debentures and bonds	Other marketable debt securities	Total
Opening balance	788	370	1,158
Additions	—	428	428
Disposals	(774)	(594)	(1,368)
Revaluation and other movements	(14)	—	(14)
Closing balance	—	204	204
Details of maturities:			
Non-current	—	—	—
Current	—	204	204

The balance of “Non-convertible debentures and bonds” in 2017 was referred to Telefónica’s bond issuance made on July 24, 2014 amounting to 750 million euros. The bonds were mandatorily exchangeable into ordinary shares of Telecom Italia, S.p.A, maturing on July 24, 2017. At the maturity date, the Company fulfilled its commitments to deliver the shares with the vesting of the equity swap instrument arranged for that purpose. This movement was shown as disposals in the 2017 chart of movements.

At December 31, 2018 and 2017 there are no debentures and bonds outstanding.

Financial Statements

13.2 At December 31, 2018, Telefónica, S.A. had a corporate promissory note programme registered with the CNMV, with the following features:

Millions of euros	Amount	Placement system	Nominal amount of the Promissory notes	Terms of the Promissory notes	Placement
500 million; can be increased to 2,000 million		Auctions	100,000 euros	30, 60, 90, 180, 365, 540 and 731 days	Competitive auctions
		Tailored	100,000 euros	Between 3 and 731 days	Specific transactions

At December 31, 2018 the outstanding balance on this promissory note programme is 181 million euros (204 million euros in 2017).

13.3 The average interest rate during 2017 on debentures and bonds outstanding was 6.17%.

The average interest rate during 2018 on corporate promissory notes was -0.21% (-0.090% in 2017).

Telefónica, S.A. 42

Financial Statements

Note 14. Interest-bearing debt and derivatives

14.1 The balances at December 31, 2018 and 2017 are as follows:

December 31, 2018

Millions of euros	Current	Non-current	Total
Loans with financial entities (Note 12)	2,094	2,033	4,127
Derivative financial liabilities (Note 16)	208	2,207	2,415
Total	2,302	4,240	6,542

December 31, 2017

Millions of euros	Current	Non-current	Total
Loans with financial entities (Note 12)	896	4,186	5,082
Derivative financial liabilities (Note 16)	252	2,796	3,048
Total	1,148	6,982	8,130

14.2 The nominal values of the main interest-bearing debts at December 31, 2018 and 2017 are as follows:

2018

Description	Value Date	Maturity Date	Currency	Limit	12/31/18 (millions)	Balance (million of euros)
Structured Financing (*)	05/03/11	07/30/21	USD	106		93
Structured Financing (*)	02/22/13	01/31/23	USD	434		379
Structured Financing (*)	08/01/13	10/31/23	USD	359		314
Bilateral loan (1)	06/26/14	06/26/19	EUR	1,000		1,000
Structured Financing (*)	12/11/15	03/11/26	USD	591		516
Structured Financing (*)	12/11/15	03/11/26	EUR	401		401
Bilateral loan	02/23/16	02/23/21	EUR	100		100
Bilateral loan	10/24/16	03/19/19	EUR	150		150
Credit	12/27/02	12/27/20	EUR	380		271
Bilateral loan	12/28/17	10/22/20	EUR	100		100
Bilateral loan	11/24/17	01/30/26	EUR	100		100
Bilateral loan	12/20/17	07/22/19	EUR	385		385
Credit	05/23/13	03/01/20	GBP	100		112

(1) On July 17, 2018 the 500 million euros bilateral loan was cancelled prior to its maturity originally agreed in contract on June 26, 2019.

(*) Facility with amortization schedule, showing in the column "Limit 12/31/17" the outstanding amount.

Financial Statements

2017

Description	Value Date	Maturity Date	Limit Currency (millions)	Limit 12/31/17 (millions)	Balance (million of euros)
Structured Financing (*)	05/03/11	07/30/21	USD	153	128
Structured Financing (*)	02/22/13	01/31/23	USD	551	460
Structured Financing (*)	08/01/13	10/31/23	USD	446	371
Bilateral Loan (1)	06/26/14	06/26/19	EUR	1,500	1,500
Structured Financing (*)	12/11/15	03/11/26	USD	679	566
Structured Financing (*)	12/11/15	03/11/26	EUR	469	423
Bilateral loan	02/23/16	02/23/21	EUR	100	100
Loan	03/08/16	03/08/21	EUR	300	300
Bilateral loan	10/24/16	03/19/19	EUR	150	150
Credit	03/27/13	03/14/20	EUR	200	167
Credit	12/27/02	12/27/18	EUR	380	292

(*) Facilities with amortization schedule, showing in the column "Limit 12/31/17" the outstanding amount.

On January 17, 2017 an amendment was made to the bilateral loan, with an outstanding amount of 1,500 million euros, split into two tranches with a new amortization schedule: tranche A for 500 million euros maturing on June (1)26, 2017 and tranche B for 1,000 million euros maturing on June 26, 2019. Later, on February 17, 2017 a new amendment was signed extending the maturity of the tranche A for 500 million euros up to June 26, 2019. Facility with amortization schedule.

14.3 Maturities of balances at December 31, 2018 and 2017 are as follows:

December 31, 2018	Maturity							Closing balance
	2019	2020	2021	2022	2023	Subsequent years		
Millions of euros								
Loans with financial entities	2,094	171	517	247	175	923		4,127
Derivative financial liabilities (Note 16)	208	600	293	221	126	967		2,415
Total	2,302	771	810	468	301	1,890		6,542
December 31, 2017	Maturity							
Millions of euros	2018	2019	2020	2021	2022	Subsequent years		Closing balance
Loans with financial entities	896	1,799	461	540	322	1,064		5,082
Derivative financial liabilities (Note 16)	252	209	820	440	174	1,153		3,048
Total	1,148	2,008	1,281	980	496	2,217		8,130

Financial Statements

14.4 Interest-bearing debt arranged or repaid in 2018 mainly includes the following:

Description	Limit 12/31/18 (millions)	Currency	Outstanding	Arrangement date	Maturity date	Drawdown	Repayment
			balance 12/31/2018 (million euros)			2018 (million euros)	2018 (million euros)
Telefónica, S.A.							
Syndicated facility (1)	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	—
Loan (2)	—	EUR	—	03/08/16	09/28/18	—	(300)
Bilateral loan (3)	1,000	EUR	1,000	06/26/18	06/26/19	—	(500)

(1) On March 15, 2018, 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 2022. The facility agreement matures in 2023, with two annual extension options, at the request of Telefónica, for a maximum maturity in 2025.

(2) On September 28, 2018, an early repayment was made by Telefónica S.A. for the 300 million euros loan originally scheduled to mature on March 8, 2021.

(3) On July 17, 2018, an early repayment was made by Telefónica S.A. for 500 million euros originally scheduled to mature on June 26, 2019.

14.5 Average interest on loans and borrowings

The average interest rate in 2018 on loans and borrowings denominated in euros was 0.435% (0.47% in 2017) and 2.236% (2.516% in 2017) for foreign-currency loans and receivables.

14.6 Unused credit facilities

The balances of loans and borrowings only relate to drawn down amounts.

At December 31, 2018 and 2017, Telefónica had undrawn credit facilities amounting to 9,908 million euros and 9,967 million euros, respectively.

Financing arranged by Telefónica, S.A. at December 31, 2018 and 2017 is not subject to compliance with financial ratios (covenants).

Financial Statements

Note 15. Payable to group companies and associates

15.1 The breakdown of payable to group companies and associates at the 2018 and 2017 year ends is as follows:

December 31, 2018

Millions of euros	Non-current	Current	Total
Loans	41,127	15,339	56,466
Trade payables to Group companies and associates	—	166	166
Derivatives (Note 16)	—	23	23
Tax Group payables to subsidiaries	27	50	77
Total	41,154	15,578	56,732

December 31, 2017

Millions of euros	Non-current	Current	Total
Loans	40,610	13,569	54,179
Trade payables to Group companies and associates	—	264	264
Derivatives (Note 16)	3	6	9
Tax Group payables to subsidiaries	29	262	291
Total	40,642	14,101	54,743

The maturity of these loans at the 2018 and 2017 year ends is as follows (figures in millions of euros):

December 31, 2018

Company	2019	2020	2021	2022	2023	2024 and subsequent years	Final balance, current and non-current
Telefónica Emisiones, S.A.U.	4,029	4,673	3,421	3,621	2,181	17,114	35,039
Telefónica Europe, B.V.	2,562	782	291	996	2,239	5,224	12,094
Telfisa Global, B.V.	8,748	—	—	—	—	—	8,748
Telefónica Participaciones, S.A.U.	—	—	585	—	—	—	585
Total	15,339	5,455	4,297	4,617	4,420	22,338	56,466

December 31, 2017

Company	2018	2019	2020	2021	2022	2023 and subsequent years	Final balance, current and non-current
Telefónica Emisiones, S.A.U.	4,248	3,491	4,632	3,389	3,641	15,454	34,856
Telefónica Europe, B.V.	2,052	849	1,421	622	995	5,538	11,476
Telfisa Global, B.V.	7,269	—	—	—	—	—	7,269
Telefónica Participaciones, S.A.U.	—	—	—	578	—	—	578
Total	13,569	4,340	6,053	4,589	4,636	20,992	54,179

Financing raised by Telefónica, S.A. through its subsidiary Telefónica Europe, B.V. at December 31, 2018 amounting 12,094 million euros (11,476 million euros in 2017). This financing entails a number of loans paying market interest rates calculated on a Euribor plus spread basis, with an average interest rate in 2018 of 0.04%

Financial Statements

(4.55% in 2017). The main source of this financing was the funds obtained through the issuance of undated deeply subordinated reset rate guaranteed securities amounting to 7,484 million euros (7,026 million euros in 2017), bonds and debentures amounting to 1,559 million euros (1,542 million euros in 2017) and commercial paper amounting to 1,666 million euros (1,850 million euros in 2017).

Financing raised by Telefónica, S.A. through Telefónica Emisiones, S.A.U. at December 31, 2018 was 35,039 million euros (34,856 million euros in 2017). This financing is arranged as loans between these companies on the similar terms and conditions as those of the notes issued under the debt issuance programmes of Telefónica Emisiones, S.A.U. The average interest rate in 2018 was 3.36% (3.86% in 2017). The financing arranged includes, as a related cost, the fees or premiums taken to the income statement for the period corresponding to the financing based on the corresponding effective interest rates. Telefónica Emisiones, S.A.U. raised financing in 2018 by tapping the European, American and Taiwanese capital markets, issuing bonds totaling 3,611 million euros (7,324 million euros in 2017). The characteristics of the main bonds issued during 2018 are the following:

Description	Issue date	Maturity date	Amount in millions (nominal)	Currency of issue	Amount in millions of euros (nominal)	Coupon
Telefónica Emisiones, S.A.U.						
EMTN bond	1/22/2018	1/22/2027	1,000	EUR	1,000	1.447 %
SHELF bond	3/6/2018	3/6/2038	750	USD	655	4.665 %
SHELF bond	3/6/2018	3/6/2048	1,250	USD	1,091	4.895 %
EMTN bond	9/11/2018	9/11/2025	1,000	EUR	1,000	1.495 %

Part of the amount owed by Telefónica, S.A. to Telefónica Emisiones, S.A.U. and to Telefónica Europe, B.V. includes adjustments to amortized cost at December 31, 2018 and 2017 as a result of fair value interest rate and exchange rate hedges.

Telfisa Global, B.V. centralizes and handles cash management and flows for the Telefónica Group in Latin America, the United States, Europe and Spain. The balance payable to this subsidiary is formalized through several deposit agreements accruing interest at market rates and amounting to 8,748 million euros in 2018 (7,269 million euros in 2017).

Financing raised by Telefónica, S.A. through Telefónica Participaciones, S.A.U. at December 31, 2018 totals 585 million euros (578 million euros in 2017) and corresponds to a loan with a principal of 600 million euros at an annual interest rate of 0.25%; which funds are a result of the issuance of non-dilutive convertible bonds carried out by Telefónica Participaciones, S.A.U., guaranteed by Telefónica, S.A. at March 9, 2016. These bonds are benchmarked against the value of Telefónica S.A. shares, with an aggregate nominal amount of 600 million euros, an issue price of 101.25% and 5-year maturity.

15.2 The balance of “Payable to subsidiaries due to taxation on a consolidated basis” was 77 and 291 million euros at December 31, 2018 and 2017, respectively. This basically includes payables to Group companies for their contribution of taxable income (tax loss carryforwards) to the tax group headed by Telefónica, S.A. (see Note 17). The current or non-current classification is based on the Company’s projection of maturities.

The most significant amounts correspond to Telefónica Digital España, S.L.U. for 31 million euros (34 million in 2017), Telefónica International Wholesale Services II, S.L. for 7 million euros, and Telefónica Innovación Alpha, S.L. for 4 million euros (2 million in 2017).

Financial Statements

Note 16. Derivative financial instruments and risk management policies

a) Derivative financial instruments

During 2018, the Group continued to use derivatives to limit interest and exchange rate risk on otherwise unhedged positions, and to adapt its debt structure to market conditions.

At December 31, 2018, the total outstanding balance of derivatives transactions was 115,410 million euros (116,580 million euros in 2017), of which 89,341 million euros related to interest rate risk and 26,069 million euros to foreign currency risk. In 2017, 92,948 million euros related to interest rate risk and 23,632 million euros to foreign currency risk.

It should be noted that at December 31, 2018, Telefónica, S.A. had transactions with financial institutions to hedge exchange rate risk for other Telefónica Group companies amounting to 1,684 million euros (1,637 million euros in 2017). At year-end 2018 and 2017, the Company had no transactions to hedge interest rate risk for other Group companies. These external trades are matched by intra-group hedges with identical terms and maturities between Telefónica, S.A. and Group companies, and therefore involve no risk for the Company. External derivatives not backed by identical intragroup transactions consist of hedges on net investment and future acquisitions that, by their nature, cannot be transferred to Group companies and/or transactions to hedge financing raised by Telefónica, S.A. as parent company of the Telefónica Group, which are transferred to Group subsidiaries in the form of financing rather than via derivative transactions.

The breakdown of Telefónica, S.A.'s interest rate and exchange rate derivatives at December 31, 2018, their notional amounts at year end and the expected maturity schedule is as follows:

Telefónica, S.A. 48

Financial Statements

2018

Millions of euros		Telefónica receives		Telefónica pays	
Type of risk	Value in Euros	Carrying	Currency	Carrying	Currency
Euro interest rate swaps	65,786				
Fixed to fixed	200	200	EUR	200	EUR
Fixed to floating	32,933	32,933	EUR	32,933	EUR
Floating to fixed	32,653	32,653	EUR	32,653	EUR
Foreign currency interest rate swaps	22,467				
Fixed to floating					
CHFCHF	333	375	CHF	375	CHF
GBPGBP	2,688	2,405	GBP	2,405	GBP
USDUSD	18,340	21,006	USD	21,006	USD
Floating to fixed					
GBPGBP	425	380	GBP	380	GBP
USDUSD	410	470	USD	470	USD
Floating to floating					
USDUSD	271	310	USD	310	USD
Exchange rate swaps	16,464				
Fixed to fixed					
EURBRL	123	123	EUR	546	BRL
Fixed to floating					
JPYEUR	95	15,000	JPY	95	EUR
Floating to fixed					
USDEUR	162	200	USD	162	EUR
Floating to floating					
CHFEUR	308	375	CHF	308	EUR
GBPEUR	2,048	1,600	GBP	2,048	EUR
USDEUR	13,728	16,230	USD	13,728	EUR
Forwards	9,605				
BRLEUR	100	444	BRL	100	EUR
CLPEUR	1	640	CLP	1	EUR
CZKEUR	66	1,708	CZK	66	EUR
EURBRL	2,160	2,160	EUR	9,584	BRL
EURCLP	339	339	EUR	269,670	CLP
EURGBP	4,061	4,061	EUR	3,634	GBP
EURMXN	1	1	EUR	29	MXN
EURUSD	1,575	1,575	EUR	1,804	USD
GBPEUR	280	252	GBP	280	EUR
GBPUSD	2	2	GBP	3	USD
USDBRL	19	22	USD	83	BRL
USDCLP	5	6	USD	4,060	CLP

Telefónica, S.A. 49

Financial Statements

USDCOP	2	2	USD7,193	COP
USDEUR	965	1,110	USD965	EUR
USDGBP	22	26	USD20	GBP
USDPEN	3	3	USD10	PEN
CLPUSD	1	1,071	CLP 2	USD
BRLUSD	3	13	BRL 3	USD
PENUSD	—	1	PEN —	USD
COPUSD	—	1,675	COP 1	USD
Swaption	250			
Fixed to floating				
EUREUR	205	205	EUR205	EUR
Floating to fixed				
EUREUR	45	45	EUR45	EUR
Subtotal	114,572			

Millions of euros

Notional amounts of structured products with options	Value in euros	Notional	Currency
Caps&Floors	838		
GBP	838	750	GBP
TOTAL	115,410		

The breakdown by average maturity is as follows:

Millions of euros

Hedged underlying item	Notional	Up to 1 year	From 1 to 3 years	From 3 to 5 years	Over 5 years
Promissory notes	1,700	—	1,700	—	—
Pension Plans	4,347	630	955	970	1,792
Loans	15,492	2,478	6,135	4,168	2,711
in national currency	10,260	1,425	4,560	1,925	2,350
in foreign currencies	5,232	1,053	1,575	2,243	361
Debentures and bonds MtM	63,550	2,989	25,687	4,921	29,953
in national currency	15,967	550	8,650	2,767	4,000
in foreign currencies	47,583	2,439	17,037	2,154	25,953
Other underlying*	30,321	20,622	3,594	3,753	2,352
CCS	373	123	250	—	—
Forward	9,605	9,605	—	—	—
IRS	20,343	10,894	3,344	3,753	2,352
Total	115,410	26,719	38,071	13,812	36,808

(*) Most of these transactions are related to economic hedges of investments, assets and liabilities of subsidiaries

Financial Statements

The breakdown of Telefónica, S.A.'s derivatives in 2017, their notional amounts at year end and the expected maturity schedule is as follows:

2017

Type of risk	Value in Euros	Telefónica receives		Telefónica pays	
		Carrying	Currency	Carrying	Currency
Millions of euros					
Euro interest rate swaps	67,355				
Fixed to fixed	390	390	EUR	390	EUR
Fixed to floating	34,020	34,020	EUR	34,020	EUR
Floating to fixed	32,945	32,945	EUR	32,945	EUR
Foreign currency interest rate swaps	23,523				
Fixed to floating					
CHFCHF	534	625	CHF	625	CHF
GBPGBP	3,865	3,430	GBP	3,430	GBP
JPYJPY	74	10,000	JPY	10,000	JPY
USDUSD	17,026	20,421	USD	20,421	USD
Floating to fixed					
GBPGBP	1,217	1,080	GBP	1,080	GBP
USDUSD	807	968	USD	968	USD
Exchange rate swaps	16,040				
Fixed to fixed					
EURBRL	138	138	EUR	546	BRL
Fixed to floating					
JPYEUR	95	15,000	JPY	95	EUR
Floating to fixed					
USDEUR	702	765	USD	702	EUR
Floating to floating					
CHFEUR	515	625	CHF	515	EUR
GBPEUR	2,048	1,600	GBP	2,048	EUR
JPYEUR	101	10,000	JPY	101	EUR
USDEUR	12,441	14,849	USD	12,441	EUR
Forwards	7,592				
BRLEUR	9	33	BRL	9	EUR
CLPEUR	1	640	CLP	1	EUR
CZKEUR	67	1,708	CZK	67	EUR
EURBRL	728	728	EUR	2,889	BRL
EURCLP	367	367	EUR	270,421	CLP
EURGBP	3,056	3,056	EUR	2,712	GBP
EURMXN	1	1	EUR	18	MXN
EURUSD	1,269	1,269	EUR	1,522	USD
GBPEUR	1,021	906	GBP	1,021	EUR
GBPUSD	1	1	GBP	1	USD
USDBRL	20	24	USD	77	BRL

Financial Statements

USDCLP	3	4	USD2,353	CLP
USDCOP	1	1	USD4,130	COP
USDEUR	1,018	1,216	USD1,018	EUR
USDGBP	28	33	USD25	GBP
USDPEN	2	3	USD9	PEN

Swaption 425

Fixed to floating

EUREUR	205	205	EUR205	EUR
--------	-----	-----	--------	-----

Floating to fixed

EUREUR	220	220	EUR220	EUR
--------	-----	-----	--------	-----

Subtotal 114,935

Millions of euros

Notional amounts of structured products with options Value in Euros Notional Currency

Interest rate options Caps & Floors

1,645

Caps&Floors

1,645

GBP

845

750

GBP

EUR

800

800

EUR

Currency options

—

USDEUR

120

120

EUR

EURUSD

(120

)(120

)EUR

Subtotal

1,645

TOTAL

116,580

The breakdown by average maturity is as follows:

Millions of euros

Hedged underlying item	Notional	Up to 1 year	From 1 to 3 years	From 3 to 5 years	Over 5 years
Promissory notes and Commercial Paper	200	—	200	—	—
Pension plans	5,009	700	1,145	935	2,229
Loans	21,041	4,158	7,838	4,525	4,520
in national currency	14,635	2,425	6,600	1,660	3,950
in foreign currencies	6,406	1,733	1,238	2,865	570
Debentures and bonds MtM	63,822	7,696	18,311	13,470	24,345
in national currency	18,767	2,200	8,250	2,917	5,400
in foreign currencies	45,055	5,496	10,061	10,553	18,945
Other underlying*	26,508	13,851	5,647	3,030	3,980
CCS	390	73	317	—	—
Forward	7,591	7,591	—	—	—
IRS	18,527	6,187	5,330	3,030	3,980
Total	116,580	26,405	33,141	21,960	35,074

(*) Most of these transactions are related to economic hedges of investments, assets and liabilities of subsidiaries

Financial Statements

The debentures and bonds hedged relate to both those issued by Telefónica, S.A. and intragroup loans on the same terms as the issues of Telefónica Europe, B.V. and Telefónica Emisiones, S.A.U.

b) Risk management policy

Telefónica, S.A. is exposed to various financial market risks as a result of: (i) its ordinary business activity, (ii) debt incurred to finance its business, (iii) its investments in companies, and (iv) other financial instruments related to the above commitments.

The main market risks affecting Telefónica are as follows:

Exchange rate risk

Foreign currency risk primarily arises in connection with: (i) Telefónica's international presence, through its investments and businesses in countries that use currencies other than the euro (primarily in Latin America and in the United Kingdom), and (ii) debt denominated in currencies other than that of the country where the business is conducted or the home country of the company incurring such debt.

Interest rate risk

Interest rate risk arises primarily in connection with changes in interest rates affecting (i) financial expenses on floating rate debt (or short-term debt likely to be renewed), due to changes in interest rates and (ii) the value of non-current liabilities at fixed interest rates.

Share price risk

Share price risk arises primarily from changes in the value of the equity investments (that may be bought, sold or otherwise involved in transactions), from changes in the value of derivatives associated with such investments, from changes in the value of treasury shares and from equity derivatives.

Other risks

Telefónica, S.A. is also exposed to liquidity risk if a mismatch arises between its financing needs (operating and financial expense, investment, debt redemptions and dividend commitments) and its sources of finance (revenues, divestments, credit lines from financial institutions and capital market operations). The cost of finance could also be affected by movements in the credit spreads (over benchmark rates) demanded by lenders.

Credit risk appears when a counterparty fails to meet or delays its payment obligations in accordance with the agreed terms, driving an impairment in an asset due to: (i) solvency issues, or (ii) no intention to pay.

Finally, Telefónica is exposed to country risk (which overlaps with market and liquidity risks). This refers to the possible decline in the value of assets, cash flows generated or cash flows returned to the parent company as a result of political, economic or social instability in the countries where Telefónica, S.A. operates, especially in Latin America.

Risk management

Telefónica, S.A. actively manages these risks through the use of derivatives (primarily on exchange rates, interest rates and share prices) and by incurring debt in local currencies, where appropriate, with a view to optimize the financial cost and to stabilizing cash flows, the income statement and investments. In this way, Telefónica attempts to protect its solvency, facilitate financial planning and take advantage of investment opportunities.

Telefónica manages its exchange rate risk and interest rate risk in terms of net debt and net financial debt as calculated by them. Telefónica believes that these parameters are more appropriate to understanding its debt position. Net debt and net financial debt take into account the impact of the Group's cash balance and cash equivalents including derivatives positions with a positive value linked to liabilities. Neither net debt nor net

Financial Statements

financial debt as calculated by Telefónica should be considered an alternative to gross financial debt (the sum of current and non-current interest-bearing debt) as a measure of leverage.

Exchange rate risk

The fundamental objective of the exchange rate risk management policy is that, in event of depreciation in foreign currencies relative to the euro, any potential losses in the value of the cash flows generated by the businesses in such currencies, caused by depreciation in exchange rates of a foreign currency relative to the euro, are offset (to some extent) by savings from the reduction in the euro value of debt denominated in such currencies and/or synthetic debt in such currencies. This objective is also reflected on the decrease of the sensitivity to exchange rate variations of the net debt to operating income before depreciation and amortization (OIBDA) ratio, in order to protect the Group solvency. The degree of exchange rate hedging employed varies depending on the type of investment. For transactions of purchase or sale of business in currencies other than euro, additional hedges can be made on the estimate prices of the transactions or on estimated cash flows and OIBDA.

Telefónica occasionally takes out dollar-denominated debt to hedge the euro-dollar intermediate component in the relation euro-Latin American currencies, either in Spain (where such debt is associated with an investment as long as it is considered to be an effective hedge) or in the country itself, where the market for local currency financing or hedges may be inadequate or non-existent.

At December 31, 2018, the net financial debt in pounds sterling was approximately 1.97 times the value of the business' OIBDA in 2018 for Group companies in the United Kingdom, which was in line with the policy of previous years of 2 times the OIBDA ratio. At December 31, 2018, the net financial debt denominated in pounds sterling was equivalent to 3,566 million euros (3,089 million euros at December 31, 2017).

Telefónica also manages its exchange rate risk, seeking to significantly reduce the negative impact of any currency exposure on the income statement, both from transactions recognized on the balance sheet and those classified as highly probable, regardless of whether or not open positions are held. Such open position exposure can arise for any of three reasons: (i) a thin market for local derivatives or difficulty in obtaining funding in the local currency, making it impossible to arrange a low-cost hedge (as in Argentina and Venezuela); financing through intra-group loans, where the accounting treatment of exchange rate risk is different from that for funding through capital contributions, and (iii) as the result of a deliberate policy decision, to avoid the high cost of hedges that are not warranted by expectations or high depreciation risks.

The main transactions that generate or may generate exchange rate risk (regardless of whether or not they have an impact on the income statement) are, among others, as follows: issues in currencies other than the euro, which is Telefónica S.A.'s functional currency, highly probable transactions in other currencies, future cash inflows in other currencies, investments and divestments, provisions for collections or payments in foreign currency, the actual value of the investments (subsidiaries) in currencies other than the euro.

Interest rate risk

The Telefónica's financial expenses are exposed to changes in interest rates. In 2018 Euribor, the dollar Libor and the pound sterling Libor were the short term rates that accounted for most of the exposure. Telefónica manages its interest rate risk by entering into derivative financial instruments, primarily swaps and interest rate options.

Telefónica analyzes its exposure to changes in interest rates at the Telefónica Group level. The table illustrates the sensitivity of finance costs and the balance sheet to variability in interest rates at Group and Telefónica, S.A. level. To calculate the sensitivity of the income statement, a 100 basis point rise in interest rates in all currencies in which there are financial positions at December 31, 2018 has been assumed, as well as a 100 basis point decrease in all currencies in order to avoid negative rates. The constant position equivalent to that prevailing at the end of the year has also been assumed.

Financial Statements

To calculate the sensitivity of equity to variability in interest rates, a 100 basis point increase in interest rates in all currencies and terms in which there are financial positions at December 31, 2018 was assumed, as well as a 100 basis point decrease in all currencies and terms. Cash flow hedge positions were also considered as they are the only positions where changes in market value due to interest-rate fluctuations are recognized in equity.

In both cases, only transactions with external counterparties have been considered.

Impact on Consolidated net income	Impact on P/L Telefónica, S.A.	Impact on Consolidated Equity	Impact on Telefónica, S.A. Equity
+100bp(102)	(58)	317	317
-100bp 88	55	(317)	(317)

Share price risk

The Telefónica Group is exposed to changes in the value of equity investments derivatives associated with such investments, convertible or exchangeable instruments issued by Telefónica Group, Share-based payments plans, treasury shares and equity derivatives over treasury shares.

According to the share-based payments plans (see Note 19) the shares to be delivered to employees under such plan may be either the parent company treasury shares, acquired by them or any of its Group companies; or newly-issued shares. The possibility of delivering shares to beneficiaries of the plan in the future, implies a risk since there could be an obligation to hand over a maximum number of shares at the end of each phase, whose acquisition (in the event of acquisition in the market) in the future could imply a higher cash outflow than required on the start date of each phase if the share price is above the corresponding price on the phase start date. In the event that new shares are issued for delivery to the beneficiaries of the plan, there would be a dilutive effect for ordinary shareholders of Telefónica as a result of the higher number of shares delivered under such plan outstanding.

In 2018, the General Shareholder's Meeting approved a new long-term incentive plan consisting of the delivery of shares of Telefónica, S.A. allocated to Senior Executive Officers of the Telefónica Group. The characteristics of the plan are described in Note 19. Additionally, the Shareholder's Meeting approved a share plan for the incentivised purchase of shares for employees of the Telefónica Group, which will be implemented in 2019.

To reduce the risk associated with variations in share price under these plans, Telefónica could acquire instruments that hedge the risk profile of some of these plans.

In addition, part of the treasury shares of Telefónica, S.A. held at December 31, 2018 might be used to cover the shares deliverable under the new plans. The fair value of the treasury shares at liquidation moment could increase or decrease depending on the variations in Telefónica, S.A.'s share quotation.

Liquidity risk

The Telefónica Group seeks to match the schedule for its debt maturity payments to its capacity to generate cash flows to meet these maturities, while allowing for some flexibility. In practice, this has been translated into two key principles:

The Telefónica Group's average maturity of net financial debt is intended to stay above 6 years, or be restored above that threshold in a reasonable period of time if it eventually falls below it. This principle is considered as a guideline when managing debt and access to credit markets, but not a rigid requirement. When calculating the average maturity for the net financial debt and part of the undrawn credit lines can be considered as offsetting the shorter debt maturities, and extension options on some financing facilities may be considered as exercised, for calculation purposes.

Financial Statements

The Telefónica Group must be able to pay all commitments over the next 12 months without accessing new borrowing or tapping the capital markets (drawing upon firm credit lines arranged with banks), assuming budget projections are met.

Country risk

The Telefónica Group managed or mitigated country risk by pursuing two lines of action (in addition to its normal business practices):

- Partly matching assets to liabilities (those not guaranteed by the parent company) in the Telefónica Group's Latin American companies such that any potential asset impairment would be accompanied by a reduction in liabilities; and,
1. Repatriating funds generated in Latin America that are not required for the pursuit of new, profitable business development opportunities in the region.

Credit risk

The Telefónica Group trades in derivatives with creditworthy counterparties. Therefore, Telefónica, S.A. generally trades with credit entities whose "senior debt" ratings are of at least "A-" or in case of Spanish entities in line with the credit rating of Kingdom of Spain. In Spain, where most of the Group's derivatives portfolio is held, there are netting agreements with financial institutions, with debtor or creditor positions offset in case of bankruptcy, limiting the risk to the net position. In addition, the CDS (Credit Default Swap) of all the counterparties with which Telefónica, S.A. operates is monitored at all times in order to assess the maximum allowable CDS for operating at any given time.

Transactions are generally only carried out with counterparties whose CDS is below the threshold.

CVA or Credit Valuation Adjustment is the method used to measure credit risk for both counterparties and Telefonica in order to determine the fair value of the derivatives portfolio. This adjustment reflects the probability of default or the deterioration of the credit quality of both Telefonica and its counterparties. The simplified formula to calculate CVA is Expected Exposure times Probability of Default times Loss Given Default. In order to calculate these variables standard market practices are used.

When managing credit risk, Telefonica considers the use of CDS, novations, derivatives with break clauses and signing CSA's under certain conditions.

For other subsidiaries, particularly those in Latin America, assuming a stable sovereign rating provides a ceiling which is below "A", trades are with local financial entities whose rating by local standards is considered to be of high creditworthiness.

Meanwhile, with credit risk arising from cash and cash equivalents, the Telefónica Group places its cash surpluses in high quality and highly liquid money-market assets. These placements are regulated by a general framework, revised annually. Counterparties are chosen according to criteria of liquidity, solvency and diversification based on the conditions of the market and countries where the Group operates. The general framework sets: the maximum amounts to be invested by counterparty based on its rating (long-term debt rating); and the instruments in which the surpluses may be invested (money-market instruments).

The Telefónica Group considers customer credit risk management as a key element to achieve its business and customer base growth targets in a sustainable way. This management approach relies on the active evaluation of the risk-reward balance within the commercial operations and on the adequate separation between the risk ownership and risk management functions.

Formal delegation of authority procedures and management practices are implemented in the different Group companies, taking into account benchmark risk management techniques but adapted to the local characteristics of each market. Commercial debtors that may cause a relevant impact on the Telefónica Group consolidated financial statements and increased risk profile products - due to customer target, term, channels or other commercial characteristics - are subject to specific management practices in order to mitigate the exposure to credit risk.

Financial Statements

This customer credit risk management model is embedded in the day-to-day operational processes of the different companies, where the credit risk assessment guides both the product and services available for the different customers and the collection strategy.

Telefónica's maximum exposure to credit risk is initially represented by the carrying amounts of the assets (see Notes 8 and 9) and the guarantees given by Telefónica.

Capital management

Telefónica's corporate finance department takes into consideration several factors for the evaluation of the capital structure of the Company, with the aim of maintaining the solvency and creating value to the shareholders.

The corporate finance department estimates the cost of capital on a continuous basis through the monitoring of the financial markets and the application of standard industry approaches for calculating weighted average cost of capital, or WACC, so that it can be applied in the valuation of businesses in course and in the evaluation of investment projects. Telefónica also uses as reference a net financial debt (excluding items of a non-recurring or exceptional nature) that allows for a comfortable investment grade credit rating as assigned by credit rating agencies, aiming at protecting credit solvency and making it compatible with alternative uses of cash flow that could arise at any time. These general principles are refined by other considerations and the application of specific variables, such as country risk in the broadest sense, or the volatility in cash flow generation that are considered, when evaluating the financial structure of the Telefónica Group and its different areas.

Derivatives Policy

Telefónica's derivatives policy emphasizes the following points:

- Derivatives based on a clearly identified underlying.
- Matching of the underlying to one side of the derivative.
- Matching the company contracting the derivative and the company that owns the underlying.
- Ability to measure the derivative's fair value using the valuation systems available to the Telefónica Group.
- Sale of options only when there is an underlying exposure.

Hedge accounting

Hedges can be of three types:

Fair value hedges.

Cash flow hedges. Such hedges can be set at any value of the risk to be hedged (interest rates, exchange rates, etc.) or for a defined range (interest rates between 2% and 4%, above 4%, etc.). In this last case, the hedging instrument used is options and only the intrinsic value of the option is recognized as an effective hedge.

Hedges of net investment in consolidated foreign subsidiaries. Generally such hedges are arranged by the parent company and the other Telefónica holding companies. Wherever possible, these hedges are implemented through real debt in foreign currency. Often, however, this is not always possible as many Latin American currencies are non-convertible, making it impossible for non-resident companies to issue local currency debt. It may also be that, due to the debt market deepness, the debt in the currency concerned is not enough to accommodate the required hedge, or that an acquisition is made

Financial Statements

in cash with no need for market financing. In these circumstances derivatives, either forwards or cross-currency swaps are mainly used to hedge the net investment.

Hedges can comprise a combination of different derivatives.

There is no reason to suppose management of accounting hedges will be static, with an unchanging hedging relationship lasting right through maturity. Hedging relationships may change to allow appropriate management that serves our stated principles of stabilizing cash flows, stabilizing net financial income/expense and protecting our equity. The designation of hedges may therefore be cancelled, before maturity, because of a change in the underlying, a change in the perceived risk on the underlying or a change in market view. The hedges must meet the effectiveness test and be well documented. To gauge the efficiency of transactions defined as accounting hedges, we analyze the extent to which the changes in the fair value or in the cash flows attributable to the hedged item would offset the changes in fair value or cash flows attributable to the hedged risk using a linear regression model for both forward- and backward-looking analysis.

The possible sources of ineffectiveness that Telefónica can have when designing a hedging relationship and that will be considered when establishing the hedging rationale are:

- The hedging instrument and the hedged item have different maturity dates, initial dates, contract dates, repricing dates, etc.

- The hedging instrument starts with initial value and a financing effect is produced.

- When a cross-currency swap is designated as a hedging instrument on a foreign currency bond and the currency basis spread remains within the coverage.

- When the underlying items have different sensitivity and are not homogeneous, for example EURIBOR 3M versus EURIBOR 6M.

The main guiding principles for risk management are laid down by Telefónica's finance department and implemented by company financial officers (who are responsible for balancing the interests of each company and those of the Telefónica Group). The Corporate finance department may allow exceptions to this policy where these can be justified, normally when the market is too thin for the volume of transactions required or on clearly limited and small risks.

In 2018 the Company recognized a loss of 28.4 million euros for the ineffective part of cash flow hedges (a loss of 6.3 million euros in 2017).

The fair value of Telefónica, S.A. derivatives with third parties amounted to a positive MTM (accounts receivable) of 848 million euros in 2018 (254 million euros in 2017).

The fair value of Telefónica, S.A. intragroup derivatives amounted to a positive MTM (accounts payable) of 14 million euros in 2018 (+1 million euros in 2017).

The breakdown of the Company's derivatives with third party counterparties at December 31, 2018 and 2017 by type of hedge, their fair value at year end and the expected maturity schedule is as follows:

Financial Statements

2018

Millions of euros	Fair value	Notional amount maturities (*)				
Derivatives	(**)	2019	2020	2021	Subsequent years	Total
Interest rate hedges	(174)	(786)	1,698	—	(431)	481
Cash flow hedges	180	(650)	1,523	—	944	1,817
Fair value hedges	(354)	(136)	175	—	(1,375)	(1,336)
Exchange rate hedges	44	262	2,219	1,102	5,980	9,563
Cash flow hedges	44	262	2,219	1,102	5,980	9,563
Interest and exchange rate hedges	(467)	962	800	2,002	1,743	5,507
Cash flow hedges	(467)	962	800	2,002	1,743	5,507
Other derivatives	(251)	(9,904)	(321)	(1,481)	(2,551)	(14,257)
Interest rate	(132)	(3,571)	(321)	(881)	(2,551)	(7,324)
Exchange rate	(123)	(6,333)	—	—	—	(6,333)
Other	4	—	—	(600)	—	(600)

(*) For interest rate hedges, the positive amount is in terms of fixed “payment.” For foreign currency hedges, a positive amount means payment in functional vs. foreign currency.

(**) Positive amounts indicate payables.

2017

Millions of euros	Fair value	Notional amount maturities (*)				
Derivatives	(**)	2018	2019	2020	Subsequent years	Total
Interest rate hedges	(159)	(1,407)	(780)	1,690	577	80
Cash flow hedges	246	(900)	(650)	1,523	1,844	1,817
Fair value hedges	(405)	(507)	(130)	167	(1,267)	(1,737)
Exchange rate hedges	341	1,266	621	2,219	4,720	8,826
Cash flow hedges	341	1,266	621	2,219	4,720	8,826
Interest and exchange rate hedges	(389)	308	962	800	3,744	5,814
Cash flow hedges	(389)	308	962	800	3,744	5,814
Other derivatives	(63)	(3,418)	1,766	(495)	(3,401)	(5,548)
Interest rate	(123)	(3,035)	1,840	(495)	(3,401)	(5,091)
Exchange rate	(9)	(1,193)	(74)	—	—	(1,267)
Other	69	810	—	—	—	810

(*) For interest rate hedges, the positive amount is in terms of fixed “payment.” For foreign currency hedges, a positive amount means payment in functional vs. foreign currency.

(**) Positive amounts indicate payables.

Financial Statements

Note 17. Income tax

Pursuant to a Ministerial Order dated December 27, 1989, Telefónica, S.A. has filed consolidated tax returns with certain Group companies. The consolidated tax group in 2018 and 2017 comprised 44 and 45 companies, respectively. Consolidated tax group is valid during an indefinite period as long as the law requirements are fulfilled, or the Company decides to expressly resign to it.

Tax balances as of December 31, 2018 and 2017 are as follows:

Millions of euros	2018	2017
Tax receivables:	3,157	3,167
Deferred tax assets:	2,978	2,857
Deferred income tax (income)	277	406
Long-term tax credits for loss carryforwards	1,831	1,060
Unused tax deductions	870	1,391
Current tax receivables (Note 10):	179	310
Withholdings	20	19
Corporate income tax payable	154	284
VAT and Canary Islands general indirect tax refundable	5	7
Tax payable:	470	680
Deferred tax liabilities:	291	427
Current payables to public administrations (Note 18):	179	253
Personnel income tax withholdings	5	4
Withholding on investment income, VAT and other	173	247
Social security	1	2

Telefónica, S.A. has tax credits for loss carryforwards, unused by Tax Group in Spain at December 31, 2018 amounting to 8,291 million euros (gross):

31/12/2018	Total carryforwards	Less than 1 year	More than 1 year	Total recognized
Tax Group tax credits for loss carryforwards	8,040	3,322	4,718	6,784
Prior to Tax Group loss carryforwards (*)	251	—	251	—

(*) Unused tax credits for loss carryforwards

Total tax credits based on the taxable income recognized in the balance sheet at December 31, 2018 therefore amounts to 1,831 million euros (1,160 million euros in 2017).

During 2018, Telefónica, S.A., as head of the Telefónica tax group, made payments on account of income tax amounting to 20 million euros (131 million euros in 2017).

17.1 Movement in deferred tax assets and liabilities

The balances and movements in “Deferred tax assets” and “Deferred tax liabilities” for Telefónica, S.A. at December 31, 2018 and 2017 are as follows:

Telefónica, S.A. 60

Financial Statements

2018

Millions of euros	Tax credits	Temporary differences, assets	Deductions	Total deferred tax assets	Deferred tax liabilities
Opening balance	1,060	406	1,391	2,857	427
Arising in the year	780	4	10	794	2
Reversal	—	(93)	(472)	(565)	—
Transfers to the tax group's net position	(9)	(40)	(59)	(108)	(138)
Closing balance	1,831	277	870	2,978	291

2017

Millions of euros	Tax credits	Temporary differences, assets	Deductions	Total deferred tax assets	Deferred tax liabilities
Opening balance	1,174	479	1,310	2,963	571
Arising in the year	—	19	9	28	—
Reversal	(114)	(56)	(6)	(176)	(2)
Transfers to the tax group's net position	—	(36)	78	42	(142)
Closing balance	1,060	406	1,391	2,857	427

Due to the amendment of the Corporate Tax Law by Royal Legislative Decree (RLD) 3/2016, of December 2, that limits the offsetting of negative tax bases to 25%, as a result of the impairment testing on the recoverability of deferred tax assets carried out by the Group, 98 million euros of tax loss carryforwards were reversed in 2017. In 2018, the schedule of deferred tax assets and liabilities consumption has been built in accordance with the resolution issued by the Spanish Central Economic-Administrative Tax Court (Tribunal Económico Administrativo Central), notified on January 22, 2019, partially upholding the claims of the Company regarding the usage of tax credits, mainly tax loss carryforwards, during the years 2008, 2009 and 2010. As a consequence of this assumption, tax loss carryforwards amounting to 780 million euros have been activated and tax deductions of 472 million euros have been reversed (9 million euros were capitalized in 2017).

The effect of deferred taxes in equity in 2018 is a net disposal of 66 million euros (5 million euros of additions in 2017).

On the other hand, and in compliance with the sixteenth transitional provision of this RDL 3/2016, which requires the inclusion of one-fifth of the investment portfolio impairment losses which had been deductible in the tax base before January 1, 2013, 138 million euros of recorded deferred tax liabilities have been reversed, offsetting the negative gross tax payable (141 million euros in 2017).

Financial Statements

17.2 Reconciliation of accounting profit to taxable income and income tax expense to income tax payable.

The calculation of the income tax expense and income tax payable for 2018 and 2017 is as follows.

Millions of euros	2018	2017
Accounting profit before tax	2,264	274
Permanent differences	(4,489)	(2,241)
Temporary differences:	464	394
Arising in the year	15	32
Arising in prior years	449	362
Tax result	(1,761)	(1,573)
Gross tax payable	(440)	(393)
Corporate income tax refundable	(440)	(393)
Activation/Reversion of loss carryforwards and/or deductions	(319)	89
Temporary differences for tax valuation	(116)	(99)
Other effects	71	84
Corporate income tax accrued in Spain	(804)	(319)
Foreign taxes	54	39
Income tax	(750)	(280)
Current income tax	(386)	(355)
Deferred income tax	(364)	75

The permanent differences mainly correspond to the change in the write-off of the investments in Group companies, to the non-tributable dividends received, to the non-tributable capital gains on the non-monetary contribution of the stake in Telxius transferred to Pontel and the subsequent sale of 16.65% share capital of Pontel (see Note 8) and to the financial goodwill.

The heading "Activation/reversion of loss carryforwards and/or deductions" mainly includes the reversion of deductions by 472 million euros (activation of deductions amounting to 9 million euros in 2017) and the activation of loss carryforwards by 780 million euros (reversal of loss carryforwards by 98 million euros in 2017), as mentioned in caption 17.1.

The caption "Other effects" mainly includes the impact arising from the provision made in relation to the tax deductibility of the financial goodwill taken in the year (see section 17.3).

17.3 Tax inspections and tax-related lawsuits

In 2012, tax inspections for all taxes for the years 2005 to 2007 were completed, with the Company signing off a corporate income tax assessment of 135 million euros, which was paid in 2012, whilst disputing other adjustments with which it disagreed. Although the settlement agreement for the disputed tax assessment did not give rise to any tax payment, since the adjustments proposed were offset by unused tax credits for loss carryforwards, the Company filed an appeal with the Central Economic-Administrative Court against these adjustments in May 2015, regarding the tax treatment of the "juros sobre el capital propio" (interest on own capital) as dividends.

On the other hand, in July 2015, tax inspections for all taxes for the years 2008 to 2011 were completed, with the Company signing off certain corporate income tax assessments and disputing others. This resulted in an expense amounting to 206 million euros in 2015. However, no cash payment was made, as the adjustments arising from the inspection were offset by unused tax credits for loss carryforwards, at the corresponding tax rate for each period.

Financial Statements

Although the settlement agreement for the disputed tax assessment did not give rise to any tax payment, in July 2015 the Company filed an appeal with the Central Economic-Administrative Court against the adjustments in dispute, regarding the tax treatment of the “juros sobre el capital propio” (interest on own capital) as dividends, and the criteria to use tax credits for loss carryforwards in the years subject to settlement.

In June 2017 the Company received an order of the Audiencia Nacional extending the effects of its ruling from February 27, 2014 from another tax payer to the individual legal status of Telefónica in connection with the “Juros sobre el capital propio” (interest on own capital). As a consequence of the aforementioned, the Audiencia Nacional has voided the corporate income tax assesment, for the years 2005 to 2007 and 2008 to 2011 related to “Juros sobre el capital propio” settled by the tax authorities.

With respect to the use of tax loss carryforwards in the years subject to settlement during the inspection 2008 to 2011, still under litigation, in November 2017 the Company brought a judicial appeal to the Audiencia Nacional, against the alleged dismissal of the claim in the absence of a reply from the authorities. On January 22, 2019, Telefónica was notified of a resolution issued by the Central Economic-Administrative Court which partially upheld the claims made by Telefónica in connection with the tax inspections in dispute. Telefónica intends to appeal this resolution, which has not been executed yet, in respect of such matters that were resolved against the Company's interest.

At 2018 year end, it is not expected that there is any need to recognize additional liabilities for the outcome of this litigation.

Tax deductibility of financial goodwill

The tax regulations added article 12.5 to the Corporate Income Tax Law, which came into force on January 1, 2002. The article regulated the deductibility of tax amortization of financial goodwill arising from the acquisition of non-Spanish companies, which could be amortized over 20 years at 5% per annum. Following the entry into force of the Laws 9/2011 of August 19, 2011 and 16/2013 of October 29, 2013, the amount of goodwill amortization deductible for tax purposes under article 12.5 for the years 2011 to 2015 was reduced from 5% to 1%. The effect is temporary because the 4% not amortized during five years (20% in total) will be recovered extending the deduction period from the initial 20 years to 25 years.

The Telefónica Group, under this regulation, has been amortizing for tax purposes the financial goodwill from its investments, both direct and indirect, in O2, BellSouth and ColTel (prior to December 21, 2007) and Vivo (acquired in 2010). The positive accumulated effect in the corresponding settlements of corporate income tax from 2004 to the closing of December 31, 2018, was 1,389 million euros.

In relation to this tax incentive, the European Commission (EC) has in recent years commenced three proceedings against the Spanish State as it deems that this tax benefit could constitute an example of state aid. Although the EC itself acknowledged the validity of its first two decisions for those investors that invested in European companies (for operations carried out before December 21, 2007 in the first decision, and before May 21, 2011 for investments in other countries in the second decision), in its third decision from October 15, 2014 it calls into question the applicability of the principle of legitimate expectations in the application of the incentive for indirect acquisitions, whatever the date of acquisition may have been.

As of the date of these annual financial statements, the three decisions continue subject to a final ruling. The first two were annulled by two judgments of the General Court of the European Union, which were appealed by the EC before the Court of Justice of the European Union and sent again to the General Court by the Judgment dated December 21, 2016, to reassess the tax incentive. The Court sentenced November 15, 2018, confirming the applicability of legitimate expectations principle, but considering the "goodwill amortization" as state aid no compatible with the common market. The last Sentence has been appealed before the Court of Justice of the European Union; the third decision is still pending.

Financial Statements

Furthermore, there are doubts in the Spanish courts regarding the classification of the incentive as a deduction and if this deduction would remain in the case of a subsequent transfer of the relevant stake.

The Group has continued accruing the amount of the goodwill amortized for tax purposes, corresponding mainly to the purchase of Vivo, for a total of 283 million euros at December 31, 2018 (215 million euros at December 31, 2017).

Telefónica, S.A. 64

Financial Statements

Note 18. Trade, other payables and provisions

A) Trade and other payables

The breakdown of "Trade and other payables" is as follows:

Millions of euros	2018	2017
Suppliers	83	84
Accounts payable to personnel	37	36
Other payables	63	166
Other payables to public administrations (Note 17)	179	253
Total	362	539

Other payables

In accordance with Telefónica's irrevocable commitment, undertaken in 2015, to pay a 325 million euros donation to Fundación Telefónica, in 2018 cash payments have been made in an amount of 94 million euros and in-kind contributions amounting to 2 million euros. The outstanding amount of this item as of December 31, 2018 totals 49 million euros.

Information on deferred payments to third parties. (Third additional provision, "Information requirement" of Law 15/2010 of July, 5).

In accordance with the aforementioned Law, the following information corresponding to the Company is disclosed:

	2018	2017
	Number of days	Number of days
Weighted average maturity period	39	37
Ratio of payments	39	38
Ratio of outstanding invoices	39	19
	Millions of euros	Millions of euros
Total Payments	303	323
Outstanding invoices	29	28

Telefónica, S.A. has adapted its internal processes and payment schedules to the provisions of Law 15/2010 (amended by Law 31/2014) and Royal Decree 4/2013, amending Law 3/2004, establishing measures against late payment in commercial transactions. Engagement conditions with commercial suppliers, as contractually agreed with them, in 2018 included payment periods with a maximum of 60 days.

For reasons of efficiency and in line with general practice in the business, the Company has set payment schedules, whereby payments are made on set days. Invoices falling due between two payment days are settled on the following payment date in the schedule.

Payments to Spanish suppliers in 2018 surpassing the legal limit were due to circumstances or incidents beyond the payment policies, mainly the delay in the billing process (a legal obligation for the supplier), the closing of agreements with suppliers over the delivery of goods or the rendering of services, or occasional processing issues.

Financial Statements

B) Provisions

In 2018 and 2017 the concepts and amounts under the provision captions are the following:

2018

Millions of euros	Non-current	Current	Total
Tax Provisions	298	—	298
Termination plans (Note 19)	82	18	100
Other provisions	114	75	189
Total	494	93	587

2017

Millions of euros	Non-current	Current	Total
Tax Provisions	230	—	230
Termination plans (Note 19)	115	44	159
Other provisions	114	79	193
Total	459	123	582

Movements in the provisions during 2018 and 2017 are disclosed below:

Millions of euros	2018	2017
Opening balance:	582	488
Additions	68	142
Amortization and reversals	(59)	(29)
Transfers	—	(22)
Fair value adjustments and others	(4)	3
Closing balance:	587	582
Maturity:		
Non-current	494	459
Current	93	123

In 2018 the caption “Additions” includes 68 million euros (62 million euros in 2017) of tax provisions for the article 12.5 of the Spanish Corporate Tax Law related to the acquisition of Vivo (see Note 17).

The caption “Transfers” included in 2017 the partial recovery of the value of certain investments which had a negative book value in 2016.

With respect to the simplification and transformation process of the Telefónica Group, Telefónica, S.A. launched in 2015 a voluntary termination plan ending in December 2017 for the employees who met the requirements defined by the Plan regarding age and seniority in the Company, among others. Following this transformation and simplification framework, the Company, on the one hand, extended the plan termination till 2018 and on the other hand, set up in December 2016 a new voluntary programme aimed at some employees who met certain requirements related to seniority in the Company. In 2017 the last programme was extended, with an additional provision of 11 million euros shown as "Additions" in the 2017 chart of movements.

Regarding the aforementioned termination plan, the caption “Amortization and reversals” includes in 2018 a provision reversal amounting to 18 million euros and amortizations of the same provision amounting to 41 million euros. During 2017 amortization and reversals related to this plan were recorded amounting to 36 million euros.

Financial Statements

Note 19. Revenue and expenses

19.1 Revenue

a) Rendering of services

Telefónica, S.A. has contracts for the right to use the Telefónica brand with Group companies which use the license. The amount each subsidiary must recognize as a cost for use of the license is stipulated in the contract as a percentage of income obtained by the licensor. In 2018 and 2017, “Rendering of services to Group companies and associates” included 440 and 481 million euros, respectively, for this item.

Telefónica, S.A. has signed contracts to provide management support services to Telefónica de España, S.A.U, Telefónica Móviles España, S.A.U., Telefónica UK, Ltd., Telefónica Latinoamérica Holding, S.L., Telxius Telecom, S.A. and since 2018, Telefónica Germany, GmbH. Revenues received for this concept in 2018 and 2017 amounted to 30 and 31 million euros, respectively, recognized under “Rendering of services to Group companies and associates”. Revenues also include property rental income amounting to 43 and 45 million euros in 2018 and 2017, respectively, mainly generated from the lease of office space in Distrito Telefónica to several Telefónica Group companies (see Note 7).

b) Dividends from Group companies and associates

The detail of the main amounts recognized in 2018 and 2017 is as follows:

Millions of euros	2018	2017
Telfisa Global, B.V.	700	733
Telefónica de España, S.A.U.	1,574	664
Telefónica Europe, plc.	609	619
Telefónica Móviles España, S.A.U.	552	305
Telefônica Brasil, S.A.	447	355
Sao Paulo Telecomunicações, Ltda	77	130
Telefónica Móviles Argentina, S.A.	31	164
Telefónica Centroamérica Inversiones, S.L.	42	34
Telefónica Luxembourg Holding S.à.r.L	165	—
Telxius Telecom, S.A.	32	—
Other companies	30	23
Total	4,259	3,027

Telefónica, S.A. 67

Financial Statements

c) Interest income on loans to Group companies and associates

This heading includes the return obtained on loans granted to subsidiaries to carry out their business (see Note 8.5).

The breakdown of the most significant amounts is as follows:

Millions of euros	2018	2017
Telefónica Móviles México, S.A. de C.V.	49	43
Telefónica Móviles España, S.A.U.	6	7
Telefónica Latinoamérica Holding, S.L.	32	—
Telefónica Móviles Argentina, S.A.	—	4
Other companies	37	41
Total	124	95

19.2 Non-core and other current operating revenues

“Non-core and other current operating revenues – Group companies” relates to revenues on centralized services that Telefónica, S.A., as head of the Group, provides to its subsidiaries. Telefónica, S.A. bears the full cost of these services and then charges each individual subsidiary for the applicable portion.

19.3 Personnel expenses and employee benefits

The breakdown of “Personnel expenses” is as follows:

Millions of euros	2018	2017
Wages, salaries and other personnel expenses	119	151
Pension plans	3	2
Social security costs	21	21
Total	143	174

In 2018, “Wages, salaries and other personnel expenses” includes a reversal of compensation accruals amounting to 18 million euros (11 million euros of compensation accrual in 2017). The outstanding figure of this concept at 2018 closing balance has been described in Note 18.

Telefónica has reached an agreement with its staff to provide an Occupational Pension Plan pursuant to Legislative Royal Decree 1/2002, of November 29, approving the revised Pension Plans and Funds Law. The features of this plan are as follows:

Defined contribution of 4.51% of the participating employees’ base salary. The defined contributions of employees transferred to Telefónica from other Group companies with different defined contributions (e.g. 6.87% in the case of Telefónica de España, S.A.U.) will be maintained.

•Mandatory contribution by participants of a minimum of 2.2% of their base salary.

•Individual and financial capitalization systems.

This fund was outsourced to Telefónica subsidiary, Fonditel Entidad Gestora de Fondos de Pensiones, S.A., which has added the pension fund assets to its Fonditel B fund.

At December 31, 2018, 2,152 employees have signed up for the plan (2,059 employees in 2017). This figure includes both employees contributing and those who have ceased to contribute to the plan, as provided for in Royal Decree 304/2004 approving the regulations for Pension Plans and Funds. The cost for the Company amounted to 4 million euros both in 2017 and 2018.

Financial Statements

In 2006, a Pension Plan for Senior Executives, wholly funded by the Company, was created and complements the previous plan and involves additional defined contributions at a certain percentage of the executive's fixed remuneration, based on professional category, plus some extraordinary contributions depending on the circumstances of each executive, payable in accordance with the terms of the plan.

Telefónica, S.A. has recorded costs related to the contributions to this executive plan of 8 million euros in both 2017 and 2018. In 2018 and 2017 some executives under this Pension Plan for Senior Executives have left the Company, and accordingly their accumulated contributions have been retrieved by Telefónica, S.A. and registered as a minor expense totaling 9 million euros in both years.

No provision was made for this plan as it has been fully externalized.

The main share-based payment plans in place in the 2017-2018 period are as follows:

Long-term incentive plan based on Telefónica, S.A. shares: Performance Share Plan 2018-2022

At the General Shareholders' Meeting held on June 8, 2018, a long-term incentive plan was approved, consisting of the delivery of shares of Telefónica, S.A. aimed at senior executive officers of the Telefónica Group, including the Executive Directors of Telefónica, S.A. The plan consists of the delivery to the participants of a certain number of shares of Telefónica, S.A. based on compliance with the objectives established for each of the cycles into which the plan is divided.

In the first cycle of the plan, the number of shares to deliver will depend (i) 50% on achievement of the total shareholder return ("TSR") objective for shares of Telefónica, S.A. and (ii) 50% on the generation of free cash flow of the Telefónica Group ("FCF").

For each of the remaining cycles, the Board of Directors of Telefónica, S.A. may introduce new objectives linked to sustainability, the environment or corporate governance, as well as vary the relative weight accorded to each of them. The plan will have a total duration of five years and will be divided into three cycles of three years each. The first cycle commenced in 2018 and will be finalized on December 31, 2020, with delivery of the respective shares in 2021. The maximum number of shares assigned to senior executive officers of the Telefónica Group in this cycle of the plan is 8,466,996 shares and the outstanding shares at December 31, 2018 8,451,511, with the following breakdown:

First cycle	No. of shares assigned	Outstanding shares as of December 31, 2018	Unit fair value
TSR Objective	4,233,498	4,225,755.5	4.52
FCF Objective	4,233,498	4,225,755.5	6.46
Total number of shares	8,466,996	8,451,511	

From this total, the shares assigned to Telefónica, S.A.'s employees are 2,950,982. The outstanding shares as of December 31, 2018 are 2,931,478.

Long-term incentive plan based on Telefónica, S.A. shares: "Performance and Investment Plan 2014-2019"

The Telefónica, S.A. General Shareholders' Meeting on May 30, 2014 approved a new installment of the long-term share-based incentive "Performance and Investment Plan" for certain senior executives and members of the Group's management team, operational on completion of the first "Performance and Investment Plan".

The term of the plan was a total of five years divided into three cycles. The initial and the second share allocations took place on October 1, 2014, and on October 1, 2015, respectively. Regarding the third cycle of this 2016-2019 Plan, the Company's Board of Directors, following a favorable report from the Nomination, Compensation and Corporate Governance Committee, resolved not to execute or implement it, after having decided that it was

Financial Statements

not sufficiently in line with the Telefónica Group's strategic plan, taking into account the circumstances and macroeconomic environment.

The first cycle expired on September 30, 2017. The maximum number of shares assigned to this cycle of the plan was 6,927,953 shares assigned on October 1, 2014, with a fair value of 6.82 euros per share. The second cycle expired on September 30, 2018. The maximum number of shares assigned to this cycle was 6,775,445 shares assigned on October 1, 2015, with a fair value of 6.46 euros per share. Delivery of shares was not required at the end of each of these cycles according to the general conditions of the plan; therefore, managers did not receive any shares.

Long-term incentive plan based on Telefónica, S.A. shares: "Talent for the Future Share Plan 2018-2022" (TFSP)
The Telefónica, S.A.'s Board of Directors, at its meeting on June 8, 2018, agreed the launch of a new installment of the long-term incentive plan "Talent for the Future Share Plan".

The term of this new plan is also five years and it is divided into three cycles. As in the case of the Performance Share Plan described above, in the first cycle of the plan the number of shares to deliver will depend (i) 50% on achievement of the total shareholder return ("TSR") objective for shares of Telefónica, S.A. and (ii) 50% on the generation of free cash flow of the Telefónica Group ("FCF").

The first cycle commenced in 2018 and will be finalized on December 31, 2020, with delivery of the respective shares in 2021. The maximum number of shares assigned to employees of the Telefónica Group in this cycle of the plan is 787,500 shares and the outstanding shares at December 31, 2018 785,750, with the following breakdown:

First cycle	No. of shares assigned	Outstanding shares as of December 31, 2018	Unit fair value (euros)
TSR Objective	393,750	392,875	4.52
FCF Objective	393,750	392,875	6.46
Total number of shares	787.500	785.750	

From this total, the shares assigned to Telefónica, S.A.'s employees are 92,500. This same number of shares are outstanding at year end.

Long-term incentive plan based on Telefónica, S.A. shares: "Talent for the Future Share Plan 2014-2019" (TFSP)

At the General Shareholders' Meeting held on May 30, 2014, a long-term share-based incentive plan called "Talent for the Future Share Plan" was approved for certain Telefónica Group employees.

The plan consisted of the delivery of a certain number of shares of Telefónica, S.A. to participants selected by the Company who had opted to take part in the scheme and had met the requirements and conditions stipulated to this end.

The term of the plan was five years and it was divided into three cycles. The initial and the second share allocations took place on October 1, 2014, and on October 1, 2015, respectively. Regarding the third cycle of this 2016-2019 Plan, the Company's Board of Directors, following a favorable report from the Nomination, Compensation and Corporate Governance Committee, resolved not to execute or implement it, after having decided that it was not sufficiently in line with the Telefónica Group's strategic plan, taking into account the circumstances and macroeconomic environment.

Financial Statements

The first cycle expired on September 30, 2017. The maximum number of shares assigned to this phase of the plan was 556,795 shares assigned on October 1, 2014, with a fair value of 6.82 euros per share. The second cycle expired on September 30, 2018. The maximum number of shares assigned to this phase of the plan was 618,000 shares assigned on October 1, 2015, with a fair value of 6.46 euros per share. Delivery of shares was not required at the end of each of these cycles according to the general conditions of the plan.

Telefónica, S.A. global share plans "Global Employee Share Plans"

The Telefónica, S.A. Ordinary General Shareholders' meeting on May 30, 2014 approved a new voluntary plan for incentivised purchases of shares of Telefónica, S.A. for the employees of the Group, with certain exceptions. Under this Plan, employees were offered the option to acquire Telefónica, S.A. shares during a twelve-month period (the acquisition period), with the company undertaking to deliver a certain number of free shares to participants, subject to certain requirements. Each employee was limited to buying a maximum of 1,800 euros in Telefónica, S.A. shares, subject to a minimum of 300 euros. The employees that remained part of the Telefónica Group and held on to the shares for one year following the acquisition period (the shareholding period), were entitled to receive one free share for each share they acquired and retained throughout the shareholding period.

The acquisition period commenced in July 2015 and ended in June 2016. The share holding period ended in August 2017. 27,018 employees on the scheme were rewarded with a total of 3,187,055 Telefónica shares, valued at approximately 33 million euros at the time they were delivered.

In addition, at the General Shareholders' Meeting held on June 8, 2018, a new global employee incentive share purchase plan for shares of Telefónica, S.A. was approved, aimed at employees of the Telefónica Group, that will be launched in 2019. The total number of free shares to be delivered for the whole plan may never exceed 0.1% of the share capital of Telefónica, S.A.

19.4 Average number of employees in 2018 and 2017 and number of employees at year-end:
2018

Professional category	Employees at 12/31/18			Average no. of employees in 2017		
	Females	Males	Total	Females	Males	Total
Chairman and General Managers	—	1	1	—	1	1
Directors	58	130	188	56	132	188
Managers	152	174	326	145	158	303
Project Managers	168	126	294	167	117	284
University graduates and experts	161	114	275	155	104	259
Administration, clerks, advisors	105	8	113	104	5	109
Total	644	553	1,197	627	517	1,144

2017

Professional category	Employees at 12/31/17			Average no. of employees in 2016		
	Females	Males	Total	Females	Males	Total
Chairman and General Managers	—	1	1	—	1	1
Directors	53	125	178	60	130	190
Managers	145	151	296	141	151	292
Project Managers	155	112	267	159	113	272
University graduates and experts	145	92	237	136	85	221
Administration, clerks, advisors	106	6	112	104	6	110
Total	604	487	1,091	600	486	1,086

Financial Statements

According to the new requirement of the Spanish Companies Law established in article 260, the average number of employees in 2018 with disability of 33% or higher, establishing the categories to which they belong are the following:

Professional category	Average number of employees
Project Managers	1
University graduates and experts	2
Administration, clerks, advisors	1
Total	4

19.5 External services.

The items composing “External services” are as follows:

Millions of euros	2018	2017
Rent	12	12
Independent professional services	136	128
Donations (Note 18)	1	1
Marketing and advertising	110	138
Other expenses	41	121
Total	300	400

On December 19, 2007, Telefónica, S.A. signed a rental contract with a view to establishing the headquarters of the “Telefónica Corporate University”. The lease period is 15 years (until 2023), renewable for another five.

Future minimum rentals payable under non-cancellable operating leases without penalization at December 31, 2018 and 2017 are as follows:

Millions of euros	Total	Up to 1 year	From 1 to 3 years	From 3 to 5 years	Over 5 years
Future minimum rentals 2018	28	6	6	11	5
Future minimum rentals 2017	30	5	15	10	—

19.6 Finance revenue

The items composing “Finance revenue” are as follows:

Millions of euros	2018	2017
Dividends from other companies	12	14
Other third parties financial revenues and gains on derivative instruments	347	397
Total	359	411

“Other third parties finance revenues and gains on derivative instruments” include the effect of the financial hedges arranged to unwind positions for 2018 and 2017, which have the same amount under “Finance costs payable to third parties by financial hedges” and therefore do not have a net impact in the income statement.

Telefónica, S.A. 72

Financial Statements

19.7 Finance costs

The breakdown of "Finance costs" is as follows:

Millions of euros	2018	2017
Interest on borrowings from Group companies and associates	1,910	1,894
Finance costs payable to third parties and losses on interest rates of financial hedges	320	405
Total	2,230	2,299

The breakdown by Group company of debt interest expenses is as follows:

Millions of euros	2018	2017
Telefónica Europe, B.V.	648	479
Telefónica Emisiones, S.A.U.	1,223	1,335
Other companies	39	80
Total	1,910	1,894

Other companies includes financial costs with Telfin Ireland Limited and Telfisa Global, B.V. related to current payables for specific cash needs.

The amount included as "Finance costs payable to third parties and losses on interest rate of financial hedges" refers to fair value effects in the valuation of derivative instruments described in Note 16. As it has been explained in the Note 19.6, some of these derivative instruments do not have a net impact in the income statement because they are part of the hedges to unwind positions, so they have a similar impact under "other financial revenues".

19.8 Exchange differences:

The breakdown of exchange losses recognized in the income statement is as follows:

Millions of euros	2018	2017
On current operations	20	33
On loans and borrowings	92	299
On derivatives	710	1,007
On other items	50	29
Total	872	1,368

The breakdown of exchange gains recognized in the income statement is as follows:

Millions of euros	2018	2017
On current operations	21	28
On loans and borrowings	116	88
On derivatives	604	1,013
On other items	82	54
Total	823	1,183

Financial Statements

The variation in exchange gains and losses is due to the fluctuations in the main currencies the Company works with. In 2018 US dollar exchange rate has strengthened by 4.72% against euro, unlike 2017 trend, when it was significantly depreciated by 13.8% against euro. Pound sterling exchange rate has depreciated by 0.81% (in 2017 there was a depreciation of 3.77% against euro). Brazilian real has significantly depreciated by 10.60%, (in 2017 it was depreciated by 15.5% against euro). These impacts are offset by the hedges contracted to mitigate exchange rate fluctuations.

19.9 Impairment losses on disposal of financial instruments with third parties

In 2017 the Company recognized a write-down of its investment in Prisa (see Note 9.3) amounting to 30 million euros. In 2018 there has been no need to make additional value adjustments regarding this investment.

Financial Statements

Note 20. Other information

a) Financial guarantees

At December 31, 2018, Telefónica, S.A. had provided financial guarantees for its subsidiaries and investees to secure their transactions with third parties amounting to 46,218 million euros (45,220 million euros at December 31, 2017). These guarantees are measured as indicated in Note 4.g).

Millions of euros

Nominal Amount	2018	2017
Debentures and bonds and equity instruments	43,833	42,659
Loans and other payables	719	711
Other marketable debt securities	1,666	1,850
Total	46,218	45,220

The debentures, bonds and equity instruments in circulation at December 31, 2018 issued by Telefónica Emisiones, S.A.U., Telefónica Europe, B.V., Telefónica Finanzas México, S.A. de C.V. and Telefónica Participaciones, S.A.U., were guaranteed by Telefónica, S.A. The nominal amount guaranteed was equivalent to 43,833 million euros at December 31, 2018 (42,659 million euros at December 31, 2017). During 2018, Telefónica Emisiones, S.A.U. issued debt instruments on capital markets for an equivalent of 3,611 million euros (6,852 million euros in 2017) and 3,713 million euros matured during 2018 (5,372 million euros during 2017).

The main loans and other debts guaranteed by Telefónica, S.A. at December 31, 2018 are: the cash-settled equity link bonds non-dilutive issued by Telefónica Participaciones, S.A.U., whose outstanding amount at December 31, 2018 and 2017 was 600 million euros in both years.

“Other marketable debt securities” includes the guarantee of Telefónica, S.A. relating to the commercial paper issue program of Telefónica Europe, B.V. The outstanding balance of commercial paper in circulation issued through this programme at December 31, 2018 was 1,666 million euros (1,850 million euros at December 31, 2017).

Telefónica, S.A. provides operating guarantees granted by external counterparties, which are offered during its normal commercial activity. At December 31, 2018 and 2017, these guarantees amounted to approximately 41 million euros in both years.

b) Litigation

Telefónica and its group companies are party to several legal proceedings which are currently in progress in the courts of law and the arbitration bodies of the various countries in which we are present.

Based on the advice of our legal counsel it is reasonable to assume that these legal proceedings will not materially affect the financial condition or solvency of the Telefónica Group.

It is worth highlighting the following aspects relating to the unresolved legal proceedings or those underway during 2018 (see Note 17 for details of tax-related cases):

Appeal against the Decision of the European Commission dated January 23, 2013 to sanction Telefónica for the infringement of Article 101 of the Treaty on the functioning of the European Union

On January 19, 2011, the EC initiated formal proceedings to investigate whether Telefónica, S.A. (Telefónica) and Portugal Telecom SGPS, S.A. (Portugal Telecom) had infringed European Union anti-trust laws with respect to a clause contained in the sale and purchase agreement of Portugal Telecom’s ownership interest in Brasilcel, N.V., a joint venture in which both were venturers and which was the owner of the Brazilian company Vivo.

Financial Statements

On January 23, 2013, the European Commission passed a ruling on the formal proceedings. The ruling imposed a fine on Telefónica of 67 million euros, as the European Commission ruled that Telefónica and Portugal Telecom committed an infraction of Article 101 of the Treaty on the Functioning of the European Union for having entered into the agreement set forth in Clause Nine of the sale and purchase agreement of Portugal Telecom's ownership interest of Brasilcel, N.V.

On April 9, 2013, Telefónica filed an appeal for annulment of this ruling with the European Union General Court. On August 6, 2013, the European Union General Court notified Telefónica of the response issued by the European Commission, in which the European Commission reaffirmed the main arguments of its ruling and, specially, that Clause Nine includes a competition restriction. On September 30, 2013, Telefónica filed its reply. On December 18, 2013, the European Commission filed its appeal.

A hearing was held on May 19, 2015, at the European Union General Court.

On June 28, 2016, the European Union General Court ruled. Although it declares the existence of an infringement of competition law, it annuls Article 2 of the contested Decision and requires the European Commission to reassess the amount of the fine imposed. The General Court considers that the European Commission has not neutralized the allegations and evidences provided by Telefónica on services in which there was not potential competition or were outside the scope of Clause Nine.

Telefónica understands that there are grounds for believing that the ruling does not suit at law; consequently, it filed an appeal to the Court of Justice of the European Union, on September 11, 2016.

On November 23, 2016, the EC filed its response against the Telefónica's appeal. On January 30, 2017, Telefónica filed its reply. On March 9, 2017, the European Commission filed its rejoinder.

On December 13, 2017, the General Court dismissed the appeal filed by Telefónica. The European Commission must issue a new resolution in accordance with the judgment of the General Court of June 2016, which urged the Commission to recalculate the amount of the fine.

Decision by the High Court regarding the acquisition by Telefónica of shares in Český Telecom by way of tender offer Venten Management Limited ("Venten") and Lexburg Enterprises Limited ("Lexburg"), were minority shareholders of Český Telecom. In September 2005 both companies sold their shares to Telefónica in a mandatory tender offer.

Subsequently Venten and Lexburg, in 2006 and 2009, respectively, filed actions against Telefónica claiming a higher price than the price for which they sold their shares in the mandatory tender offer.

On August 5, 2016, the hearing before the High Court in Prague took place in order to decide the appeal against the second decision of the Municipal Court, which had been favourable to Telefónica's position (as was also the case with the first decision of the Municipal Court). At the end of the hearing, the High Court announced the Second Appellate Decision by which it reversed the second decision of the Municipal Court and ordered Telefónica to pay 644 million Czech koruna (approximately 23 million euros) to Venten and 227 Czech koruna (approximately 8 million euros) to Lexburg, in each case plus interest.

On December 28, 2016, the decision was notified to Telefónica. Telefónica filed an extraordinary appeal, requesting the suspension of the effects of the decision.

In March 2017, Telefónica was notified of the decision of the Supreme Court, which ordered the suspension of the effects of the unfavorable decision to Telefónica issued by the High Court.

Venten and Lexburg filed with the Supreme Court a motion to partially abolish the suspension of enforceability of the Decision of the High Court in Prague. On January 17, 2018, Telefónica filed its response seeking dismissal of such motion for lack of legal basis.

On February 14, 2019, notification was given to Telefónica of the resolution of the Supreme Court which, based on the extraordinary appeal filed by Telefónica, abolished the decision of the High Court in Prague dated August 5, 2016 and remanded the case back to the High Court.

Financial Statements

c) Other contingencies

Telefónica is currently conducting internal investigations covering various countries regarding possible violations of applicable anti-corruption laws. Telefónica continues to cooperate with governmental authorities and continues with the ongoing investigations. Although it is not possible at this time to predict the scope or duration of these matters or their likely outcome, Telefónica believes that, considering the size of the Group, any potential penalty as a result of the resolution of these investigations would not materially affect the Group's financial condition.

d) Commitments

Agreement related to the Sale of Customer Relationship Management (CRM) Business, Atento

As a result of the sale agreement of Atento by Telefónica, announced on October 12, 2012, and ratified on December 12, 2012, both companies signed a Master Service Agreement which regulates Atento's relationship with the Telefónica Group as a service provider for a period of nine years and which was amended on May 16, 2014, on November 8, 2016 and on May 11, 2018. This period was extended only for Spain and Brazil in November 2016, for two additional years until 2023.

By virtue of this agreement, Atento became Telefónica's preferred Contact Center and Customer Relationship Management (CRM) service provider, stipulating annual commitments in terms of turnover which is updated based on inflation and deflation that vary from country to country, pursuant to the volume of services Atento has been providing to the entire Group. Effective January 1, 2017, the minimum volume commitments that Telefónica must comply with have significantly decreased for Brazil.

Failure to meet the annual turnover commitments in principle results in the obligation to the counterparty, to pay additional amounts, which would be calculated based on the difference between the actual amount of turnover and the predetermined commitment, applying a percentage based on the Contact Center's business margin to the final calculation.

Notwithstanding the above, as a consequence of the amendment signed with the Atento Group on May 11, 2018, starting on January 1, 2018 the payment obligation for failure to meet the annual turnover commitment will be calculated for each year of the agreement but will only be liquidated upon termination of the agreement. Such payment will only be due if the balance is in favor of Atento after adding certain amounts agreed between the parties and deducting an annual percentage of the Atento Group's sales to the Telefónica Group.

The Master Agreement sets forth a reciprocal arrangement, whereby Atento assumes similar commitments to subscribe its telecommunications services to Telefónica.

Agreement for the sale of the shares of Telefónica Gestión de Servicios Compartidos España, S.A.U., Telefónica Gestión de Servicios Compartidos Argentina, S.A. and T-Gestiona Servicios Contables y Capital Humano, S.A.C. On March 1, 2016, a share purchase agreement between, on one hand, Telefónica, S.A., Telefónica Servicios Globales, S.L.U. and Telefónica Gestión de Servicios Compartidos Perú, S.A.C. (as sellers), and, on the other hand, IBM Global Services España, S.A., IBM del Perú, S.A.C., IBM Canada Limited and IBM Americas Holding, LLC (as purchasers) for the sale of the companies Telefónica Gestión de Servicios Compartidos España, S.A.U., Telefónica Gestión de Servicios Compartidos Argentina, S.A. and Tgestiona Servicios Contables y Capital Humano, S.A.C., for a total price of approximately 22 million euros, was ratified before Notary Public. This share purchase agreement was subscribed on December 31, 2015.

Following the aforementioned share purchase agreement and in connection with the latter transaction, also, on December 31, 2015, Telefónica subscribed a master services agreement with IBM for the outsourcing of economic-financial and HR activities and functions to be provided to the Telefónica Group during a period of ten years, for a total amount of approximately 450 million euros. Most of the Telefónica Group's subsidiary companies have already adhered to that master services agreement.

Financial Statements

e) Directors' and senior executives' compensations and other benefits

The compensation of the members of Telefónica's Board of Directors is governed by article 35 of the Company's By-Laws, which provides that the annual amount of the compensation to be paid thereby to all of the Directors in their capacity as such, i.e., as members of the Board of Directors and for the performance of the duty of supervision and collective decision-making inherent in such body, shall be fixed by the shareholders at the General Shareholders' Meeting. The Board of Directors shall determine the exact amount to be paid within such limit and the distribution thereof among the Directors, taking into account the duties and responsibilities assigned to each Director, their membership on Committees within the Board of Directors and other objective circumstances that it deems relevant. Furthermore, Executive Directors shall receive such compensation as the Board determines for the performance of executive duties delegated or entrusted to them by the Board of Directors. Such compensation shall conform to the Director compensation policy approved by the shareholders at the General Shareholders' Meeting.

In accordance with the foregoing, the shareholders acting at the Ordinary General Shareholders' Meeting held on April 11, 2003 set at 6 million euros the maximum amount of annual gross compensation to be received by the Board of Directors as a fixed allotment and as attendance fees for attending the meetings of the Advisory or Control Committees of the Board of Directors. Thus, as regards fiscal year 2018, the total amount of compensation accrued by the Directors of Telefónica, in their capacity as such, was 2,838,067 euros for the fixed allocation and for attendance fees.

The compensation of the Directors of Telefónica in their capacity as members of the Board of Directors, of the Executive Commission and/or of the Advisory or Control Committees consists of a fixed amount payable monthly and of attendance fees for attending the meetings of the Advisory or Control Committees.

Set forth below are the amounts established in fiscal year 2018 as fixed amounts for belonging to the Board of Directors, the Executive Commission and the Advisory or Control Committees of Telefónica and the attendance fees for attending meetings of the Advisory or Control Committees of the Board of Directors:

Compensation of the Board of Directors and of the Committees thereof

Amounts in euros

Position	Board of Directors	Executive Commission	Advisory or Control Committees (*)
Chairman	240,000	80,000	22,400
Vice chairman	200,000	80,000	—
Executive Member	—	—	—
Proprietary Member	120,000	80,000	11,200
Independent Member	120,000	80,000	11,200
Other external	120,000	80,000	11,200

(*) In addition, the amount of the attendance fee for each of the meetings of the Advisory or Control Committees is 1,000 euros.

In this regard, it is noted that the current Executive Chairman, Mr. José María Álvarez-Pallete López, has waived the receipt of the above amounts (i.e., 240,000 euros as Chairman of the Board of Directors and 80,000 euros as Chairman of the Executive Commission).

Likewise, the fixed remuneration, for their executive roles, of 1,923,100 euros that the Executive Chairman, Mr. José María Álvarez-Pallete López, has established for the 2019 financial year is equal to the one received in the years 2018, 2017 and 2016, which was set in his capacity as Chief Operating Officer, remaining invariably after his appointment as Chairman. This compensation is a 13.8% lower to the compensation established for the position of Executive Chairman prior to his appointment as such.

Financial Statements

The fix remuneration, for their executives tasks, of 1,600,000 euros that the Chief Operating Officer (C.O.O.), Mr. Ángel Vilá Boix, has established for the 2019 financial year is equal to the one received in the year 2018.

Individualized description

Annex II provides an individual breakdown by item of the compensation and benefits that the members of the Board of Directors and of the Senior Management of the Company have accrued and/or received from Telefónica, S.A. and from other companies of the Telefónica Group during fiscal year 2018. Likewise, the compensation and benefits accrued and/or received, during such year, by the members of the Company's Senior Management are broken down.

f) Related-party transactions

Significant shareholders

The significant shareholders of the Company are Banco Bilbao Vizcaya Argentaria, S.A. (BBVA), Blackrock, Inc. and Caja de Ahorros y Pensiones de Barcelona (“la Caixa”) with stakes in Telefónica, S.A. of 5.28%, 5.01% and 5.08%, respectively.

During 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 Telefónica, S.A. and the companies of BBVA and those of la Caixa, carried out at market prices, is as follows:

Millions of euros

2018	BBVA	la Caixa
Financial expenses	11	7
Receipt of services	2	1
Total expenses	13	8
Dividends received (1)	11	—
Total revenues	11	—
Financing transactions	595	891
Guarantees granted	—	8
Time deposits	262	271
Dividends distributed	124	105

(1) As of December 31, 2018 Telefónica holds 0.66% investment in BBVA (See Note 9.3.).

Millions of euros

2017	BBVA	la Caixa
Financial expenses	9	4
Receipt of services	2	2
Total expenses	11	6
Dividends received (1)	11	—
Total revenues	11	—
Financing transactions	1,209	414
Guarantees granted	—	8
Time deposits	995	292
Dividends distributed	128	104

(1) As of December 31, 2017 Telefónica held 0.66% investment in BBVA.

Financial Statements

In addition, the nominal outstanding value of derivatives held with BBVA and la Caixa in 2018 amounted to 17,041 and 543 million euros, respectively (20,738 million euros held with BBVA and 404 million euros with la Caixa in 2017). The fair value of these derivatives in the balance sheet is 353 and -10 million euros, respectively, in 2018 (332 and -28 million euros, respectively, in 2017). As explained in Derivatives policy in Note 16, this figure is inflated by the use in some cases of several levels of derivatives applied to the nominal value of a single underlying. Moreover, in 2018 there are collateral guarantees (liabilities) of certain derivatives held with BBVA amounting to 8 million euros (an asset of 286 million euros in 2017).

On the other hand, in July 2018, there was a non-extinguishing modifying novation of the investment and agreement between shareholders related to Telefónica Consumer Finance, E.F.C., S.A. The agreement had been signed between Telefónica, S.A., CaixaBank Consumer Finance, E.F.C., S.A. (formerly Finconsum, E.F.C., S.A.) and CaixaBank, S.A. on September 6, 2013, adhered to by Telefónica Consumer Finance, E.F.C., S.A. on February 6, 2014 (the "Novation of the Agreement of Investment and Contract between Shareholders"), in order to implement as an activity of Telefónica Consumer Finance, E.F.C., S.A. the granting of financing products from users from the universe of customers of the Telefónica Group in Spain, as well as for the corporate governance of Telefónica Consumer Finance, E.F.C., S.A. to adapt to the new regulatory framework applicable to the Financial Credit Institutions.

Likewise, in December 2018 a financial collaboration agreement was signed between Telefónica, S.A. and Banco Bilbao Vizcaya Argentaria, S.A., with special conditions for employees, pensioners and early-retirees of the Telefónica Group.

Group companies and Associates

Telefónica, S.A. is a holding company for various investments in companies in Latin, Spain and the rest of Europe which do business in the telecommunications, media and entertainment sectors.

The balances and transactions between the Company and these subsidiaries (Group and Associated Companies) at December 31, 2018 and 2017 are detailed in the notes to these individual financial statements.

Directors and senior executives

During the financial year to which these accompanying financial statements refer, the Directors and senior executives did not perform any transactions with Telefónica, S.A. or any Telefónica Group company other than those in the Group's normal trading activity and business.

Compensation and other benefits paid to members of the Board of Directors and senior executives are detailed in Note 20 e) and Appendix II of these financial statements.

Certain Telefónica Group subsidiaries, mainly Telefónica de España, S.A.U., performed transactions in 2018 with Global Dominion Access Group related to the Group's ordinary course of business amounting to 25 million euros (23 million euros in 2017).

Telefónica S.A. contracted a civil liability insurance scheme (D&O) for Directors, managers and staff with similar functions in the Telefónica Group, with standard conditions in these type of insurance and a premium attributable to 2018 of 1,916,209.75 euros (1,943,007.09 euros in 2017). This scheme provides coverage for Telefónica S.A. and its subsidiaries, in certain cases.

g) Auditors' fees

The expenses accrued refer to the fees for services rendered by the various member firms of the PwC international organization, of which PricewaterhouseCoopers Auditores, S.L. (the auditor of Telefónica) forms part, amount to 3.19 million euros and 3.56 million euros in 2018 and 2017, respectively.

The detail of these amounts is as follows:

Financial Statements

Millions of euros	2018	2017
Audit services	3.01	3.16
Audit-related services	0.18	0.16
Other services	—	0.24
Total	3.19	3.56

Audit services: mainly audit services of the annual statements and reviews of interim financial statements, work to comply with the requirements of the Sarbanes-Oxley Act (Section 404), the work in connection with the 20-F report to be filed with the US Securities and Exchange Commission (SEC) and the issuance of Comfort Letters.

Audit-related services: mainly services related to the verification of the Statement of Non Financial Information -Digital Responsibility and well-being (Corporate Social Responsibility Report).

All other services: permitted services by the applicable independence regulation, mainly advisory services on migration questions to expatriates employees.

h) Environmental matters

Telefónica has an Environmental Policy which is applicable to all of its companies, which sets out the road map for the company to advance towards a green economy, reducing the environmental impact of its facilities at the same time as developing the potential for digital services to reduce the environmental footprint of other sectors.

Currently over half of the companies in the Group have Environmental Management Systems (EMS) in accordance with Regulation ISO 14001, certified by an external body, which contribute to the proper management of the environmental aspects of the company and to extending a culture of environmental responsibility across the whole supply chain.

Telefónica's environmental risks and climate change are controlled and managed under the company's global risk model. The environmental aspects of the telecommunications operations are mainly focused on the risk of high geographical dispersion and energy consumption, which is controlled by means of environmental management based on uniform processes and a global energy efficiency programme.

Telefónica has a global environmental team made up of experts in environmental management.

i) Trade and other guarantees

The Company is required to issue trade guarantees and deposits for concession and spectrum tender bids and in the ordinary course of its business. No significant additional liabilities in the accompanying financial statements are expected to arise from guarantees and deposits issued (see Note 20.a).

Financial Statements

Note 21. Cash flow analysis

Cash flows from/(used in) operating activities

The net result before tax in 2018 amounted to positive 2,264 million euros (see income statement), adjusted by items recognized in the income statement that did not require an inflow or outflow of cash in the year, or are included within the investing and financing activities.

These adjustments relate mainly to:

- The impairment of investments in Group companies, associates and other investments of 587 million euros (in 2017 an impairment of 1,443 million euros).

The gains on disposal of subsidiaries amounting to 175 million euros, mainly corresponding to the sale of 16.65% of the share capital of Pontel Participaciones, S.L. (gains amounting to 313 million euros in 2017, mainly due to the partial sale of Telxius Telecom, S.A.).

Declared dividends as income in 2018 for 4,259 million euros (3,027 million euros in 2017), interest accrued on loans granted to subsidiaries of 124 million euros (95 million euros in 2017) and a net financial expense of 1,822 million euros (1,733 million euros in 2017), adjusted initially to include only movements related to cash inflows or outflows during the year under "Other cash flows from operating activities."

"Other cash flows from operating activities" amounted to 2,489 million euros (1,374 million euros in 2017). The main items included are:

a) Net interest paid:

Payments of net interest and other financial expenses amounted to 1,618 million euros (1,505 million euros in 2017), including:

- Net proceeds from external credit entities, net of hedges, for 291 million euros, (net payments of 396 million euros in 2017 offset by their hedges), and

Interest and hedges paid to Group companies of 1,909 million euros (1,901 million euros in 2017).

b) Dividends and other distributions from reserves and paid-in capital received: the main receipts relate to:

Millions of euros	2018	2017
Telefónica Móviles Argentina, S.A.	30	163
Telefónica Móviles España, S.A.U.	306	—
Telefónica Europe, plc.	609	619
Telefónica de España, S.A.U.	664	—
Telefónica Latinoamérica Holding, S.L.	391	1,650
Telfisa Global, B.V.	733	—
Telxius Telecom, S.A.	250	—
Telefônica Brasil, S.A.	279	294
Sao Paulo Telecomunicações, Ltda	77	116
Other dividend collections	179	89
Total	3,518	2,931

Financial Statements

In addition to the dividends declared in 2018 (see Note 19.1) and collected in the same period, this caption also includes dividends from 2017 collected in 2018.

Income tax collected: Telefónica, S.A. is the parent of its consolidated Tax Group (see Note 17) and therefore it is liable for filing income tax with the Spanish Treasury. It subsequently informs companies included in the Tax Group of the amounts payable by them. Payments of totaling 20 million euros were made in 2018 (131 million in 2017), as disclosed in Note 17 and income taxes repayments of 2016 and 2017 have been received amounting to 155 million euros. In this regard, the main amounts passed on to subsidiaries of the tax group were as follows:

• Telefónica Móviles España, S.A.U.: collection of 185 million euros, corresponding to: 150 million euros for the 2017 income tax settlement and 35 million in payments of account of 2018 income tax.

In 2017, there was an income collected of 110 millions euros, mainly due to the settlement of income tax of 86 million euros in 2016 and 24 million euros in payments of account of 2017 income tax.

• Telefónica de España, S.A.U.: collection of 405 million euros, corresponding to: 317 million euros for the 2017 income tax settlement and 88 million euros in payments of account of 2018 income tax.

In 2017 there was an income collected of 215 million euros, mainly corresponding to: 134 million euros for the 2016 income tax settlement and 81 million euros in payments of account of 2017 income tax.

Cash flows from/(used in) investing activities

“Payments on investments” under “Cash flows from/ (used in) investing activities” included a total payment of 2,139 million euros (6,441 million euros in 2017). The main transactions to which these payments refer are as follows:

Capital increases: the main disbursements correspond to Telefónica Móviles México, S.A. de C.V. amounting to 176 million euros in March, and a second disbursement amounting to 284 million in December, Telefónica Digital España, S.L. amounting to 194 million euros. These capital increases, as well as other minor disbursements of this same concept are disclosed fully in Note 8.1.a. The capital increase of Prisa (see Note 9) is also included in this caption.

• Payments of financial investments related to the reinvestment of treasury overage amounting to 551 million euros.

• Payments of collaterals related to financial derivative instruments amounting to 756 million euros.

Proceeds from disposals totaling 2,075 million euros in 2018 (3,612 million euros in 2017) includes:

• Proceeds from the sale of 16.65% investment in Pontel Participaciones, S.L. amounting to 379 million euros (see Note 8).

• Proceed from the repayment at maturity of the loan granted to Telefónica Móviles España, S.A.U. amounting to 400 million euros and the early cancellation amounting to 140 million euros of Telxius Telecom, S.A. (see Note 8).

• Proceeds from financial investments related to the reinvestment of treasury overage amounting 300 million euros.

Financial Statements

Cash flows from/(used in) financing activities

This caption mainly includes the following items:

i. Proceeds from financial liabilities:

a) Debt issues: The main collections comprising this heading are as follows:

Millions of euros	2018	2017
Bilateral loans with several entities (Note 14.4)	585	—
Telefónica Emisiones, S.A.U. (Note 15)	3,756	3,324
Credit lines with several entities	710	—
Telfisa Global, B.V. financing (Note 15)	1,479	3,759
Structured Financing	34	558
Credit lines	—	1,016
Telefónica Europe B.V. (Note 15)	3,217	1,750
Other collections	202	280
Total	9,983	14,687

b) Prepayments and redemption of debt: The main payments comprising this heading are as follows:

Millions of euros	2018	2017
Bond redemption (Note 13)	—	727
Bilateral loans with several entities (Note 14.4)	800	665
Syndicated facilities with several entities (Note 14)	0	550
Telefónica Europe, B.V. (Note 15)	2,438	779
Telefónica Europe, B.V. promissory notes (Note 15)	216	—
Promissory notes redemption	23	166
Telefónica Emisiones, S.A.U. (Note 15)	3,713	5,232
Structured Financing	389	542
Credit lines with several entities	1,288	460
Other payments	198	236
Total	9,065	9,357

The commercial paper transactions with Telefónica Europe, B.V. are stated at their net balance as recognized for the purposes of the cash flow statement, being high-turnover transactions where the interval between purchase and maturity never exceeds six months.

The financing obtained by the Company from Telfisa Global, B.V. relates to the Group's integrated cash management (see Note 15). These amounts are stated net in the cash flow statement as new issues or redemptions on the basis of whether or not at year-end they represent current investment of surplus cash or financed balances payable.

Payments of dividends for an amount of 2,048 million euros (1,904 million euros in 2017) differ from the figure iii. shown in Note 11.1.d) because of the withholding taxes deducted in the payment to certain major shareholders, which will be paid to Tax Authorities in 2019.

Financial Statements

Note 22. Events after the reporting period

The following events regarding the Company took place between the reporting date and the date of preparation of the accompanying financial statements:

Financing

On January 23, 2019, Telefónica, S.A. made a repayment for 100 million euros of its bilateral loan signed on December 20, 2017.

On January 25, 2019, Telefónica Emisiones, S.A.U. redeemed 150 million euros of its notes issued on January 25, 2017. The notes were guaranteed by Telefónica, S.A.

On February 5, 2019, Telefónica Emisiones, S.A.U. issued under its Guaranteed Euro Programme for the Issuance of Debt Instruments (EMTN Programme) notes in the Euro market guaranteed by Telefónica, S.A. amounting to 1,000 million euros. These notes are due on February 5, 2024, pay an annual coupon of 1.069% and were issued at par (100%). The net proceeds of the Notes are to be allocated towards projects aiming to improve energy efficiency in the network transformation from copper to fiber optic in Spain.

- On February 18, 2019, Telefónica, S.A. made an early repayment for 500 million euros of its bilateral loan of 1,000 million euros signed on June 26, 2014 and originally scheduled to mature on June 26, 2019.

Investments

In order to provide the funds needed to rebalance its equity and to execute share capital increases in its direct affiliates, Telefónica Digital España, S.L.U. on January 10, 2018 carried out a capital increase amounting to 137 million euros, totally subscribed and disbursed by Telefónica, S.A.

On the same date, Telefónica Innovación Alpha, S.L. has completed a capital increase amounting to 19 million euros fully subscribed and paid by Telefónica, S.A.

On January 24, 2019, Telefónica Centroamérica Inversiones, S.L. (60% of which is owned, directly and indirectly, by Telefónica and 40% of which is owned by Corporación Multi Inversiones), reached an agreement with América Móvil, S.A.B. of C.V. for the sale of the entire share capital of Telefónica Móviles Guatemala, S.A. and 99.3% of Telefónica Móviles El Salvador. The closing of the Telefónica El Salvador sale is subject to the applicable regulatory conditions while the sale of Telefónica Móviles El Salvador was completed on such date.

The aggregate consideration for both companies (enterprise value) is 648 million US dollars (approximately 570 million euros at the exchange rate on the date of the agreement, 293 million of which correspond to Telefónica Guatemala and 277 million of which correspond to Telefónica Móviles El Salvador).

On February 14, 2019, once the pertinent regulatory approvals were obtained, Telefónica transferred to Grupo Catalana Occidente 100% of Antares' share capital for a total amount of 161 million euros. On the closing of the sale, Telefónica and Grupo Catalana Occidente executed an agreement pursuant to which Grupo Catalana Occidente will continue to manage the insurance policies of the Telefónica Group on an exclusive basis for the next 10 years.

On February 20, 2019, the Board of Directors of Telefónica, S.A. has approved the sale of the Telefónica Group businesses in Panamá, Nicaragua and Costa Rica. The closing of the agreement is expected in the short term. The net book value of the direct stake in Costa Rica amounts to 291 million euros (see Exhibit I). The investments in Panamá and Nicaragua are indirectly owned through Telefónica Centroamérica Inversiones, S.L.

Financial Statements

Others

On January 23, 2019, Telefónica announced that it was notified of a resolution issued by the Spanish Central Economic-Administrative Tax Court (Tribunal Económico-Administrativo Central) partially upholding the claims filed against the assessments relating to the 2008-2011 Corporate Income Tax Audit. Final implementation of this resolution will most likely lead to a tax refund related to overpayments made by the company in those tax years. At this point of time, it is not possible to quantify the exact amount of the expected refund since, as pointed out by the Central Economic-Administrative Court's resolution, the final amount shall only be settled once the resolution is duly executed by the Spanish Tax Authorities.

Telefónica, S.A. 86

Financial Statements

Note 23. Additional note for English translation

These annual financial statements were originally prepared in Spanish and were authorized for issue by the Company's Directors in the meeting held on February 20, 2019. In the event of a discrepancy, the Spanish-language version prevails.

Telefónica, S.A. 87

Financial Statements

Appendix I: Details of subsidiaries and associates at December 31, 2018

MILLIONS OF EUROS NAME AND CORPORATE PURPOSE	%OWNERSHIP					INCOME (LOSS)		
	Direct	Indirect	Capital	Reserves	Dividends	From operations	For the year	Net carrying amount
Telefónica Latinoamérica Holding, S.L. (SPAIN) Holding company Distrito	100%	—	237	13,146	—	(456)	(22)	15,205
Telefónica. Ronda de la comunicación s/n 28050 Madrid Telefónica Móviles España, S.A.U. (SPAIN) Wireless communications services provider Distrito Telefónica, Ronda de la Comunicación s/n 28050 Madrid	100%	—	209	606	552	1,039	778	5,561
Telfin Ireland Limited (IRELAND) Intragroup financing 28/29 Sir John Rogerson's Quay, Dublin 2	100%	—	—	8,510	—	—	134	8,191
Telefónica Europe, plc (UNITED KINGDOM) Wireless communications Wellington Street, Slough, SL11YP	100%	—	13	14,339	609	1	303	14,720
Telefónica Móviles México, S.A. de C.V. (MEXICO) Holding company Prolongación Paseo de la Reforma 1200 Col. Cruz Manca, México D.F. CP.05349	100%	—	5,451	(3,783)	—	(495)	(998)	406
Telefónica de España, S.A.U. (SPAIN) Telecommunications service provider in Spain Gran Vía, 28 - 28013 Madrid	100%	—	1,024	1,688	1,574	1,659	1,219	2,455
O2 (Europe) Ltd. (UNITED KINGDOM) Holding company Wellington Street, Slough, SL11YP	100%	—	1,239	3,635	—	—	144	2,764
Telefónica de Contenidos, S.A.U. (SPAIN) Organization and operation of multimedia service-related activities and businesses Distrito Telefónica, Ronda de la Comunicación s/n, Madrid 28050	100%	—	226	934	—	(2)	(2)	1,158
Telfisa Global, B.V. (NETHERLANDS) Integrated cash management, consulting and financial support for Group companies Strawinskylaan 1259; tower D; 12th floor 1077 XX - Amsterdam	100%	—	—	864	700	(6)	26	712
Telefónica Chile Holdings, S.L (SPAIN)	100%	—	—	1,209	—	—	—	473

Edgar Filing: TELEFONICA S A - Form 6-K

Holding company Distrito Telefónica, Ronda de la Comunicación s/n, Madrid 28050 Telefónica Innovación Alpha, S.L. (SPAIN) Telecommunications activities	100%	—	1	13	—	(17)	(11)	3
Distrito Telefónica, Ronda de la Comunicación s/n, Madrid 28050 Telco TE, S.p.A. (ITALY) Holding company	100%	—	—	—	—	—	—	—
Via dell' Annunciata n.21 - 20121 Milano Panamá Cellular Holdings, B.V. (NETHERLANDS) Holding company	100%	—	—	1	—	—	—	1
Strawinskylaan 3105, Atium 7th, Amsterdam Teléfono de Costa Rica TC, S.A. (COSTA RICA) Holding company	100%	—	291	(158)	—	19	9	291
Plaza Roble, Edificio Los Balcones 4º, San José Telefónica Global Technology, S.A.U. (SPAIN) Global management and operation of IT systems	100%	—	16	136	—	10	9	160
Gran Vía, 28 - 28013 Madrid Telefónica Capital, S.A. (SPAIN) Finance company	100%	—	7	176	—	—	6	110
Gran Via, 28 - 28013 Madrid								

Telefónica, S.A. 88

Financial Statements

MILLIONS OF EUROS	%OWNERSHIP					INCOME	For the year a
	Direct	Indirect	Capital	Reserves	Dividends	(LOSS)	
NAME AND CORPORATE PURPOSE						From operations	
Telefónica Digital España, S.L.U. (SPAIN) Holding company Ronda de la Comunicación, s/n Distrito Telefónica Edificio Central - 28050 Madrid	100%	—	24	398	—	(265)	(209)2
Taetel, S.L. (SPAIN) Holding company Gran Vía, 28 - 28013 Madrid	100%	—	28	39	—	—	— 6
Telefónica Internacional USA, Inc. (U.S.A.) Financial Advisory services 1221 Brickell Avenue suite 600 - 33131 Miami - Florida	100%	—	—	2	—	—	— —
Lotca Servicios Integrales, S.L. (SPAIN) Holding, operation and aircraft leases Gran Vía, 28 - 28013 Madrid	100%	—	17	58	—	(7)	(5) 7
Telefónica Ingeniería de Seguridad, S.A. (SPAIN) Security services and systems Ramón Gómez de la Serna, 109-113 Posterior 28035 Madrid	100%	—	13	21	—	(7)	(10) 2
Compañía Española de Tecnología, S.A. (SPAIN) Promotion of business initiatives and holding of real estate assets Gran Vía, 28 - 28013 Madrid	100%	—	5	5	—	19	19 1
Telefónica Finanzas, S.A.U. (TELFISA) (SPAIN) Integrated cash management, consulting and financial support for Group companies Ronda de la Comunicación, s/n – 28050 Madrid	100%	—	3	108	—	(4)	37 1
Centro de Investigación y Experimentación de la Realidad Virtual, S.L. (SPAIN) Design of communications products Vía de Dos Castillas, 33 - Comp. Ática Ed. 1, 1ª Plta. Pozuelo de Alarcón - 28224 Madrid	100%	—	N/D	N/D	N/D	N/D	N/D –
Telefónica International Wholesale Services II, S.L. (SPAIN) International services provider Ronda de la Comunicación, s/n – 28050 Madrid	100%	—	1	193	—	(25)	(20) 4
Telefónica Investigación y Desarrollo, S.A.U. (TIDSA) (SPAIN) Telecommunications research activities and projects Ronda de la Comunicación, s/n – 28050 Madrid	100%	—	7	5	—	14	9 2
Telefónica Luxembourg Holding S.à.r.L. (LUXEMBOURG) Holding company 26, rue Louvingny, L-1946- Luxembourg	100%	—	3	97	165	—	82 4
Telefónica Servicios Globales, S.L.U. (SPAIN) Management and administrative services rendered Ronda de la Comunicación, s/n – 28050 Madrid	100%	—	1	17	—	5	(3) 1
Fisatel Mexico, S.A. de C.V. (MEXICO)	100%	—	195	(6)	—	—	14 1

Edgar Filing: TELEFONICA S A - Form 6-K

Integrated cash management, consulting and financial support for
Group Companies

Boulevard Manuel Avila Camacho, 24 - 16^a Plta. - Lomas de
Chapultepec - 11000 México D.F.

Telefónica Participaciones, S.A.U. (SPAIN)

Issues of preferred shares and/or other debt financial instruments	100%	—	—	1	—	—	—
--	------	---	---	---	---	---	---

Gran Via, 28 - 28013 Madrid

Telefónica Emisiones, S.A.U. (SPAIN)

Issues of preferred shares and/or other debt financial instruments	100%	—	—	11	—	(2)	2
--	------	---	---	----	---	-----	---

Gran Via, 28 - 28013 Madrid

Telefónica Europe, B.V. (NETHERLANDS)

Fund raising in capital markets	100%	—	—	5	2	(1)	3
---------------------------------	------	---	---	---	---	-----	---

Strawinskylaan 1259 ; tower D ; 12th floor 1077 XX – Amsterdam

O2 Oak Limited (UNITED KINGDOM)

Private Limited Company	100%	—	—	—	—	—	—
-------------------------	------	---	---	---	---	---	---

260 Bath Road, Slough Berkshire SL1 4BX

Telefónica, S.A. 89

Financial Statements

MILLIONS OF EUROS	%OWNERSHIP					INCOME (LOSS)		
	NAME AND CORPORATE PURPOSE	Direct	Indirect	Capital Reserves	Dividends	From operations	For the year	Net carrying amount
O2 Worldwide Limited (UNITED KINGDOM) Private Limited Company 20 Air Street, London, England W1B 5AAN	100%	—	—	—	—	—	—	—
Telefónica Consumer Finance E.F.C., S.A. (SPAIN) Lending and consumer loans c/Caleruega, 102 -28033 Madrid	50.00%	—	5	31	3	7	5	15
Pontel Participaciones, S.L. Private Limited Company Distrito Telefónica, Ronda de Comunicación, s/n	83.35%	—	—	1,145	—	—	—	954
Corporation Real Time Team, S.L. (SPAIN) Internet design, advertising and consulting Plaza Canalejas, 3 – 28014 Madrid	87.96%	12.04%	—	—	—	—	—	—
Telefónica Móviles Argentina, S.A. (1) (ARGENTINA) Mobile communications and services operator Ing Enrique Butty 240, piso 20 - Buenos Aires	73.20%	26.80%	293	2,066	31	264	170	1,359
Telefónica Centroamérica Inversiones, S.L. (SPAIN) Holding company Distrito Telefónica. Avda. Ronda Comunicación, s/n. - 28050 Madrid	60.00%	—	1	692	42	183	252	655
Comtel Comunicaciones Telefónicas, S.A. (VENEZUELA) Holding company Torre Edicampo, Avda. Francisco de Miranda, Caracas 1010	65.14%	34.86%	—	—	—	—	—	—
Aliança Atlântica Holding B.V. (NETHERLANDS) Portfolio company Strawinskylaan 1725 – 1077 XX – Amsterdam	50.00%	50.00%	150	(107)	—	—	—	21
Sao Paulo Telecomunicações Participações, Ltda (BRAZIL) Holding company Rua Martiniano de Carvalho, 851 20º andar, parte, Sao Paulo	39.40%	60.60%	5,346	(1,570)	77	(1)	386	1,954
Telefônica Brasil, S.A. (BRAZIL) (1)(*) Wireline telephony operator in Sao Paulo Sao Paulo	29.77%	43.76%	23,164	(7,906)	447	2,239	2,115	8,380
	7.90%	59.60%	1	1,495	—	179	149	272

Edgar Filing: TELEFONICA S A - Form 6-K

Colombia Telecomunicaciones, S.A. ESP
(COLOMBIA)

Wireless operator

Calle 100, N° 7-33, Piso 15, Bogotá, Colombia

Pléyade Peninsular, Correduría de Seguros y
Reaseguros del grupo Telefónica, S.A. (SPAIN)

Insurance contracts, operating as a broker	16.67%	83.33%	—	—	1	3	4	—
--	--------	--------	---	---	---	---	---	---

Distrito Telefónica, Ronda de la Comunicación,
s/n Edificio Oeste 1 – 28050 Madrid

Telefónica Móviles Chile, S.A. (CHILE)

Mobile communications operator Miraflores, 1301.10% - 12° - Santiago de Chile	98.87%	—	—	2	—	—	47	
--	--------	---	---	---	---	---	----	--

Telefónica de Argentina, S.A. (1)

(ARGENTINA)

Telecommunications services provider	1.46%	98.39%	725	173	—	(21)	2	9
--------------------------------------	-------	--------	-----	-----	---	------	---	---

Av. Ingeniero Huergo, 723, PB – Buenos Aires

Telefónica Venezolana, C.A. (VENEZUELA)

(1) Mobile communications operator

Av. Francisco de Miranda, Edif. Parque Cristal, Caracas 1060	0.09%	99.91%	—	—	—	—	—	—
---	-------	--------	---	---	---	---	---	---

Telefónica Canal 21, S.C. (SPAIN)

TV Channel

Ronda de la comunicación s/n Edif.Norte 1. Planta 5 28050 Madrid	50.00%	—	19	(14)	—	(2)	(2)	1
---	--------	---	----	------	---	-----	-----	---

Telefónica Factoring España, S.A. (SPAIN)

Factoring Zurbano, 76, 8 Plta. - 28010 Madrid	50.00%	—	5	2	4	5	7	3
---	--------	---	---	---	---	---	---	---

Telefónica Factoring México, S.A. de C.V.

SOFOM ENR (MEXICO) Factoring México	40.50%	9.50%	2	—	1	(1)	1	1
-------------------------------------	--------	-------	---	---	---	-----	---	---

D.F.

Telefónica, S.A. 90

Financial Statements

MILLIONS OF EUROS NAME AND CORPORATE PURPOSE	%OWNERSHIP					INCOME (LOSS)		
	Direct	Indirect	Capital	Reserves	Dividends	From operations	For the year	Net carrying amount
Telefónica Factoring Perú, S.A.C. (PERÚ) Factoring Lima	40.50%	9.50%	1	2	1	—	2	1
Telefónica Factoring Colombia, S.A. (COLOMBIA) Factoring Bogotá	40.50%	9.50%	1	—	—	2	1	1
Telefónica Factoring Chile, S.A. (CHILE) Factoring Santiago de Chile	40.50%	9.50%	1	—	—	1	—	—
Telefónica Factoring Do Brasil, Ltd. (BRAZIL) Factoring Avda. Paulista, 1 106 – Sao Paulo	40.00%	10.00%	2	(2)	5	(2)	10	1
Jubii Europe N.V. (NETHERLANDS) (*) Internet portal Richard Holkade 36, 2033 PZ Haarlem Torre de Collçerola, S.A. (SPAIN)	32.10%	—	N/D	N/D	—	N/D	N/D	3
Operation of telecommunicatios mast and technical assistance and consulting services. Ctra. Vallvidrera-Tibidabo, s/n - 08017 Barcelona	30.40%	—	5	—	—	—	—	2
Total group companies and associates					4,216			66,530

(1) Consolidated data.

(*) Companies listed on international stock exchanges at December 31, 2018.

Financial Statements

Appendix II: Board and Senior Management Compensation

TELEFÓNICA, S.A.

(Amounts in euros)

Directors	Salary ¹	Fixed compensation ²	Attendance fees ³	Short-term variable compensation ⁴	Compensation for belonging to Committees of the Board ⁵	Other items ⁶	Total
Mr. José María Álvarez-Pallete López	1,923,100	—	—	3,478,888	—	5,794	5,407,782
Mr. Isidro Fainé Casas	—	200,000	—	—	80,000	—	280,000
Mr. José María Abril Pérez	—	200,000	9,000	—	91,200	—	300,200
Mr. Ángel Vilá Boix	1,600,000	—	—	2,412,000	—	16,960	4,028,960
Mr. Juan Ignacio Cirac Sasturain	—	120,000	10,000	—	11,200	—	141,200
Mr. José Javier Echenique Landiribar	—	120,000	23,000	—	113,600	—	256,600
Mr. Peter Erskine	—	120,000	12,000	—	113,600	—	245,600
Ms. Sabina Fluxà Thienemann	—	120,000	9,000	—	11,200	—	140,200
Mr. Luiz Fernando Furlán	—	120,000	11,000	—	11,200	—	142,200
Ms. Carmen García de Andrés	—	120,000	16,000	—	22,400	—	158,400
Ms. María Luisa García Blanco ⁷	—	80,000	9,000	—	13,067	—	102,067
Mr. Jordi Gual Solé ⁷	—	110,000	16,000	—	20,533	—	146,533
Mr. Peter Löscher	—	120,000	13,000	—	24,267	—	157,267
Mr. Ignacio Moreno Martínez	—	120,000	25,000	—	44,800	—	189,800
Mr. Francisco Javier de Paz Mancho	—	120,000	35,000	—	124,800	—	279,800
Mr. Francisco José Riberas Mera	—	120,000	—	—	—	—	120,000
Mr. Wang Xiaochu	—	120,000	—	—	—	—	120,000

1 Salary: Regarding Mr José María Álvarez-Pallete López and Mr Ángel Vilá Boix, the amount includes the non-variable remuneration earned from their executive functions.

2 Fixed remuneration: Amount of the compensation in cash, with a pre-established payment periodicity, subject to consolidation over time or not, earned by the member for his/her position on the Board, regardless of the effective attendance of the member to board meetings.

3 Allowances: Total amount of allowances for attending Advisory or Steering Committee meetings.

4 Variable short-term remuneration (bonuses): Variable amount linked to the performance or achievement of a series of individual or group objectives (quantitative or qualitative) within a period of time equal to or less than a year, corresponding to the year 2018 and paid in the year 2019. In reference to the bonus corresponding to 2017, which was paid in 2018, Executive Board Member Mr José María Álvarez-Pallete López perceived 3,426,964 euros and Executive Board Member Mr Ángel Vilá Boix perceived 990,000 euros (Mr Vilá's bonus only included the amount accrued since his appointment as Director of the company, on July 26, 2017).

5 Remuneration for belonging to the Board Committees: Amount of items other than allowances, which the directors are beneficiaries through their position on the Executive Committee and the Advisory or Steering Committees, regardless of the effective attendance of the board member such Committee meetings.

Telefónica, S.A. 92

Financial Statements

6. Other concepts: This includes, among others, the amounts received as remuneration in kind (general medical and dental coverage and vehicle insurance), paid by Telefónica, S.A.

7 Mr Jordi Gual Solé was appointed Director of the company on January 31, 2018, and Ms María Luisa García Blanco was named Director on April 25, 2018, reflecting, therefore, the remuneration accrued and perceived, respectively, from the aforementioned dates.

Likewise, Ms Eva Castillo Sanz stood down as Board Member on April 25, 2018, reflecting below the payment received and accrued by her, in 2018 until the dates mentioned.

Directors	Salary ¹	Fixed compensation ²	Attendance fees ³	Short-term variable compensation ⁴	Compensation for belonging to Committees of the Board ⁵	Other items ⁶	Total
Ms. Eva Castillo Sanz	—	40,000	7,000	—	11,200	—	58,200

1 to 6: Definitions of these concepts are those included in the previous table.

The following table breaks down the amounts accrued and/or received from other companies of the Telefónica Group other than Telefónica, S.A. individually, by the Board Members of the Company, by the performance of executive functions or by their membership to the Board of Directors of such companies:

Financial Statements

OTHER COMPANIES OF THE TELEFÓNICA GROUP

(Amounts in euros)

Directors	Salary ¹	Fixed compensation ²	Attendance fees ³	Short-term variable compensation ⁴	Compensation for belonging to Committees of the Board ⁵	Other items ⁶	Total
Mr. José María Álvarez-Pallete López	—	—	—	—	—	—	—
Mr. Isidro Fainé Casas	—	—	—	—	—	—	—
Mr. José María Abril Pérez	—	—	—	—	—	—	—
Mr. Ángel Vilá Boix	—	—	—	—	—	—	—
Mr. Juan Ignacio Cirac Sasturain	—	—	—	—	—	—	—
Mr. José Javier Echenique Landiribar	—	104,652	—	—	—	—	104,652
Mr. Peter Erskine	—	20,000	—	—	—	—	20,000
Ms. Sabina Fluxà Thienemann	—	—	—	—	—	—	—
Mr. Luiz Fernando Furlán	—	85,366	—	—	—	—	85,366
Ms Carmen García de Andrés	—	—	—	—	—	—	—
Ms. María Luisa García Blanco	—	—	—	—	—	—	—
Mr. Jordi Gual Solé	—	—	—	—	—	—	—
Mr. Peter Löscher	—	—	—	—	—	—	—
Mr. Ignacio Moreno Martínez	—	—	—	—	—	—	—
Mr. Francisco Javier de Paz Mancho	—	260,440	—	—	—	—	260,440
Mr. Francisco José Riberas Mera	—	—	—	—	—	—	—
Mr. Wang Xiaochu	—	—	—	—	—	—	—

1 Salary: Amount of non-variable remuneration earned by the Director from other companies of the Telefónica Group for his/her executive functions.

2 Fixed remuneration: Amount of the compensation in cash, with a pre-established payment periodicity, subject to consolidation over time or not, earned by the member for his/her position on the boards of other companies of the Telefónica Group.

Herewith it is stated that Mr Ángel Vilá Boix received during the year 2018, for his position on the Supervisory Board of Telefónica Deutschland Holding, A.G. during 2017 (resigned from his office on October 4, 2017), an amount of 2,000 euros. Similarly, Mr Peter Erskine received during the 2018 fiscal year, for his position on the Supervisory Board of Telefónica Deutschland Holding, A.G. during 2017, an amount of 20,000 euros.

3 Allowances: Total amount of the allowances for attending the board meetings of other companies of the Telefónica Group.

4. Variable short-term remuneration (bonuses): Variable amount linked to the performance or achievement of a series of individual or group objectives (quantitative or qualitative) within a period of time equal to or less than a year, corresponding to the year 2018 and paid in the year 2019 by other companies of the Telefónica Group.

Remuneration for belonging to the Board Committees of other companies of the Telefónica Group: Amount of items other than allowances, which the directors are beneficiaries through their position on the Advisory or Steering Committees of other companies of the Telefónica Group, regardless of the effective attendance of the board member such Committee meetings.

6. Other concepts: This includes, among others, the amounts received as remuneration in kind (general medical and dental coverage and vehicle insurance), paid by other companies of the Telefónica Group.

Financial Statements

Likewise, Ms Eva Castillo Sanz stood down as Board Member on April 25, 2018, reflecting below the payment accrued by her, in 2018 until the dates mentioned.

Directors	Salary ¹	Fixed compensation ²	Attendance fees ³	Short-term variable compensation ⁴	Compensation for belonging to Committees of the Board ⁵	Other items ⁶	Total
Ms Eva Castillo Sanz	—	26,849	—	—	—	—	26,849

1 to 6: Definitions of these concepts are those included in the previous table.

Herewith, it is stated that Ms. Eva Castillo Sanz received during the year 2018, for her position on the Supervisory Board of Telefónica Deutschland Holding, A.G. during 2017, an amount of 80,000 euros.

Additionally, as mentioned in the Remuneration Policy section, the Executive Board Members have a series of Assistance Services. Below, the contributions made during 2018 are detailed for the Company to long-term savings systems (Pension Plans and Social Welfare Plan):

LONG-TERM SAVINGS SYSTEMS

(Amounts in euros)

Directors	Contributions for fiscal year 2018
Mr. José María Álvarez-Pallete López	673,085
Mr. Ángel Vilá Boix	560,000

The breakdown of the long-term saving systems includes contributions to Pension Plans, to the Benefit Plan and to the Unit link-type Insurance, as set out below:

(Amounts in euros)

Directors	Contributions to Pension Plans	Contributions to Benefit Plan ¹	Contributions to Unit link-type Insurance/Pension Plan Surplus ²
Mr. José María Álvarez-Pallete López	6,060	540,968	126,057
Mr. Ángel Vilá Boix	5,377	487,840	66,783

1 Contributions to the Executive Social Welfare Plan established in 2006, financed exclusively by the Company, to complement the current Pension Plan, which involves defined contributions equivalent to a certain percentage of the fixed remuneration of the Director, depending on the professional levels in the organization of the Telefónica Group.
2 Contributions to Unit link-type Insurance/Pension Plan Surplus: In 2015 applicable law reduced the financial and tax limits of the contributions to Pension Plans; for this reason, in order to compensate for the difference in favor of the Beneficiaries, a Unit-link type group insurance policy was arranged to channel such differences that occur during each fiscal year.

This Unit-link type insurance is arranged with the entity Seguros de Vida y Pensiones Antares, S.A., and covers the same contingencies as those of the “Pension Plan” and the same exceptional liquidity events in case of serious illness or long-term unemployment.

The 2018 amounts for life insurance premiums were as follows:

Financial Statements

LIFE INSURANCE PREMIUMS

(Amounts in euros)

Directors	Life insurance premiums
Mr. José María Álvarez-Pallete López	13,176
Mr. Ángel Vilá Boix	14,116

As regards to remuneration plans based on shares (exclusively involving Executive Directors), the following two long-term variable remuneration plans were in existence during the year 2018:

1.- The so-called "Performance & Investment Plan" ("PIP"), made up of three cycles (2014-2017; 2015-2018; 2016-2019), approved by the General Shareholders' Meeting held on May 30, 2014, which has already ended. The first cycle of this Plan began in 2014 and concluded in October 2017. The second cycle of this Plan began in 2015 and concluded in October 2018. In accordance with the provisions of its terms and conditions, the delivery of shares did not proceed for the first and second cycle of the Plan (2014-2017; 2015-2018), so no shares were delivered to the Executive Directors participating in these cycles.

As for the third cycle of this Plan (2016-2019), the Company's Board of Directors, following a favorable report from the Appointments, Remuneration and Good Governance Committee, agreed not to execute nor implement the plan as it was not sufficiently aligned with the Telefónica Group's strategic plan, taking into account the circumstances and the macroeconomic situation.

2.- The so-called "Performance Share Plan" ("PSP"), made up of three cycles (2018-2020; 2019-2021; 2020-2022), approved by the General Shareholders' Meeting held on June 8, 2018. The first cycle began on January 1, 2018 (with delivery of the corresponding shares in 2021), the second cycle began January 1, 2019 (with delivery of the corresponding shares in 2022), and the third will begin January 1, 2020 (with delivery of the corresponding shares in 2023).

It is hereby stated in following the maximum number of shares assigned if maximum compliance with the TSR ("Total Shareholder Return") and FCF ("Free Cash Flow") targets set for the first and second cycle of the Plan.

PSP - First Cycle / 2018-2020

Directors	Maximum number of shares (*)
Mr. José María Álvarez-Pallete López	421,000
Mr. Ángel Vilá Boix	312,000

(*) Maximum possible number of shares to be received in case of maximum completion of FCF and TSR target.

PSP - Second Cycle / 2019-2021 (shares allocate in February 2019)

Directors	Maximum number of shares (*)
Mr. José María Álvarez-Pallete López	468,000
Mr. Ángel Vilá Boix	347,000

(*) Maximum possible number of shares to be received in case of maximum completion of FCF and TSR target.

Financial Statements

In any case, herewith it is stated that no shares have been delivered to the Executive Directors under the first and second cycle of the PSP and that the above tables only reflect the potentially deliverable number of shares, without this in any way implying all or part thereof will be effectively delivered.

Indeed, the number of Telefónica, S.A. shares that, always within the established maximum, could be delivered, where appropriate, to the participants is conditioned and determined by the established goals: 50% % of the compliance with the targets set out for Total Shareholder Return ("TSR") on Telefónica, S.A. shares and 50% of the Free Cash Flow (the "FCF") of the Telefónica Group.

To determine compliance with the TSR target and calculate the specific number of shares to be delivered for this concept, the evolution of the TSR of Telefónica, S.A. shares will be measured during the period of the duration of each three-year cycle in relation to the TSR experienced by certain companies belonging to the telecommunications sector, weighted according to their relevance for Telefónica, S.A., which for the purposes of the Plan will constitute the comparison group (hereinafter the "Comparison Group"). The companies included in the comparison group are listed below: América Móvil, BT Group, Deutsche Telekom, Orange, Telecom Italy, Vodafone Group, Proximus, Royal KPN, Millicom, Swisscom, Telenor, TeliaSonera, and Tim Participações.

With regard to compliance with the TSR target, the Plan foresees that the number of shares to be delivered in relation to the fulfillment of this objective will range between 15% of the number of theoretical shares assigned, in the event that the evolution of the TSR of the Telefónica, S.A. share is found within, at least, the mean of the Comparison Group, and 50% in the case that the evolution is placed in the third quartile or higher of the comparison group, by calculating the percentage by linear interpolation for cases which are situated between the mean and the third quartile.

To determine completion of the FCF target and calculate the specific number of shares to be delivered under this concept, the level of FCF generated by the Telefónica Group during each year will be measured against the value set in the budgets approved by the Board of Directors for each financial year.

In relation to the FCF, at the beginning of each cycle, a scale of achievement will be determined that will include a minimum threshold below which an incentive is not paid and whose compliance will require the delivery of 25% of the assigned theoretical shares, and a maximum level, which will involve the delivery of 50% of the assigned theoretical shares.

At least 25% of the shares are delivered under the Plan to the Executive Directors and other participants determined by the Board of Directors shall be subject to a one-year retention.

In addition, it should be noted that the external directors of the company do not perceive nor have perceived remuneration during the year 2018 in concept of pensions or life insurance, nor do they participate in compensation plans referenced to the value of the share price.

Furthermore, the company does not grant nor has granted during the year 2018, an advance, loan or credit in favor of its Board Members or its Senior Management, complying with the requirements of the Sarbanes-Oxley Act published in the United States, which is applicable to Telefónica as a listed company in this market.

Financial Statements

Remuneration of the Company's Senior Management.

As for the Directors who made up the Senior Management¹ of the company in the year 2018, excluding those who form an integral part of the Board of Directors, have accrued² a total amount of 7,966,605 euros during the 2018 fiscal year.

In addition, and in terms of long-term savings systems, the contributions made by the Telefónica Group during the year 2018 to the Social Security Plan described in the "Income and expenditure" note with regard to these directors increased to 854,125 euros; the contributions corresponding to the Pension Plan increased to 21,508 euros; the contributions to the Seguro Unit link-Excess Pension Fund increased to 107,493 euros.

Furthermore, the amount related to the remuneration in kind (which includes the fees for life insurance and other insurance, such as the general medical and dental coverage, and vehicle insurance) was 95,256 euros.

On the other hand, regarding share-based remuneration plans, during the year 2018, there were the following two long-term variable remuneration plans:

1.- The so-called "Performance & Investment Plan" ("PIP"), made up of three cycles (2014-2017; 2015-2018; 2016-2019), approved by the General Shareholders' Meeting held on May 30, 2014, which has already ended. The first cycle of this Plan began in 2014 and concluded in October 2017. The second cycle of this Plan began in 2015 and concluded in October 2018. In accordance with the provisions of its terms and conditions, the delivery of shares did not proceed for the first and second cycle of the Plan (2014-2017; 2015-2018), so no shares were delivered to the Directors participating in these cycles.

As for the third cycle of this Plan (2016-2019), the company's Board of Directors, following a favorable report from the Appointments, Remuneration and Good Governance Committee, agreed not to execute nor implement the plan as it was not sufficiently aligned with the Telefónica Group's strategic plan, taking into account the circumstances and the macroeconomic situation.

2.- The so-called "Performance Share Plan" ("PSP"), made up of three cycles (2018-2020; 2019-2021; 2020-2022), approved by the General Shareholders' Meeting held on June 8, 2018. The first cycle of this Plan began in 2018 and will conclude December 31, 2020. The maximum number of shares assigned in the event of maximum compliance with the TSR ("Total Shareholder Return") and FCF ("Free Cash Flow") target, at the beginning of the first cycle (2018-2020) to the group of directors forming part of the company's senior management was of 491,570. The second cycle of this Plan began in 2019 and will conclude December 31, 2021. The maximum number of shares assigned in the event of maximum compliance with the TSR ("Total Shareholder Return") and FCF ("Free Cash Flow") target, at the beginning of the second cycle (2019-2021) to the group of Directors part of the company's Senior Management was 545,591.

¹ Senior Management being understood, for these purposes, those persons that implement, de facto or de jure, senior management duties reporting directly to the Board of Directors or Executive Committees or Managing Directors of the Company, including in any case the supervisor of Internal Auditing.

² Similarly, herewith it is stated that the amount perceived in the year 2018 by the directors forming part of the company's Senior Management, excluding those on the Board of Directors, was 19,221,735 euros. This amount includes the remuneration perceived by Mr Ramiro Sánchez de Lerín García-Ovies, former Secretary-General and Secretary of the Board of Directors of Telefónica, S.A., until the date of his disengagement from the company, including the compensation perceived as a result of his removal.

2018 Management Report

Management report 2018

This Management Report has been prepared taking into consideration the 'Guidelines on the preparation of annual corporate governance reports for listed companies', published by CMNV in July 2013.

In accordance with Law 11/2018 of December 28, and following the amendment of the article 262.5 of Commerce Law, the Company is not complied to include non-financial information in the Management Report. The disclosure of this information can be found in the Consolidated Management Report of the Telefónica Group which will be filed as well as the Consolidated Financial Statements in the Companies' Register of Madrid.

Business Model

Today, Telefónica is a communication networks, digital services and entertainment company using technology to create a better, more inclusive society. Telefónica is committed to developing infrastructure and solutions that make the digital world accessible to everyone, whatever their location, economic status, knowledge or capabilities. That network is precisely the gateway to the digital world, giving meaning to communications, facilitating relations among people, speedy transmission, the acceleration of change and the exponential growth of many industries.

Telefónica is at the cutting edge of technological transformation through its platforms strategy:

¶ First platform. The network, as the basis of connectivity.

¶ Second platform. The information systems, as the source of digitalization.

¶ Third platform. Offer of services and products.

¶ Fourth platform. A centralized and normalized view of the data.

1. FIRST PLATFORM: The network is the basis of connectivity

The network is Telefónica's main asset, the platform that enables us to develop all the other platforms, our springboard for innovation. A network originally designed to carry voice traffic that has become a flexible, open, dynamic and secure data network, evolving through initiatives such as virtualization and 'cloudification', incorporating artificial intelligence technologies to improve its management.

2. SECOND PLATFORM: The information systems, as the source of digitalization

Telefónica's systems, which make up the second platform, are also being transformed in order to adapt to the digital challenge. The barrier between the systems and the network is steadily being broken down. For some time now, Telefónica has been working to facilitate the integration of those two worlds, with the development of systems for the automatic management, configuration and monitoring of the network or the development of our own and third-party services.

Our customers demand a truly digital, personalized experience, control over the entire purchase cycle and subsequent use of the services and products, and their interaction with the Company from any place and any device. At close of December 2018, 65% of the processes were digitalized and managed in real time (+6 pp year-on-year), improving the 'time-to-market' and customer experience. Furthermore, 30% of the entire customer base had been migrated to 'Full Stack' systems (+7 pp year-on-year). Our aim is to consolidate that

2018 Management Report

transformation, evolving towards end-to-end automation of the processes, inspired by 'zero touch', ultimately to unify the experience of customers with our brands.

3. THIRD PLATFORM: Offer of services and products

We work to win our customers' trust through simplicity, transparency and integrity. In our offer and in all the contacts with them, we strive to make their life easier in a permanently connected world.

First of all, we provide both land-line and mobile services, including voice telephony, as well as broadband access for access to value-added services, applications and content. On the other hand, Telefónica offers wholesale roaming services (use of mobile services while roaming internationally).

Telefónica offers its customers bundled or integrated services which, under one single invoice, provide our customers with access to all land-line and mobile voice, Internet, broadband and television services in one single package. An example of this is the Fusión service in Spain.

One of the main barriers to accessing the Internet, especially in some sectors of society, is the cost of services and terminals. Therefore, although the price per Gigabyte falls year after year, as part of our effort to bring connectivity to the entire population, we work on models and commercial proposals adapted to people with fewer economic resources. Prepay service models (55% of our mobile customer base) and specific broadband packages such as 'Charges per Day' (affordable Internet tariffs offered in several Latin American countries for access to connectivity services by low-income sectors), are just a few examples.

We are focusing our offer on more flexible and personalized options to provide customers with the possibility of a tailored product adapted to their needs. This is the goal of several initiatives recently launched in some of our main markets: 'Customize your plan' (UK), 'Vivo Easy' (Brazil), 'Connect' (Germany), 'Pack Digital' (Chile), 'Pasá GB' (Argentina) and 'Phoenix' (Spain, Peru and Argentina in 2018, extendible to others in 2019).

We help our customers manage their digital life. With services such as 'Smart WiFi', 'Security' or 'Connected Car', they can extend and manage their communications in a safe and accessible way that also takes into account the digital well-being of the whole family. Smart WiFi is available in 6 countries

In video we have a global platform that offers traditional Pay TV, Video on Demand and multi-device access. We already have almost 10 million TV customers and the leading content offering in the Spanish-speaking world. Our growing capacity for producing our own content has brought successes that include Campeones, La Peste, Gigantes, Virtual Hero and El embarcadero.

Our Movistar Home service provides customers with voice-based management of their digital life. It is a way of recovering the land-line telephone in the home, turning communications back into something that connects and brings families together at home. It enables access to all our services through the voice of Aura. In addition, it makes it possible for our customers to use natural language with their devices.

Services accessible to all: In line with our commitment to placing technology at the service of society, we want to ensure that all these people can attain the benefits of digital transformation, building a more accessible world.

4. FOURTH PLATFORM:

Our fourth platform processes all the data generated by Telefónica in an integrated manner, ensuring power and control for the customer and always placing privacy and security as the top priority. It ensures a set of consistent capabilities in our business management and provides greater flexibility for sharing the data generated through the services we provide with our customers.

2018 Management Report

As an absolute reference, the core of this initiative is the protection of our customers' privacy, providing them with tools to understand the potential of their data but also the risks involved when they are used in a non-transparent manner.

A centralized and standardized view of data allows us to apply artificial intelligence on an industrial scale to all our business areas, from operations to supply (LUCA, Aura, etc.). In particular, the technologies associated with Big Data and data analysis are proving an invaluable tool for serving our customers and contributing to a more digital and humane society by allowing, among other things, the analysis of indicators that increase understanding of the challenges facing different communities.

Telefónica, S.A. 101

2018 Management Report

Economic results of Telefónica, S.A.

Telefónica, S.A. obtained net profit of 3,014 million euros in 2018. Highlights of the 2018 income statement include: Revenue from operations, amounting to 4,921 million euros has been increased year on year, primarily due to the dividend distributions from Telefónica de España, S.A.U. The subsidiary has distributed 1,574 million euros in 2018 versus 664 million euros in 2017.

The figure of "Impairment losses and other losses" amounting to write-off of 587 million euros in 2018 (1,443 million in 2017).

The impact of the sale of 15.65% of Pontel Participaciones, S.L. is included under the caption "Gain on disposal of investments" for an amount of 175 million euros.

Net financial expense totaled 1,822 million euros in 2018 (1,733 million euros of financial expense in 2017). This was mainly due to finance costs with Group companies and associates, principally from Telefónica Europe, B.V. amounting to 648 million euros (479 million euros in 2017) and Telefónica Emisiones, S.A.U. totaling 1,223 million euros (1,335 million euros in 2017).

2018 Management Report

Investment activity

2018

On July 13 2018, a new company named Reginatorium Participaciones, S.L.U. was incorporated by Telefónica, S.A. On July 26, 2018 Telefónica made a non-monetary contribution to this new subsidiary equivalent to the net carrying value of its stake in Telxius Telecom, S.A. ("Telxius") corresponding to 60% of Telxius' share capital.

On July 27, 2018 the company was renamed Pontel Participaciones, S.L. ("Pontel") and on the same date, Telefónica sold 16.65% of it to the Pontegadea Group amounting to 378,8 million euros (a valuation of 15.2 euros per share of Telxius). An investment of 16.65% in Pontel is equivalent to a 9.99% indirect ownership in Telxius. The transaction has generated a revenue of 175 million euros in the profit and loss account of 2018.

On November 8, 2018 Telefónica reached an agreement with Catalana Occidente Group for the sale of its total stake in Seguros de Vida y Pensiones Antares, S.A., the insurance company in Spain, amounting to 161 million euros. As of December 31, 2018 the net carrying value of the investment has been transferred to "Long Term assets held for sale" totaling 69 million euros and shown as Transfers in the 2018 chart of movements. The closing of this transaction has taken place on February 14, 2019 after the pertinent regulatory authorizations were obtained.

2017

On February 10, 2017 Telefónica and Taurus Bidco S.à.r.l. (hereinafter "KKR", an entity managed by Kohlberg Kravis Roberts & Co. L.P.) reached an agreement for the sale of up to 40% of the share capital of Telxius Telecom, S.A. in exchange for an aggregate amount of 1,275 million euros (12.75 euros per share).

The agreement envisaged a sale of 62 million shares of Telxius Telecom, S.A.U. (representing 24.8% of its share capital) for an amount of 790,5 million euros as well as a call option over additional 38 million shares (representing 15.2% of its total share capital) for a minimum price of 484.5 million euros.

On October 24, 2017, Telefónica announced that, after obtaining all the relevant regulatory approvals, it has transferred to KKR 62 million shares of Telxius with a profit of 191 million euros. On December 13, 2017 KKR exercised the call option foreseen in the agreement over 38 million shares of Telxius Telecom, S.A. in exchange for 484.5 million euros resulting in an income on the "Gain on disposals" caption of the 2017 income statement amounting to 120 million euros.

The Group is carrying out a simplification process of corporate structure and pursuant to this process several mergers by absorption have been completed in 2017. The net book value of the absorbed companies has been accounted for in the surviving company as an increase in its investment cost. Therefore the cost and the impairment provision of the absorbed investments have been reversed.

The merger transactions affecting 2017 investments were the following:

• In September 2017 Telefónica Latinoamérica Holding, S.L. carried out a merge by absorption of Telefónica Datacorp, S.A. and Ecuador Cellular Holding, S.L., which were both direct subsidiaries of Telefónica, S.A.

• On the same date, Telefónica Digital Holding, S.L.U. was merged and absorbed by Telefónica Digital España, S.L.U., and after this transaction the latter company becomes a direct affiliate of Telefónica, S.A.

• In November, 2017 Telefónica Móviles Argentina Holding, S.A. was merged to Telefónica Móviles Argentina, S.A. After this transaction the Company increased its direct ownership from 21.1% to 73.2%.

• In December 2017, Telefónica International Wholesale Services II, S.L. carried out a merge by absorption of Telefónica International Wholesale Services, S.L., which was a direct affiliate of Telefónica, S.A.

2018 Management Report

Assessment of impairment of investments

At each year end, the Company re-estimates the future cash flows derived from its investments in Group companies and associates. The estimate is based on the expected cash flows to be received from each subsidiary in its functional currency, discounted using the appropriate rate, net of the liabilities associated with each investment (mainly net debt), considering the percentage of ownership in each subsidiary and translated to euros at the official closing rate of each currency at December 31. Moreover, and only for the companies where discounted cash flow analysis is not available, due to the specific nature of their businesses, the impairment is calculated by comparing their Equity figure as of the end of the period and the net book value of those investments.

As a result of these estimations and the effect of the net investment hedge in 2018, an impairment provision of 587 million euros was recognized (write down of 1,443 million euros in 2017). This amount derives mainly from the following companies:

- a. a write down of 1,038 million euros for Telefônica Brasil, S.A. (write down amounting to 510 million euros in 2017) and 243 million euros for Sao Paulo Telecomunicações, Ltda (113 million euros in 2017);
- b. a write down reversal, net of hedges, of 4,062 million euros for Telefónica Europe, plc (an impairment of 460 million euros, net of hedges, was registered in 2017);
- c. write down of 2 million euros for Telefónica Contenidos, S.A.U. (177 million euros in 2017);
- d. write down of 219 million euros for Telefónica Digital España, S.L.U. (141 million euros in 2017) and
- e. a write down by 1,075 million euros for Telefónica México, S.A. de C.V. (write down reversal by 96 million euros in 2017);

In 2017 no write down was recorded for the investment of Telefónica Latinoamérica Holding, S.L.U. In 2018 an impairment of 1,962 million euros has been recorded. The write down is mainly originated by the write down of Telefônica Brasil, S.A. as indicated in section a).

Main hypothesis used for the calculation of the discounted cash flows of investments

Brazil has faced a complex macro-economic scenario in 2018. Several adverse effects have caused, on the one hand, a growth rate lower than its target (1.4% versus target of 2% at the beginning of the year) and on the other hand, an exchange rate depreciation of the Brazilian Real by 17% and a 30 basic points (b.p.) increase in the country risk. For 2019, the macroeconomic scenario envisages a slight growth in the Gross Domestic Product (GDP) up to 2.5% and in domestic consumption. The Operating Income before Depreciation and Amortization (OIBDA) margin for Brazil is 42%, within the range of analysts' long-term forecasts (between 37% and 43%). Over the term of the strategic plan, the operator will invest a percentage in line with the investment needs identified by analysts (18%). The perpetuity growth rate is in line with the Brazilian Central Bank's medium-term inflation target (4%, within a range of ± 1.5 p.p.) and is aligned with the analyst consensus for the Strategic Plan horizon (below 4.5%) yet below the forecast nominal GDP growth rate (which oscillates around 6.5%).

Mexican economy in 2018 has grown around 2%, 1 b.p. below the average growth rate since 2010. Uncertainty arising from the presidential and parliament elections in July as well as the lack of agreement regarding the new Mexico, United States and Canada commercial treaty are the answers for the under performance of the economy. The Mexican peso versus US dollar exchange rate reflects this uncertainty: Its quotation for the most part of the year has been historically high, preventing inflation rate from dropping and allowing an improvement domestic rent for Mexican families. Interest rate increase in the United States has a harmful effect in Mexico as the investment in the country becomes less profitable from investors' point of view. In the mid term, the key is the government commitment to structural changes in-force several years ago, specially related to the efficiency in the oil sector, tax administration and public sector. In this context, the WACC has increased to 10.6% (9.6%

2018 Management Report

in 2017). Mexican economy is estimated to accelerate during the strategic plan horizon with an inflation rate below 4% from 2019. However, the cell phone market is expected to decrease due to a strong competition with AMX who has a 72% market share in 2018, 5 b.p. bigger than the previous year. AMX and AT&T are using aggressive commercial campaigns aimed to reduce prepaid cell phone tariffs to a minimum price within the region. Telefónica Móviles México has not launched new price promotions for this segment since the beginning of 2018. As a consequence of these two reasons the revenues of Telefónica Móviles México have been reduced in 2018.

With respect to the United Kingdom, domestic consumption was shown a more dynamic trend (growing above 1%) thanks to the improvement in the families' rent. Their income has been benefited from the increase in salaries, the drop of the inflation rate and the positive behaviour of the labour market, with an unemployment rate at its lowest. On the other hand, if the expectation of a more favourable end of the BrExit process is finally confirmed, the stability of the pound sterling exchange rate will extend the positive scenario to the following years ahead. The Strategic Plan includes a hypothesis of soft BrExit in the net results of the company. O2 UK is estimating to keep their market share of revenues based on the quality of services, adapting the range of products to the customer demands and improvement in B2B and IoT (Internet of Things). The increase in the OIBDA figure is achieved through an efficiency plan to keep the growth in expenses below the inflation rate, network sharing scheme with Vodafone and spectrum optimum usage). The long-term OIBDA margin is in line with analysts' forecasts over a three-year horizon, 26%. Regarding the ratio of CapEx over revenues, over the term of the strategic plan, the valuations consider the opinions of analysts with regard to investment needs (around 12%).

Telefónica, S.A. 105

2018 Management Report

Share price performance

Following the synchronized global GDP rebound in 2017, expectations were for continued robust growth in 2018, but resulted in disappointment almost everywhere except for the U.S., with Europe and Japan being particularly poor, and a sharper than expected economic deceleration in China. Rising U.S. rates became an additional macro challenge for many emerging market economies. With regards to monetary policy, the ECB maintained marginal lending facility rate stable throughout the year at 0.25%, but in December 2018 decided to end the net purchases under the Asset Purchase Program, as anticipated, and announced the intention to continue reinvesting the principal payments as long as necessary to maintain favorable liquidity conditions and an ample degree of monetary accommodation. In the US, Federal Reserve's continued the gradual normalization of USD monetary conditions, with the Open Market Committee increasing interest rates 4 times in the year from 1.50% to 2.50%, while balance sheet normalization continued throughout the year.

On the political front, the focus was on trade disputes between the U.S. and China, the U.S. midterm elections which led to a divided congress, negotiations over Brexit between Brussels and the UK, as well as Italian March elections that resulted into a coalition government between a populist party and an anti-EU sovereignty party, while in Spain political instability arose as a result of the no-confidence vote leading to a change in Government.

In this context, the main European indexes closed 2018 with a negative performance; EStoxx-50 (-14.3%), DAX (-18.3%), CAC-40 (-11.0%), FTSE-100 (-12.5%), and Ibex-35 (-15.0%).

European DJ Stoxx-600 (-13.2%) sectors posted negative performances across-the-board, being Auto & Parts (-28.1%) and Banks (-28.0%) the bottom performers. The performance of the Telecommunications sector (-13.0%) was in-line with the wider market, and was explained by a weak growth outlook, adverse regulatory environment, intense competition in some markets, high leverage and stressed capital intensity,. However, in the last quarter of the year, the Telecommunications sector outperformed the wider market by +13.7 percentage points, within a rotation to defensive sectors that was followed by most operators beating Q3 18 results expectations and raising guidance for the year, leading to improved EPS estimates momentum, and some positive news flow regarding European regulators' stance on M&A.

Telefónica closed 2018 at 7.34 euros per share, (-9.7%) in the year, though following a dividend distribution of 0.40 euros per share in cash total shareholder return was (-4.8%), better than the European sector average. The Telecommunications sector in Europe (-13.0%) posted a total shareholder return after dividends of (-8.2%). The performance of Telefónica was mainly explained by the adverse evolution of exchange rates throughout most of the year, which affected earnings momentum. In the last quarter of the year, Telefónica outperformed the broad sector by +5.8 pp, after beating Q3 18 results expectations and raising revenue guidance for the year, within a better exchange-rate environment.

Telefónica closed the 2018 financial year with a market capitalization of 38,105 million euros, ranking as the thirteenth company in the telecommunications sector worldwide.

2018 Management Report

Research, Development and Innovation

Innovation has been part of Telefónica's DNA since the very beginning. Our strategy is based on striking a balance between in-house innovation, dedicated to our core business, and open innovation.

This means that 80% of the innovation work focuses on identifying future opportunities in our business - Core Innovation - and the other 20% on looking for new areas where the company can reinvent itself through disruptive models - Open Innovation. By doing this, we guarantee our capability to anticipate short, mid and long term needs as regards developing our own services and platforms and finding new opportunities that are yet unknown.

An intrinsic part of the innovation process is our commitment to developing sustainable innovative solutions that have a good impact on the environment and on economic and social progress in the regions where we operate. In addition, we promote accessibility of our products through technology in order to provide all groups with access to the digital world.

The following indicators reflect our innovation capability in 2017 and 2018.

	2017	2018
Investment in R&D and innovation (million euros)	5,970	6,114
Investment in R&D and innovation / revenue (%)	11.48	12.5
Investment in R&D (million euros)	862	947
Investment in R&D / revenue (%)	1.66	1.9
Annual increase/decrease investment in R&D (%)	-4.8	+8.9
Patent portfolio	643	601
Registered patents	32	22

*These figures have been calculated using the OECD guidelines.

We invested more than 900 million euros in R&D in 2018.

Telefónica registered 22 new patent applications in 2018, 19 of which were European applications, one Spanish (all of them via the Spanish Patent and Trademark Office) and two Chilean applications. Telefónica registered 3 new industrial designs with EUIPO (European Union Intellectual Property Office) in 2018.

New assets generated in 2018	Filing office	Territory of the assets
22 Patents	20 OEPM (Spanish Patent and Trademark Office)	19 European patents 1 Spanish patent
	2 INAPI (National Institute of Industrial Property)	2 Chilean patents
3 Industrial designs	3 EUIPO (European Union Intellectual Property Office)	3 EU designs

INTERNAL INNOVATION (CORE INNOVATION)

A large part of the innovation activities and projects are implemented by the Core Innovation area. Its mission is to increase our competitiveness by improving networks, communications and data, developing new products and experimental and applied research. To carry out its functions, this unit collaborates with external organisations and universities that share our goal of boosting technological innovation.

A key ingredient of this way of working is the Lean Startup methodology. Telefónica started applying this methodology to innovation projects in 2012. Lean Startup has enabled us to shorten the innovation process

2018 Management Report

and do more with less with a clear market and customer approach. The model divides the design process into 4 phases which are developed up until the commercial launch, during which various targets must be achieved to determine the continuity of the project and whether it is adequate or to reject it:

Phase 1: Pre-ideation

Phase 2: Ideation

Phase 3: Stage-gating

Phase 4: Deployment

Another main internal pillar is seeking ideas from employees and creating an in-house innovation culture. Through the 'IN_Prendedores' global program we integrate all assets dedicated to innovation in order to provide funding and resources to the best ideas submitted by employees.

Within this framework we have promoted projects associated to security, sustainability the Internet of Things, connected home, online channels and others. The most noteworthy are the Internet for All projects, Niji (security) or Smart Cities and Smart Energy (Internet of Things).

Telefónica continued working on edge computing technology throughout 2018 in order to enhance the quality of the services it provides to customers. This year the first global virtual switchboard with real customers connected was deployed, creating the first multi-access edge computing laboratory in the world (residential, business and mobile).

Innovation in networks and communications

The main goal of this activity is to get our infrastructures ready for the future by building a high-capacity, programmable, flexible, scalable and open multi-service network capable of offering the features that our new services will demand in a financially sustainable manner through network virtualization.

We continued fostering research and development of new 5G networks in 2018. In the long term, our networks and information technologies will integrate with a shared and ubiquitous high capacity network based on using high performance and programmable general purpose hardware that will offer transport, routing, storage, and process execution resources.

The European Commission and IT industry are working on the '5G Infrastructure Public-Private Partnership' (5G PPP) in order to rethink the current infrastructure and create the next generation of networks and services that will provide ultrafast ubiquitous connectivity and enable services to be provided under any circumstances.

Innovation in new products and solutions

We are working on developing solutions and applications associated to the digital world, advanced user interfaces, television and multimedia content distribution and other added-value services, leveraging the potential of the telecommunications infrastructures deployed.

More specifically, the main activities in 2018 were associated with developing customer-based network services, Big Data and data analytics services, video and multimedia services, and advanced business, the Internet of Things (IoT) and cognitive digital marketing solutions, applying Artificial Intelligence to company sales processes in order to personalize the relationship with customers of solutions that strengthen identity authentication security, thereby enhancing security and the user experience.

In 2018, 5G based solutions such as the 5G self-driving bus and the pilot of the first mobile 4K television demonstrator in Spain were developed. Enhancements to the Movistar+ user experience were also promoted with applications like Xstreamr.

Disruptive, applied and experimental innovation

We have innovation teams that analyze the future possibilities of technology. The results of these innovation activities and areas include the creation of the Internet of Things (IoT) and Artificial Intelligence business units,

2018 Management Report

which have become strategic areas for developing our business. We have also worked with universities, suppliers and internal bodies in areas like networks, the future of the Internet and automatic learning.

Mobile data is a constant source of extremely useful information about human activity. No other data source can currently provide such a high level of global data flow and scope. For this reason it is the data of choice for analyzing any human behavior that involves mobility. In many cases mobile data is complemented by other data sources that can be applied, for example, to understand and stop infectious diseases from spreading or for crime prevention. Telefónica is currently developing Artificial Intelligence related research projects to analyze online abuse. In addition, we continue positioning the company as a pioneer in the development of blockchain technology.

In addition to the development projects that enable us to offer our customers innovative solutions, we have initiatives designed to address some of the major global challenges whilst generating a sustainable business model for our company. This is what we call sustainable innovation and at Telefónica it is built on three pillars or subjects:

• Connecting everyone: Connectivity projects in remote areas, portable communications as emergency response or accessible connectivity services for groups with disabilities.

• Protecting the planet: Renewable energy solutions, energy efficiency and circular economy, both for internal application and for marketing (Ecosmart solutions).

• Sustainable societies: Sustainable transport solutions, intelligent cities or digital development of the rural environment. Smart Agro solutions or Open Government services.

The activities conducted in 2018 include the '4th sustainable Innovation Initiative', in which 155 projects were submitted from teams and employees in the countries where we operate, the startups in the Wayra and Open Future ecosystem and Telefónica suppliers. We promote projects that address the United Nations Sustainable Development Goals.

The projects promoted by this edition of the Sustainable Innovation Initiative were:

a. Producing Right!

A solution to help farmers gradually improve their production methods, taking into account social and environmental aspects. This project focuses on the food crises that are becoming more recurrent due to the advancement of climate change and directly affect people, such as the case of climate refugees. It will be developed in Ecuador by the BovControl startup, accelerated by Wayra Brazil, and the LUCA Big Data for Social Good team.

b. Electricity and Connectivity for All.

A Telefónica and Acciona.org solution for creating a business model that rolls out connectivity and electricity to remote areas of Latin America with a pilot program in the Napo river basin, Peru.

c. IoT drones for traffic control.

Development of IoT drones that could be controlled from the traffic control center via a mobile network and send real-time information on road and traffic conditions and provide connectivity to remote areas. This solution would be very useful in a road emergency to reduce the response times of emergency services and provide the information necessary for acting in real-time.

d. VIVO Financial Assistant.

Build a financial education platform integrated with Aura virtual assistant to help reduce the financial gap in Brazil through education and digital innovation.

e. Constant measuring of radon gas levels.

2018 Management Report

Radon is the second leading cause of lung cancer in the world, after smoking. Constantly detecting the concentration of this gas in closed spaces via the IoT spaces enables mitigating measures to be implemented.

This area of activity also includes Telefónica Alpha, Telefónica's disruptive innovation subsidiary, which has become Europe's leading moonshot factory, or in other words, the leading factory of solutions designed to invent and create technologies that could make the world a radically better place. Alpha mainly works on mid and long-term projects with a large social impact and more specifically, it is currently working on solutions that seek to resolve some of the major challenges associated to health and energy.

OPEN INNOVATION

Telefónica's strategy, in the area of Open Innovation, is based on supporting innovative companies that they are in different stages of development. Thanks to our Telefónica Open Future units and Wayra as well as the Innovation Funds, we have global and open programs designed to connect entrepreneurs, startups, investors and public and private organizations around the world.

The main goal of these programs is to develop and foster talent and technological entrepreneurship in the local ecosystem where Telefónica is present in order to incorporate the innovation of the startup it supports in the company. It does this by promoting project scale up and companies and detecting and supporting talent at any stage of maturity. Our more than 60 open innovation hubs are a single point of access for startup to sales acceleration programs with Telefónica and with our corporate partners, investors, governments and public institutions. We promote the global entrepreneurship ecosystem, supported by more than 140 public and private partners that extend our service offering and provide our entrepreneurs with access to events, competitions, funding rounds, etc.

We currently operate in 17 countries in three continents and have an active portfolio of more than 400 startups, 20% of which do business with Telefónica units and more than 100 have developed applications and services that are integrated with Telefónica; 60% in Latin America and 40% in Europe.

Entrepreneurial ecosystem

Wayra is the global interface between Telefónica and the entrepreneurial ecosystem. As a strategic partner, Wayra operates through 11 hubs in 10 countries: Argentina, Brazil, Chile, Colombia, Germany, Mexico, Peru, Spain, United Kingdom and Venezuela, taking entrepreneurs from these ecosystems to a global scale. Its mission is to connect innovators with Telefónica to create joint business opportunities or operating efficiencies.

In 2018 we relaunched Wayra with the aim of accelerating and investing in technology companies that are more mature and that fit in with the Company's strategic projects or in fields such as Big Data, Artificial Intelligence, Internet of Things, cybersecurity or fintech. Coinciding with this relaunch, the value has been placed on the new IoT activation program; a program especially aimed at startups that need to boost the development of Internet solutions for Things by making exclusive services and tools available to creators, developers and entrepreneurs so that they can try out new IoT solutions for free to reduce the time it takes to launch onto the market.

In 2018, the agreement between Renfe and Wayra España for the development of the TrenLab project stands out, which launches three major business challenges for the innovation and entrepreneurship community: Digital Mobility, Digitization of Operations and On-Demand Logistics.

Additionally, we collaborate with public and private partners, generating spaces for entrepreneurship with the Open Future hubs, which offer physical work space, mentoring, access to exclusive offers from commercial partners, etc. Companies that do not yet have a viable product or that generate business are potential candidates to enter the Open Future programs. We have 50 hubs in 16 countries that reinforce Wayra's hub network.

Investment Funds

2018 Management Report

Our network of venture capital innovation funds includes public and private co-investors for the financing and acceleration of technology companies. This capacity to attract external capital multiplies the investment capacity and extends its scope. We have a total of 9 investment funds through which we have invested in more than 100 startups in Europe and Latin America, with presence in Spain, Brazil, Chile, Colombia, Mexico and Peru.

At the same time, we have a corporate investment fund, Telefónica Ventures, with scouting offices in Silicon Valley, Israel, China and Spain. Through this fund we invest in mature startups aligned with Telefónica's global strategy, which can sign agreements to provide their services to the Company's millions of customers.

In summary, our main open innovation data are:

- ♣ More than 400 startups in portfolio/active.
- ♣ More than 100 startups working with Telefónica.
- ♣ 16 countries.
- ♣ More than 60 Open Future and Wayra spaces.
- ♣ 4 scouting centers in Silicon Valley, Israel, China and Spain.

Telefónica, S.A. 111

2018 Management Report

Environment

Telefónica would like to create a world where digital technology contributes to protecting the planet. To achieve this, we have reduced our footprint on the environment whilst promoting digitalisation as a key tool for addressing the main environmental challenges. Some of our products and services already provide solutions for climate change, waste, water, air pollution, fires and biodiversity.

This is just the beginning, because there are more and more opportunities for growth in the green economy. In a digital world there are more opportunities for eco-efficiency and a decarbonised and circular economy.

At the end of 2018 we announced the Telefónica Sustainable Financing Framework, under which the company issued the first Green Bond of the sector in January 2019. The environment has become a strategic issue for the Company. The Green Bond, for an amount of 1,000 million euros and a five-year term, was participated by more than 310 investors. The funds obtained will be used to finance projects aimed at increasing the Company's energy efficiency through the process of transforming copper into fiber optic in Spain and can be used, in any case, for existing initiatives (no older than three years) and for future projects.

The FTTH (Fiber to the home) is 85% more energy efficient in customer access than the copper network. And it has saved 208 GWh in the last three years, which means avoiding the emission into the atmosphere of 56,500 tons of CO₂, equivalent to the carbon sequestered by more than 900,000 trees. In addition, the deployment of fiber is allowing Telefónica to close a copper plant daily, recycling all the material as part of its commitment to the circular economy. We have a global environmental strategy and act at different levels in alignment with our business strategy:

• Environmental management under ISO 14001:2015.

• Internal eco-efficiency.

• Promotion of the circular economy.

• Decarbonisation of our activities.

• Development of products and services that provide solutions for environmental problems.

The environment is a central issue throughout the Company, involving the areas of operations and management, as well as business and innovation.

Environmental strategy is the responsibility of the Board of Directors, which approves the environmental Policy and objectives, within the framework of our Global Responsible Business Plan. The most significant environmental objectives affect the remuneration of the managers responsible for operations and sustainability.

Telefónica has a global multidisciplinary team spread out across different countries that is responsible for carrying out this strategy at different levels of responsibility.

Materiality

We conduct analysis to determine our major environmental aspects based on our business strategy, the regulatory environment, impact and the demands of our stakeholders. In this way, we prioritise our efforts towards the most significant aspects: energy consumption and renewable energies, EcoSmart services, the responsible deployment of the network and greenhouse gas emissions.

However, we do not neglect other environmental aspects and manage all of them to progressively reduce our impact whilst increasing our resilience.

Environmental risks and climate change

2018 Management Report

Telefónica's activities, like those of any other company, have an impact on the environment and can be affected by climate change. The Company's environmental and climate change risks are controlled and managed under the Telefónica Group's global risk management model, in accordance with the precautionary principle.

Our environmental aspects have their greatest risk focus on the high geographic dispersion of infrastructure, which is controlled through environmental management based on uniform processes and certified according to the ISO 14001 standard.

With regard to the guarantees and provisions arising from environmental risk, during the year 2018 the Group has maintained and maintains, both locally in the countries where it operates and globally, several insurance programs in order to mitigate the possible occurrence of an incident derived from the risks of environmental liability and/or natural disasters, to guarantee the continuity of its activity. We currently have fully comprehensive insurance and coverage for all risks, material damages and loss of profit, in order to cover any material losses, damage to assets and loss of income and/or customers, among other problems, as a consequence of natural events, and environmental liability insurance to cover the environmental liabilities required by the laws and rules applicable. Both coverages are based on insurance market standards in terms of limits, sub-limits and coverage.

Meanwhile, we specifically analyse the risks derived from climate change in accordance with the recommendations of the Task Force on Climate - Related Financial Disclosures (TCFD), with regard to both physical and transitional risks. (see section 'Energy and climate change' and chapter 'Risk').

Environmental management

Environmental Management System (EMS) ISO 14001 is the model that we chose to ensure the protection of the environment.

During 2018 we continued to improve our EMS and we currently have 100% of our operators certified under the new requirements of the 2015 version of this standard.

We have a full range of standards that incorporate the life cycle perspective, with which we also incorporate the aspects of our value chain and we pay particular attention to involving our suppliers in environmental management. Having a certified EMS enables us to ensure the correct control and compliance with the environmental legislation applicable to each operation and the preventive model of compliance is associated with the Company's overall compliance process. During 2018, we were not subject to any significant environmental penalties.

Furthermore, we continue to maintain the certification of the Energy Management Systems (ISO 50.001) for our operations in Spain and Germany (around 40% of our revenue) and we are working to extend this standard to other operations.

A responsible network

We ensure that there is an adequate control of risks and environmental impacts in the management of our network throughout its life cycle, which enables us to provide a high-quality service whilst looking after the environment. In 2018, we invested over 10 million euros with this objective.

The main environmental aspects of the network are the consumption of energy and waste, although we manage all of our possible impacts such as noise and water consumption. For more information see sections 'Energy and Climate Change' and 'Circular Economy'. An example of the responsible management of the network is the fact that 97% of our waste was recycled in 2018.

In order to minimise the impact of network deployment we implement best practices, for example, noise insulation measures when necessary. The sharing of infrastructure significantly reduces the entire sector's impact on the environment. Therefore, whenever possible when installing our facilities we share space with other operators. This makes it possible to keep the occupation of land, the visual impact, energy consumption and waste generation to a minimum.

2018 Management Report

With regard to biodiversity, the impact of our facilities is limited, although we carry out environmental impact studies and implement corrective measures when necessary, such as in protected areas.

Energy Efficiency Plan

In order to optimise the power consumption of our network, in 2010 we compiled the Energy Efficiency Plan. Since then, we have implemented 740 projects, with an annual growth rate of 7%, thanks to the Global Energy Center created in 2015 to accelerate efficiency, with managers responsible for encouraging energy efficiency projects in each country. In 9 years we have saved more than 4,000 GWh, 553 million euros, and avoid 1.27 million tonnes of CO₂ eq emissions.

In 2018 we implemented 139 initiatives in our networks and offices. These initiatives have led to savings of 181 GWh and prevented over 73,145 tonnes of CO₂ eq emissions.

The global initiatives include modernising our network to increase its efficiency, for example by replacing copper by fibre optic; power plants and HVAC equipment renovation projects; using free cooling to cool with air directly from the outside; shutting down legacy networks; implementing power saving features in the access network; and reducing fuel consumption by implementing hybrid stations.

This effort is reflected in a 64% improvement in our energy intensity ratios (MWh/PB) compared to 2015 and we decoupled the growth of our services from power consumption.

MILESTONES 2018

- ♣ We announced our Telefónica Sustainable Financing Framework.
- ♣ 99.4% certified company under the new ISO standard 14001:2015.
- ♣ We consume 100% renewable electricity in Europe, 58% at global level (Brazil 100% renewable from November 2018).
- ♣ We are 2 years ahead of meeting the energy and emissions targets for 2020.
- ♣ We reduce our carbon emissions by 37% with respect to 2015.
- ♣ With our services we avoid 1.4 million tCO₂e, equivalent to 1.2 times our carbon footprint.
- ♣ We reduce our energy consumption per traffic unit by 64% with regard to 2015.
- ♣ We have been awarded the maximum “A” classification in CDP Climate Change.
- ♣ We set objectives for reducing our Scope 3 emissions.
- ♣ We signed a PPA in Mexico for 40% of the electricity consumed.
- ♣ We generated 4% less waste and recycled 97%.

CHALLENGES

- ♣ Avoid 10 tons of CO₂ for each ton we emit by 2025.
- ♣ Reduce CO₂ emissions in our supply chain to 30% per euro at 2025 compared to 2016.
- ♣ 100% renewable electricity consumption in 2030.
- ♣ Extend digitalisation of our waste management (GreTeL) of all operations.

2018 Management Report

• Reduce our CO₂ emissions (scopes 1 + 2) by 50% in 2030.

• Sign a PPA agreement in Spain and Argentina

• Drive development of technological solutions to promote the revolution towards the circular economy. 100% renewable electricity consumption in 2030.

Telefónica, S.A. 115

2018 Management Report

Human Resources

The key element driving and increasing Telefónica's sustainable growth, is the team of professionals that form part of the Company. A diverse team, and one committed to our values, which also reflects the diversity of our customers.

To drive the growth we strive for as a Company, the strategy of the HR management area is based, on one side, on dynamizing the work environment and the new ways of working, in order to stimulate the management skills and autonomy of teams; and on the other, on encouraging a growth mindset in each one of Telefónica's employees, through continuous learning and self-development.

Our strategy is supported in an ever increasing digitalization of the HR management processes, backed by the roll out of the "Success Factors" global tool for managing the training, recruitment, performance, remuneration and administration processes and enabling multi-device access. There are currently over 120,000 employees in 39 countries and 179 entities who have had a global employee experience with Success Factors.

Talent Management

In order to transform our company and adapt to our latest challenges, it is crucial to have the right people in the right posts and to develop their individual skills.

We are committed to incorporating new profiles in a more global, digital and efficient way, using new recruitment methods (hackathons, searches in specialized forums) and automating our selection tools to maximize the effectiveness of our processes.

To obtain the diverse and committed team necessary to ensure our Company's future, here at Telefónica we want to guarantee that our employees fully develop their potential and to do this we encourage various local and global talent development initiatives and programs, encouraging movement and rotation between different areas and supporting internal promotion and diversity as elements of professional growth.

Besides, the implementation of talent development programs for key groups (women and young people) are essential for increasing gender and generational diversity, and inclusive leadership. Moreover, the identification of the talent map, in order to design visibility actions, is key in the assessment and maximization of talent within the Company.

Skills Development

To ensure the competitiveness and employability of our teams, we are developing a new global learning model based on the flexibility, agility and continuous learning of all our employees, enabling them to develop digital skills and us to anticipate our need for new skills.

Through the global tool of SuccessFactors and the platforms that we have in the Telefónica Group (DatAcademy, Learn4Sales and MiriadaX) we have made a wide range of courses available to all our employees, from languages to technical skills and business training (Big Data, Digital Security, Privacy, eWork), alongside mandatory courses (Responsible Business Principles, GDPR, Anti-corruption).

At Universitas Telefónica we train our employees, and those of other companies, to become Transforming Digital Leaders, which will allow them to accept the challenges of the current digital revolution. Universitas offers a special space, where you can disconnect completely from daily life and focus 100% on your mission during your stay on campus. Our external lecturers at Universitas are of the highest category. University lecturers from the IESE Business School, Oxford Leadership Academy and Singularity University, among others, have all taught at Universitas. We

also have an internal teaching staff that provides us with a comprehensive view of Telefónica and the sector as a whole.

Telefónica, S.A. 116

2018 Management Report

In 2018, in both the “On Campus” and the “On the Road” programs, which are held in the various different geographical areas, around 4,000 of the Company's leaders have been trained in leadership skills, global business strategy and, for the first time this year, new methods of agile working.

As well as the platforms already mentioned, we also make a lot of resources available to our employees for more informal learning through such things as conferences, blogs and articles. In this regard, we would like to highlight the eKISS digital knowledge platform, which has over 30,000 active users, and makes articles, news and reports from both internal experts and the most prestigious market analysts available to all employees. We are also driving the use of “on the job chats” by experts from outside or other areas of the Company, to encourage the flow and exchange of knowledge throughout the Company.

New working procedures

In order for us to adapt to a new reality we have promoted a deep cultural change in the Company, a new concept of working that enables us to be open to more transversal and flexible ways of working, which have more respect for our employees' free time, that allow an improvement both in employee performance and satisfaction. In other words, we are talking about "smart working".

More and more of Telefónica's areas and departments are adopting various “Agile” methodologies. They are being encouraged as part of the new strategic plan in all countries. Also, an “Agile Bluebook” has been produced to ensure a standardized adoption of the existing methodologies to the specific needs of each different area.

Labor Relations

At Telefónica, we are committed to the ILO's Declaration on Fundamental Principles and Rights at Work, in particular we recognize freedom of association and the right of collective bargaining in all countries and jurisdictions where we operate.

As a Company, we recognize the important role that unions perform in defending workers interests and we recognize UNI and the European Works Council as key partners in global labor management.

We understand that, at local level, the management of Company Committees is guided by the specific Policies and Rules established by each Legal Entity and, therefore, the procedures for informing, consulting and negotiating may contain different definitions, but they are always in line with Telefónica's guiding principles.

Maintaining a neutral position with respect to union activities is vital to ensure a free and open environment that allows the right to freedom of association to be exercised. If workers wish to form a union, Telefónica will recognize those unions that organize themselves in accordance with the conditions set out in ILO convention 87, and which respect local legislation. We also guarantee that workers' representatives receive fair treatment, free of discrimination, and that they have all the facilities they need to carry out their role.

Right to disconnect

At Telefónica we believe that technology should improve people's lives. For that reason, we believe it is essential that our workers can disconnect when necessary and create healthy habits in this regard, giving them the tools to develop their own sense of digital wellbeing.

Telefónica's commitment to their employees right to disconnect has materialized into an agreement signed with the largest unions in Spain (UGT and CCOO).

Through this agreement, Telefónica is committed to promoting measures to increase respect of employee's leisure time, recognizing the right to disconnect as a basic element to achieve a better organization of working hours in order to respect private and family life, and improve employee's quality of life and health.

Telefónica, S.A. 117

2018 Management Report

The right to disconnect commitment will be extended to all the countries where Telefónica is present and will soon be added, as an appendix, to the International Framework Agreement which the Company currently has in force with unions at global level.

Health and Safety at work

Health and safety at work is a concept that has grown and changed with society, and we now understand "health" to be a state of complete physical, mental and social wellbeing in harmony with the environment. To achieve this, a responsible and sustainable management requires that we include health, safety and wellbeing at work as commitments to our employees, their families and the community, and this is established in Telefónica's Responsible Business Principles: "We establish all the processes necessary to prevent workplace accidents, injuries, and illnesses associated with our professional activity through strict compliance with our regulatory environments, training and workplace risk prevention management. We encourage all our employees take care of their health and the health of the people around them."

With the aim of ratifying this Telefónica principle, we have approved a Global Policy with regard to the health, safety and wellbeing of our employees, our supply chain and partners. This Policy includes Telefónica's commitments that promote the promotion of workplace health, safety and wellbeing, one of our global objectives is the implementation of this regulation in all the activities in those countries where we operate.

2018 Management Report

Managing Diversity

At Telefónica, we include diversity as a key element and we do so because we firmly believe that its effective management not only responds to principles of social justice, but in addition provides major advantages for the business. We approach our diversity strategy from the viewpoint of four main stakeholders: employees, society, customers and providers.

Taking into account all of these stakeholders allows us to broaden the scope of our actions at the same time as creating an inclusive environment in which every employee has room for self-development.

Policies and bodies

We ensure the mainstreaming of our diversity and inclusion strategy through various corporate policies and management bodies:

- Global Diversity Committee:** made up of top-level executives, it has the objective of driving and monitoring the Company's diversity strategy. In addition, the roles of the Chief Diversity Officer, to support the work of the Committee, and of Diversity Champions, who act as internal change agents in all areas of the Company, have been created.
- Executive Appointment and Dismissal Policy:** guarantees transparency and meritocracy in the selection and promotion of executive talent. Similarly, in relation to the Board of Directors, our procedures also guarantee that the appointment and re-election of Directors is based on an objective needs analysis and favors diversity.

These policies and bodies are accompanied by measures to reduce inequality in the area of gender diversity. Among them, it is worth highlighting that we ensure the presence of both genders in the final candidate shortlist for internal selection processes. To guarantee compliance with this measure, in June 2018, a Transparency Committee was set up, comprising the Chairman and four top-level executives.

Likewise, our Supply Chain Sustainability Policy establishes the requirement for every provider not to discriminate against any particular group of people in their employment contracts, training and promotion.

The policies, bodies and actions described above, aimed at encouraging diversity and equality among all demographic groups within the Company, are included under the umbrella of our Global Diversity and Inclusion Policy, approved by the Board in 2017, the purpose of which is to ensure a management free of prejudice associated with individual differences.

Through our Global Diversity and Inclusion Policy we guarantee equality of opportunity and non-discriminatory, fair and impartial treatment of people in all areas of our Company, free of prejudice based on gender, nationality, ethnic origin, religion, sexual orientation and identity, marital status, age, family responsibility or disability.

Through our Global Policy, we are committed to continue to advance the effective integration of people with disabilities into the labor force, introducing the technical aids and support that enables the reduction and removal of the barriers to employing disabled people, in order to ensure that they can participate on equal terms in the workplace.

Finally, we would like to highlight that from 2019 we will be including our global gender diversity target - to achieve 30% of women in executive posts by 2020 - in the Company's executive variable remuneration scheme.

Results and indicators of the policies and initiatives

The number of employees at Telefónica as of 31 December 2018 was 120,138. The number of female employees increased to 45,320 (37.7% of the total), with the number of male employees standing at 74,818 (62.3% of the total). The percentage of women at executive level was 23.8%. Similarly, it is worth noting that Telefónica has employees in

more than 35 countries, who belong to over 104 nationalities.

A more comprehensive sample of relevant indicators will be published in the company's 2018 Integrated Report under the Global Reporting Initiative (GRI) Standards.

Telefónica, S.A. 119

2018 Management Report

Liquidity and capital resources

Financing

The main financing transactions carried out in the bond market in 2018 are as follows:

Item	Date	Maturity Date	Nominal (millions)	Currency	Currency of issuance	Coupon
Telefónica Emisiones, S.A.U. ⁽¹⁾						
EMTN BOND	01/22/2018	01/22/2027	1,000	1,000	EUR	1.447 %
SHELF BOND	03/06/2018	03/06/2038	750	655	USD	4.665 %
SHELF BOND	03/06/2018	03/06/2048	1,250	1,091	USD	4.895 %
EMTN BOND	09/11/2018	09/11/2025	1,000	1,000	EUR	1.495 %

(1) Guaranteed by Telefónica, S.A.

During 2018 there was no outstanding amount under the main financing transactions arranged in 2018 in the bank market.

Available funds

At December 31, 2018, Telefónica S.A.'s available funds from undrawn lines of credit in different financial institutions totaled 9,908 million euros (of which 9,843 million euros maturing in more than 12 months). Additionally, cash and cash equivalents as of December 31, 2018 amount to 4,011 million euros.

Additional information on sources of liquidity and undrawn lines of credit available to the Company, on liquidity risk management, on the Company's debt levels, and on capital management is provided in Notes 13, 14, 15 and 16 of the financial statements.

Contractual commitments

Note 19 to the financial statements provides information on firm commitments giving rise to future cash outflows and associated with operating leases, primarily.

Credit risk management

The credit risk in Telefónica, S.A. mainly refers to the one associated with financial derivative instruments arranged with different entities. The detailed description of how those risks are managed and hedged is included in Note 16.

Credit rating

At December 31, 2018, Telefónica, S.A.'s long-term issuer default rating is "BBB stable outlook" from Fitch, "Baa3 stable outlook" from Moody's and "BBB stable outlook" from Standard & Poor's. During 2017, there have not been changes in the credit ratings by any of the three agencies. Last changes in the credit ratings took place in 2016 when Moody's downgraded the rating to "Baa3 stable" from "Baa2 negative" on November 7, 2016, Fitch downgraded the rating to "BBB stable" from "BBB+ stable" on September 5, 2016 and Standard and Poor's revised the outlook to "stable" from "positive" on May 17, 2016.

European Commission's decision to block the proposed sale of O2 U.K. to Hutchison's Three U.K. in 2016 had an impact on Telefónica's credit ratings and outlooks by Moody's and Standard and Poor's, as they considered that decision would delay the Company's deleveraging process. In 2018, among the measures taken to protect the credit rating, it is noteworthy an intensive financing activity, taking advantage of historical low refinancing

2018 Management Report

rates to extend average debt life, together with the maintenance of an appropriate level of liquidity and an active portfolio management through the completion of the 16.65% divestment of the share capital of Pontel Participaciones, S.L. that owns 60% of the share capital of the company Telxius Telecom, S.A.

Dividend policy

Telefónica, S.A.'s dividend policy is revised yearly based on the Group's earnings, cash generation, solvency, liquidity, flexibility to make strategic investments, and shareholder and investor expectations.

On October 27, 2016, the Board of Directors of Telefónica, S.A. announced the dividend policy for the year 2017, that would be 0.40 euros per share: 0.20 euros in the fourth quarter of 2017 and 0.20 euros in the second quarter of 2018, both in cash.

On March 29, 2017 the Board of Directors of Telefónica, S.A. decided to define the corresponding payment periods of the dividends. Therefore, from there on, the dividend payment in the second quarter will take place in June, and the dividend payment in the fourth quarter will take place in December, in both cases on or before the third Friday of the corresponding month. In this regard, the dividends paid during 2017 were paid on June 16 and December 14.

In February 2018, Telefónica announced the dividend policy for the year 2018: 0.40 euros per share in cash, in December 2018 (0.20 euros per share) and in June 2019 (0.20 euros per share).

The Annual General Meeting held in 2018, approved a dividend distribution in cash charged to Unrestricted Reserves, by means of a payment of a fixed gross amount of 0.40 euros during 2018 payable in two tranches, 0.20 euros per share on June 15, 2018 and 0.20 euros per share on December 20, 2018.

Telefónica, S.A. 121

2018 Management Report

Treasury shares

Telefónica has performed, and may consider performing, transactions with treasury shares and financial instruments or contracts that confer the right to acquire treasury shares or assets whose underlying is Company shares.

Treasury share transactions will always be for legitimate purposes, including:

- Undertaking treasury share acquisitions approved by the Board of Directors or pursuant to General Shareholders' Meeting resolutions.

- Honoring previous legitimate commitments assumed.

- Covering requirements for shares to allocate to employees and management under stock option plans.

- Other purposes in accordance with prevailing legislation. In the past, treasury shares purchased on the stock market were exchanged for other shares-securities (as in the case of preferred capital securities), swapped for stakes in other companies (e.g. China Unicom or Telco S.p.A.), or acquired to reduce the number of shares in circulation (by redeeming the shares acquired), thereby boosting earnings per share.

Treasury share transactions will not be performed in any event based on privileged information or in order to intervene in free price formation. In particular, any of the conduct referred to in Articles 83.ter.1 of the Spanish Securities Market Law and 2 of Royal Decree 1333/2005 of November 11 implementing the Spanish Securities Market Law, with regards to market abuse will be avoided.

At December 31, 2018 and 2017, Telefónica, S.A. held the following treasury shares:

		Euros per share		Market	
	Number of shares	Acquisition price	Trading price	value	%
				(1)	
Treasury shares at 12/31/18	65,496,120	10.48	7.34	481	1.26145 %
Treasury shares at 12/31/17	65,687,859	10.48	8.13	534	1.26514 %

(1) Millions of euros

The movement in treasury shares of Telefónica, S.A. during the years 2018 and 2017 is as follows:

	Number of shares
Treasury shares at 12/31/16	141,229,134
Share plan delivery (see Note 19.3)	(3,518,795)
Other movements	(72,022,480)
Treasury shares at 12/31/17	65,687,859
Share plan delivery	(191,739)
Treasury shares at 12/31/18	65,496,120
Acquisitions	

There have been no acquisitions of treasury shares in 2018 and 2017.

2018 Management Report

Share redemption and disposals

In 2018 and 2017 there have been no share redemption or disposals of treasury shares.

Employee share option plan

Treasury shares sold, including share plans redemptions, in 2018 and 2017 amount to 2 million euros and 37 million euros, respectively.

On September 30, 2018 the second phase of the "Performance and Investment Plan 2014-2019" ("PIP 2014-2019") as well as the second phase of the "Talent for the future Share Plan" (TFSP2) ended. No share have been delivered to Telefónica Group executives or managers (see Note 19).

On July 31, 2017 the third phase of the Global Employee Share Plan ("the GESP") matured and 3,187,055 treasury shares were delivered to Group employees who met the established requirements.

On September 30, 2017 the first phase of the "Performance and Investment Plan 2014-2019" ("PIP 2014-2019") and the first phase of the "Talent for the Future Share Plan" (TFSP1) ended. No shares were delivered to Telefónica Group executives or managers (see Note 19).

Other movements

On March 14, 2017 Telefónica entered into a swap agreement with Koninklijke KPN NV (hereinafter, KPN) to deliver 72 million of its treasury shares in exchange for 178.5 million shares of its subsidiary Telefónica Deutschland Holding AG, representing 6.0% of the share capital of the latter. On the same date, this stake was sold at the same price to Telefónica Germany Holdings, GmbH so that, at 2017 year end, Telefónica, S.A. has no direct participation in Telefónica Deutschland Holding AG and the transfer of the stake has not had impact in the income statement.

The Company also has a derivative instrument, to be settled by offset, on a nominal value equivalent to 21.7 million of Telefónica shares in 2018 (35.2 million of Telefónica shares in 2017), recognized in both years under "Current interest-bearing debt" in the accompanying balance sheet.

2018 Management Report

Risk factors associated with the issuer

The Telefónica Group's business is affected by a series of intrinsic risk factors that affect exclusively the Group, as well as a series of external factors that are common to businesses of the same sector. The main risks and uncertainties facing Telefónica which could affect its business, financial position, reputation, corporate image and brand and its results of operations are set out below and must be considered jointly with the information set out in the Telefónica, S.A.:

Worsening of the economic and political environment could negatively affect Telefónica's business.

Telefónica's international presence enables the diversification of its activities across countries and regions, but it exposes Telefónica to diverse legislation, as well as to the political and economic environments of the countries in which it operates. Any adverse developments or even uncertainties in this regard, including exchange-rate or sovereign-risk fluctuations, may adversely affect Telefónica's business, financial position, cash flows and results of operations and/or the performance of some or all of the Group's financial indicators.

Economic conditions may adversely affect the level of demand of existing and prospective customers, as they may no longer deem critical the services offered by the Group.

In Europe, the macro-financial outlook showed a slight deterioration during the second half of 2018, influenced by external factors such as the weaker and maturing global economic cycle, the recent tightening of financial conditions, the greater uncertainty associated with the trade tensions between China and the United States and the risks that such tensions pose on economic growth and global stability. On the regional front, the political uncertainty in Europe has diminished in part after the results of the general elections in some European countries, but it still persists in various countries, including Italy, given the lack of political commitment with a reformist agenda. Economic activity and financial stability in Europe could also be affected by the monetary normalization that the European Central Bank is expected to continue implementing and by how Greece continues to manage its ongoing banking and economic restructuring process, after the country's recent exit from its bailout program.

Furthermore, the planned exit of the United Kingdom from the European Union ("EU") following the outcome of the referendum held in June 2016 is expected to result in economic adjustments regardless of the nature of the new trade and investment relationships between the United Kingdom and the rest of Europe in the future. As of the date of this Annual Report, there is significant uncertainty regarding the Brexit negotiations and required parliamentary approvals, both in terms of timing (the process can be subject to delays) and the final outcome, with multiple options still being possible, including a no deal Brexit. In the meantime, uncertainty surrounding Brexit could have a negative impact on investment, economic activity and employment. It could also lead to financial market volatility, which could limit or restrict access to capital markets. This situation could worsen depending on the final terms of Brexit, which could increase regulatory and legal complexities, including those relating to tax, trade and security. Such changes could be costly and potentially disruptive to business relationships in these markets, including those of Telefónica, its suppliers and its customers. The elections to the European Parliament in May 2019 could also lead to political uncertainty, as they could result in a rebalancing of political groupings and significant changes in goals for the European project in the medium term, as well as in changes in key positions of the main European institutions during 2019.

In Spain, another possible source of uncertainty is Catalonia's political situation and its impact on the Spanish economy. Although recent developments have contributed to reduce such uncertainty, if political tensions re-emerge or intensify, there could be a negative impact both on financing conditions and on the Spanish macroeconomic scenario, given the demanding sovereign bond maturity calendar and the high dependence of the Spanish economy on the international investors and economic outlook. There is also some uncertainty regarding the economic policy mix to be implemented in 2019 as a result of the current high parliamentary fragmentation. In 2018, the Telefónica Group obtained 26.1% of its revenues in Spain (24.3% in 2017), 15.0% in Germany (14.0% in 2017) and 13.9% in the United Kingdom (12.6% in 2017).

In Latin America, exchange rate risk is particularly noteworthy. Certain external factors contributing to this risk are the uncertainty derived from the monetary normalization process in the United States, increasing global trade tensions, the continuing low commodity prices in certain cases and doubts about growth and financial

2018 Management Report

imbalances in China. Certain internal factors contributing to this risk are the high fiscal and external deficits in major Latin American countries and the low liquidity in certain exchange markets, together with low productivity growth, which hinder a more accelerated progress in economic development and the rebalancing of still existing mismatches. In Argentina, the government is focused on resolving the country's macroeconomic and financial imbalances and on recovering international confidence, particularly after the agreement reached with the International Monetary Fund to provide financial support in the medium term. Even though the measures taken by the government are expected to have positive effects in the medium term, both the macroeconomic and exchange rate risks remain high in the short term. The major challenges the economy is facing, both internally (with an ongoing sharp reduction of public deficit in an environment of economic recession and high inflation) and externally (with significant financing needs in the medium term), make the Argentine economy vulnerable to episodes of volatility in the financial markets. Moreover, the presidential elections due to take place in 2019 pose additional risks, as they could result in a change in the current economic policy stance with very limited economic policy levers.

In Brazil, after the presidential elections resulted in a change of government, the effectiveness of such government in implementing the announced and needed reforms that would improve the potential growth of the economy and drive the fiscal accounts towards sustainability remains to be seen. On the other hand, while signs of stabilization have emerged and the economy has started to show positive growth figures, the pace of the recovery is still gradual. Despite the decreasing external financing needs, internal financing needs remain high, and financing conditions remain challenging, as the country sovereign credit rating remains below investment grade.

Mexico has a high commercial and financial exposure to the United States, which could generate uncertainty. Domestically, there is also uncertainty surrounding the new government's political agenda, despite having a relatively stable economic outlook. Both the political management by the new government of the structural achievements made in recent years and the final approval of the Agreement between the United States, Mexico and Canada (USMCA) are expected to have a material impact on the economy. While the signing of USMCA has significantly reduced uncertainty, it has not eliminated it, as the agreement still needs to be ratified by the respective national legislative chambers. Any higher than expected increase in interest rates in the United States and/or a possible re negotiation of trade agreements between the abovementioned countries could result in higher restrictions on imports into the United States, which, together with political uncertainty surrounding such matters, could negatively impact economic activity and exchange rates in Mexico. The relative weight of Mexico in the consolidated revenues of the Telefónica Group was 2.4% in 2018.

Chile, Colombia and Peru have been able to stabilize their economies with growth rates close to their potential growth led by domestic demand, while recent adjustments and political decisions have addressed certain fiscal and external account issues. Nevertheless, these economies are exposed not only to changes in the global economy given their vulnerability to abrupt movements in commodity prices, but also to unexpected changes in financial conditions.

In Ecuador, a decrease in domestic political uncertainty has allowed for an improvement in economic activity through exports, but risks persist, mainly on the fiscal front. The country's financing needs are still high, which, together with low international reserves, keep the country in a vulnerable position against volatility shocks.

In 2018, Telefónica Brazil represented 20.8% of the Telefónica Group's revenues (23.1% in 2017). In 2018, Telefónica Hispam Norte and Telefónica Hispam Sur represented 8.4% and 13.7% of the Telefónica Group's revenues, respectively (8.3% and 15.8%, respectively, in 2017). In 2018, 4.3% of Telefónica Group's revenues came from Chile, 4.3% from Peru and 4.8% from Argentina. In 2018, 28.2% of the Group's revenues were generated in countries that do not have investment grade status (in order of their contribution to the Group's revenues: Brazil, Argentina, Ecuador, Costa Rica, Nicaragua, Guatemala, El Salvador and Venezuela) and other countries are only one notch away from losing this status.

2018 Management Report

"Country risk" factors include, among others, the following:

• unexpected adverse changes in regulation or administrative policies, including changes that modify the terms and conditions of licenses and concessions and their renewal (or delay their approval);

• abrupt exchange-rate movements;

• high inflation rates;

• expropriation or nationalization of assets, adverse tax decisions, or other forms of state intervention;

• economic and financial downturns, political instability and civil disturbances; and

• maximum limits on profit margins imposed in order to limit the prices of goods and services through the analysis of cost structures (for example, in Venezuela, a maximum profit margin has been introduced that is set annually by the Superintendence for Defense of Socioeconomic Rights).

Any of the foregoing may adversely affect the business, financial position, results of operations and/or cash flows of the Group.

The Group's financial condition and results of operations may be adversely affected if it does not effectively manage its exposure to foreign currency exchange rates or interest rates.

In nominal terms, as of December 31, 2018, 73.6% of the Group's net financial debt plus commitments was pegged to fixed interest rates for a period greater than one year. As of the same date, 18.7% of the Group's net financial debt plus commitments was denominated in a currency other than the euro.

To illustrate the sensitivity of financial expenses to variations in short-term interest rates as of December 31, 2018: (i) a 100 basis points increase in interest rates in all currencies in which Telefónica had a financial position at that date would have led to an increase in financial expenses of 102 million euros, (ii) whereas a 100 basis points decrease in interest rates in all currencies (even if negative rates are reached), would have led to a reduction in financial expenses of 88 million euros. These calculations were made assuming a constant currency and balance position equivalent to the position at that date and taking into account the derivative financial instruments arranged by the Group.

According to the Group's calculations, the impact on results and specifically on net exchange differences due to a 10% depreciation of Latin American currencies against the U.S. dollar and a 10% depreciation of the rest of the currencies against the euro would result in exchange losses of 1 million euros for the year ended December 31, 2018, primarily due to the weakening of the Venezuelan bolivar and, to a lesser extent, the Argentine peso. These calculations have been made assuming a constant currency position with an impact on profit or loss as of December 31, 2018, taking into account derivative instruments in place.

During 2018, Telefónica Brazil represented 27.7% (25.9% in 2017), Telefónica United Kingdom represented 12.0% (10.1% in 2017), Telefónica Hispam Norte represented 5.1% (7.8% in 2017) and Telefónica Hispam Sur represented 11.0% (14.1% in 2017) of the operating income before depreciation and amortization ("OIBDA") of the Telefónica Group.

The Telefónica Group uses a variety of strategies to manage this risk, among others the use of financial derivatives, which themselves are also exposed to risk, including counterparty risk. However, the Group's risk management strategies may not achieve the desired effect, which could adversely affect the Group's business, financial condition, results of operations and/or cash flows.

The evolution of exchange rates negatively impacted the Group's 2018 results, decreasing the year-on-year growth of the Group's consolidated revenues and OIBDA by an estimated 8.8 percentage points and 10.3 percentage points, respectively, mainly due to the depreciation of the Brazilian real and the Argentine peso (3.2 percentage points and 4.7 percentage points, respectively in 2017, mainly due to the depreciation of the Argentine peso, the Venezuelan Bolivar and the pound sterling). Furthermore, translation differences had a

2018 Management Report

negative impact on the Group's equity of 2,043 million euros as of December 31, 2018, whereas they had a negative impact on the Group's equity of 4,279 million euros as of December 31, 2017.

If the Group does not effectively manage its exposure to foreign currency exchange rates or interest rates, it may adversely affect its business, financial position, results of operations and/or cash flows.

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

The operation, expansion and improvement of the Telefónica Group's networks, the development and distribution of the Telefónica Group's services and products, the implementation of Telefónica's strategic plan and new technologies, the renewal of licenses or the expansion of the Telefónica Group's business in countries where it operates, may require a substantial amount of financing.

A decrease in the liquidity of Telefónica, or a difficulty in refinancing maturing debt or raising new funds as debt or equity could force Telefónica to use resources allocated to investments or other commitments to pay its financial debt, which could have a negative effect on the Group's business, financial condition, results of operations and/or cash flows.

Funding could be more difficult and costly in the event of a deterioration of conditions in the international or local financial markets due, for example, to monetary policies set by central banks, including increases in interest rates and/or balance sheet reductions, increasing global political and commercial uncertainty and oil price instability, or if there is an eventual deterioration in the solvency or operating performance of Telefónica.

As of December 31, 2018, the Group's net financial debt amounted to 41,785 million euros (44,230 million euros as of December 31, 2017) and the Group's gross financial debt amounted to 54,702 million euros (55,746 million euros as of December 31, 2017). As of December 31, 2018, the average maturity of the debt was 8.98 years (8.08 years as of December 31, 2017).

As of December 31, 2018, the Group's gross financial debt scheduled to mature in 2019 amounted to 9,368 million euros and gross financial debt scheduled to mature in 2020 amounted to 6,417 million euros.

In accordance with its liquidity policy, Telefónica has covered its gross debt maturities for the next 12 months with cash and credit lines available at December 31, 2018. As of December 31, 2018, the Telefónica Group had undrawn committed credit facilities arranged with banks for an amount of 12,219 million euros (11,887 million euros of which were due to expire in more than 12 months). Telefónica's liquidity could be affected if market conditions make it difficult to renew existing undrawn credit lines. As of December 31, 2018, 2.7% of the aggregate undrawn amount under credit lines was scheduled to expire prior to December 31, 2019.

In addition, given the interrelation between economic growth and financial stability, the materialization of any of the economic, political and exchange rate risks referred to above could lead to a negative impact on the availability and cost of Telefónica's financing and its liquidity strategy. This in turn could have a negative effect on the Group's business, financial condition, results of operations and/or cash flows.

Adoption of new accounting standards could affect the Group's reported results and financial position.

Accounting standard-setting bodies and other authorities may periodically change accounting regulations that govern the preparation of the Group's consolidated financial statements. Those changes could have a significant impact on the way the Group accounts for certain matters and presents its financial position and its results of operations. In some instances, a modified standard or a new requirement with retroactive effect must be implemented, which requires the Group to restate previous financial statements.

In particular, Telefónica is required to adopt the new accounting standard IFRS 16 Leases ("IFRS 16") effective from January 1, 2019.

This standard requires significant changes that will affect the accounting treatment for all lease contracts where Telefónica acts as lessee, other than certain short-term leases and leases of low-value assets. The Group estimates that the first-time adoption of IFRS 16 will have a material impact on the Group's financial statements

2018 Management Report

and may make comparisons between periods less meaningful. It will also likely materially affect the amounts used to calculate certain financial metrics reported by the Group or used by analysts and investors to analyze the Group. The Group operates in a highly regulated industry which requires government concessions for the provision of a large part of its services and the use of spectrum, which is a scarce and costly resource.

The telecommunications sector is subject to laws and sector-specific regulations in the majority of the countries where the Group operates. Additionally, many of the services the Group provides require the granting of a license, concession or official approval, which usually requires certain obligations and investments to be made, such as those relating to the acquisition of spectrum capacity. Among the main legal risks are those related to spectrum regulation and licenses/concessions, rates, universal service regulation, regulated wholesale services over fiber networks, privacy, functional separation of businesses and network neutrality. The fact that the Group's business is highly regulated both affects its revenues and imposes costs on its operations.

As the Group provides most of its services under licenses, authorizations or concessions, it is vulnerable to administrative bodies' decisions, such as economic fines for serious breaches in the provision of services and, potentially, revocation or failure to renew these licenses, authorizations or concessions, or the granting of new licenses to competitors for the provision of services in a specific market. The spectrum to which most of the licenses and administrative concessions refer to is used for the provision of mobile services on 2G, 3G and 4G technologies. The complementarity between the different frequency bands successively assigned to an operator in a geographic market enables greater flexibility and efficiency in both the deployment of the network and the provision of services to final customers over the capacities resulting from such network.

Any challenges or amendments to the terms of licenses, authorizations or concessions granted to the Group and necessary for the provision of its services or the Group's failure to obtain sufficient or appropriate spectrum capacity in the jurisdictions discussed below or any others in which it operates, or its inability to assume the related costs, could have an adverse impact on its ability to launch and provide new services and on its ability to maintain the quality of existing services, which may adversely affect the Group's business, financial condition, results of operations and/or cash flows.

Additionally, the Telefónica Group could be affected by regulatory actions of the antitrust authorities. These authorities could prohibit certain actions, such as new acquisitions or specific practices, create obligations or impose heavy fines. Any such measures implemented by the antitrust authorities could result in economic and/or reputational loss for the Group, in addition to a loss of market share and/or harm to the future growth of certain businesses.

Regulation of spectrum and access to new government licenses/concessions of spectrum

In Europe, the Directive (EU) 2018/1972 of the European Parliament and of the Council establishing the European Electronic Communications Code ("EECC"), was approved on December 11, 2018. The aim of the EECC is fostering investment in new high-capacity networks (principally fiber networks and the fifth generation of mobile telecommunications, or 5G) and create a 'level playing field' between telecommunications companies and over-the-top providers ("OTTs"). Member States have a period of two years (until December 21, 2020) to transpose said Directive into their national legislation. Certain provisions included in the EECC are so extensive and complex that their final impact on operators, such as Telefónica, will largely depend on how they are interpreted by regulatory authorities in each Member State. The EECC will continue to oblige national regulatory authorities to analyze telecommunications markets and determine whether any operators dominate the market. Such operators will continue to be designated as having significant market power ("SMP") and face additional obligations in that territory. In the case of new fiber networks, such SMP obligations could be relaxed if co-investment agreements bear fruit among SMP and non-SMP networks operators.

Furthermore, in Europe, spectrum auctions are expected to take place in the coming years, requiring potential cash outflows to obtain additional spectrum or to meet the coverage requirements associated with some of these licenses.

2018 Management Report

In Spain, the auction of the 3.6 GHz band was carried out during July 2018, and Telefónica was awarded 50 MHz. The Ministry of Economy and Business Affairs has published the roadmap to clear spectrum in the 700 MHz band from its current use (digital television), in line with the calendar approved by the European Commission ("EC") and with the 5G National Plan adopted in December 2017. The plan foresees the completion of the release of the 700 MHz band before June 30, 2020 and the Ministry has indicated its intention to hold the auction in 2020.

In the United Kingdom, the Office of Communications ("Ofcom"), the national telecommunications regulatory authority, conducted a spectrum auction for the 2.3 GHz and 3.4 GHz bands in March and April 2018. Telefónica United Kingdom won all of the 2.3 GHz spectrum available (40 MHz) and an additional 40 MHz of the 3.4 GHz spectrum band (out of the 150 MHz available), in both cases under 20-year renewable licenses. In December 2018, Ofcom launched a public consultation regarding the coverage obligations and auction design relating to the 700 MHz/3.6GHz bands, which are expected to be auctioned in the first quarter of 2020.

In Germany, on May 14, 2018 the Regulatory Agency for Electricity, Gas, Telecommunications, Post and Railway ("BNetzA") published Decisions I and II on the method to award frequencies nationwide, in the 2GHz band and a large part of the 3.6 GHz band. In addition, under the same decisions, BNetzA allocated 100 MHz in the 3.6 GHz band and also frequencies in the 26 GHz band, both for local/regional assignments upon application.

Subsequently, on November 26, 2018, BNetzA published Decisions III and IV establishing the conditions for frequency usage and auction rules on the above-mentioned 2 GHz and 3.6 GHz bands (Auction Rules). The rules include obligations for better coverage in both urban and rural areas, as well as along transport routes and other conditions, such as the obligation to negotiate on national roaming and network sharing. The above four decisions have been challenged in Court by Telefónica Deutschland Group. Nevertheless, Telefónica Deutschland Group submitted its application to the auction by January 25, 2019. The auction is scheduled to begin in the first quarter of 2019.

All of the bands mentioned above are considered to be technologically neutral, which means that they could potentially be used in the future for 5G services.

In Latin America, spectrum auctions are expected to take place in the coming years, potentially requiring cash outflows to obtain additional spectrum or to meet the coverage requirements or other obligations associated with these licenses. Specifically, the procedures that will take place in 2019 in jurisdictions that are relevant for the Group are: Argentina: the government issued on January 21, 2018 a decree (Decreto de Necesidad y Urgencia) that contemplates the possibility of auctioning the spectrum previously reserved for ARSAT (a public company). The spectrum that was reserved for ARSAT includes 20 MHz in the 700 MHz band (national), 50 MHz in the AWS band (national) and 20 MHz in the 1900 MHz band (regional).

Brazil: In September 2018, the Brazilian regulator, Anatel, launched a first consultation to award spectrum in the 2.3GHz TDD (time-division duplexing) band and spectrum in the 3.5GHz TDD band. A consultation on the auction of the remaining spectrum in the 700 MHz band is expected to take place in the first half of 2019. Anatel's 5G commission has also identified 1500 MHz which could be auctioned. An auction to award spectrum in any of these bands could take place in 2019 or 2020.

Colombia: The consultation processes launched in 2017 and early 2018 on the conditions of the 700 MHz spectrum auction were suspended following the change of government that took place in August 2018. The new government has submitted to Congress a draft bill with regards to information and communication technologies. Among the measures included in the draft bill, there is an extension of the duration of spectrum licenses. The approval process of the draft bill may have an impact on the timing of the auction. This draft bill is expected to be discussed in the first quarter of 2019.

2018 Management Report

Peru: In October 2018, the Ministry of Transport and Communications approved a new regulation for the reorganization of frequency bands, known as "refarming". This could result in a spectrum award process in 2019 or 2020.

It is possible that some of the abovementioned spectrum tender procedures will not be completed, or even initiated within the proposed time frames. In addition, in the cases where Telefónica has submitted comments to the proposed conditions of auctions or allocation procedures, there is no certainty as to whether and to what extent such comments will be considered by the relevant regulator. In addition, Telefónica may decide to abstain from a particular process once it reviews the viability of each spectrum acquisition opportunity.

In addition to the spectrum tender procedures referred to above, it may be the case that certain administrations which have not yet announced their intention to release new spectrum may do so during 2019 and thereafter. The above does not include processes announced through general statements by administrations, which involve bands not key to Telefónica's needs. Furthermore, Telefónica may also seek to acquire spectrum on the secondary market where opportunities might arise.

Risks relating to concessions and licenses previously granted

In Spain, pursuant to the license for the 800 MHz spectrum band, there are a series of obligations that Telefónica is subject to with the aim of reaching coverage that allows access, with a speed of at least 30 Mb per second, to at least 90% of the inhabitants in population units of less than 5,000 inhabitants. The approval of the final terms and conditions to implement this coverage obligation was published in November 2018. Telefónica is undergoing a constant process of deployment and densification of Long Term Evolution ("LTE") solutions over the 800 MHz band that will be the base for compliance with such obligation.

Telefónica owns two concessions in the 2.1 GHz and 3.5 GHz spectrum, both awarded in 2000, which expire in April 2020 but may be extended for an additional ten years.

In the state of São Paulo, Telefónica Brazil provides local and national long-distance Fixed Switched Telephony Services ("STFC") under the so-called public regime, through a concession agreement, which is expected to remain in force until 2025. At December 31, 2018, the estimated residual value of the assets assigned to the provision of STFC was 8,622 million Brazilian reais (approximately 1,943 million euros under the exchange rate applicable on such date) (8,763 million Brazilian reais as of December 31, 2017, approximately 2,209 million euros under the exchange rate applicable on such date), which comprised switching and transmission equipment and public use terminals, external network equipment, energy, system and operational support equipment. In principle, such assets were considered to be reversible assets, and were thus supposed to revert to the federal government at the end of the concession agreement. However, the implementation of a bill amending the regulatory framework in Brazil which establishes, among other things, that such assets would no longer be reversible under a new license regime in exchange for investment commitments, is currently pending. The bill was approved at both legislative houses, but was challenged before the Federal Supreme Court due to an alleged procedural defect. The outcome of this lawsuit is uncertain, although the Senate's board may overcome it by sending the bill for voting in the Plenary. In the event that the bill is finally approved, ANATEL would be entitled to adopt the relevant administrative decisions for the amendment of the respective licenses with the consequent amendment of the future obligations imposed on STFC providers.

2018 Management Report

As of the date of this Annual Report, there is no certainty that the proposed change in the regulatory framework will be completed, or that it will be completed in fully satisfactory terms for Telefónica Brazil. Only after this bill or a similar law is adopted (enabling the exchange of reversion obligations for investment commitments) could ANATEL impose the investment obligations referred to above.

As of the date of this Annual Report, it is not possible to estimate the hypothetical investment obligations that ANATEL could impose on the concessionaires, including Telefónica Brazil, in exchange for eliminating their obligation to revert assets used for the provision of the STFC services.

In Colombia, the ITC issued resolution 597 on March 27, 2014 to renew 850 MHz/1900 MHz band licenses for ten additional years. Under the scope of such resolution, Colombia Telecomunicaciones, S.A. ("ColTel") (67.5% of which is owned, directly and indirectly, by Telefónica and 32.5% of which is owned by the government of Colombia), renewed its license to exploit such spectrum to provide telecommunication services.

The concession agreements from 1994, which were renewed in 2004 and under which the mobile telephone services were provided until November 28, 2013, contained a reversion clause for the underlying assets. However, Law 422 of 1998 and Law 1341 of 2009 provided that upon expiration of a concession agreement for telecommunication services, only the spectrum reverts to the State. That was the understanding under which all the operators, including the authorities, operated between 1998 and 2013. In 2013, however, when analyzing an appeal on the constitutionality of said laws, the Constitutional Court confirmed the constitutionality of the laws but ruled that it could not be concluded that those laws modified with retroactive effect the reversion clause of the concession agreements of 1994. On February 16, 2016, the ITC started an arbitration proceeding against ColTel and other defendants in accordance with the terms of the relevant concession agreement of 1994, in order to clarify the validity and scope of such reversion clause. The arbitration award was rendered on July 25, 2017 and was not favorable to ColTel and its co-defendants.

The arbitration tribunal ordered ColTel to pay 1,651,012 million Colombian pesos. On August 29, 2017, the shareholders' meeting of ColTel approved a capital increase in a total amount of 1,651,012 million Colombian pesos (470 million euros at the exchange rate as of such date) to pay the amount imposed by the arbitration award. The Telefónica Group and the Colombian government subscribed the capital increase pro rata to their respective shareholding in ColTel. Telefónica's decision to participate in the capital increase does not constitute, and should not be understood as, an acceptance of the arbitration award. Telefónica reserves all of its legal rights and the exercise by Telefónica or ColTel of any applicable legal action, national or international. Both ColTel and Telefónica have started legal actions. On August 18, 2017, ColTel filed an appeal to challenge the arbitration award at Colombia's highest court of administrative litigation (Consejo de Estado), which was dismissed on May 24, 2018. In addition, on December 18, 2017, ColTel also filed a constitutional action (acción de tutela) with the Constitutional Court seeking to protect its constitutional rights, jeopardized by the arbitration award. On March 15, 2018, the constitutional action was denied and ColTel filed an appeal against this ruling on April 18, 2018, which was dismissed on May 24, 2018. On November 27, 2018 a recusal motion was filed at the Constitutional Court, which is pending resolution.

In addition, pursuant to the relevant bilateral treaty, Telefónica notified Colombia of its intention to file a claim in the International Center for Settlement of Investment Disputes ("ICSID"). After the expiration of the required 90-day notice period, on February 1, 2018, Telefónica submitted the arbitration request to the ICSID and, on February 20, 2018, the General Secretary of ICSID registered the request for the institution of arbitration proceedings. The request for arbitration is ongoing and the arbitral tribunal is in the process of being appointed.

In Peru, Telefónica has concessions for the provision of fixed-line services until November 2027. In December 2013, Telefónica filed a partial renewal request for these concessions for five more years. On November 26, 2018, the Ministry of Transportation and Communications (Ministerio de Transportes y Comunicaciones) notified the denial of such renewals. Telefónica has filed an appeal for reconsideration. On February 5, 2019 the Ministry dismissed the mentioned appeal and Telefónica is considering to challenge the decision. In December 2014, June 2016 and May 2017 Telefónica filed renewal requests for an additional 20 years in relation to a concession for the provision of local carrier services, one of the concessions to provide mobile services in certain provinces, and one concession to provide fixed-line services, respectively. In addition, in April 2016, Telefónica filed a renewal request in relation to the 1900 MHz frequency spectrum for the Provincias (all of Peru except for Lima and Callao), which license expired in 2018.

2018 Management Report

As of the date of this Annual Report, the decision of the Ministry of Transport and Communications (Ministerio de Transportes y Comunicaciones) in these proceedings is still pending and, according to the legislation, the underlying concessions remain in force as long as the proceedings are pending.

In Chile, Telefónica Móviles Chile, S.A. and other two telecommunications operators were awarded spectrum in the 700 MHz band in March 2014, with Telefónica Móviles Chile being awarded 2x10 MHz. While services are being provided on such spectrum, a consumer organization filed a claim before the Tribunal for the Defense of Free Competition (the "TDFC") against Telefónica Móviles Chile, S.A. and the other two operators, regarding the allocation of spectrum in the 700 MHz band and challenging the outcome of the spectrum allocation. The TDFC rejected this claim on consecutive occasions but, on June 25, 2018, the Supreme Court issued a final judgment stating that the assignment of spectrum in the 700 MHz band to the mobile operators constituted anticompetitive behavior as it awarded spectrum blocks without respecting the 60 MHz spectrum cap set by the Supreme Court in a ruling from 2009.

The Supreme Court ruled that the incumbent operators have to relinquish the same amount of spectrum that they acquired in the 700 MHz band auction. However, the ruling of the Supreme Court allows the operators to choose the band from which the spectrum that exceeds the fixed cap (60 MHz) is to be relinquished and no deadline has been set to complete such relinquishment. As of the date of this Annual Report, Telefónica Móviles Chile has not relinquished any of the required spectrum, since the proceeding has been temporally suspended by a resolution issued by the Constitutional Court on January 29, 2019.

The Supreme Court ruling also states that if the sector-specific authority ("Subtel") considers it necessary to review the maximum spectrum cap, it should put in place a consultation process before the TDFC. Subtel must otherwise initiate the necessary procedures to adapt the set cap to the fixed parameters of 60 MHz for each participating operator in the aforementioned radio spectrum. On October 3, 2018, Subtel submitted its proposal on the review of the maximum spectrum cap to the TDFC.

Additionally, Subtel submitted to the TDFC a proposal of "complementary conditions" with a general scope which would be applicable to all bands, as well as another proposal of "special conditions" to be considered in future auctions. The TDFC set a deadline of December 28, 2018 for interested parties to provide their comments. The process initiated by the TDFC is expected to last several months.

In addition, the Supreme Court rejected the appeal filed by Telefónica Móviles Chile, S.A. against the resolution of the TDFC that ordered immediate compliance with the spectrum relinquishment obligations, without waiting for the result of the spectrum cap consultation. However, on January 29, 2019, the Constitutional Court temporarily suspended the obligation to immediately comply with such spectrum relinquishment obligations until the remedy of inapplicability that has been filed by Telefónica is resolved.

Additionally, regarding the 3.5 GHz band, Subtel issued a decision on June 21, 2018 regarding the 3.4-3.8 GHz spectrum band, which, among other things, has suspended the granting of authorizations, the modification of concessions and the reception of network rollouts in connection with this spectrum band. Its purpose is to carry out an in-depth study on the efficiency of the usage of this band for 5G and ensuring the efficient usage of this band in light of international best practices and the need for efficient spectrum management. The decision had a limited impact on Telefónica's operations as Telefónica Chile, S.A. only has 50 MHz of spectrum assigned in that band in Regions XI and XII (representing less than 2% of the population) and that spectrum is currently not in use. On October 3, 2018, Subtel modified the above mentioned resolution and resolved to release part of this spectrum to enable operators to provide wireless fixed services. Of the 50 MHz awarded to Telefónica Chile, S.A., 30 MHz were released and may only be used for mobile services, which is a required change for 5G provision, once future auctions on 3400-3800 MHz range are firmly awarded. The remainder of the spectrum may not currently be used for any service.

On November 20, 2018, Telefónica Chile, S.A. requested the TDFC to initiate a consultation process to determine whether the decision of Subtel regarding the 3.5 GHz band violates competition law. The deadline for third parties to provide background information expired on February 18, 2019.

In Mexico, in August 2018, Telefónica participated in the auction of the 2500-2690 MHz band and was awarded 2x20 MHz of spectrum. The rules and the procedure of the auction were challenged by an operator and Telefónica

2018 Management Report

has responded to the allegations made. Telefónica's regional holdings in the 1900 MHz band (approximately 44% of the total 1900 MHz band) expired in October 2018. Telefónica has requested the renewal of this concession. The Instituto Federal de Telecomunicaciones ("IFT") is expected to decide on the renewal request during the first quarter of 2019. Telefónica may continue to use this spectrum while the IFT decision is pending..

In 2018, the Group's consolidated investment in spectrum acquisitions and renewals amounted to 868 million euros (538 million euros in 2017).

Regulation of wholesale services

The EC's proposal in respect of the regulatory framework for wholesale services intends, among other measures, to incorporate a costing methodology to fix a European upper limit for the call-termination prices for landline phones/mobile phones (FTRs/MTRs) applicable in the EU. According to this proposal, the decreases in wholesale mobile termination rates ("MTRs") in Europe have been noteworthy. It should be noted that since termination fees in mobile and fixed communications have decreased substantially in recent years, future decreases are expected to become smaller so that the negative impact on turnover is expected to be less significant than in the past.

In the United Kingdom, on June 1, 2018, the price of MTRs fell to 0.489 pence per minute. From April 1, 2019, they will be priced at 0.479 pence per minute, with a further reduction based on inflation (consumer prices index ("CPI") minus 3.7% from April 1, 2020).

In Spain, in January 2018 the Spanish National Regulatory and Competition Authority (Comisión Nacional de los Mercados y la Competencia or "CNMC") approved a decision setting the new MTRs for all mobile operators, which will result in a progressive reduction of 40% from January 2018 levels (0.0109 euros per minute). The approved MTRs are as follows: from the date the decision became effective until December 31, 2018 0.0070 euros per minute; from January 1, 2019 until December 31, 2019 0.0067 euros per minute; and as from January 1, 2020 0.0064 euros per minute. The CNMC launched a public consultation in November 2018 regarding fixed termination rates ("FTRs"), which proposed a progressive reduction in prices of 34% from November 2018 levels. The proposed prices are as follows: from the date the decision becomes effective until December 31, 2019 0.0640 euros per minute; from January 1, 2020 until December 31, 2020 0.0591 euros per minute and as from January 1, 2021 0.0543 euros per minute. A final decision is expected to be adopted in the first quarter of 2019.

In Germany, on December 1, 2018 the price of the MTR fell from 1.07 euro cents per minute to 0.95 euro cents per minute. This price will be in force until November 30, 2019. MTRs for subsequent periods will be decided in 2019.

In Brazil, Resolution 639/2014 established that MTRs will be subject to successive yearly reductions from 2016 until 2019, when the definitive cost-oriented-model fees are expected to be in force. In addition, through Act No. 6211/2014, ANATEL published the reference prices to be applied by operators with significant market power ("SMP"). In 2018, through Act No. 9919/2018, ANATEL published the reference prices to be applied by SMP operators from 2020 until 2023. In addition to the planned implementation of the cost-oriented-model, the Plano Geral de Metas de Competição ("PGMC"), amended by Resolution 649/2015, among other changes, updated the partial "bill and keep" model for MTRs, aiming to fix an imbalanced remuneration pattern between SMP operators and other companies operating in the relevant market. This measure was intended to adapt the networks to the reductions of MTRs and promote a gradual adaptation to the enforcement of the cost-oriented fees in early 2019. However, the new PGMC that was published in July 2018, among other changes, extended the "bill and keep" model, which was expected to expire in February 2019, until the next revision of the PGMC in four years.

In Mexico, on November 13, 2018, the IFT announced that the MTRs applicable to the so-called Prevailing Economic Agent ("PEA") for 2019 shall be 0.028313 pesos per minute while the MTRs applicable to the operators other than the PEA shall be 0.112623 pesos per minute. Both this decision and the decision that established the MTRs applicable to 2018 were challenged by Telefónica.

2018 Management Report

In Peru, on December 21, 2018, the regulator, OSIPTEL, published the new MTRs. The new MTRs applicable to all operators of mobile public services was fixed at 0.00302 dollars per minute rated at the second, which entails a 54% decrease from the previous rate (0.00661 dollars per minute rated at the second). The new rates have been in effect since January 1, 2019 and will remain in effect until a new MTR value is defined by the regulator.

In Argentina, on August 17, 2018, the Ente Nacional de Comunicaciones ("Enacom") published the provisional termination and local origination charges for mobile communications services provided by networks until the final charges are decided pursuant to a cost model. Enacom set a tariff of 0.0108 dollars per minute and the measurement unit for valuation is per second. During the summer of 2018, Enacom launched a public consultation on the cost models for mobile communications services. On November 22, 2018, Enacom set the provisional termination charge in fixed networks at 0.0045 dollars per minute, the tariff for local transit services at 0.0010 dollars per minute, and the tariff for long distance transportation services at 0.0027 dollars per minute. In each case the measurement unit for valuation is per second.

In Chile, regarding mobile termination rates, on February 5, 2019, Subtel notified TMCH of a new proposal on tariff decree, which will be applicable for the next five years. The average tariff which will apply until 2024 is 1.8 Chilean pesos per minute (0.0024 euros, without VAT, based on the exchange rate as of February 6, 2019, to be charged on a per second basis). The new tariff decree is in effect since January 26, 2019. New tariffs on fixed operations will come into force in May 2019.

In Colombia, in December 2018, the regulator (Comisión de Regulación de Comunicaciones) published two consultations. The first initiative would reduce the FTRs from 0.01 to 0.003 dollars in 2019, which would be beneficial to ColTel as it is a net payer of FTRs. As of 2020, FTRs between fixed networks would be completely eliminated. The second initiative, on one hand seeks to substitute the national roaming charges in incoming calls charged to operators using national roaming, for mobile termination rates, which would negatively impact the revenues of ColTel; and, on the other hand, modifies the formula that defines the maximum regulated rate for network provision charged to MVNOs, from the minimum ARPU reported by MVNOs to the average ARPU from the past four (4) quarters.

As a result of the foregoing actions, the prices for certain wholesale services may be reduced, which may materially adversely affect the Group's business, financial condition, results of operations and/or cash flows. During 2018, the negative impact of these wholesale regulations (mainly MTRs, FTRs and roaming) is estimated to have resulted in the deduction of approximately 1.1 percentage points from the organic growth of the Group's revenues.

Regulation of universal service obligations

Universal service obligations ("USO") refers to the obligations imposed on telecommunication operators which are aimed at granting access to all consumers in a country to a minimum set of services offered at reasonable and fair prices in order to avoid social exclusion.

As stated above, Directive (EU) 2018/1972, of December 11, 2018, which approves the EECC, updates USO provisions in Europe, removing the mandatory inclusion of the legacy outdated services (payphone boxes, directories and information services) and focusing on the provision of affordable broadband services. The EECC provides Member States with full flexibility in relation to the financing required for the provision of these services, allowing Member States to choose between public or industry funding. This ample room for discretion, together with the possibility that the affordability obligations could end up being too onerous, might result in higher costs for the industry.

In Spain, Telefónica is the operator responsible for the provision of universal service elements with respect to fixed network access with a broadband bandwidth of at least 1 Mb per second (until December 2019). On December 28, 2018, the government approved (by Royal Decree 1517/2018) the modification of the USO framework, eliminating the obligation to provide telephone directories to users (which had been assigned from January 1, 2017 to Telefónica), but maintaining Telefónica's designation as the operator responsible for the provision of public payphones until December 31, 2019, date on which it is expected that such obligation will be removed.

2018 Management Report

In Brazil, the General Plan of Univerzalization Targets (PGMU IV) of Fixed Switched Telephony Services (the "General Plan") that was due to have been published in 2016 was finally published on December 21, 2018 (Presidential Decree n. 9.619/2018) after a long period of discussion.

The General Plan lessens the USO framework in three ways: (i) there is a material decrease in the maintenance obligations with respect to Public Use Terminals; (ii) there is a material reduction of the obligations to meet requests for installation of individual accesses within seven days; and (iii) the extinction of the obligations to install and maintain Multifacilities Service Stations.

However, the General Plan imposes a new obligation with respect to "fixed wireless access systems with support for broadband connection" through the implementation of a base radio station in 310 pre-determined localities in the State of São Paulo.

The imposition on the Telefónica Group of additional or more onerous USO in the jurisdictions where it operates could have a material adverse effect on its business, financial condition, results of operations and/or cash flows.

Regulation of fiber networks

In Spain, on March 6, 2018, the CNMC approved a final decision on the economic replicability methodology (or ERT in its acronym in English) to be used to assess the maximum wholesale access price which Telefónica can charge other operators for accessing the optical fiber network in regulated areas (NEBA Local and NEBA services).

According to this methodology, from April 2018, Telefónica is to apply a wholesale access price (NEBA) of 17.57 euros per month, with this price being updated twice a year in order to assess whether Telefónica's retail offers (broadband flagship products) are economically replicable with such wholesale NEBA price. In July 2018, the CNMC approved a final decision on the methodology to assess if Telefónica's retail offers for the business sector can be replicated by other operators.

This and any other similar obligations and restrictions which may be imposed in the future in the various jurisdictions where the Telefónica Group operates could raise costs and limit Telefónica's flexibility in providing the aforementioned services, which could materially adversely affect Telefónica's business, financial condition, results of operations and/or cash flows.

2018 Management Report

Regulations on privacy

In Europe, the General Data Protection Regulation ("GDPR") of April 27, 2016, has been directly applicable in all Member States since May 25, 2018 and implementing measures have been introduced by Member States, including Spain, Germany and the United Kingdom.

In Spain, on December 5, 2018 the Personal Data Protection and Digital Rights Act was approved. This Act implements GDPR in Spain, addressing several particularities concerning data blocking for judicial purposes or specific matters on databases for advertising purposes or data relating to deceased people. Equally, it implements procedural mechanisms within the framework of legal investigations concerning potential infringements of the GDPR.

In addition, on January 10, 2017, the EC presented its proposal for a regulation on privacy and electronic communications ("ePrivacy Regulation"), which will replace the current Directive 2002/58/EC. The proposal implies an extra layer of regulation on top of the GDPR and also introduces administrative fines of up to 4% of an undertaking's annual global turnover for breaching new regulations. In this area, a strict data protection and privacy regulation may result in limitations on the ability to offer innovative digital services such as big data services. The future ePrivacy Regulation is not expected to be adopted before the end of 2019.

The Privacy Shield, approved by the EC on July 12, 2016 to lay out the framework for the international transfer of personal data from the EU to the US, was challenged before the EU's General Court by civil-society groups. One of the appeals was not admitted and the admission of a second appeal is still pending as of the date of this Annual Report. The results of the second annual revision of the Privacy Shield by the Commission were published on December 19, 2018. The report concludes that the United States continues to guarantee an adequate level of protection of transferred personal data under the Privacy Shield and that the measures adopted by US authorities to implement the recommendations made by the Commission in the 2017 report have improved the functioning of the framework. In Brazil, the Personal Data Protection Act (Act 13709/2018) was approved on August 14, 2018. This Act entails further obligations and restrictions for operators in relation to the collection of personal data and its processing and is based on the GDPR. The text was approved in the Chamber of Deputies and the Senate but the President vetoed the creation of the Authority for the Protection of Personal Data and of the National Council for the Protection of Personal Data and Privacy, after considering them to be unconstitutional. On December 27, 2018 the President of Brazil signed provisional measure 869/2018 that created the National Data Protection Authority (ANPD) and postponed to August 2020 the entry into force of the new Personal Data Protection Act. The approval of provisional measure 869/2018 by the National Congress and its conversion into law is still pending.

In Chile and Argentina, two bills aligned with the GDPR are in process to pass into law.

Any obligations and restrictions arising from privacy regulations could raise costs and limit Telefónica's ability to provide certain services, which could materially adversely affect Telefónica's business, financial condition, results of operations and/or cash flows.

Regulation of network neutrality

Under the principle of network neutrality applicable to the Internet access services realm, network operators are not permitted to establish technical or commercial restrictions regarding the terminals that can be connected or the services, or applications and contents that can be accessed or distributed through the Internet by the end user. It also refers to the non-discriminatory behavior (e.g. non-anticompetitive) to be adopted by operators regarding the different types of Internet traffic circulating through their networks.

Net neutrality regulation is being implemented all across Europe and in most of the Latin America countries where Telefónica is operating.

In Mexico, it is expected that IFT will issue guidelines during 2019.

2018 Management Report

Any changes to regulation as it is established in the various jurisdictions where the Telefónica Group operates, could limit the commercial flexibility and might have an impact on its business, financial condition, results of operations and/or cash flows of the Group.

The Telefónica Group is exposed to risks in relation to compliance with anti-corruption laws and regulations and economic sanctions programs.

The Telefónica Group is required to comply with the laws and regulations of various jurisdictions where it conducts operations. In particular, the Group's international operations are subject to various anti-corruption laws, including the US Foreign Corrupt Practices Act of 1977 and the United Kingdom Bribery Act of 2010, and economic sanctions programs, including those administered by the United Nations, the European Union and the United States, including the US Treasury Department's Office of Foreign Assets Control. The anti-corruption laws generally prohibit providing anything of value to government officials for the purposes of obtaining or retaining business or securing any improper business advantage. As part of the Telefónica Group's business, it may deal with entities, the employees of which are considered government officials. In addition, economic sanctions programs restrict the Group's business dealings with certain sanctioned countries, individuals and entities.

Although the Group has internal policies and procedures designed to ensure compliance with applicable anti-corruption laws and sanctions regulations, there can be no assurance that such policies and procedures will be sufficient or that the Group's employees, directors, officers, partners, agents and service providers will not take actions in violation of the Group's policies and procedures (or, otherwise in violation of the relevant anti-corruption laws and sanctions regulations) for which the Group or they may be ultimately held responsible. Violations of anti-corruption laws and sanctions regulations could lead to financial penalties, exclusion from government contracts, damage to the Group's reputation and result in other consequences, that could have a material adverse effect on the Group's business, results of operations and financial condition.

As of the date of this Annual Report, Telefónica is currently conducting internal investigations covering various countries regarding possible violations of applicable anti-corruption laws. Telefónica continues to cooperate with governmental authorities and continues with the ongoing investigations. Although it is not possible at this time to predict the scope or duration of these matters or their likely outcome, Telefónica believes that, considering the size of the Group, any potential penalty as a result of the resolution of these investigations would not materially affect the Group's financial condition.

Telefónica may not anticipate or adapt in a timely manner to changing customer demands and/or new ethical or social standards, which could adversely affect Telefónica's business and reputation.

To maintain and improve its position in the market vis-à-vis its competitors, it is vital that Telefónica has the ability to anticipate and adapt to the evolving needs and demands of its customers, and that it avoids commercial actions that may generate a negative perception of the Group or the products and services it offers, or that may have or be perceived to have a negative impact on society. In addition to harming Telefónica's reputation, such actions could also result in fines and other sanctions.

There is growing social and regulatory demand for companies to behave in a socially responsible manner. In addition, the risks associated with potential damage to a brand's reputation have become more relevant, especially due to the impact that the publication of news through social networks can have.

If Telefónica were not able to anticipate or adapt to the evolving needs and demands of its customers or avoid inappropriate actions, its reputation could be adversely affected or it could otherwise have an adverse effect on the business, financial condition, results of operations and/or cash flows of the Group.

Telefónica's competitive position in some markets could be affected by the evolution of competition and market consolidation.

The Telefónica Group operates in highly competitive markets and it is possible that the Group may not be able to market its products and services effectively or respond successfully to the different commercial actions carried out by its competitors. The Group may also fail to meet its growth plans or to retain its customers, any of which may result in the decrease of the Group's profits and revenue margins.

2018 Management Report

In addition, increased market concentration, including as a result of mergers and acquisitions, or alliances and collaboration agreements among other industry players, could adversely affect the competitive position of Telefónica, as well as the efficiency of its operations and its business continuity.

The entry of new competitors into markets where Telefónica is a leader, in addition to changes in market dynamics which have led to aggressive data offers and broadband deployments by the Group's competitors and mergers of operators in certain markets, have adversely affected the competitive position of Telefónica, negatively impacting the evolution of revenues and its share of customers.

If Telefónica is not able to face the challenges posed by its competitors, the business, financial condition, results of operations and/or cash flows of the Group could be negatively affected.

Telefónica operates in a sector characterized by rapid technological changes and it may not be able to anticipate and adapt to such changes or select the right investments to make.

The pace of innovation and Telefónica's ability to keep up with its competitors is a critical issue in a sector so affected by technology such as telecommunications.

While automation and other digital processes may lead to significant cost and efficiency gains, there are also significant risks associated with such transformation processes.

New products and technologies are constantly emerging that can render products and services offered by the Telefónica Group obsolete, as well as its technology. In addition, the explosion of the digital market and the entrance of new players in the communications market, such as MNVOs, Internet companies or device manufacturers, could imply the loss of value of certain assets, affect the generation of income, or otherwise cause Telefónica to have to update its business model. This forces Telefónica to invest in the development of new products, technology and services in order to compete effectively with current or future competitors, which may result in the decrease of the Group's profits and revenue margins. Additionally, this investment may not lead to the development or commercialization of successful products or services. In this respect, margins from traditional voice and data business are shrinking, while new sources of revenues are derived from mobile Internet and connectivity services that are being launched. Examples of these services include IPTV services, IoT services, financial, security and cloud services. Research and development costs amounted to 947 million euros in 2018, representing an increase of 9.8% from 862 million euros in 2017 (906 million euros in 2016). These expenses represented 1.9%, 1.7% and 1.7% of the Group's consolidated revenues in 2018, 2017 and 2016, respectively. These figures have been calculated using the guidelines established in the Organization for Economic Cooperation and Development ("OECD") manual.

One of the technologies currently being developed by telecommunications operators, including Telefónica (in Spain and Latin America), is the new FTTx type networks, which allow to offer broadband accesses over fiber optics with high performance, such as 600MB Internet connections or high definition television services. However, the deployment of such networks, in which the copper of the access loop is totally or partially replaced by optical fiber, implies high levels of investments. As of December 31, 2018, in Spain, fiber coverage reached 21.3 million premises. There is a growing demand for the services that these new networks can offer to the end customer. However, the high level of investments required by these networks results in the need to continuously consider the expected return on investment, and no assurance can be given that these investments will be profitable.

In addition, the ability of the Telefónica Group's IT systems (operational and backup) to adequately support and evolve to respond to Telefónica's operating requirements is a key factor in the commercial development, customer satisfaction and business efficiency of the Telefónica Group. Any failure by the Telefónica Group to develop or implement IT systems that adequately support and respond to the Group's evolving operating requirements could have an adverse effect on the Group's business, financial condition, results of operations and/or cash flows.

If Telefónica were not able to anticipate and adapt to the technological changes and trends in the sector, or to properly select the investments to be made, this could negatively affect the Group's business, financial condition, results of operations and/or cash flows.

2018 Management Report

Telefónica depends on its suppliers.

The existence of critical suppliers in the supply chain, especially in areas such as network infrastructure, information systems or handsets with a high concentration in a small number of suppliers, poses risks that may affect Telefónica's operations, and may cause legal contingencies or damages to its image in the event that a participant in the supply chain engages in practices that do not meet acceptable standards or that otherwise fail to meet Telefónica's performance expectations. This may include delays in the completion of projects or deliveries, poor-quality execution, cost deviations and inappropriate practices.

As of December 31, 2018, the Telefónica Group depended on two handset suppliers and ten network infrastructure suppliers, which, together, accounted for 71% and 80%, respectively, of the total contracted handsets as of such date. One of the handset suppliers represented 42% of all contracted handsets as of such date.

These suppliers may, among other things, extend delivery times, raise prices and limit supply due to their own stock shortfalls and business requirements or for other reasons. In addition, the suppliers on which Telefónica relies may also be subject to litigation with respect to technology on which Telefónica depends, including litigation involving claims of patent infringement. Such claims are frequently made in the communications industry.

If suppliers cannot supply their products to the Telefónica Group within the agreed deadline or such products and services do not meet the Group's requirements, this could hinder the deployment and expansion plans of the network, which in certain cases could affect Telefónica's compliance with the terms and conditions of the licenses under which it operates, or otherwise adversely affect the business and operating results of the Telefónica Group. In addition, the possible adoption of new protectionist measures in certain parts of the world, including as a result of trade tensions between the United States and China, may have an adverse impact on certain of Telefónica's suppliers and other significant players in the industry.

The imposition of trade restrictions could result in higher costs and lower margins, and could adversely affect the Group's business, financial condition, results of operations and/or cash flows.

Unanticipated network interruptions can lead to quality loss or the interruption of the service.

Unforeseen network interruptions due to system failures, including those due to natural disasters caused by natural or meteorological events or phenomena, network failures, hardware or software failures, theft of network elements or cyber-attacks that affect the quality of, or cause interruption to, the provision of the services of the Telefónica Group, could cause customer dissatisfaction, a reduction in revenues and traffic, the realization of expensive repairs, the imposition of sanctions or other measures by regulatory bodies, and damage to the image and reputation of the Telefónica Group or could otherwise have an adverse effect on the business, financial condition, results of operations and/or cash flows of the Group.

Information technology is key to the Group's business and it could be subject to cybersecurity risks.

The Group operates in an environment increasingly prone to cyber-threats. Consequently, it is necessary for the Group to continue to advance its capacity to identify and detect technical threats and vulnerabilities and improve its ability to react to incidents. This includes the need to strengthen security controls in the supply chain as well as to place increased focus on security measures adopted by partners of the Group and other third parties.

Telecommunications companies worldwide face increasing cybersecurity threats as businesses have become increasingly dependent on telecommunications and computer networks and have adopted cloud computing technologies. Cybersecurity threats may include gaining unauthorized access to Telefónica's systems or inserting computer viruses or malicious software in its systems to misappropriate consumer data and other sensitive information, corrupt Telefónica's data or disrupt its operations. Unauthorized access may also be gained through traditional means such as the theft of laptop computers, data devices and mobile phones and intelligence gathering by employees with access. Further, the Group's employees or other persons may have unauthorized or authorized access to the Group's systems and/or take actions that affect the Group's networks in an

2018 Management Report

inconsistent manner with the Group's policies or otherwise adversely affect the Group or its ability to adequately process internal information.

Telefónica attempts to mitigate these risks through a number of measures, including backup, log review, vulnerabilities checks, network segregation measures and protective systems such as firewalls, intrusion detection or prevention systems, virus scanners and other physical and logical security measures. However, the application of these measures may not always be effective. The Telefónica Group has insurance policies in place which could cover, subject to the policies terms, conditions, exclusions, limits and sublimits of indemnity, and deductibles applying, certain losses arising out of this type of incidents. To date the insurance policies in place have covered some incidents of this sort, yet due to the potential severity and uncertainty of the mentioned events, these policies may not be sufficient to cover all possible monetary losses arising out of an individual event.

Possible regulatory, business, economic or political changes and other factors could lead to asset impairment.

The Telefónica Group reviews on an annual basis, or more frequently when the circumstances require it, the value of assets and cash-generating units, to assess whether their carrying values can be supported by the future expected cash flows, including, in some cases synergies allowed for in acquisition costs. Potential changes in the regulatory, business, economic or political environment may result in the need to introduce changes to estimates made and to recognize impairments in goodwill, intangible assets, property, plant and equipment or financial assets. Although the recognition of impairments of these assets results in a non-cash charge on the income statement, it could adversely affect the results of the Telefónica Group's operations. In this respect, the Telefónica Group has experienced impairments on certain of its investments, affecting its results of operations in the year in which they were experienced. In 2018, impairment losses in the value of goodwill, have been recognized amounting to 350 million euros, related to Telefónica's operations in Mexico. No impairments were recognized in 2017. In 2016, impairment losses, in the value of goodwill, were recognized amounting to 215 million euros, related to Telefónica's operations in Venezuela (124 million euros) and in Mexico (91 million euros). In addition, Telefónica may not be able to realize deferred tax assets on its statement of financial position to offset future taxable income. The recoverability of deferred tax assets depends on the Group's ability to generate taxable income over the period for which the deferred tax assets remain deductible. If Telefónica believes it is unable to utilize its deferred tax assets during the applicable period, it may be required to record an impairment against them resulting in a non-cash charge on the income statement. In 2018, Telefónica Móviles México derecognized deferred tax assets amounting to 327 million euros. Further details on intangible assets and goodwill are provided in Notes 6 and 7 to the Consolidated Financial Statements.

The Telefónica Group's networks carry and store large volumes of confidential, personal and corporate data, and its Internet access and hosting services may lead to claims for illegal or illicit use of the Internet.

The Telefónica Group's networks carry and store large volumes of confidential, personal and business data, through both voice and data traffic. The Telefónica Group stores increasing quantities and types of customer data in both business and consumer segments. Despite its best efforts to prevent it, the Telefónica Group may be found liable for any loss, transfer, or inappropriate modification of the customer data or general public data stored on its servers or transmitted through its networks, any of which could involve many people and have an impact on the Group's reputation, or lead to legal claims and liabilities that are difficult to measure in advance.

In addition, the Telefónica Group's Internet access and hosting servers could lead to claims for illegal or unlawful use of the Internet. Telefónica, like other telecommunications providers, may be held liable for any loss, transfer or inappropriate modification of the customer data stored on its servers or carried by its networks.

In most countries in which the Telefónica Group operates, the provision of its Internet access and hosting services (including the operation of websites with shelf-generated content) are regulated under a limited liability regime applicable to the content that it makes available to the public as a technical service provider, particularly content protected by copyright or similar laws. However, regulatory changes have been introduced imposing additional obligations on access providers (such as blocking access to a website) as part of the struggle against some illegal or illicit uses of the Internet, notably in Europe.

2018 Management Report

Any of the foregoing could have an adverse effect on the business, financial position, results of operations and/or cash flows of the Group.

Telefónica and Telefónica Group companies are party to lawsuits, antitrust, tax claims and other legal proceedings. Telefónica and Telefónica Group companies are party to lawsuits, tax claims, antitrust and other legal proceedings in the ordinary course of their businesses, the financial outcome of which is unpredictable. An adverse outcome or settlement in these or other proceedings could result in significant costs and may have a material adverse effect on the Group's business, financial condition, results of operations, reputation and/or cash flows. In particular, the Telefónica Group is party to certain judicial tax proceedings in Peru concerning the clearance of certain previous years' income tax, in respect of which a contentious-administrative appeal is currently pending and to certain tax and regulatory proceedings in Brazil, primarily relating to the ICMS (a Brazilian tax on telecommunication services) and the corporate tax. Further details on these matters are provided in Note 20 to the Annual Accounts. Additional details on provisions for litigation, tax sanctions and claims can be found in Note 17 to the Annual Accounts.

The telecommunications industry could be affected by factors related to sustainability and the environment. It could also be affected by the possible effects that electromagnetic fields could have on health.

Telefónica's operations and assets (including its towers and submarine cables) are located in many areas that are subject to natural disasters and severe weather, and which may be adversely affected in the future by climate change. Climate-related factors, such as heat waves, drought, sea levels, storms or flooding, could lead to unanticipated network interruptions and costly repairs, and negatively impact the demand for Telefónica's services in affected areas. Furthermore, if the Group's insurance did not fully cover business interruptions or losses resulting from these events, any of the foregoing could have an adverse effect on the business, financial position, results of operations and/or cash flows of the Group.

In addition, government restrictions, standards, or regulations intended to reduce greenhouse gas emissions or potential climate change impacts are likely to result in increased energy, transportation, or raw material and other supply costs. Moreover, local, national or international policy responses to climate change, such as carbon pricing or levies, emission caps or subsidy withdrawals may also lead to the stranding or financial impairment of certain of the Group's assets. Furthermore, the Group may face increased reputational pressure if its activities are perceived to be inconsistent with addressing climate change.

While the Group has taken several steps to increase its resilience to climate change and to limit its carbon footprint, there is no certainty as to whether such steps will be effective or sufficient.

The telecommunications industry could also be affected by the possible effects that electromagnetic fields emitted by mobile devices and base stations could have on health, as well as by concerns relating to such matters. These concerns have led some governments and administrations to take measures that have compromised the deployment of the necessary infrastructures to ensure quality of service, and have affected the criteria for the deployment of new networks and the development of digital services such as smart meters.

There is consensus among several groups of experts and public health agencies, including the World Health Organization, who state that, to date, there have been no proven risks of exposure to low radio-frequency signals from mobile communications. The scientific community continues to investigate this issue, especially with regard to mobile devices.

Concerns about electromagnetic fields may discourage the use of mobile telephony and new digital services, and may lead government authorities to impose significant restrictions on the location and operation of antennas or cells and the use of radio frequencies by mobile phones, as well as the deployment of smart meters and other products that use mobile technology. This could lead to the impossibility of expanding or improving the Group's mobile network. Any of the foregoing could have an adverse effect on the business, financial position, results of operations and/or cash flows of the Group.

2018 Management Report

Telefónica, S.A. 142

2018 Management Report

Trend evolution

The environment in which Telefónica carries on its business underwent considerable change over the course of the last financial year, driven by two fundamental trends: growing instability and the need and desire for long-term sustainability.

Instability is inherent in times that represent or precede a change of era, as is the case today. That is particularly evident in two areas: in political terms, 2018 saw a number of fast-evolving upheavals around the world, the outcomes or consequences of many of which, such as Brexit, are still far from clear; in economic terms, volatility has been high and has specifically affected leading technology companies, whose (until now) solid business models are being questioned.

All of this is having considerable social consequences. Last year, mistrust among citizens and companies increased, notably affecting people's perceptions and expectations regarding technological challenges and advances. There is growing concern about the level of technology and how it is used and this has led to greater caution and a demand for accountability in both its management and impact. This has been the case, for example, with personal privacy, the use of data as a mass-management and decision-making tool and the effects and uncertainties associated with digitalization, such as digital well-being or the possible impacts on employment and social relations.

The World Economic Forum has referred to this context as 'Globalisation 4.0' and has included a number of imbalances which have yet to be resolved:

• Economic growth vs conservation of the planet.

• Global citizenship vs patriotism.

• People's work vs machines.

• Technology 'for' vs 'against' people.

• Economic growth vs reduction of inequalities/eradication of poverty.

• International competition vs collaboration.

The solutions to these issues are a priority which require a genuine focus on sustainability in keeping up with the demands of every stakeholder: from society, governments and regulatory bodies to the world's leading investors, in the conviction that sustainability is necessary if we are to achieve prosperity, efficiency and profitability in the medium term.

Addressing these challenges also entails a wide range of growth opportunities for society in all its fields. The combination of sustainability with the latest technology is especially important and this is where Telefónica already plays a special and increasingly important role. Our Company, because of its position as the enabler of all digital services, its history, its social and economic involvement in all the countries in which it operates, is in a key position to make a substantial contribution to sustainable development. A contribution which, despite being a company with almost 100 years of existence, has only just begun and which is fundamentally articulated around three lines of action:

• Provide people with the power of connectivity.

• Optimize our capabilities for a sustainable digital future.

• Ensure maximum responsibility in all our actions.

2018 Management Report

Events after the reporting period

The following events regarding the Company took place between the reporting date and the date of preparation of the accompanying financial statements:

Financing

On January 23, 2019, Telefónica, S.A. made a repayment for 100 million euros of its bilateral loan signed on December 20, 2017.

On January 25, 2019, Telefónica Emisiones, S.A.U. redeemed 150 million euros of its notes issued on January 25, 2017. The notes were guaranteed by Telefónica, S.A.

On February 5, 2019, Telefónica Emisiones, S.A.U. issued under its Guaranteed Euro Programme for the Issuance of Debt Instruments (EMTN Programme) notes in the Euro market guaranteed by Telefónica, S.A. amounting to 1,000 million euros. These notes are due on February 5, 2024, pay an annual coupon of 1.069% and were issued at par (100%). The net proceeds of the Notes are to be allocated towards projects aiming to improve energy efficiency in the network transformation from copper to fiber optic in Spain.

On February 18, 2019, Telefónica, S.A. made an early repayment for 500 million euros of its bilateral loan of 1,000 million euros signed on June 26, 2014 and originally scheduled to mature on June 26, 2019.

Investments

In order to provide the funds needed to rebalance its equity and to execute share capital increases in its direct affiliates, Telefónica Digital España, S.L.U. on January 10, 2018 carried out a capital increase amounting to 137 million euros, totally subscribed and disbursed by Telefónica, S.A.

On the same date, Telefónica Innovación Alpha, S.L. has completed a capital increase amounting to 19 million euros fully subscribed and paid by Telefónica, S.A.

On January 24, 2019, Telefónica Centroamérica Inversiones, S.L. (60% of which is owned, directly and indirectly, by Telefónica and 40% of which is owned by Corporación Multi Inversiones), reached an agreement with América Móvil, S.A.B. of C.V. for the sale of the entire share capital of Telefónica Móviles Guatemala, S.A. and 99.3% of Telefónica Móviles El Salvador. The closing of the Telefónica El Salvador sale is subject to the applicable regulatory conditions while the sale of Telefónica Móviles El Salvador was completed on such date.

The aggregate consideration for both companies (enterprise value) is 648 million US dollars (approximately 570 million euros at the exchange rate on the date of the agreement, 293 million of which correspond to Telefónica Guatemala and 277 million of which correspond to Telefónica Móviles El Salvador).

On February 14, 2019, once the pertinent regulatory approvals were obtained, Telefónica transferred to Grupo Catalana Occidente 100% of Antares' share capital for a total amount of 161 million euros. On the closing of the sale, Telefónica and Grupo Catalana Occidente executed an agreement pursuant to which Grupo Catalana Occidente will continue to manage the insurance policies of the Telefónica Group on an exclusive basis for the next 10 years.

On February 20, 2019, the Board of Directors of Telefónica, S.A. has approved the sale of the Telefónica Group businesses in Panamá, Nicaragua and Costa Rica. The closing of the agreement is expected in the short term. The net book value of the direct stake in Costa Rica amounts to 291 million euros (see Exhibit I). The investments in Panamá and Nicaragua are indirectly owned through Telefónica Centroamérica Inversiones, S.L.

2018 Management Report

Others

On January 23, 2019, Telefónica announced that it was notified of a resolution issued by the Spanish Central Economic-Administrative Tax Court (Tribunal Económico-Administrativo Central) partially upholding the claims filed against the assessments relating to the 2008-2011 Corporate Income Tax Audit. Final implementation of this resolution will most likely lead to a tax refund related to overpayments made by the company in those tax years. At this point of time, it is not possible to quantify the exact amount of the expected refund since, as pointed out by the Central Economic-Administrative Court's resolution, the final amount shall only be settled once the resolution is duly executed by the Spanish Tax Authorities.

Telefónica, S.A. 145

2018 Management Report

Annual Corporate Governance Report for Listed Companies

A. Capital Structure

A.1 Complete the table below with details of the share capital of the company:

Date of last change Share capital (€) Number of shares Number of voting rights

20/09/2017 5,192,131,686.005,192,131,686 5,192,131,686

Please state whether there are different classes of shares with different associated rights:

No

A.2 Please provide details of the company's significant direct and indirect shareholders at year end, excluding any directors:

Name or corporate name of shareholder	% of shares carrying voting rights		% of voting rights through financial instruments		% of total voting rights
	Direct	Indirect	Direct	Indirect	
	Banco Bilbao Vizcaya Argentaria, S.A	5.26	0.01	0.00		0.00	5.28
CaixaBank, S.A	5.00	0.01	0.00	0.00	5.01
BlackRock, Inc.	0.00	4.85	0.00	0.22	5.08

Breakdown of the indirect holding:

Telefónica, S.A. 146

2018 Management Report

Name or corporate name of indirect shareholder	Name or corporate name of direct shareholder	% of shares carrying voting rights	% of voting rights through financial instruments	% of total voting rights
Banco Bilbao Vizcaya Argentaria, S.A.	BBVA Seguros, S.A. de Seguros y Reaseguros	0.01	0.00	0.01
CaixaBank, S.A.	VidaCaixa, S.A. de Seguros y Reaseguros	0.01	0.00	0.01
BlackRock, Inc.	Grupo BlackRock	4.85	0.22	5.08

Indicate the most significant movements in the shareholding structure during the year:

--

A.3 In the following tables, list the members of the Board of Directors (hereinafter directors) with voting rights in the company:

Telefónica, S.A. 147

2018 Management Report

Name of director	% of shares carrying voting rights		% of voting rights through financial instruments		% of total voting rights	% voting rights that can be transmitted through financial instruments	
	Direct	Indirect	Direct	Indirect		Direct	Indirect
Mr. José María Álvarez-Pallete López	0.03%	0.00%	0.01%	0.00%	0.03%	0.00%	0.00%
Mr. Isidro Fainé Casas	0.01%	0.00%	0.00%	0.00%	0.01%	0.00%	0.00%
Mr. José María Abril Pérez	0.01%	0.01%	0.00%	0.00%	0.01%	0.00%	0.00%
Mr. Ángel Vilá Boix	0.01%	0.00%	0.01%	0.00%	0.01%	0.00%	0.00%
Mr. José Javier Echenique Landiribar	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Mr. Peter Erskine	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Mr. Luiz Fernando Furlán	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Ms. Carmen García de Andrés	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Ms. Maria Luisa Garcia Blanco	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Mr. Peter Löscher	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Mr. Ignacio Moreno Martínez	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Mr. Francisco Javier de Paz Mancho	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Mr. Francisco José Riberas Mera	0.00%	0.05%	0.00%	0.00%	0.05%	0.00%	0.00%
Total percentage of voting rights held by the board of directors							
0.13%							

Breakdown of indirect holding:

Telefónica, S.A. 148

2018 Management Report

Name of director	Name of direct shareholder	% of shares carrying voting rights	% of voting rights through financial instruments	% of total voting rights	% voting rights that can be transmitted through financial instruments
Mr. José María Abril Pérez	Other company shareholders	0.01%	0.00%	0.01%	0.00%
Mr. José Javier Echenique Landiribar	Other company shareholders	0.00%	0.00%	0.00%	0.00%
Mr. Francisco José Riberas Mera	Other company shareholders	0.05%	0.00%	0.05%	0.00%

Remarks

It is pointed out that the Company has, among its rules of governance, an Internal Code of Conduct in matters relating to the Securities Markets, which include, among other matters, the action rules for the performance of personal transactions by Directors and management personnel on securities issued by Telefónica, S.A. and financial instruments and contracts whose underlying are securities or instruments issued by the Company.

The general operating principles of such Internal Code of Conduct include operations subject to communication; action limitations; as well as the minimum maintenance period in the event of acquisition Company Shares, during which they shall not be transferred, unless there are exceptional situations that justify their transfer, with the prior authorization of the Regulatory Compliance Committee.

A.4 If applicable, state any family, commercial, contractual or corporate relationships that exist among significant shareholders to the extent that they are known to the company, unless they are insignificant or arise in the ordinary course of business, except those that are reported in Section A.6:

Name of related party Nature of relationship Brief description

- - -

A.5 If applicable, state any commercial, contractual or corporate relationships that exist between significant shareholders and the company and/or group, unless they are insignificant or arise in the ordinary course of business:

Telefónica, S.A. 149

2018 Management Report

Name of related party	Nature of relationship	Brief description
Banco Bilbao Vizcaya Argentaria, S.A.	Corporate	Shareholding of Banco Bilbao Vizcaya Argentaria, S.A. (or any of the companies of its Group), together with Telefónica, S.A. and with CaixaBank, S.A., in Telefónica Factoring España, S.A., Telefónica Factoring Perú, S.A.C. (TFP Perú), Telefónica Factoring Colombia, S.A., Telefónica Factoring do Brasil, Ltda., and Telefónica Factoring México, S.A. de C.V., SOFOM, E.N.R.
Banco Bilbao Vizcaya Argentaria, S.A.	Corporate	Shareholding of Ciérvana, S.L. (a company which belongs to Grupo BBVA), together with Telefónica Compras Electrónicas, S.L.U., in Adquira España, S.A.
Banco Bilbao Vizcaya Argentaria, S.A.	Corporate	Shareholding of BBVA Bancomer, Institución de Banca Múltiple, Grupo Financiero Bancomer (subsidiary of Banco Bilbao Vizcaya Argentaria, S.A.) together with Telefónica Móviles México, S.A. de C.V. (subsidiary of Telefónica, S.A.) in Adquira de México, S.A. de C.V.
Banco Bilbao Vizcaya Argentaria, S.A.	Contractual	Memorandum of understanding executed by Telefónica Digital España, S.L.U. with the aim of exploring a potential collaboration to offer loans to consumers and SME in Argentina, Colombia, Perú and México.
CaixaBank, S.A.	Corporate	Shareholding of CaixaBank, S.A., with Telefónica, S.A. and with Banco Bilbao Vizcaya Argentaria, S.A. (or with any of the companies of its Group), in Telefónica Factoring España, S.A., Telefónica Factoring Perú, S.A.C. (TFP Perú), Telefónica Factoring Colombia, S.A., Telefónica Factoring do Brasil, Ltda., Telefónica Factoring México, S.A. de C.V., SOFOM, E.N.R., and Telefónica Factoring Chile, S.A.
CaixaBank, S.A.	Corporate	Shareholding of Caixabank Consumer Finance, E.F.C., S.A. (subsidiary of CaixaBank, S.A.) together with Telefónica, S.A., in Telefónica Consumer Finance, E.F.C., S.A.

A.6 Describe the relationships, unless insignificant for the two parties, that exist between significant shareholders or shareholders represented on the Board and directors, or their representatives in the case of proprietary directors. Explain, as the case may be, how the significant shareholders are represented. Specifically, state those directors appointed to represent significant shareholders, those whose appointment was proposed by significant shareholders and/or companies in its group, specifying the nature of such relationships or ties. In particular, mention the existence, identity and post of directors, or their

Telefónica, S.A. 150

2018 Management Report

representatives, as the case may be, of the listed company, who are, in turn, members of the Board of Directors or their representatives of companies that hold significant shareholdings in the listed company or in group companies of these significant shareholders.

Name or company name of related director or representative	Name of company name of related significant shareholder	Company name of the group company of the significant shareholder	Description of relationship/post
Mr. José María Abril Pérez	Banco Bilbao Vizcaya Argentaria, S.A.	Banco Bilbao Vizcaya Argentaria, S.A.	In process of retirement. Formerly General Manager of Wholesale and Investment Banking in Banco Bilbao Vizcaya Argentaria, S.A.
Mr. Isidro Fainé Casas	CaixaBank, S.A.	CaixaBank, S.A.	-
Ms. Sabina Fluxà Thienemann	Banco Bilbao Vizcaya Argentaria, S.A.	Banco Bilbao Vizcaya Argentaria, S.A.	Member of Eastern Territorial Regional Advisory Board (Spain) of Banco Bilbao Vizcaya Argentaria, S.A.
Mr. Jordi Gual Solé	CaixaBank, S.A.	CaixaBank, S.A.	Chairman of CaixaBank, S.A.
Mr. Ignacio Moreno Martínez	Banco Bilbao Vizcaya Argentaria, S.A.	Banco Bilbao Vizcaya Argentaria, S.A.	Formerly General Manager of Chairman's Office in Banco Bilbao Vizcaya Argentaria, S.A.

Remarks

Mr. José María Abril Pérez and Mr. Ignacio Moreno Martínez Name
or company name of the shareholder represented or that has proposed their appointment: Banco Bilbao Vizcaya Argentaria, S.A.

Mr. Isidro Fainé Casas and Mr. Jordi Gual Solé Name or company name of the
shareholder represented or that has proposed their appointment: CaixaBank, S.A.

Ms. Sabina Fluxà Thienemann Member
of the Eastern Territorial Regional Advisory Board (which includes the regions of Valencia, Murcia and Balears) of Banco Bilbao Vizcaya, S.A., to whom she advises as prominent businesswoman on their objective to keep on approaching their business strategy to the current social-economic situation of such regions, without receiving any remuneration for such position.

2018 Management Report

A.7 State whether the company has been notified of any shareholders' agreements that may affect it, in accordance with Articles 530 and 531 of the Ley de Sociedades de Capital (Corporate Enterprises Act or LSC). If so, describe these agreements and list the party shareholders:

No

State whether the company is aware of any concerted actions among its shareholders. If so, provide a brief description:

No

If any of the aforementioned agreements or concerted actions have been modified or terminated during the year, please specify expressly:

Shareholders Agreement Telefónica, S.A. - Vivendi, S.A.

In September 2015, after obtaining regulatory approval from the Conselho Administrativo (Administrative Council) de Defesa Econômica (CADE), Telefónica, S.A. delivered to Vivendi, S.A. 46.0 million shares of its treasury stock, representing, at that time, 0.95% of its share capital, in exchange for 58.4 million shares of Telefónica Brasil, S.A. (received by Vivendi, S.A. in the framework of the acquisition of GVT Participações, S.A.) representing approximately 3.5% of the capital stock of Telefónica Brasil, S.A.

By virtue of this agreement, Vivendi, S.A. undertook, among other obligations, to: (i) refrain from selling Telefónica shares during certain periods (lock up), and to (ii) assume certain restrictions which, in the event of a transfer, after the lock up periods have elapsed, guarantee an orderly sale of such shares.

At the date of issue of this Report such shareholders agreement is no longer in force.

A.8 State whether any individual or company exercises or may exercise control over the company in accordance with Article 5 of the Ley de Mercados de Valores (Spanish Securities Market Act or LMV). If so, please identify them:

No

A.9 Complete the following table with details of the company's treasury shares:

At close of the year:

Number of direct shares	Number of indirect shares (*)	Total percentage of share capital
65,496,120	—	1.26 %

(*) Through:

--

Explain any significant changes during the year:

Explain significant changes

There is not significant change of the treasury stock in 2018. There have been only transmissions corresponding to the execution of different incentive plans for employees, which represent less than 0,01% of the stock.

2018 Management Report

A.10 Provide a detailed description of the conditions and terms of the authority given to the Board of Directors to issue, repurchase, or dispose of treasury shares.

At Telefónica's Ordinary General Shareholders Meeting held on June 8, 2018, the shareholders resolved to renew the authorization granted at the General Shareholders Meeting of May 30, 2014, for the derivative acquisition of treasury stock, either directly or through Group companies, in the terms literally transcribed below:

To authorize, pursuant to the provisions of Section 144 et seq., of the Spanish Companies Act (Ley de Sociedades "A) de Capital), the derivative acquisition by Telefónica, S.A. -either directly or through any of the subsidiaries - at any time and as many times as it deems appropriate, of its own fully-paid in shares through purchase and sale, exchange or any other legal transaction.

The minimum acquisition price or minimum value consideration shall be equal to the par value of the shares of its own stock acquired, and the maximum acquisition price or maximum value consideration shall be equal to the listing price of the shares of its own stock acquired by the Company on an official secondary market at the time of the acquisition.

Such authorization is granted for a period of 5 years as from the date of this General Shareholders' Meeting and is expressly subject to the limitation that the par value of the Company's own shares acquired directly or indirectly pursuant to this authorization added to those already held by Telefónica, S.A. and any of its subsidiaries shall at no time exceed the maximum amount permitted by the Law at any time, and the limitations on the acquisition of the Company's own shares established by the regulatory Authorities of the markets on which the shares of Telefónica, S.A. are traded shall also be observed.

It is expressly stated for the record that the authorization granted to acquire shares of its own stock may be used in whole or in part to acquire shares of Telefónica, S.A. that it must deliver or transfer to directors or employees of the Company or of companies of its Group, directly or as a result of the exercise by them of their option rights, all within the framework of duly approved compensation systems referencing the listing price of the Company's shares.

To authorize the Board of Directors, as broadly as possible, to exercise the authorization granted by this resolution and to implement the other provisions contained therein; such powers may be delegated by the Board of Directors B) to the Executive Commission, the Executive Chairman of the Board of Directors, the Chief Operating Officer or any other person expressly authorized by the Board of Directors for such purpose.

To deprive of effect, to the extent of the unused amount, the authorization granted under Item V on the Agenda by C) the shareholders at the Ordinary General Shareholders Meeting of the Company on May 30, 2014 ".

A.11 Estimated working capital:

%

Estimated working capital 83.24

2018 Management Report

A.12 State whether there are any restrictions (article of associations, legislative or of any other nature) placed on the transfer of shares and/or any restrictions on voting rights. In particular, state the existence of any type of restriction that may inhibit a takeover attempt of the company through acquisition of its shares on the market, and those regimes for the prior authorisation or notification that may be applicable, under sector regulations, to acquisitions or transfers of the company's financial instruments.

Yes

Description of restrictions

In accordance with article 26 of the Company's Bylaws, no shareholder may exercise a number of votes exceeding 10 per cent of the total share capital with voting rights existing at any time, regardless of the number of shares held; all of the foregoing with full and mandatory submission to the provisions of the Law. In determining the maximum number of votes that each shareholder may cast, only the shares held by the shareholder in question shall be computed, not including those held by other holders who have delegated their representation to that shareholder, without prejudice to the application of the same percentage limit of 10% to each of the shareholders represented individually.

The limitation established in the preceding paragraph shall also apply to the maximum number of votes that may be cast - either jointly or separately - by two or more shareholder companies belonging to the same group of entities, as well as to the maximum number of votes that may be cast by an individual or legal entity that is a shareholder, and the entity or entities, also shareholders, that the former directly or indirectly controls.

For the purposes indicated in the previous paragraph, in order to consider the existence of a group of entities, as well as the control situations indicated above, the provisions of article 18 of the Corporations Act shall apply.

In addition, and in accordance with article 527 of the Corporations act, in listed companies, the bylaw's clauses that, directly or indirectly, establish, in general terms, the maximum number of votes that may be cast by a single shareholder, companies belonging to the same group or those acting in concert with the foregoing shall cease to have effect when, following a takeover bid, the offerer has reached a percentage equal to or greater than 70 per cent of the capital carrying voting rights, unless the said offerer is not subject to equivalent neutralization measures or has not adopted them.

On the other hand, the provisions of Law 19/2003 of 4 July, on the Legal System of Transfers of Capital and of Financial Transactions with Foreign Countries and on Certain Measures for the Prevention of Money Laundering (Article 7), establishes that the Government may agree to the suspension of the regime of deregulation on foreign investments set out in such with regard to acts, businesses, transactions or operations that, by their nature, form or conditions of performance, affect or may affect activities directly related to national defense, or activities that affect or may affect public order, public safety and public health.

.13 State if the shareholders have resolved at a meeting to adopt measures to neutralise a take-over bid pursuant to the provisions of Act 6/2007.

No

If so, please explain the measures approved and the terms under which such limitations would cease to apply:

Explain the measures approved and the terms under which such limitations would cease o apply

--

2018 Management Report

A.14 State if the company has issued shares that are not traded on a regulated EU market.

Yes

If so, please list each type of share and the rights and obligations conferred on each.

List each type of share

At the date of issue of this Report, shares of Telefónica, S.A. are traded on the Spanish electronic trading system (the "Continuous Markets"), and also on the stock exchanges of New York, London, Lima and Buenos Aires, and they have all the same characteristics, rights and obligations.

On the New York and Lima Stock Exchanges, Telefónica, S.A. shares are traded through American Depositary Shares (ADSs), where each ADS represents a Company share.

Telefónica, S.A. 155

2018 Management Report

B. General Shareholders' Meeting

B.1 State whether there are any differences between the quorum established by the LSC for General Shareholders' Meetings and those set by the company and if so, describe them in detail:

No

B.2 State whether there are any differences in the company's manner of adopting corporate resolutions and the manner for adopting corporate resolutions described by the LSC and, if so, explain:

No

Describe how it is different from that contained in the LSC.

--

B.3 State the rules for amending the company's Articles of Association. In particular, state the majorities required for amendment of the Articles of Association and any provisions in place to protect shareholders' rights in the event of amendments to the Articles of Association.

The Bylaws and Regulations for the General Shareholders Meeting of Telefónica confer upon the General Shareholders Meeting the power to agree the amendment of the Corporate By-laws (articles 15 and 5, respectively), being subject to legal provisions applicable for all other matters.

The procedure for amending the Bylaws is established on Articles 285 and following articles of the revised text of the Spanish Corporations Act, and needs to be approved at the General Shareholders Meeting with the majorities stated in Articles 194 and 201 of the same law. In particular, if the Shareholders Meeting is summoned to deliberate on Bylaw amendments, including capital increases or decreases, on eliminating or restricting the preferential acquisition right for new shares, and the transformation, merger, spin-off, or the global assignment of assets and liabilities and the relocation of the registered offices abroad, then shareholders which own at least fifty per cent of the subscribed capital with voting rights will have to be present or be represented by proxy on first call. If there is no sufficient quorum, then the Shareholders' Meeting will be held on second call, on this occasion at least twenty-five per cent of the subscribed capital with voting rights will need to be present, either in person or by proxy. When shareholders which represent less than fifty per cent of the subscribed capital with voting rights are present at the Shareholders Meeting, either in person or by proxy, the resolutions referred to above can only be approved when two thirds of the capital, present or represented by proxy at the Shareholders Meeting, vote in favor of the resolution.

Pursuant to article 286 of the Spanish Corporations Act, if the Bylaws are amended, then the Directors, or, if applicable, the shareholders who have made the proposal, will have to draw up in full the text of their proposed amendment, and a written report justifying the amendment, which must be made available to shareholders when the General Meeting is called to deliberate on the amendment.

Furthermore, pursuant to article 287 of the Spanish Corporations Act, the announcement calling the General Shareholders Meeting will have to clearly state the questions which might be amended, and note that all the Shareholders are entitled to analyze the full text of the proposed amendment and the report on such amendment at the registered offices, as well as to request such documents to be delivered or sent to them free of charge.

According to article 291 of the Spanish Corporations Act, when new obligations are established for Shareholders due to amendment of the Bylaws, the resolution will have to be passed with the approval of the affected Shareholders.

Furthermore, if the amendment directly or indirectly affects a type of shares, or part of them, then the provisions of article 293 of that Act will be applicable.

Telefónica, S.A. 156

2018 Management Report

The procedure for voting on proposed resolutions by the Shareholders' Meeting is also regulated in Article 197 bis of the Spanish Corporations Act, in the internal regulations of Telefónica (in particular, in Article 23 of the Regulations of the General Shareholders Meeting). This Article states that, when amendments are made to the Bylaws, each article or group of articles which are materially different will be voted for separately.

B.4 Give details of attendance at General Shareholders' Meetings held during the year of this report and the previous year:

Attendance data

Date of general meeting	% physically present	% present by proxy	% distance voting		Total
			Electronic voting	Other	
12/05/2016	0.21%	55.34%	0.03%	0.55%	56.13%
Of which, free float	0.03%	32.91%	0.03%	0.55%	33.52%
09/06/2017	0.27%	55.71%	0.03%	0.49%	56.50%
Of which, free float	0.06%	35.87%	0.03%	0.49%	36.45%
08/06/2018	0.09%	52.80%	0.04%	0.49%	53.42%
Of which, free float	0.03%	34.64%	0.04%	0.49%	35.20%

B. 5 State whether any point on the agenda of the General Shareholders' Meetings during the year has not been approved by the shareholders for any reason.

No

B.6 State if the Articles of Association contain any restrictions requiring a minimum number of shares to attend General Shareholders' Meetings, or on distance voting:

Yes

Number of shares requires to attend General Meetings 300

Number of shares requires for distance voting 300

B.7 State whether it has been established that certain decisions other than those established by law exist that entail an acquisition, disposal or contribution to another company of essential assets or other similar corporate transactions that must be subject to the approval of the General Shareholders' Meeting.

No

Telefónica, S.A. 157

2018 Management Report

Explain the decisions that must be subject to the General Shareholders' Meeting, other than those established by law

-

B.8 State the address and manner of access to the page on the company website where one may find information on corporate governance and other information regarding General Shareholders' Meetings that must be made available to shareholders through the company website.

Telefónica complies with applicable legislation and best practices in terms of the content of its website concerning Corporate Governance. In this respect, it fulfills both the technical requirements for access and content of the Company website, including information on General Shareholders Meetings, through direct access from the homepage of Telefónica, S.A. (www.telefonica.com) in the section "Shareholders and Investors"

(www.telefonica.com/accionistaseinversores), which includes not only all of the information that is legally required, but also information that the Company considers to be of interest.

All the available information included on the Company website, except for certain specific documents, is available in two languages: Spanish and English.

Telefónica, S.A. 158

2018 Management Report

C.1 Board of Directors

C.1.1 Maximum and minimum number of directors established in the Articles of Association and the number set by the general meeting:

Maximum number of directors 20

Minimum number of directors 5

Number of directors set by the general meeting 17

Remarks

The General Ordinary Shareholders' Meeting held on June 9, 2017, approved the establishment of seventeen members as the number of Board of Directors.

C.1.2 Please complete the following table on directors:

Name of director	Natural person representative	Director category	Position on the Board	Date first appointed to Board	Last re-election date	Method of selection to Board
Mr. José María Álvarez-Pallete López	—	Executive	Chairman	07/26/2006	09/06/2017	Resolution of General Shareholders' Meeting
Mr. Isidro Fainé Casas	—	Proprietary	Vice Chairman	01/26/1994	12/05/2016	Resolution of General Shareholders' Meeting
Mr. José María Abril Pérez	—	Proprietary	Vice Chairman	07/25/2007	08/06/2018	Resolution of General Shareholders' Meeting
Mr. Ángel Vilá Boix	—	Executive	Chief Operating Officer (C.O.O.)	26/07/2017	08/06/2018	Resolution of General Shareholders' Meeting
Mr. Juan Ignacio Cirac Sasturain	—	Independent	Director	08/04/2016	12/05/2016	Resolution of General Shareholders' Meeting
Mr. José Javier Echenique Landiribar	—	Independent	Director	08/04/2016	12/05/2016	Resolution of General Shareholders' Meeting
Mr. Peter Erskine	—	Other External	Director	01/25/2006	12/05/2016	Resolution of General Shareholders' Meeting
Ms. Sabina Fluxà Thienemann	—	Independent	Director	08/04/2016	12/05/2016	Resolution of General Shareholders' Meeting
Mr. Luiz Fernando Furlán	—	Independent	Director	01/23/2008	08/06/2018	Resolution of General Shareholders' Meeting

Edgar Filing: TELEFONICA S A - Form 6-K

Ms. Carmen García de Andrés	—	Independent Director	04/05/2017	09/06/2017	Resolution of General Shareholders' Meeting
Ms. María Luisa García Blanco	—	Independent Director	25/04/2018	08/06/2018	Resolution of General Shareholders' Meeting

Telefónica, S.A. 159

2018 Management Report

Mr. Jordi Gual Solé	P roprietary Director	31/01/2018	08/06/2018	Resolution of General Shareholders' Meeting
Mr. Peter Löscher	I ndependent Director	08/04/2016	12/05/2016	Resolution of General Shareholders' Meeting
Mr. Ignacio Moreno Martínez	P roprietary Director	14/12/2011	09/06/2017	Resolution of General Shareholders' Meeting
Mr. Francisco Javier de Paz Mancho	I ndependent Director	19/12/2007	08/06/2018	Resolution of General Shareholders' Meeting
Mr. Francisco José Riberas Mera	I ndependent Director	04/05/2017	09/06/2017	Resolution of General Shareholders' Meeting
Mr. Wang Xiaochu	P roprietary Director	30/09/2015	12/05/2016	Resolution of General Shareholders' Meeting

Total number of directors 17

State if any directors, whether through resignation, dismissal or any other reason, have left the Board during the period subject to this report:

Name of director	Director type at time of leaving	Date of last appointment	Date director left	Specialised committees of which he/she was member	Indicate whether the director left before the end of the term
Ms. Eva Castillo Sanz	Other external Director	31/05/2013	25/04/2018	Regulation and Institutional Affairs Committee (Member) Service Quality and Consumer Service Committee (Member) Strategy and Innovation Committee (Member)	Yes

Reason for leaving and other remarks

The Director Ms. Eva Castillo Sanz, in order to facilitate the renewal of the Board of Directors, formally and expressly stated her voluntary resignation to the Board of Directors, at its meeting held on April 25, 2018, effective as of that date, from its position as Director of Telefónica, S.A., and thus from all of her position within the Board of Directors and within the Committees of such Board (member of the Service Quality and Customer Service Committee, of the Regulation and Institutional Affairs Committee, and of the Strategy and Innovation Committee).

2018 Management Report

C.1.3 Complete the following tables regarding the members of the Board and their categories:

EXECUTIVE DIRECTORS

Name or company name of director	Post in organisational chart of the company	Profile
Mr. José María Álvarez-Pallete López	Executive Chairman	Degree in Economics. International Management Program (IPM) from IPADE Business School (Instituto Panamericano de Alta Dirección de Empresa). An Advance Research Degree from the Department of Financial Economics and Accounting.
Mr. Ángel Vilá Boix	Chief Operating Officer (C.O.O.)	Degree in Industrial Engineering. MBA at Columbia Business School.
Total number of executive directors	2	
Percentage of Board	11.76%	

Telefónica, S.A. 161

2018 Management Report

PROPRIETARY DIRECTORS

Name of Director	Name or company name of the significant shareholder represented or that has proposed their appointment	Profile
Mr. José María Abril Pérez	Banco Bilbao Vizcaya Argentaria, S.A.	Degree in Economics. Professor at the University of Deusto.
Mr. Ignacio Moreno Martínez	Banco Bilbao Vizcaya Argentaria, S.A.	Degree in Economics and Business Administration. MBA at INSEAD. Chairman of Metrovacesa, S.A. and Director of Roadis Transportation Holding, S.L.U. Senior Advisor of BC Partners for Spain. PhD in Economics. ISMP in Business Administration. Post graduate degree in senior management at IESE. An academic at the Royal Academy of Economic and Financial Sciences and at the Real Academia de Doctores. Chairman of the Board of Trustees of Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona "la Caixa" and Criteria Caixa, S.A.U. Honorary Chairman of Naturgy Energy Group, S.A. Chairmanship of the Spanish Confederation of Savings Banks (CECA), and Chairman of the Spanish Confederation of Directors and Executives (CEDE). PhD in Economics. Professor of Economics at the IESE Business School.
Mr. Isidro Fainé Casas	CaixaBank, S.A.	Research Fellow at the Centre for Economic Policy Research (CEPR) in London. Chairman of CaixaBank, S.A. Chairman of Fundación de Estudios de Economía Aplicada (FEDEA).
Mr. Jordi Gual Solé	CaixaBank, S.A.	Degree in Telecommunications Engineering. Doctorate degree in Business Administration. Professor level senior engineer. Chairman of China United Network Communications Group Company Limited ("Unicom Group"), China United Network Communications Limited and China United Network Communications Corporation Limited, and as an Chairman and Chief Executive Officer of China Unicom (Hong Kong) Limited.
Mr. Wang Xiaochu	China Unicom (Hong Kong) Limited	
Number of independent directors		5
Percentage of the Board		29.41 %

Telefónica, S.A. 162

2018 Management Report

INDEPENDENT DIRECTORS

Name of director	Profile
Mr. Juan Ignacio Cirac Sasturain	Graduated in Theoretical Physics. PhD in Physics. Fields of specialization in Quantum Optics, Quantum Computation, Atomic Physics. Economics and Actuarial Sciences Graduate. Professor of Social Security Quantitative Techniques.
Mr. José Javier Echenique Landiribar	ViceChairman of Banco Sabadell, S.A. Director of ACS Actividades de Construcción y Servicios, S.A., of ACS Servicios, Comunicaciones y Energía, S.L., and Grupo Empresarial ENCE, S.A.
Ms. Sabina Fluxà Thienemann	Degree in Business Management and Administration. MBA from ESADE. High Business Management Program at IESE. ViceChairman and CEO of Iberostar Group.
Mr. Luiz Fernando Furlán	Degree in chemical engineering and business administration, specialising in financial administration. From 2003 to 2007 he was Minister of Development, Industry and Foreign Trade of Brazil.
Ms. Carmen García de Andrés	Degree in Economic and Business Sciences. Chairwoman of Tomillo Foundation.
Ms. María Luisa García Blanco.	Degree in Law. State Attorney (on leave of absence). Founding Partner at law firm Salama García Blanco.
Mr. Peter Löscher	Degree in Economics and Business. MBA at Vienna University of Economics. Advanced Management Program at Harvard Business School. Chairman of the Supervision Board of OMV Aktiengesellschaft and Sulzer AG.
Mr. Francisco Javier de Paz Mancho	Graduate in Information and Advertising. Law Studies. IESE business Management Program. Formerly Chairman of the State owned company MERCASA.
Mr. Francisco José Riberas Mera	Degree in Law and in Economics and Business Administration. Chief Executive Officer of Gestamp Automoción, S.A.
Total number of independent directors	9
Percentage of the Board	52.94%

State whether any independent director receives from the company or any company in the group any amount or benefit other than compensation as a director, or has or has had a business relationship with the company or any company in the group during the past year, whether in his or her own name or as a significant shareholder, director or senior executive of a company that has or has had such a relationship.

Telefónica, S.A. 163

2018 Management Report

No

In this case, include a statement by the Board explaining why it believes that the director in question can perform his or her duties as an independent director.

--

OTHER EXTERNAL DIRECTORS

Identify the other external directors and state the reasons why these directors are considered neither proprietary nor independent, and detail their ties with the company or its management or shareholders:

Name of director	Reason	Company, director or shareholder to whom the director is related	Profile
Mr. Peter Erskine	Mr. Peter Erskine was appointed Director of Telefónica, S.A. in 2006, and therefore, in accordance with article 529 duodecies of the Spanish Companies Act ("Those who, among other situations, have been Directors for a continuous period of more than 12 years may not be considered Independent Directors under any circumstances"), and 12 years after his appointment, he was reclassified from Independent Director to "Other External" Director.	Telefónica, S.A.	Degree in Psychology. Until December 2007 he was General Manager of Telefónica Europe. Until December 2015 he was Chairman of Ladbrokes, Plc.

Total number of other external directors 1

Percentage of the Board 5.88%

State any changes in status that has occurred during the period for each director:

Name of director	Date of change	Previous Status	Current Status
Mr. Peter Erskine	25/01/2018	Independent Director	Other External Director

C.1.4 Complete the following table with information relating to the number of female directors at the close of the past 4 years, as well as the category of each:

Telefónica, S.A. 164

2018 Management Report

	Number of female directors				% of directors for each category			
	Year 2018	Year 2017	Year 2016	Year 2015	Year 2018	Year 2017	Year 2016	Year 2015
Executive	0	0	0	0	0.00%	0,00%	0,00%	0,00%
Proprietary	0	0	0	0	0.00%	0,00%	0,00%	0,00%
Independent	3	2	1	0	33.33%	22.22%	11.11%	0,00%
Other external	0	1	1	1	0.00%	100.00%	33.33%	33.33%
Total	3	3	2	1	17.65%	18.75%	11.11%	5.56%

Remarks

The number of female Directors in the financial year 2017 and 2018 was the same (3 female Directors). However, the percentage of female Directors over the total number of Board members is different in one year and in another, since at December 31, 2017 the number of Directors was 16, and at December 31, 2018 it was 17.

C.1.5 State whether the company has diversity policies in relation to the Board of Directors of the company on such questions as age, gender, disability and training and professional experience. Small and medium-sized enterprises, in accordance with the definition set out in the Accounts Audit Act, will have to report at least the policy they have implemented in relation to gender diversity.

Yes

Should this be the case, describe these diversity policies, their objectives, the measures and way in which they have been applied and their results over the year. Also state the specific measures adopted by the Board of Directors and the appointments and remuneration committee to achieve a balanced and diverse presence of directors.

In the event that the company does not apply a diversity policy, explain the reasons why.

Description of policies, objectives, measures and how they have been implemented, including results achieved

Telefónica S.A. has a Board Member Selection Policy as of November 25, 2015. This Policy was updated on December 13, 2017 to include the Diversity Policy applicable to the Board of Directors and, as a consequence, was renamed the Diversity Policy in relation to the Telefónica S.A. Board of Directors and the Selection of Board Members. This Policy is concrete and verifiable, and as of November 25, 2015 (before its update of December 13, 2017), assures that the proposals for appointments or re-election of Board Members is based on a prior analysis of the Board of Director's needs, and favor a diversity of knowledge, training and professional experience, age and gender, ensuring that such proposals are free from any implicit bias entailing any kind of discrimination, particularly by reason of gender, disability or any other personal condition.

In accordance with the aforementioned Policy, the selection of candidates for Director of Telefónica shall adhere to the following principles:

1. Efforts will be made for the Board of Directors to have a balanced composition, with a large majority of non-Executive Directors and an appropriate mix of Proprietary and Independent Directors.
2. The Board of Directors shall endeavor to ensure that the Director selection procedures favor diversity of knowledge, training, professional experience, age and gender, and are free from any implicit bias entailing any kind of discrimination. All of the foregoing is in order for the Board of Directors to have a diverse and balanced

2018 Management Report

composition overall, which i) enriches analysis and debate, ii) contributes to multiple viewpoints and positions, iii) favors decision-making, and iv) gives it maximum independence.

It shall also ensure that the candidates for non-Executive Director have sufficient available time to properly perform their duties.

3. The process for selecting candidates for Director shall also be based on a prior analysis of the needs of the Company and of its Group. Such analysis must be performed by the Company's Board of Directors, with the advice and with the required prior justifying report of the Nominating, Compensation and Corporate Governance Committee.

4. Such report of the Nominating, Compensation and Corporate Governance Committee shall be published upon occasion of the call to the General Shareholders' Meeting at which the ratification, appointment or re-election of each Director is submitted.

5. The Nominating, Compensation and Corporate Governance Committee shall verify compliance with the Diversity Policy in relation to the Board of Directors of Telefónica, S.A. and the Selection of Directors on an annual basis, and information thereon shall be included in the Annual Corporate Governance Report and in such other documents as are deemed appropriate.

On the other hand, the Board of Directors and the Nominating, Compensation and Corporate Governance Committee shall ensure, within the scope of their respective powers, that the candidates chosen for the position of Director are persons of recognized caliber, qualifications, training and professional experience, who are willing to devote a sufficient portion of their time and the required effort to the performance of their duties, and shall take extreme care in the selection of the persons to be appointed as Independent Directors.

In this regard, candidates for Director shall be persons of recognized prestige, caliber, training and professional experience, especially in the telecommunications, economic/financial, accounting, auditing, risk management and/or business management fields, with the ability to lead teams made up of persons belonging to various fields of activity, and extensive knowledge about large companies.

Likewise, it should be noted that the same criteria and principles that the Company applies in the process of selection and appointment of the members of the Board of Directors are also applied to the appointment of the Directors that are part of the different Committees of the Board of Directors of the Company.

Finally, and with regard to the performance evaluation, the Board of Directors must undertake an annual evaluation of its operations and that of its Committees, particularly evaluating the application of the various aspects of diversity contained in this Policy in the composition and powers of the Board of Directors, as well as the performance of the Chairman of the Board of Directors, of the Company's Chief Executive Officer, and of the various Directors, paying special attention to the heads of the various Committees of the Board, and shall adopt appropriate measures for the improvement thereof.

The Diversity Policy in relation to the Telefónica, S.A. Board of Directors and the Selection of Board Members is public and may be viewed on the corporate web page (www.telefonica.com).

The Reports of the Board of Directors and the Nominating, Compensation and Corporate Governance Committee, drafted in relation to the proposals for re-election and ratification of appointments of Directors submitted to the General Shareholders' Meeting held on June 8, 2018, explain in detail how the Diversity Policy was applied in relation to the Board of Directors of Telefónica, S.A. and the Selection of Directors, as well as the diversity criteria applied in the selection process.

C.1.6 Describe the means, if any, agreed upon by the appointments committee to ensure that selection procedures do not contain hidden biases which impede the selection of female directors and that the company deliberately seeks and includes women who meet the target professional profile among potential candidates and which makes it possible to achieve a balance between men and women:

2018 Management Report

Explanation of means:

In accordance with Article 10.3 of the Board Regulations, the Board of Directors and the Nominating, Compensation and Corporate Governance Committee shall ensure, within the scope of their respective powers, that the candidates chosen are persons of recognized caliber, qualifications and experience, who are willing to devote a sufficient portion of their time to the Company, and shall take extreme care in the selection of the persons to be appointed as Independent Directors.

In this context, and as mentioned above, the Nominating, Compensation and Corporate Governance Committee analyzed and favorably reported the update of the Board Member Selection Policy (approved, in its first version, on November 25, 2015), which included the Diversity Policy applicable to the Telefónica, S.A. Board of Directors. It was thus renamed the Diversity Policy related to the Telefónica, S.A. Board of Directors and Board Member Selection, approved by the Board of Directors at their meeting held on December 13, 2017.

Furthermore, subject to Article 10.4 of the Regulations of the Board of Directors, the results of the preliminary analysis of the needs of the Board of Directors will be set out in the report of the Nominating, Compensation and Corporate Governance Committee, which will be published on calling the General Shareholders Meeting at which each Director will be submitted for ratification, appointment or re-election.

In the event there are few or no female directors in spite of any measures adopted, please explain the reasons that justify such situation:

Explanation of reasons:

As shown in Table C.1.4, the selection procedures do not suffer from implicit biases that hinder the selection of Directors and in fact the Company has deliberately sought women who meet the professional profile sought. In this sense, regarding the percentage that female Directors represent with respect to the total number of members of the Board of Directors, in Table C.1.4, shows the qualitative leap that the Company has made in this area, having gone from 5.56% in 2015, to 17.65% in 2018.

All the measures and processes agreed and adopted by the Board of Directors and the Nominating, Compensation and Corporate Governance Committee to ensure the number of female directors on the Board guarantee an even balance and to ensure that the selection processes are not subject to implicit bias that would make it difficult to select female directors have been implemented and initiated by the Company.

Thus, in the amendment carried out during the year 2016 in the composition of the Company's Board of Directors, Ms. Sabina Fluxà Thienemann was appointed unanimously by the Board of Directors, at the proposal of the Nominating, Compensation and Corporate Governance Committee, as Independent Director of Telefónica. This appointment was ratified by the Telefónica General Shareholder's Meeting held on May 12, 2016.

Likewise, in the amendment brought into effect in 2017 on the composition of the Board of Directors of the Company, the Board of Directors unanimously appointed Ms. Carmen García de Andrés as Independent Board Member of Telefónica, at the proposal of the Nominating, Compensation and Corporate Governance Committee. This appointment was ratified by the Telefónica General Shareholder's Meeting held on June 9, 2017.

Furthermore, in 2018, the Company's Board of Directors unanimously appointed Ms. María Luisa García Blanco as Independent Board Member of Telefónica, at the proposal of the Nominating, Compensation and Corporate Governance Committee. This appointment was ratified by the Telefónica General Shareholder's Meeting held on June 8, 2018.

In all the above mentioned proposals to appoint (Ms. Sabina Fluxà Thienemann, Ms. Carmen García de Andrés and Ms. María Luisa García Blanco), the Nominating, Compensation and Corporate Governance Committee considered the solvency, competency, experience, professional merits and availability of Ms. Fluxà, Ms. García de Andrés and Ms. García Blanco for their effective performance of the duties, exclusively considering their individual and professional characteristics. All of this was included in the framework of the Board Member Selection Policy, which, with respect to the promotion of the presence of Board Members in the Board of

2018 Management Report

Directors, already expressly imposed the obligation to favor gender diversity in Board Member selection procedures, and prohibited any type of implicit bias that could entail any discrimination.

C.1.7 Describe the conclusions of the appointments committee regarding verification of compliance with the selection policy for directors; in particular, as it relates to the goal of ensuring that the number of female directors represents at least 30% of the total membership of the Board of Directors by the year 2020.

Explanation of the conclusions:

Telefónica S.A. has a Board Member Selection Policy as of November 25, 2015. This Policy was updated on December 13, 2017 to include the Diversity Policy applicable to the Board of Directors and, as a consequence, was renamed the Diversity Policy in relation to the Telefónica S.A. Board of Directors and the Selection of Board Members. This Policy is concrete and verifiable, and as of November 25, 2015 (before its update of December 13, 2017), assures that the proposals for appointments or re-election of Board Members is based on a prior analysis of the Board of Director's needs, and favor a diversity of knowledge, training and professional experience, age and gender, ensuring that such proposals are free from any implicit bias entailing any kind of discrimination, particularly by reason of gender, disability or any other personal condition.

Within the framework of the Selection of Board Members Policy in relation to the Telefónica S.A. Board of Directors and the Selection of Board Members, during the 2018 fiscal year, the Nominating, Compensation and Corporate Governance Committee proposed and/or informed, as the case may be, the appointment of Telefónica S.A. Board Members in accordance to the aforementioned criteria, considering the solvency, competency, experience, professional merits, and disposition of the candidates to dedicate the time and effort necessary for the efficient performance of their duties, exclusively considering their personal and professional characteristics, all of this to favor a diversity of knowledge, training and professional experience, age and gender, ensuring that such proposals are free from any implicit bias entailing any kind of discrimination, particularly by reason of gender, disability or any other personal condition.

Thus, in its meeting celebrated on January 30, 2018 the Committee favorably informed the appointment by co-option as Proprietary Director, and at the proposal of CaixaBank, S.A., of Mr. Jordi Gual Solé, after the voluntary resignation from its position as Board Member presented by Mr. Antonio Massanell Lavilla. Likewise, in its meeting celebrated on April 24, 2018, the Committee proposed to the Company's Board of Directors the appointment by co-option as Independent Board Member of Ms. María Luisa García Blanco, replacing Ms. Eva Castillo Sanz. These appointments were ratified by the Ordinary General Shareholders' Meeting of Telefónica held on June 8, 2018, as explained below. Likewise, within the framework of the Selection of Board Members Policy in relation to the Telefónica S.A. Board of Directors and the Selection of Board Members, the Committee favorably informed and/or proposed, as the case may be, the re-election and ratification of the Telefónica S.A. Board Members by the Company's Ordinary General Shareholders Meeting, considering and assessing the duties performed and the dedication of the Board Members, basing all of the proposals on a prior analysis of the Board of Director's needs, and favouring the diversity of knowledge, experiences, and gender.

Thus, the Ordinary General Shareholders' Meeting held on June 8, 2018 approved, at the proposal of the Company's Board of Directors, the re-election of Mr. Luiz Fernando Furlán, Mr. Francisco Javier de Paz Mancho, and Mr. José María Abril Pérez, as well as the ratification of the appointment by co-optation of Mr. Ángel Vilá Boix, Mr. Jordi Gual Solé, and Ms. María Luisa García Blanco.

In this sense, it must be noted that the Nominating, Compensation and Corporate Governance Committee verified the compliance of the Selection of Board Members Policy in relation to the Telefónica S.A. Board of Directors and the Selection of Board Members, on the occasion of the preparation of the proposals for appointment, re-election, and/or ratification of the Board Members submitted to the General Shareholders' Meeting held on June 8, 2018.

As for the percentage that the female Board Members represent with respect to the total number of members of the Board of Directors, a qualitative leap that the Company has taken in this field can be observed in figure C.1.4, passing from 5.56% in 2015 to 17.65% in 2018.

2018 Management Report

C.1.8 If applicable, please explain the reasons for the appointment of any proprietary directors at the request of shareholders with less than a 3% equity interest:

Name of shareholder	Reason
China Unicom (Hong Kong) Limited	On January 23, 2011, Telefónica, S.A. and China Unicom (Hong Kong) Limited (China Unicom), expanding on their existing strategic alliance, signed an extension to their Strategic Partnership Agreement, in which both companies agreed to strengthen and deepen their Strategic Partnership in certain business areas, and committed to investing the equivalent of 500 million US dollars in ordinary shares of the other party. Telefónica also agreed to propose the appointment of a board member nominated by China Unicom, in accordance with prevailing legislation and the Company's Bylaws. Mr. Wang Xiaochu, Chairman and Chief Executive Officer of China Unicom (Hong Kong Limited) is currently member of the Board of Directors of Telefónica, S.A.

State whether the Board has failed to meet any formal requests for membership from shareholders whose equity interest is equal to or higher than that of others at whose request proprietary directors have been appointed. If this is the case, please explain why the aforementioned requests were not met:

No

C.1.9 State the powers delegates by the Board of Directors, as the case may be, to directors or Board committees:

Name of director	Brief description
Mr. José María Álvarez-Pallete López - Executive Chairman (Chief Executive Officer)	The Chairman of the Company, as the Executive Chairman (Chief Executive Officer), has been expressly delegated to him all the powers and competences of the Board of Directors, except those that cannot be delegated by Law, by the Corporate ByLaws, or by the Regulations of the Board of Directors which establishes, in article 5.4, the powers that the Board of Directors reserves for itself, and may not delegate. In addition to the aforementioned delegation of powers, the Chairman of the Company has been granted in certain (not general) powers to perform specific operations approved by the company. The Chief Operating Officer (C.O.O.) has been delegated those powers of the Board of Directors related to the management of the business and the performance of the highest executive functions over all the Company's business areas, except those which cannot be delegated by Law, under the Corporate By-laws or according to the Regulations of the Board of Directors. In addition to the aforementioned delegation of powers, the C.O.O. of the Company has been granted in certain (not general) powers to perform specific operations approved by the company.
Mr. Ángel Vilá Boix - Chief Operating Officer (C.O.O.)	
Executive Commission of the Board of Directors	The Executive Commission has been delegated all the faculties and powers of the Board of Directors, except those which cannot be delegated.

2018 Management Report

C.1.10 Identify any members of the Board who are also directors or officers in other companies in the group of which the listed company is a member:

Name of director	Name of group member	Position	Does the director have executive powers?
Mr. José Javier Echenique Landiribar	Telefónica Móviles Mexico, S.A de C.V.	Director	No
	Telefónica Audiovisual Digital, S.L.U	Director	No
Mr. Peter Erskine	Telefónica Deutschland Holding, AG	Member of Supervisory Board	No
Mr. Luiz Fernando Furlan	Telefónica Brasil, S.A.	Director	No
	Telefónica Móviles Argentina, S.A	Director	No
Mr. Francisco Javier de Paz Mancho	Telefónica Brasil, S.A	Director	No
	Telefónica Móviles México, S.A de C.V	Director	No
	Telefónica Ingeniería de Seguridad, S.A	Chairman	No

C.1.11 List any legal-person directors of your company who are members of the Board of Directors of other companies listed on official securities markets other than group companies, and have communicated that status to the Company:

Telefónica, S.A. 170

2018 Management Report

Name of director	Name of listed company	Position
	Banco Sabadell, S.A	Vice-Chairman
Mr. José Javier Echenique Landiribar	ACS, Actividades de Construcción y Servicios, S.A	Director
	Ence, Energía y Celulosa, S.A	Director
Mr. Isidro Fainé Casas	The Bank of East Asia	Director
	Suez Environment Company	Director
Mr. Luiz Fernando Furlán	Brasil Foods, S.A (BRF)	Director
	CaixaBank, S.A	Chairman
Mr. Jordi Gual Solé	Erste Group Bank, AG	Director
	Sulzer AG	Chairman
Mr. Peter Löscher	OMV Aktiengesellschaft	Chairman
Mr. Ignacio Moreno Martinez	Metrovacesa, S.A	Chairman
	Gestamp Automoción, S.A	Chairman
Mr. Francisco Riberas Mera	CIE Automotive, S.A	Director
	Global Dominion Access, S.A	Director
	China United Networks Communications Limited	Chairman
Mr. Wang Xiaochu	China Unicom (Hong Kong) Limited	Chairman-Chief Operating Officer

Remarks

Mr. Isidro Fainé Casas is Honorary Chairman of Naturgy Energy Group, S.A.

Mr. Jordi Gual Solé is member of the Supervisory Board of Erste Group Bank, AG.

Mr. Peter Löscher is Chairman of the Supervisory Board of OMV Aktiengesellschaft and Chairman of Sulzer AG.

C.1.12 State whether the company has established rules on the number of board on which its directors may hold sets, providing details if applicable, identifying, where appropriate, where his is regulated:

Yes

Explanation of the rules and identification of the document where this is regulated

As set forth in Article 28.2 of the Regulations of the Board of Directors, the Directors will devote the time and efforts required to perform their duties and, to such end, shall report to the Nominating, Compensation and Corporate Governance Committee on their other professional obligations if they might interfere with the performance of their duties as Directors.

In this regard, persons who belong to over five Board of Directors of other corporations other than Telefónica, S.A. and its Group companies cannot be appointed as Directors.

For these purposes, a) all the Boards of companies which form part of the same Group will be counted as a single Board; and b) Boards of asset-holding companies or companies which are vehicles or complements for the Director's own professional activity, of his/her spouse or person with an analogous affective relationship, or his/her closest relatives, will not be counted. On an exceptional basis, for justified reasons, the Board will be able to exempt the Director from this prohibition.

C.1.13 State total remuneration received by the Board of Directors:

Telefónica, S.A. 171

2018 Management Report

Board remuneration in financial year (thousand euros) 13,003

Amount of vested pension interests for current members (thousand euros) 15,900

Amount of vested pension interests for former members (thousand euros) 37,665

C.1.14 Identify senior management staff who are not executive directors and their total remuneration accrued during the year:

Name	Position
Mr. Pablo de Carvajal González	General Secretary, Secretary of the Board of Directors and Director Global of Regulation
Ms. Laura Abasolo García de Baquedano	Chief Finance and Control Officer
Mr. Guillermo Ansaldo Lutz	Chief Global Resources Officer
Mr. Mariano de Beer	Chief Commercial Digital Officer
Mr. Juan Francisco Gallego Arrechea	General Manager of Internal Audit
Total senior management remuneration (thousand euros)	9,045

Remarks

For these purposes, Senior Management is understood to be those persons who perform, de jure or de facto, senior management functions under the direct dependence of the Board of Directors, Executive Committees or Chief Executive Officers of the Company. In addition, the head of Internal Audit is included for the purposes of annual remuneration.

On January 31, 2018, Mr Pablo de Carvajal González, currently General Secretary, Secretary of the Board of Directors and Director Global of Regulation, was appointed in place of Mr Ramiro Sánchez de Lerín García-Ovies. It is stated that the amount indicated above includes the remuneration perceived by Mr Ramiro Sánchez de Lerín García-Ovies, former Secretary-General and Secretary of the Board of Directors of Telefónica, S.A., until the date of his disengagement from Telefónica, S.A., including the compensation perceived as a result of his removal. With effects as of January 2019, Mr Eduardo Navarro de Carvalho was appointed Chief Comms, Corporate Affairs, Brand and Sustainability Officer of the Telefónica Group, coming to form part of the Senior Management of the company. It is stated that the amount indicated above does not include their remuneration as a member of the Senior Management, which has accrued after the end of the 2018 fiscal year.

C.1.15 State whether the Board rules were amended during the year

No

C.1.16 Specify the procedures for selection, appointment, re-election and removal of directors: the competent bodies, steps to follow and criteria applied in each procedure.

See heading H "Other information of Interest". Note 3 to section C.1.16.

C.1.17 Explain how the annual evaluation of the Board has given rise to significant changes in its internal organisation and to procedures applicable to its activities:

2018 Management Report

Description of changes

With respect to the Board of Directors assessment corresponding to 2017, the Company Board of Directors, based on the favorable report of the Nominating, Compensation and Corporate Governance Committee, agreed to entrust this evaluation to an external consultant, Villafañe & Asociados Consultores.

The aim of this work has been to help the Telefónica, S.A. Board of Directors make their corporate governance assessment by identifying measures for improvement in the governance with possible action plans, under the terms established in the Good Governance Code of the listed companies, approved by the Spanish National Securities Market Commission.

The assessment has been carried out from the review of the Company's Annual Reports corresponding to the 2016 fiscal year, and the Company's corporate documentation, as well as interviews to Independent Board Members, and to the Secretary of the Board of Directors and the Deputy Secretary of the Board of Directors.

The results obtained in this external assessment were satisfactory, standing out some very positive aspects of the corporate governance system of the Company.

Likewise, some recommendations were reflected in this evaluation to optimize the corporate governance system of the Company, related, among others, to:

- The operation of the Board of Directors, recommending the establishment of measures in order to have the documentation related to the issues to be discussed at Board and Committee meetings as far in advance as possible.
- The organization and the operation of the General Shareholder's Meeting, proposing to analyze the possibility of implementing opportune measures for its retransmission, provided that the circumstances thus permit this.
- The composition of the Board of Directors, proposing to continue advancing towards a percentage of 30% of female Board Members in its breakdown by 2020, as well as to continue to reduce the total number of Board Members.

On the other hand, and with respect to the Board of Directors assessment corresponding to 2018, in a meeting on February 19, 2019, the Nominating, Compensation and Corporate Governance Committee revised and analysed the results of the Directors of Telefónica, S.A.'s evaluation of the Board of Directors and its Committees and of the Company's General Meeting, concluding that, on the whole, they were highly satisfied with the organisation and activities of these governing bodies.

Furthermore, and as a result of this assessment, certain improvement points were identified. In view of this and after an exhaustive examination and analysis of the results obtained, the Board followed the Nominating, Compensation and Corporate Governance Committee's proposal, approved the suggested improvements described hereon in order to optimize the operation of the Company's governing bodies:

- i) Continue with the implementation of measures and actions that allow for an optimum performance of the General Shareholder's Meeting.
- ii) Continue with the process of analyzing the composition of the Board with regard to the implantation of succession plans and with the application of the Diversity Policy.
- iii) Evaluate to include more presentations on the agenda of the Board of Directors and of the Executive Commission related to the strategy, so that they can be subject to debate by the Board Members.

Describe the evaluation process and the areas evaluated by the Board of Directors with the help, if any, of external advisors, regarding the function and composition of the board and its committees and any other area or aspect that has been evaluated.

2018 Management Report

As indicated above, on an annual basis, all the Company's Directors assess the functioning of the Board of Directors of Telefónica, S.A., its Committees and of the General Shareholders' Meeting.

Subsequently, the Nominating, Compensation and Corporate Governance Committee reviews and analyzes the results of the assessment carried out by the Directors, identifying those areas that could be improved. After a detailed examination and analysis of the results achieved, the Nominating, Compensation and Corporate Governance Committee proposes to the Board of Directors the implementation of the suggestions and recommendations deemed appropriate.

With respect to fiscal year 2018, at the meeting of the Board of Directors held on December 12, all the Directors were given a questionnaire in order to carry out the assessment corresponding to said fiscal year.

The aforementioned questionnaire contained very diverse questions grouped into the following five sections:

- Composition, functioning and powers of the Board of Directors, expressly including the adequacy of the performance and contribution of the Directors to the Board of Directors.
- Composition and functioning of the Committees, expressly including the performance and contribution of the Chairmen of the Committees of the Board of Directors.
- Performance of the Executive Chairman.
- Rights and Duties of Directors.
- General Shareholders' Meeting.
- Other

As already indicated, once the questionnaires had been received, filled in with the opinions and suggestions of all the Directors, action plans were established on those matters that were identified as susceptible to improvement.

The Board of Directors unanimously approved the proposals for improvement formulated by the Nominating, Compensation and Corporate Governance Committee, in order to optimize the operation of the Company's Governing Bodies.

It should be noted that, in accordance with the Diversity Policy in relation to the Board of Directors of Telefónica, S.A. and the Board of Directors' Selection Policy, at least, every three years the Board of Directors will be assisted in carrying out the assessment by an external consultant, whose independence will be verified by the Nominating, Compensation and Corporate Governance Committee. Thus, the assessment corresponding to fiscal year 2017 was carried out by the External Consultant, Villafañe & Asociados Consultores.

C.1.18 Describe, in those years in which the external advisor has participated, the business relationships that the external advisor or any group company maintains with the company or any company in its group.

The assessment of the Board of Directors for fiscal year 2017 was carried out by the External Consultant, Villafañe & Asociados Consultores. Such External Consultant maintained in the referred fiscal year business relationship for a total amount of 119,003.5 euros for the execution of other work to Telefónica Group Companies.

In his regard, the assessment of the Board of Directors corresponding to fiscal year 2018 has been carried out internally by the Company, without having been assisted by an External Consultant.

C.1.19 State the situation in which directors are required to resign

In accordance with Article 12 of the Regulations of the Board of Directors, Directors must tender their resignation to the Board of Directors and formalize such resignation in the following cases:

2018 Management Report

- a) When they cease to hold the executive positions to which their appointment as Directors is linked, or when the reasons for which they were appointed no longer exist.
- b) When they are affected by any of the cases of incompatibility or prohibition established by Law.
- c) When they are severely reprimanded by the Nominating, Compensation and Corporate Governance Committee for having failed to fulfill any of their obligations as Directors.
- d) When their remaining on the Board might affect the Company's credit or reputation in the market or otherwise jeopardise its interests.

The conditions listed above under Recommendation C.1.16 ("Removal") above must also be taken into consideration.

C.1.20 Are qualified majorities other than those established by law required for any specific decision?

No

If applicable, describe the differences.

-

C.1.21 Explain whether there are any specific requirements, other than those relating to directors, to be appointed as chairman of the Board of Directors.

Yes

Description of requirements

In accordance with Article 31.4 of the Corporate Bylaws, in order for a Director to be appointed Chairman, such Director must have served on the Board for at least three years prior to any such appointment. However, such length of service shall not be required if the appointment is made with the favorable vote of at least 85 percent of the members of the Board of Directors.

C.1.22 State whether the Articles of Association or the Board Rules establish any limit as to the age of directors:

No

C.1.23 State whether the Articles of Association or the Board Rules establish any term limits for independent directors other than those required by law:

No

C.1.24 State whether the Articles of Association or Board Rules establish specific proxy rules for votes at Board meetings, how they are to be delegated and, in particular, the maximum number of delegations that a director may have, as well as if any limit regarding the category of director to whom votes may be delegated and whether a director is required to delegate to a director of the same category. If so, please briefly describe the rules.

In accordance with Article 19 of the Regulations of the Board of Directors, Directors must attend meetings of the Board in person, and when unable to do so in exceptional cases, they shall endeavor to ensure that the proxy they grant to another member of the Board includes, as far as is practicable, appropriate instructions. Non-executive Directors may only delegate their proxy in another non-executive Director. Such proxies may be granted by letter or any other means that, in the Chairman's opinion, ensures the certainty and validity of the proxy granted.

2018 Management Report

Article 34.4 of the Bylaws also establishes that all Directors who are absent may grant a proxy in writing to another Director who is in attendance, with the right to speak and to vote, at the meeting or session to which the proxy refers. The Director granting the proxy shall endeavor, to the extent possible, to include voting instructions in the proxy document.

C.1.25 State the number of meetings held by the Board of Directors during the year, and if applicable, the number of times the Board met without the chairman present. Meetings where the chairman sent specific proxy instructions are to be counted as attended.

Number of Board meetings 12

Number of Board meetings without the chairman 0

State the number of meetings held by the coordinating director with the other directors, where there was neither attendance nor representation of any executive director:

Number of meetings 0

Please specify the number of meetings held by each committee of the Board during the year:

Number of meetings held by the Executive Committee 18

Number of meetings held by the Audit and Control Committee 13

Number of meetings held by the Nominating, Compensation and Corporate Governance Committee 11

Number of meetings held by the Service Quality and Customer Services Committee 4

Number of meetings held by the Regulation and Institutional Affairs Committee 11

Number of meetings held by the Strategy and Innovation Committee 10

C.1.26 State the number of meetings held by the Board of Directors during the year in which all of its directors were present. For the purposes of this section, proxies given with specific instructions should be considered as attendance:

Number of meetings attended in person by at least 80% of the directors 10

% of personal attendance over the total of votes cast during the fiscal year 89.22 %

Number of meetings attended in person, or representations made with specific instructions, of all directors 12 %

Number of meetings attended in person, or representations made with specific instructions, of all directors
% of votes personally cast and representations realized with specific instructions over the total of votes cast during the fiscal year 100 %

C. 1.27 State if the individual and consolidated financial statements submitted to the Board for preparation were previously certified:

No

Remarks

Telefónica, S.A. 176

2018 Management Report

In accordance with US securities market regulations, the information contained in the Annual Report in 20-F format (which includes the Consolidated Financial Statements of the Telefónica Group), filed with the Securities and Exchange Commission, is certified by the Executive Chairman of the Company and by the CFO. This certification is made after the Financial Statements have been prepared by the Board of Directors of the Company.

State if the individual and consolidated financial statements submitted to the Board for preparation were previously certified:

-

C.1.28 Explain any measures established by the Board of Directors to prevent the individual and consolidated financial statements prepared by the Board from being submitted to the General Shareholders' Meeting with a qualified audit opinion.

Through the Audit and Control Committee, the Board of Directors plays an essential role in supervising the preparation of the Company's financial information, controlling and coordinating the various players that participate in this process.

To achieve this objective, the Audit and Control Committee's work addresses the following basic issues:

A. Supervise internal audit and, in particular:

- a) Safeguard the independence and efficiency of the internal audit function;
- b) Propose the selection, appointment and removal of the person responsible for internal audit;
- c) Propose the budget for such service;
- d) Review the internal audit work plan and its annual activities report;
- e) Receive regular information on its activities; and
- f) Verify that the senior executive officers take into account the conclusions and recommendations of its reports.

Oversee the process of preparing and presenting mandatory financial reporting and submitting recommendations of proposals to the administrative body aimed at safeguarding its integrity. With respect thereto, it shall be responsible for supervising the process of preparation and the completeness of the financial information relating to the

B. Company and the Group, reviewing compliance with regulatory requirements, the proper determination of the scope of consolidation, and the correct application of accounting standards, informing the Board of Directors thereof.

Monitoring the effectiveness of the Company's internal control, internal audit and risk management systems, including fiscal risks, and discuss with the auditors significant weaknesses in the internal control system detected during the audit, without compromising their independence at any time. For that purposes, if deemed necessary, it can submit recommendations or proposals to the Board of Directors and an appropriate monitoring period. With respect thereto, it shall be responsible for proposing to the Board of Directors a risk control and management policy, which shall identify at least the following:

- C. a) The types of risk (operational, technological, financial, legal and reputational) facing the Company;
- b) The risk level that the Company deems acceptable; the measures to mitigate the impact of the identified risks, should they materialize; and
- c) The control and information systems to be used to control and manage these risks.

2018 Management Report

D. Establish and maintain appropriate relations with the Auditor in order to receive, for review by the Committee, information on all matters that could jeopardize the Auditor's independence, and, when applicable, the authorization of permitted services, according to current legislation, and such other communications as may be provided for in auditing legislation and in technical auditing regulations.

In any event, the Audit and Control Committee must receive, on an annual basis, written confirmation from the Auditor of its independence vis-à-vis the entity or entities directly or indirectly related thereto, as well as in-depth and individualized information regarding additional services of any kind provided as well as the fees received to such entities by the Auditor or by the persons or entities related thereto pursuant to the provisions of prevailing legislation.

E. Issue on an annual basis, prior to the issuance of the audit report, a report stating an opinion on whether the independence of the Auditor is compromised. This report will focus on the assessment of the provision of each and every one of the additional services referred to in the section above, considered individually and as a whole, other than legal audit and in relation to the regime of independence or laws regulating auditing activities.

F. Analyze and report on economic conditions, the accounting impact, and, if applicable, the proposed exchange ratio in structural and corporative modification transactions which the Company intends to perform, before being submitted to the Board of Directors.

G. Preliminary reporting to the Board of Directors regarding all matters set out in prevailing legislation and in the Bylaws, and, in particular, concerning:

1. The financial information that the Company must periodically disclose;
2. The creation or acquisition of shareholdings in special purpose entities or companies with registered addresses in countries or territories considered to be tax havens; and
3. Related party transactions.

The Audit and Control Committee verifies both the periodical financial information and the Annual Financial Statements, ensuring that all financial information is drawn up according to the same professional principles and practices. Likewise, in accordance with the current regulation, the Committee has reviewed the non-financial and diversity information prepared by the Company.

On the other hand, different members of the Telefónica Group management group attend the Audit and Control Committee meetings, with supportive and assistance duties to the Committee members on the issues that are subject to be analyzed at each of the meetings. In particular, by invitation from the Chairman of the Committee, and when considered necessary, representatives of the General Secretary and the Board, Finance and Control, Internal Auditing, Intervention and Inspection, and Compliance attend the Committee meetings.

In addition to the aforementioned, and as a requirement of its own Committee, other managers from the Company and its subsidiary companies participate to present specific issues that affect their respective businesses or their assigned duties.

The meetings held with the Account Auditor and the Internal Auditor comply with that established in article 7 of the regulations of the Audit and Control Committee of the Company, which establishes that, for the appropriate performance of their supervisory duty, the Committee must know and understand the decisions of Management regarding the application of the most significant criteria and results of the revisions made by Internal Auditing, staying in constant communication with the Account Auditor. In fact, the External Auditor has intervened in meetings of the Audit and Control Committee to explain the work done, as well as to clarify, at the Committee's request, any issues that may have arisen related to the functions assigned to said External Auditor.

2018 Management Report

The members of the Committee have held meetings separately with each of these interlocutors when it has been deemed necessary, in order to carry out a rigorous follow-up of the preparation of the Company's financial information.

The above notwithstanding, Article 40 of the Regulations of the Board of Directors establishes that the Audit and Control Committee shall ensure that the Board of Directors prepares the final financial statements in a manner that will give no reason for the Auditor to issue a qualified or reserved opinion. However, whenever the Board considers that it should maintain its standards, the Chairman of the Audit and Control Committee shall publicly explain the contents and scope of the discrepancies.

C.1.29 Is the secretary of the Board also a director?

No

If the secretary is not a member of the Board, fill in the following table:

Name of the secretary	Representative
-----------------------	----------------

Mr. Pablo de Carvajal González	—
--------------------------------	---

Remarks

On January 31, 2018, Mr Pablo de Carvajal González, currently General Secretary, Secretary of the Board of Directors and Director Global of Regulation, was appointed in place of Mr Ramiro Sánchez de Lerín García-Ovies.

C.1.30 State, if any, the concrete measures established by the entity to ensure the independence of its external auditors, financial analysts, investment banks, and rating agencies, including how legal provisions have been implemented in practice.

With regards to the independence of the External Auditor of the Company, and in accordance with the Regulations of the Board of Directors of Telefónica (Article 40), the Board has established, through the Audit and Control Committee, a stable and professional relationship with the Company's Auditor, strictly respecting the independence thereof.

Likewise, the Audit and Control Committee has a fundamental responsibility, as specified in Article 22 of the Regulations of the Board and in Article 4 of the Regulations of the Audit and Control, to establish and maintain appropriate relations with the Auditor in order to receive, for review by the Committee, information on all matters that could jeopardize the Auditor's independence, and, when applicable, the authorization of permitted services, according to current legislation, and such other communications as may be provided for in auditing legislation and in technical auditing regulations.

In any event, the Audit and Control Committee receives, on an annual basis, written confirmation from the Auditor of its independence vis-à-vis the entity or entities directly or indirectly related thereto, as well as in-depth and individualized information regarding additional services of any kind provided as well as the fees received to such entities by the Auditor or by the persons or entities related thereto pursuant to the provisions of prevailing legislation. The Committee also issues on an annual basis, prior to the issuance of the audit report, a report stating an opinion as to whether the independence of the Auditor is compromised. This report focuses on the assessment of the provision of each and every one of the additional services referred to in the section above, considered individually and as a whole, other than legal audit and in relation to the regime of independence or laws regulating auditing activities.

Moreover, and in accordance with the Regulations of the Board of Directors (Article 22), the Audit and Control Committee submits proposals for the selection, appointment, re-election and replacement of the external

2018 Management Report

auditor to the Board of Directors, and that it shall be held responsible for the selection process in accordance with prevailing laws, and also the conditions for recruiting the external auditor, regularly gathering information about the audit plan and its execution from the auditor, as well as safeguarding its independence in exercising its functions. Furthermore, the External Auditor has direct access to the Audit and Control Committee and participates regularly in its meetings, in the absence of the Company's management team when this is deemed necessary. To this effect, and in keeping with US legislation on this matter, the External Auditor informs the Audit and Control Committee at least once a year on the most significant generally accepted auditing policies and practices followed in the preparation of the Company's financial and accounting information affecting key elements in the financial statements which may have been discussed with the management team, and of all relevant communications between the Auditor and the Company's management team. Likewise, as established in Article 40 of the Regulations of the Board of Directors, every year the Auditor has a meeting with the Board of Directors in plenary session to inform it of the work conducted and about the pattern of the Company's accounting and risks situation.

In accordance with internal company regulations and in line with the requirements imposed by Spanish, European and US legislation, the engagement of any service from the Company's External Auditors must always have the prior approval of the Audit and Control Committee. Moreover, the engagement of non-audit services must be done in strict compliance with Spanish and European Auditing Act (Ley de Auditoría de Cuentas) and the Sarbanes-Oxley Act published in the United States and subsequent regulations. For this purpose, and prior to the engagement of the Auditors, the Audit and Control Committee studies the content of the work to be performed, evaluating any situations that may compromise the External Auditor's independence, and specifically supervises the percentage the remuneration for such services represent in the total revenue of the auditing firm. In this respect, the Company reports the fees paid to the External Auditor, including those paid for non-audit services, in its Notes to the Financial Statements, in accordance with prevailing legislation.

In consequence the Company has implemented, in practice, the legal provisions in this matter according to what was referred in the previous paragraph.

C.1.31 State whether the company changed its external auditor during the year. If so, please identify the incoming and outgoing auditor:

No

Remarks

The Board of Directors of Telefónica, S.A. at its meeting held April 8, 2016, on a proposal from its Audit and Control Committee and as a result of a transparent competitive process, has resolved to propose to the next Ordinary General Shareholders Meeting the appointment of PricewaterhouseCoopers Auditores S.L. as statutory auditor for the Annual Accounts of Telefonica, S.A. and its Consolidated Group of Companies for the years 2017, 2018 and 2019. Such appointment was approved by the General Shareholders Meeting held on May 12, 2016.

If there were any disagreements with the outgoing auditor, please provide an explanation:

No

C.1.32 State whether the audit firm provides any non-audit services to the company and/or its Group and, if so, the fees paid and the corresponding percentage of total fees invoiced to the company and/or Group:

No

C.1.33 State whether the auditors' report on the financial statements for the preceding year contains a qualified opinion or reservations. If so, please explain the reasons given by the chairman of the

2018 Management Report

audit committee to explain the content and extent of the aforementioned qualified opinion or reservations.

No

C.1.34 State the number of consecutive years the current audit firm has been auditing the financial statements of the company and/or group. Furthermore, state the number of years audited by the current audit firm as a percentage of the total number of years that the financial statements have been audited:

	Individual	Consolidated
Number of consecutive years	2	2
Number of years audited by the current audit firm/number of fiscal years the company has been audited (by %)	5.60	7.10

Remarks

Financial year 1983 was the first audited by an External Auditor. Previously the financial statement were revised by chartered accountants (known at the time as "censores de cuentas"). Therefore, 1983 is the base year taken for calculating the percentage in the case of audits of the Financial Statements of Telefónica, S.A., while 1991 is the date taken for the calculation of the percentage in the case of the Consolidated Financial Statements, as 1991 was the first year in which the Telefónica Group prepared Consolidated Financial Statements.

C.1.35 State whether there is a procedure whereby directors have the information necessary to prepare the meetings of the governing bodies with sufficient time and provide details if applicable:

Yes

Telefónica, S.A. 181

2018 Management Report

Explanation of procedure

The Company adopts the necessary measures, whenever possible, that the Directors receive the necessary information, specially drawn up and geared to preparing the meetings of the Board and its Committees, sufficiently in advance. Under no circumstances shall such a requirement not be fulfilled, on the grounds of the importance or the confidential nature of the information, apart from in absolutely exceptional cases.

In this regard, and in accordance with Articles 18 and 20 of the Regulation of the Board of Directors, at the beginning of each year the Board of Directors and its Committees set the calendar of ordinary meetings to be held during the year. The calendar may be amended by resolution of the Board itself, or by decision of the Chairman, in which case the Directors shall be made aware of the amendment as soon as practicable. Likewise, the Regulations of the Audit and Control Committee detail the operating regime of this Committee.

Also, at the beginning of the year the Board and its Committees shall prepare an Action Plan detailing the actions to be carried out and their timing for each year, as per their assigned powers and duties.

Likewise, all the meetings of the Board and the Board Committees have a pre-established agenda, which is communicated at least three days prior to the date scheduled for the meeting together with the call for the session. The Agenda for each meeting will clearly state points on which the Board of Directors, or the Executive Committee, have to adopt a decision or resolution.

For the same purpose, in general, the Directors are sent the documentation related to the agenda of the meetings sufficiently in advance. In accordance with Article 19 of the Regulations of the Board of Directors, the Chairman of the Board of Directors organizes the debates, promoting and encouraging all Directors to play an active role in the deliberations, safeguarding their right to freely adopt their own position on all matters. Moreover, with the assistance of the Secretary, he shall ensure that the Directors are sent sufficient information to discuss the points set out in the agenda sufficiently in advance of the meeting. He also ensures that sufficient time is given over to discussing strategic matters, and shall encourage debate during meetings, safeguarding the Directors' right to adopt their positions freely on all points discussed.

To provide all the information and clarifications necessary in relation to certain points deliberated, the Group's senior executive officers attend nearly all the Board and Committee meetings to explain the matters within their powers.

Furthermore, and as a general rule, the Regulations of the Board of Directors (Article 26) expressly establish that Directors are granted the broadest powers to obtain information about all aspects of the Company, to examine its books, records, documents and other data regarding corporate transactions. Exercising of this right to receive information shall be channeled through the Chairman or Secretary to the Board of Directors, who shall respond to the requests made by the Directors, providing them with the requested information directly or offering them the proper contacts at the appropriate level of the organization.

C.1.36 State whether the company has established rules whereby directors must provide information regarding and, if applicable, resign, in circumstances that may damage the company's standing and reputation. If so, provide details:

Yes

Explain the rules

In accordance with Article 12 of the Regulations of the Board of Directors, Directors must tender their resignation to the Board of Directors and formalize such resignation when their remaining on the Board might affect the Company's credit or reputation in the market or otherwise jeopardizes its interests.

Likewise, Article 30.h) of the Regulations establishes that Directors must report to the Board any circumstances related to them that might damage the credit or reputation of the Company as soon as possible.

Telefónica, S.A. 182

2018 Management Report

C.1.37 State whether any member of the Board of Directors has notified the company that he or she has been tried or notified that legal proceedings have been filed against him or her, for any offenses described in Article 213 of the LSC:

No

C.1.38 Detail any material agreements entered into by the company that come into force, are modified or are terminated in the event of a change in control of the company following a public takeover bid, and their effects.

1. On April 29, 2013, Telefónica, S.A. and TLK Investment, CV (which belongs to Corporación Multi-Inversiones, or "CMI", a Business Group domiciled in Guatemala) signed an agreement whereby Telefónica and CMI incorporated a joint business venture called Telefónica Centroamérica Inversiones, S.L.U. ("TCI"), in which Telefónica contributed its assets in Central America (except for its Costa Rica assets) and CMI made a monetary contribution of USD 500,000,000. As a result of these contributions, Telefónica owns a 60% interest in the share capital of TCI, while CMI's stake is 40%. This arrangement was completed on August 2, 2013.

Telefónica and CMI also entered into a Shareholders' Pact in TCI, which includes a change of control clause stipulating that if there was a change of control of CMI or Telefónica, the other party would be fully entitled to: (i) exercise the right to acquire (call option) the entire stake held in TCI by the shareholder over which control has changed at the date control changed; or (ii) exercise the right to sell (put option) the entire stake the former held in TCI to the latter. In both cases, the purchase price of the stake shall be TCI's market value calculated by an independent expert.

For the purposes of the Shareholders' Pact, a change of control shall be: (i) in the case of CMI, when the last natural person or corporate body controlling CMI ceases to do so; and (ii) for Telefónica, when a natural person or corporate body not controlling Telefónica assumes control. In both instances, "control" shall be as specified in the International Financial Reporting Standards (IFRS).

2. - Financing agreements:

On March 15, 2018, Telefónica, S.A., as borrower, and a group of credit entities, as original lenders, with National Westminster Bank plc as the agent bank, entered into a syndicated loan amounting up to EUR 5,500 million.

On December 11, 2015, Telefónica, S.A., as borrower, and Banco Bilbao Vizcaya Argentaria, S.A. Niederlassung Deutschland, the Bank of Tokyo-Mitsubishi UFJ, Ltd., sucursal in Spain, Mizuho Bank Ltd, AB Svensk Exportkredit and Société Générale S.A., as original lenders, and with the support of Exportkreditnämnden, signed a financing agreement amounting up to USD 750 million. Also on that same date, Telefónica, S.A., as borrower, and Banco Santander, S.A. and Crédit Agricole Corporate and Investment Bank as original lenders, with the support of Finnvera Plc, entered into a financing agreement amounting up to EUR 500 million.

As provided for in all of the aforementioned contracts, in the event of a change of control in Telefónica, S.A., lenders may, under certain circumstances, require the early termination of these financing agreements.

The financing contracts consider the usual criteria in these types of agreement to determine if there has effectively been a change of control, such as obtaining control of the majority of voting rights, on the appointment of the majority of members of the board of directors, or on the Company's financial and operational policies.

C.1.39 Identify individually for director, and generally in other cases, and provide detail of any agreements made between the company and its directors, executives or employees containing indemnity or golden parachute clauses in the event of resignation or dismissal or termination of employment without cause following a takeover bid or any other type of transaction.

2018 Management Report

Number of beneficiaries 27

Type of beneficiaries
Executive Directors, Senior
Managers and other
Employees

With regards to the
conditions applicable to
termination of contracts,
the Executive Chairman,
Mr. José María
Álvarez-Pallete López, and
the Chief Operating Officer
(C.O.O.), Mr. Ángel Vilá
Boix, maintain the
conditions of his previous
contract which provided
for agreed economic
compensation for the
termination of the
employment relationship,
where applicable, that can
amount to four years' of
remuneration at the most.
Annual remuneration on
which the indemnity is
based is the last fixed
remuneration and the
arithmetic mean of the last
two variable remuneration
payments received by
contract.

Regarding the contracts of
members of Senior
Management, in general,
they are contractually
entitled the right to receive
the economic
compensation indicated
below in the event that
their employment
relationship is ended for
reasons attributable to the
Company or, in some
instances, is due to
objective reasons such as a
change of control in the
Company. However, if the
employment relationship is
terminated because of a

breach attributable to the Executive, he/she will not be entitled to any compensation whatsoever. That notwithstanding, in certain cases the severance benefit to be received by the member of Senior Management according to their contract is not calculated as per these general criteria, but rather is based on other circumstances of a personal or professional nature or on the time when the contract was signed. The agreed economic compensation for the termination of the employment relationship, where applicable, consists of a maximum of three times annual remuneration plus another year based on length of service at the Company. Annual remuneration on which the indemnity is based is the last fixed remuneration and the arithmetic mean of the last two variable remuneration payments received by contract. Meanwhile, contracts that tie employees to the Company under a common employment relationship do not include indemnity clauses for the termination of their employment. In these cases, the employee is entitled to any indemnity set forth in prevailing labor legislation. However, contracts of some company employees, depending on their level and seniority, as well as their personal or professional circumstances or when they signed their contracts, establish their

right to receive compensation in the same cases as in the preceding paragraph, generally consisting of a year and a half salary. The annual salary on which the indemnity is based is the last fixed salary and the average amount of the last two variable payments received b contract.

State if these contracts have been communicated to and/or approved by management bodies of the company or of the Group. If they have, specify the procedures, events and nature of the bodies responsible for their approval or for communicating this:

Board of directors General Shareholders' Meeting

Body authorizing the severance clauses No No
Are these clauses notified to the General Shareholders' Meeting No

2018 Management Report

C.2 Committees of the Board of Directors

C.2.1 Provide details of all committees of the Board of Directors, their membership, and the proportion of executive, proprietary, independent and other external directors that comprise them:

AUDIT AND CONTROL COMMITTEE

Name	Post	Category
Mr. José Javier Echenique Landiribar	Chairman	Independent
Ms. Carmen García de Andrés	Member	Independent
Mr. Ignacio Moreno Martínez	Member	Proprietary
Mr. Francisco Javier de Paz Mancho	Member	Independent

% of executive directors 0.00 %

% of proprietary directors 25.00 %

% of independent directors 75.00 %

% of other external directors 0.00 %

Explain the duties exercised by this committee, describe the rules and procedures it follows for its organization and function. For each one of these functions, briefly describe its most important actions during the year and how it has exercise in practice each of the functions attributed thereto by law, in the Articles of Association or other corporate resolutions.

See heading H "Other information of interest. Note 4 to section C.2.1.

Identify the directors who are member of the audit committee and have been appointed taking into account their knowledge and experience in accounting or audit matters, or both, and state the date that the Chairperson of this committee was appointed.

Name of directors with experience

Mr. José Javier Echenique Landiribar

Date of appointment of the chairperson

08/04/2016

SERVICE QUALITY AND CUSTOMER SERVICE COMMITTEE

Name	Post	Category
Mr. Peter Löscher	Chairman	Independent
Ms. Carmen García Andrés	Member	Independent
Ms. María Luisa García Blanco	Member	Independent
Mr. Ignacio Moreno Martinez	Member	Proprietary

% of executive directors 0.00 %

% of proprietary directors 25.00 %

% of independent directors 75.00 %

% of other external directors 0.00 %

2018 Management Report

Explain the duties exercised by this committee, describe the rules and procedures it follows for its organisation and function. For each one of these functions, briefly describe its most important actions during the year and how it has exercise in practice each of the functions attributed thereto by law, in the Articles of Association or other corporate resolutions.

See heading H “Other information of interest”. Note 5 to section C.2.1.

STRATEGY AND INNOVATION COMMITTEE

Name	Post	Category
D. Peter Erskine	Chairman	Other external
D. José María Abril Pérez	Member	Proprietary
D. Juan Ignacio Cirac Sasturain	Member	Independent
Mr. Jordi Gual Solé	Member	Proprietary
D. Peter Löscher	Member	Independent
% of executive directors	0.00	%
% of proprietary directors	40.00	%
% of independent directors	40.00	%
% of other external directors	20.00	%

Explain the duties exercised by this committee, describe the rules and procedures it follows for its organization and function. For each one of these functions, briefly describe its most important actions during the year and how it has exercise in practice each of the functions attributed thereto by law, in the Articles of Association or other corporate resolutions.

See heading H “Other information of interest”. Note 6 to section C.2.1.

NOMINATING, COMPENSATION AND CORPORATE GOVERNANCE COMMITTEE

Name	Post	Category
Mr. Francisco Javier de Paz Mancho	Chairman	Independent
Mr. José Javier Echenique Landiribar	Member	Independent
Mr. Peter Erskine	Member	Other external
Ms. Sabina Fluxà Thienemann	Member	Independent
Mr. Luiz Fernando Furlán	Member	Independent
% of executive directors	0.00	%
% of proprietary directors	0.00	%
% of independent directors	80.00	%
% of other external directors	20.00	%

See heading H “Other information of interest”. Note 7 to section C.2.1.

2018 Management Report

REGULATION AND INSTITUTIONAL AFFAIRS COMMITTEE

Name	Post	Category
Mr. Ignacio Moreno Martinez	Chairman	Proprietary
Ms. María Luisa Garcia Blanco	Member	Independent
Mr. Jordi Gual Solé	Member	Proprietary
Mr. Francisco Javier de Paz Mancho	Member	Independent
% of executive directors	0.00 %	
% of proprietary directors	50.00 %	
% of independent directors	50.00 %	
% of other external directors	0.00 %	

Explain the duties exercised by this committee, describe the rules and procedures it follows for its organization and function. For each one of these functions, briefly describe its most important actions during the year and how it has exercise in practice each of the functions attributed thereto by law, in the Articles of Association or other corporate resolutions.

See heading H “Other information of interest”. Note 8 to section C.2.1.

EXECUTIVE COMMISSION

Name	Post	Category
Mr. José María Álvarez-Pallete López	Chairman	Executive
Mr. Isidro Fainé Casas	Vice Chairman	Proprietary
Mr. José María Abril Pérez	Vice Chairman	Proprietary
Mr. Ángel Vilá Boix	Member	Executive
Mr. José Javier Echenique Landiribar	Member	Independent
Mr. Peter Erskine	Member	Other External
Mr. Francisco Javier de Paz Mancho	Member	Independent
% of executive directors	28.57 %	
% of proprietary directors	28.57 %	
% of independent directors	28.57 %	
% of external directors	14.29 %	

Explain the duties exercised by this committee, other than those that have already been described in Section C.1.10, and describe the rules and procedures it follows for its organisation and function. For each one of these functions, briefly describe its most important actions during the year and how it has exercise in practice each of the functions attributed thereto by law, in the Articles of Association or other corporate resolutions.

The Board of Directors, always subject to the legal provisions in force, delegates all its powers to an Executive Commission, except those that cannot be delegated by Law, by the Corporate Bylaws, or by the Regulations of the Board of Directors.

The Executive Commission provides the Board of Directors with a greater efficiency and effectiveness in the execution of its tasks, since it meets more often.

2018 Management Report

Pursuant to the provisions of Article 38 of the Corporate Bylaws of Telefónica, S.A., Article 21 of the Regulations of the Board of Directors regulates the Executive Commission in the following terms:

a) Composition.

The Executive Commission shall consist of the Chairman of the Board of Directors, once appointed as a member of the Executive Commission, and not less than three or more than ten Directors appointed by the Board of Directors. The Board of Directors shall seek to have External Directors constitute a majority over the Executive Directors. In all cases, the affirmative vote of at least two-thirds of the members of the Board of Directors shall be required in order for the appointment or re-appointment of the members of the Executive Commission to be valid.

b) Operation.

The Executive Commission shall meet whenever called by the Chairman, and shall normally meet every fifteen days. The Chairman and Secretary to the Board of Directors shall act as the Chairman and Secretary to the Executive Commission. One or more Vice Chairmen and a Deputy Secretary may also be appointed.

A valid quorum of the Executive Commission shall exist with the presence, in person or by proxy, of more than one-half of its members.

Resolutions shall be adopted by a majority of the Directors attending the meeting (in person or by proxy), and in the case of a tie, the Chairman shall cast the deciding vote.

c) Relationship with the Board of Directors.

The Executive Commission shall report to the Board in a timely manner on the matters dealt with and the decisions adopted at the meetings thereof, with a copy of the minutes of such meetings made available to the members of the Board (Article 21.C) of the Regulations of the Board of Directors.

Most significant actions during the year and exercise of its duties.

During the 2018 year, the Executive Commission of the Board of Directors of Telefónica, S.A. has analyzed and reviewed, and deliberated upon and adopted resolutions (which have been ratified by the Board of Directors of the Company), on a range of matters concerning, inter alia:

- The business activity performed by the Telefónica Group: i) products and services (E2E Digitalization, Internet of Things, Security B2B, Network, Terminals, Business Intelligence, Big Data, voice and data services, video, etc.), ii) business performance in the countries in which the Telefónica Group operates, and iii) operational trends.
- Status of regulations in the telecommunications sector (such as regulatory amendments and spectrum auctions).
- Financing transactions of the Telefónica Group.

2018 Management Report

C.2.2 Complete the following table with information regarding the number of female directors who were members of Board committees at the close of the past four years:

	Number of female directors			
	2018 Year Number %	2017 Year Number %	2016 Year Number %	2015 Year Number %
Audit and Control Committee	1 (25.00%)	1 (25.00%)	0	0
Service Quality and Customer Service Committee	2 (50.00%)	2 (66.67%)	1 (20.00%)	1 (14.29%)
Strategy and Innovation Committee	0	1 (20.00%)	1 (14.29%)	0
Nominating, Compensation and Corporate Governance Committee	1 (20.00%)	1 (20.00%)	1 (20.00%)	0
Regulation and Institutional Affairs Committee	1 (25.00%)	1 (33.33%)	1 (16.67%)	0
Executive Commission	0	0	0	0

C.2.3 State, where applicable, the existence of any regulations governing Board committees, where these regulations may be found, and any amendments made to them during the year. Also state whether any annual reports on the activities of each committee have been voluntarily prepared.

The organization and operation of the Board of Directors Committees is governed under the regulations of the Board of Directors. Additionally and in particular, the Executive Commission is regulated under article 38 of the corporate bylaws; the Audit and Control Committee under article 39 of the corporate bylaws and the regulations of the Audit and Control Committee (approved by the Company Board of Directors at its meeting held on December 13, 2017, based on the recommendation of the Audit and Control Committee); and the Nominating, Compensation and Corporate Governance Committee under article 40 of the aforementioned bylaws. These documents are available for perusal on the Company website.

As mentioned in Section C.2.1 above, the Board Committees draw up an Activities Report (where, in the case of the Audit and Control Committee and the Nominating, Compensation and Corporate Governance Committee, the Operating Report is named), summarizing the main activities and actions taken during the year detailing the issues discussed at their meetings and highlighting certain aspects regarding their powers and duties, composition and operation.

Specifically, and with respect to the Nominating, Compensation and Corporate Governance Committee (in accordance with that established in Recommendation 6 of the Good Governance Code of the listed companies), and the Audit and Control Committee (in accordance with that established in Recommendation 6 of the Good Governance Code of the listed companies, in Section 79 of Technical Guide 3/2017 of the Spanish National Securities Market Commission regarding Audit Committees of Public Interest Companies, and in Article 9 of the regulations of the Audit and Control Committee of Telefónica, S.A.), an Operation Report is prepared annually. This report is published on the Company website well before the General Shareholder's Meeting is held.

2018 Management Report

D. RELATED-PARTY AND INTRAGROUP TRANSACTIONS

D.1. Describe, if applicable, the procedure for approval of related-party and intragroup transactions .

The Article 5 of the Regulations of the Board of Directors includes a number of powers of the Board which cannot be delegated, including the following:

The approval, based on a favorable report by the Audit and Control Committee, of the transactions which the company carries out with directors, significant shareholders or representatives on the board, or related parties. Also, as set forth in Article 30.f) of the Regulations of the Board of Directors, Directors shall not directly or indirectly enter into professional or commercial transactions with the Company or with any of the companies of the Group, if such transactions are unrelated to the ordinary course of business of the Company or not performed on an arm's length basis, unless the Board of Directors is informed thereof in advance and, on the recommendation of the Audit and Control Committee, it approves the transaction upon the affirmative vote of at least 90% of the Directors (present in person or by proxy).

Also, the Article 38 of the Regulations of the Board of Directors specifically regulates transactions performed with significant shareholders, and establishes that the Board of Directors, based on a favorable report by the Audit and Control Committee, will approve the transactions which the Company or its Group perform with directors, individual or together with others, of a significant shareholding, including shareholders represented in the Board of Directors of the Company or other Group companies or with persons related to them, unless this power is attributable by law to the General Shareholders Meeting.

Directors affected or which represent or which are related to affected shareholders will have to refrain from taking part in the deliberation and voting on the resolution in question.

This approval does not include transactions which, according to prevailing laws, do not require such approval or exemption, i.e. according to Article 529 ter of the Spanish Corporations Act, the transactions which simultaneously fulfill the three following requirements:

- 1.º they are performed by virtue of contracts whose conditions are standardized and are applied on an across-the-board basis to a large number of clients,
- 2.º they are performed at prices or tariffs generally set by the person supplying the goods or services, and
- 3.º their amount is not more than one per cent of the company's annual revenues.

The transactions referred to above shall be assessed from the point of view of equal treatment of shareholders and the arm's-length basis of the transaction, and shall be included in the Annual Corporate Governance Report and in the periodic public information of the Company upon the terms provided by law.

For the transaction to be approved, it will be necessary to ensure that the transaction does not compromise the capital, or, if applicable, that it is performed on an arm's-length basis and that the process is transparent.

Only where there are imperative grounds of urgency, duly justified, decisions mentioned above could be adopted by delegated bodies or persons, and subsequently ratified by the Board of Directors (Article 5.5 of the Regulations of the Board of Directors).

D.2 Describe any transactions which are significant, either because of the amount involved or subject matter, entered into between the company or entities within its group and the company's significant shareholders: .

Edgar Filing: TELEFONICA S A - Form 6-K

2018 Management Report

Name of significant shareholder	Name of company within the group	Nature of the relationship	Type of transaction	Amount (thousand euros)
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Interest paid	10,779
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Receipt of services	1,613
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Others	11,040
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Finance arrangements: Loans	261,748
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Guarantees	322
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Finance Arrangements: others	595,459
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Dividends and other distributed earning	123,650
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Interest paid	26,013
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Operating lease agreements	57
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Receipt of services	3,980
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Interest charged	41,948
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Services rendered	25,702
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Sale of goods (finished or in progress)	2,561
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Others	645,675
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Finance Arrangements: Loans	44,430
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Guarantees	201,432
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Purchase options commitments	218
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Operating lease contracts	17
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Remunerations	3,580
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Collaboration agreements	405
CaixaBank, S.A.	Telefónica, S.A.	Contractual	Interest paid	7,202
CaixaBank, S.A.	Telefónica, S.A.	Contractual	Receipt of services	1,293
CaixaBank, S.A.	Telefónica, S.A.	Contractual	Finance arrangements: Loans	270,660
CaixaBank, S.A.	Telefónica, S.A.	Contractual	Guarantees	8,231
CaixaBank, S.A.	Telefónica, S.A.	Contractual	Finance arrangements: Loans	890,958

Telefónica, S.A. 191

2018 Management Report

CaixaBank, S.A. Telefónica, S.A.	Contractual Dividends and other distributed earnings	104,955
CaixaBank, S.A. Rest of Telefónica Group	Contractual Interest paid	1,774
CaixaBank, S.A. Rest of Telefónica Group	Contractual Receipt of services	4,625
CaixaBank, S.A. Rest of Telefónica Group	Contractual Services rendered	60,104
CaixaBank, S.A. Rest of Telefónica Group	Contractual Sale of goods (finished or in progress)	48,197
CaixaBank, S.A. Rest of Telefónica Group	Contractual Operating lease contracts	9,893
CaixaBank, S.A. Rest of Telefónica Group	Contractual Guarantees	96,192
CaixaBank, S.A. Rest of Telefónica Group	Contractual Purchase options commitments	93,685
CaixaBank, S.A. Rest of Telefónica Group	Contractual Other	300,010
CaixaBank, S.A. Rest of Telefónica Group	Contractual Purchase of goods (finished or in progress)	60,473

Remarks

It is important to note that:

Transactions included in this section under 'Other', amounting to 11,040 with Banco Bilbao Vizcaya Argentaria, S.A. refer to Dividends received.

Transactions included in this section under 'Other', for the sum of 645,675 with Banco Bilbao Vizcaya Argentaria, S.A. refer to Other Revenues (2,794), to Other Expenses (75), to Gains from derecognition or disposal of assets (8), and to Outstanding factoring operations (642,798).

Transactions included in this section under 'Other', for the sum of 300,010 with CaixaBank, S.A., refer to Other Expenses (10) and to Outstanding factoring operations (300,000).

In addition, the nominal value of outstanding derivatives held with Banco Bilbao Vizcaya Argentaria, S.A. and CaixaBank, S.A. in 2018 amounted to 17,962 and 543 million euros, respectively. As explained under Derivatives policy in Note 17, 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 is 428 and -10 million euros, respectively at December 31, 2018. Additionally, at December 31, 2018, collateral guarantees on derivatives from BBVA and la Caixa have been received, amounting to 8 and 6 million euros, respectively.

On the other hand, in July 2018, there was a non-extinguishing modifying novation of the investment and agreement between shareholders related to Telefónica Consumer Finance, E.F.C., S.A. signed between Telefónica, S.A., CaixaBank Consumer Finance, E.F.C., S.A. (formerly Finconsum, E.F.C., S.A.) and CaixaBank, S.A. on 6 September 2013, adhered to by Telefónica Consumer Finance, E.F.C., S.A. on 6 February 2014 (the "Novation of the Agreement of Investment and Contract between Shareholders"), in order to implement as an activity of Telefónica Consumer Finance, E.F.C., S.A. the granting of financing products from users from the universe of customers of the Telefónica Group in Spain, as well as for the corporate governance of Telefónica Consumer Finance, E.F.C., S.A. to adapt to the new regulatory framework applicable to the Financial Credit Institutions.

Similarly, in September 2018, a statement of intent was signed between Telefónica Digital España, S.L.U. and Banco Bilbao Vizcaya Argentaria, S.A., in order to explore a potential partnership to offer financing to consumers, the self-employed and small companies in Argentina, Colombia, Peru and Mexico.

2018 Management Report

Likewise, in December 2018 a financial collaboration agreement was signed between Telefónica, S.A. and Banco Bilbao Vizcaya Argentaria, S.A., with special conditions for employees, pensioners and early-retirees of the Telefónica Group.

D.3 Describe any transactions that are significant, either because of their amount or subject matter, entered into between the company or entities within its group and directors or managers of the company:

D.4 Report any material transactions carried out by the company with other entities belonging to the same group, provided that these are not eliminated in the preparation of the consolidated financial statements and do not form part of the company's ordinary business activities in terms of their purpose and conditions.

In any event, note any intragroup transaction conducted with entities established in countries or territories which are considered tax havens:

D.5 State the amount of any transactions conducted with other related parties that have not been reported in the previous sections.

Telefónica, S.A. 193

2018 Management Report

Name of entity within the group	Brief description of the transaction	Amount (thousand euros)
China Unicom	As stated in Note 10 ("Related Parties") of the consolidated accounts of Telefónica, S.A. corresponding to the year 2018, in 2015 a "joint venture" with China Unicom was incorporated, for the development of Big Data Services in China, using the "Smart Steps" technology developed by Telefónica. Telefónica's stake in this Company is 45% through Telefónica Digital España, S.L., with China Unicom Big Data Limited Corporation owning the remaining 55% stake. In 2018 this company obtained a turnover equivalent to 10 million euros. Similarly, the operation consisting of the entry of the company Beijing Jingdong Financial Technology Holding Co., Ltd., controlled by JD.com, in the aforementioned "joint venture" was approved in December 2018, which will result in a capital increase fully to subscribe by Beijing Jingdong Financial Technology Holding Co., Ltd. (17%, approximately) with the consequent dilution of the current shareholders (Telefónica will held about 33%, approximately).	0
Grupo Global Dominion Access	As stated in note 10 ("Related Parties") of the consolidated annual accounts of Telefónica, S.A. corresponding to the year 2018, certain subsidiary companies of the Telefónica Group, in conjunction with the Global Dominion Access Group in the year 2018, transactions arising from the Group's ordinary traffic or business, mainly Telefónica de España, for a total of €25 million.	25.000

D.6. Describe the mechanisms in place to detect, determine and resolve potential conflicts of interest between the company and/or its group and its directors, senior management or significant shareholders.

See heading H "Other information of Interest", Note 11 to Section D.6.

D.7 Is there more than one company in the group listed in Spain?

No

2018 Management Report

E. RISK MANAGEMENT AND CONTROL SYSTEMS

E.1 Explain the scope of the company's Risk Management and Control System, including tax compliance risk. Telefónica continually monitors the most significant risks in the main companies comprising its Group. The Company therefore has a Corporate Risk Management Framework, based on the model established by the Treadway Commission's Committee of Sponsoring Organizations (COSO), that allows to evaluate both the impact and the probability of occurrence of the different risks. Likewise, Telefónica continues working on the alignment of its framework with the updated COSO ERM Framework ("Enterprise Risk Management - Integrating with Strategy and Performance"), released in September 2017.

The risk management and control process takes as a starting reference the strategy and the objectives of the Company, as a basis for identifying the main risks, which may affect the achievement of these objectives. Once identified, the risks are evaluated in a qualitative and/or quantitative way in order to prioritize the follow-up and response to them, either through mitigation plans or actions to avoid or transfer those risks.

In order to have a comprehensive model, oriented to the Group's needs and configuration, the Telefónica Risk Management Framework considers a risk assessment with four complementary perspectives: overall (top-down), local (bottom-up) and cross-sectional (projects and processes).

In accordance with this Framework, and based on best practices and benchmarks in risk management, the following four risk categories have been identified:

• **Business risk:** Possible loss of value or earnings resulting from changes in the business environment, the competition and market scenario, the regulatory framework or the strategic uncertainty.

• **Operational risk:** Possible loss of value or earnings as a result of events caused by inadequacies or failures in the network or the IT systems, security, customer service, supply chain, human resources, as well as operational management.

• **Financial risk:** Possible loss of value or earnings as a result of adverse movements in financial variables and the inability of the Company to meet its obligations or convert its assets into cash. Additionally, the risks of a fiscal nature are included in this category.

• **Global risk:** Possible loss of value or earnings as a result of events that affect in a transversal way the entire Telefónica Group, including sustainability and compliance issues.

E.2 Identify the bodies within the company responsible for creating and executing the Risk Management and Control System, including tax compliance risk.

In accordance with the Regulations of the Board of Directors of Telefónica S.A., the primary duty of the Audit and Control Committee shall be to support the Board of Directors in its supervisory duties, including the supervision of risk management and control systems, including tax risks. With respect thereto, it shall be responsible for proposing to the Board of Directors a Risk Management and Control Policy, which shall identify at least the following: the types of risk facing the company; the setting of the risk level that the Company deems acceptable; the measures to mitigate the impact of the identified risks, should they materialize; and the control and information systems to be used to control and manage the above-mentioned risks.

As stated by the Group's Risk Management and Control Policy, approved by the Board of Directors, various local and corporate units are involved in the risk management and control process.

The entire organization is responsible for contributing to the identification and management of risks, following the procedures defined to implement and ensure the effectiveness of the Group's risk management and control processes.

2018 Management Report

There is a function independent of the management, within the Internal Audit area, which has an overall structure and local responsible persons, whose mission is to promote, support, coordinate and monitor the implementation of the provisions of this Policy, both at Group level and in its main operations, also assisting the Audit and Control Committee with whatever issue it deems appropriate.

The Group's Fiscal Control Policy, approved by the Board of Directors of the Company in February 2012 and updated in December 2016, establishes the rules for the prevention and management of fiscal risk. The development of the fiscal control function corresponds to the Group's Fiscal Management, which performs this task through the Regional Fiscal Directorates and the local fiscal control officers in the different subsidiaries in accordance with the principles defined in said document.

E.3 State the primary risks, including tax compliance risks, and those deriving from corruption (with the scope of these risks as set out in Royal Decree Law 18/2017), to the extent that these are significant, which may affect the achievement of business objectives.

Information regarding this point is contained in the Annex to this Report.

E.4 State whether the entity has a risk tolerance level, including tolerance for tax compliance risk.

The Company has a level of risk tolerance or acceptable risk level established at a corporate level. This threshold represents the extent to which it is prepared to assume a certain level of risk, insofar as it may contribute to generating value and developing the business, achieving an appropriate balance between growth, performance and risk.

The range of risks to which the Company may be exposed, described below, is considered when evaluating risk: Generally, albeit mainly related to operational and business risks, tolerance thresholds are defined pursuant to the impact and probability of the risk. These thresholds are revised annually based on the performance of the main financials for both the Group as a whole and the business lines and main companies therein.

The tolerance level for financial risks (including fiscal risks) is set in terms of their economic impact.

A zero-tolerance level is established for global risks, principally those affecting reputation, corporate responsibility and compliance.

E.5 State which risks, including tax compliance risks, have materialised during the year.

The strategy and management of the Telefónica Group's activities tend to minimize the impact of the risks, as well as to counterbalance the negative effects of some issues with the favourable evolution of others.

The Telefónica Group reviews on an annual basis, or more frequently when the circumstances require it, the value of assets and cash-generating units, to assess whether their carrying values can be supported by the future expected cash flows, including, in some cases synergies allowed for in acquisition costs. Potential changes in the regulatory, business, economic or political environment may result in the need to introduce changes to estimates made and to recognize impairments in goodwill, intangible assets, property, plant and equipment or financial assets. Although the recognition of impairments of these assets results in a non-cash charge on the income statement, it could adversely affect the results of the Telefónica Group's operations.

In 2018 an impairment of the total goodwill allocated to Telefónica Móviles México has been recognized amounting to 350 million euros. During 2018, the macroeconomic and financial conditions in Mexico changed, which was reflected in the different risk premiums that are taken into account when computing WACC. In this context, the estimated WACC increased to 10.6% (from 9.5% used in the valuation at the end of 2017). Higher competitive market intensity during 2018 has compounded the macroeconomic situation, mainly in the prepayment segment.

Further details on Income tax matters are provided by Telefónica in its Annual Accounts (Note 17 of the Individual and Note 22 of the Consolidated Financial Statements).

2018 Management Report

E.6 Explain the response and monitoring plans for all major risks, including tax compliance risks, of the company, as well as the procedures followed by the company in order to ensure that the board of directors responds to any new challenges that arise.

The Corporate Risk Management Framework, which has been devised in accordance with the main international best practices and guidelines, involves identifying and evaluating risks to respond to and monitor them. As indicated above, Telefónica's risk management and control model considers its evolution in accordance with the provisions of the COSO ERM framework, "Enterprise Risk Management - Integrating with Strategy and Performance" of 2017 and, in this sense, it contemplates procedures to respond to the new challenges that arise through the alignment between the strategic objectives and the risks that could affect the fulfillment of such objectives.

Given the diverse range of risks, the mechanisms for responding to risks include overarching initiatives that are developed and coordinated as standard across the Group's main operations and/or specific measures aimed at managing certain risks at company level.

Global measures, mainly involving the use of financial derivatives, are undertaken to mitigate certain financial risks such as those relating to exchange-rate and interest-rate fluctuations. In relation to tax risks, the main issues are identified and monitored. The Group uses Multinational insurance Programs, or insurance policies arranged locally in each country, to cover operational risks, depending on the type of risk and cover required.

As indicated above, the Regulations of the Board of Directors of Telefónica S.A. establish that the Audit and Control Committee will have as its primary function to support the Board of Directors in its supervisory duties, including the supervision of the risk management and control systems, including tax risks. In this sense, the Board of Directors, through the Audit and Control Committee, is periodically informed of the main risks of the group, as well as the response strategies and the associated mitigation plans. Likewise, the Audit and Control Committee periodically reports on these matters to the Board of Directors. Also, specific presentations are made by those responsible for the main areas of risk and the evolution and strategies followed.

2018 Management Report

F. INTERNAL RISK MANAGEMENT AND CONTROL SYSTEMS RELATED TO THE PROCESS OF PUBLISHING FINANCIAL INFORMATION (ICFR)

Describe the mechanisms comprising the System of Internal Control over Financial Reporting (ICFR) of your company.

F.1 Control environment

Report on at least the following, describing their principal features:

F.1.1 The bodies and/or departments that are responsible for (i) the existence and maintenance of an adequate and effective ICFR; (ii) their implementation; and (iii) their supervision.

The Board of Directors of Telefónica, S.A. (hereinafter "Telefónica" or the "Company") assumes ultimate responsibility of ensuring that an adequate and effective system of internal control over financial reporting (ICFR) exists and is updated.

The Board of Directors is, in accordance with prevailing laws and the Bylaws, the highest administrative and representative body of the Company, and basically consists of a supervisory and control body, while the executive bodies and management team are responsible for the day-to-day management of the Company's businesses.

The Bylaws and Regulations of the Board of Directors state that the primary duty of the Audit and Control Committee shall be to support the Board of Directors in its supervisory duties. Specifically, highlighting, among others, the following powers and duties:

i. Submitting to the Board of Directors proposals for the selection, appointment, re-election and replacement of the external auditor, being responsible for the selection process in accordance with the provisions of the law, as well as the conditions of their engagement, and regularly collecting information from the auditor of the audit plan and its execution, in addition to preserving its independence in the exercise of its functions.

ii. Supervise the internal audit, and, in particular:

a) Ensure the independence and effectiveness of the internal audit function;

b) Propose the selection, appointment and removal of the person responsible for the Internal Audit service;

c) Propose the budget for that service;

d) Review the annual work plan of the internal audit and the annual activity report;

e) Receive periodic information on their activities; and

f) Verify that senior management takes into account the conclusions and recommendations of its reports.

Supervise the process of preparing and presenting the mandatory financial information and submit recommendations or proposals to the administration body aimed at safeguarding its integrity. In relation to this, it is responsible for supervising the process of preparation and integrity of the financial information relating to the Company and the Group, reviewing compliance with the regulatory requirements, the appropriate delimitation of the consolidation perimeter, and the correct application of the accounting criteria, reporting to the Board of Directors.

Supervise the effectiveness of the Company's internal control, internal audit and risk management systems, including fiscal ones, as well as discuss with the Auditor Accounts the significant weaknesses of the internal

2018 Management Report

control system detected in the performance of the audit, without breaking their independence. To this end, where applicable, it may submit recommendations or proposals to the Board of Directors and the corresponding deadline for their follow-up. Additionally, the Board of Directors is the responsible to propose the Risk Control and Management Policy, which will identify, at least:

- a) Risk types (at least, operational, technological, financial, legal and reputational) which the Company faces;
- b) Setting of the level of risk which the Company considers acceptable; the measures for mitigating the impact of the identified risks should they materialize; and
- c) Control and information systems to be employed to control and manage those risks.

Establish and supervise a system that enables employees to communicate, in a confidential and anonymous manner, v. irregularities of potential importance, especially financial and accounting irregularities, that may be noticed within the Company.

Establish and maintain the opportune relations with the Auditor to receive information on those issues that may be a threat to the independence of the Auditor, for examination by the Commission, and any other related to the process of developing the audit of accounts, and, when applicable, the authorization of services other than those prohibited, in the terms stated in the applicable legislation, as well as other communications included in the vi. legislation on audit of accounts, and in the auditing standards. In any case, the Audit and Control Committee shall receive annually from the Auditor the declaration of its independence in relation to the entity or entities linked to it directly or indirectly, as well as the detailed and individualized information of the additional services of any type provided and the corresponding fees received from these entities by the aforementioned Auditor, or by the persons or entities linked to them in accordance with the provisions of current regulations.

Issue on an annual basis, prior to the issuance of the accounts audit report, a report expressing an opinion on whether the Auditor's independence is compromised. This report must conclude, in any case, on the reasoned vii. assessment of the provision of each and every one of the additional services referred to in point vii above, individually considered and as a whole, other than the legal audit and in relation to the independence regime or with the regulations governing the activity of the accounts audit.

Analyse and report the economic conditions, the accounting impact and, if applicable, the exchange ratio viii. proposed for the operations of structural and corporate modifications that the Company plans to carry out, before being submitted to the Board of Directors.

ix. Inform, in advance, to the Board of Directors, on all matters stated in the law and the Bylaws, and, in particular, on:

1. The financial information that the Company must periodically publish;
2. The creation or acquisition of participations in special purpose entities or domiciled in countries or territories that are considered tax havens; and
3. Transactions with related parties.

To exercise, regarding those companies of its Group which are considered Public Interest Entities (as they are defined in the current legislation) as approved by the Board of Directors, provided that they are fully owned, x. directly or indirectly, by the Company, in accordance with the provisions of current legislation, and which are not attributed to a Board of Directors, all the functions of the Audit Committee contemplated at any time by current legislation.

The provisions abovementioned are understood without prejudice to the regulations governing the audit of accounts.

2018 Management Report

According to the Regulation of the Board of Directors, the Audit and Control Committee must meet at least once every quarter. In practice, the Committee meets approximately thirteen times throughout the year.

To carry out this supervisory function, the Audit and Control Committee is assisted by the entire Company management, including Internal Audit.

Thus, Internal Audit becomes an independent area in the management of the Company, supporting the Audit and Control Committee in its competences on assurance, risk management, and the internal control system. For this purpose, Internal Audit applies a systematic and orderly approach by the following main lines of action:

• Coordination and review of the consistency of the Internal Regulations of the Telefónica Group.

• Coordination and supervision of the Risk Management System.

• Ongoing Audit.

• Supervision of controls on outflows.

• Reviews or specific audits on the Company processes. Among these activities, the following are included:

• Audits on the internal control over financial reporting, required by the Sarbanes Oxley Act to the US listed

i) companies which also covers the assessment on the system of internal control over financial reporting (ICFR) for companies listed in Spain;

ii) Audits on the efficiency and effectiveness of the design and execution of the controls in processes; and

iii) Other audits or specific reviews for compliance across the Telefónica Group.

• Reviews or specific audits on the operations and security of networks and information technologies.

• Perform other audits or specific reviews, of interest for the board of directors or the top management of the Company.

All the different areas and functional units of the Telefónica Group are important in ICFR (internal control over financial reporting), the Finance and Control area playing a key role, as they are responsible for preparing, maintaining and updating the different procedures that govern their operations and identify the tasks to be carried out, as well as the persons in charge for executing these tasks.

F.1.2 State whether the following are present, especially if they relate to the creation of financial information:

Departments and/or mechanisms in charge of: (i) design and review of corporate structure; (ii) clear definition of lines of responsibility and authority with an adequate distribution of tasks and functions; and (iii) assurance that adequate procedures exist for proper communication throughout the entity.

The Board of Directors is responsible for designing and reviewing the Company's organizational structure, ensuring there is an adequate separation of functions and that satisfactory coordination mechanisms among the different areas are established. The People Division carries out the deployment of the organizational structure in the respective fields.

Use of the Telefónica Group's economic-financial information system is regulated through several manuals, instructions and internal rules and regulations, internally made available, the most noteworthy of which are as follows:

Corporate Regulations on the Control, Registration and Reporting of Financial and Accounting Information of the Telefónica Group, which set out the basic principles of the financial and

2018 Management Report

accounting reporting system of the Group, and the procedures and mechanisms in place to oversee this system. Accounting Policies Manual, under IFRS, based on IFRS (International Financial Reporting Standards), designed to unify and homogenize the accounting policies and criteria used by all the Group companies to ensure Telefónica operates as a consolidated and homogeneous group.

Reporting and external audit instructions, they are published on a quarterly basis and are intended to establish procedures and a calendar to be followed by all the Companies of the Telefónica Group and by their external auditors in the reporting of the financial-accounting information and results of the processes of external audit at the closing of each period, to comply with legal and information obligations of Telefónica, both in Spain and in the rest of the countries where Telefónica's Group shares are listed.

Manual for Completion of the Reporting for Consolidation of the Telefónica Group, which is updated at least annually and establishes specific instructions completing the reporting forms necessary for the preparation of consolidated financial statements and interim consolidated financial information.

Annual calendar of financial accounting information, applicable to all Telefónica Group companies to establish from the start of each period the monthly accounting-financial information reporting dates.

Corporate Accounting Plan ("PCC"), which consists of the following documents: a) Table of accounts; b) Manual of definitions and Accounting Relations; and c) Auxiliary tables. The PCC intends to homogenize the sources of financial information included in the accounts of all the Telefónica Group companies, mandatory for all Companies in the Telefónica Group

Corporate Regulations on Intragroup Operations (NCC-006), mandatory for all companies in the Telefónica Group, and whose purpose is to recast in a specific regulation the criteria of mandatory compliance with regard to the accounting register and payment of transactions between companies in the Group and reinforce controls to avoid non-compliance cases.

These documents define and delimit responsibilities at each level of the organization regarding the reliability of the information published.

Additionally, the Management levels of the Company are available on the Group Intranet.

Code of conduct, the body approving this, degree of dissemination and instruction, including principles and values, (state if there is specific mention of transaction recording and creation of financial information), a body charged with analyzing breaches and proposing corrective actions and sanctions.

With regard to the Code of Conduct, the Board of Directors of Telefónica approved, in December 2006, the unification of the Codes of Ethics of the Group's companies, in the so-called Business Principles. The Business Principles are applied as a standard in all countries where the Telefónica Group operates and apply to all its employees (the Business Principles affect at all levels of the organization, directors and non-directors).

In 2017, the Board of Directors approved a new version of the Principles which includes an update of the commitments in matters of privacy and security, compliance and fiscal transparency, responsible communication and protection of minor stockholders, among others.

The Responsible Business Principles emanate from three basic values: integrity, commitment and transparency, which are essential values to ensuring the trust that Telefónica wants with its groups of interest.

Regarding the financial information, the following principles are set:

Transparency of the information: we shall provide, immediately and without discrimination, all the relevant information. We are conscious of the importance for all our groups of interest of sharing true,

2018 Management Report

complete, opportune and clear information in the reports registered with the relevant Supervising Bodies of the Stock Markets, and in other public communications of the company as well.

Privileged Information: we abstain from using, in our profit or for third parties any privileged information, safeguarding the confidentiality and establishing the controls and processes legally required by the Supervising Bodies of the Stock Markets in all the actions related to those markets.

The Responsible Business Principles are available to all employees via the intranet, and there are update, monitoring and communication procedures of these principles inside the Telefonica Group. Likewise, training programmes are also regularly organized to ensure employees are aware of these rules and Principles.

In this respect, Telefónica has a Corporate Policy on the Integral Discipline Program which intends to define the basic principles of the Group's disciplinary system, providing for homogeneous, objective, proportional and non-arbitrary treatment of all employees, without prejudice to and with absolute respect for the legislation and regulations applicable in each case to the Group companies in the different countries in which they operate.

Telefónica has an Office of Responsible Business Principles, which comprises the most senior representatives of the General Secretary's and Regulation Office, Human Resources, Public Affairs, Chief Commercial Digital Officer (CCDO), Operations, Purchases, Compliance, Internal Audit, Corporate Ethics and Sustainability, Security and Chief Data Officer (CDO).

Among the responsibilities of this Office, the following stand out:

- Guaranteeing that Telefónica conducts business in an ethical and responsible manner, through the follow-up and monitoring of the Responsible Business Plan.

- Propose and supervise initiatives and measures that contribute to compliance with the Principles of Responsible Business in the Group.

- Analyse any matters or proposals in the Group that could represent a risk to the Business Principles and associated policies.

On a different issue should any type of conduct which does not comply with applicable laws, the Responsible Business Principles or internal regulations come to light, then, after the pertinent analysis, disciplinary measures will be applied in accordance with the regime established in the applicable labour laws, distinguishing between minor, serious and very serious sanctions, depending on the circumstances.

Telefónica also has an "Internal Code of Conduct" for Securities Markets issues, last updated on December 14, 2016, setting out the general guidelines and principles of conduct for the persons involved in securities and financial instrument transactions entered into by the Company and its subsidiaries.

Whistleblower channel, that allows notifications to the audit committee of irregularities of a financial and accounting nature, in addition to potential breaches of the code of conduct and unlawful activities undertaken in the organization, reporting, as the case may be, if this is of a confidential nature.

With regard to the whistle-blowing channel, as specified in Article 22 of Telefónica, S.A.'s Regulations for the Board of Directors, and in Article 4 of Regulation for the Audit and Control Committee, this Committee's duties include: "Establishing and maintaining a mechanism to allow employees to confidentially and anonymously report potentially significant irregularities, particularly any financial or accounting irregularities detected within the Company".

The Telefónica Group has a Policy of Management of the Whistleblowing Channel where the basis of the Whistleblowing Channel of the Group are set, by which employees and top managers at the Telefónica Group can communicate any information they become aware of, by any means -formal or not- about the existence of any possible irregularities, acts contrary to legality or the internal regulations; also including eventual irregularities referring to accounting issues, auditing and/or aspects related to the internal control on financial reporting, complying with section 301 of Sarbanes-Oxley Act of the U.S. and other requirements in this sense.

2018 Management Report

In the Management of the Whistleblowing Channel apply the confidentiality principles of data provided and declarations made, respect and legal basis; so that any decision taken from the reception of a Whistleblow will be reasoned, proportionate and considering the circumstances of the facts denounced, with full respect to the rights and due guarantees for the whistle-blower and the persons affected if there were any.

Any complaint referred to issues about accounting aspects, auditing matters, internal controls on financial Reporting and/or relative to all those questions referred to in the Sarbanes Oxley Act, including any fraud, material or not, affecting the Directorship, and affecting any society in the Group - as well as the result of the Management derived from the audit itself derived in these cases- will be received, in the first instance, by the means established in this Policy, by the Audit and Control Commission of the Board of Directors of Telefónica, and will be forwarded to, when appropriate, the equivalent bodies in other societies in the Group that could be subject in a direct manner to the requirements of the Sarbanes Oxley Act. This transfer will be made through the Internal Audit area and in accordance to the procedure that, to this effect, is set, considering the characteristics of the societies affected and, particularly, in its condition of listed company.

Training and refresher courses for personnel involved in preparing and reviewing financial information or evaluating ICFR, which address, at least, accounting rules, auditing, internal control and risk management.

With regard to employee training in financial and control issues, we would note that in 2007 the Telefónica Corporate University (Universitas Telefónica) was opened to help contribute to the Telefónica Group's advancement through lifelong learning. All the University's training programs are based on developing the corporate culture, the business strategy and management and leadership skills.

Likewise, the Consolidation and Accounting Polices Area offers training plans and seminars to all personnel working in the Group's financial areas and other pertinent areas (tax, M&A, etc.), with the aim of informing them of any accounting or financial changes which are applicable to their job of preparing consolidated financial information. This area also publishes IFRS (International Financial Reporting Standards) information bulletins summarizing the main changes to accounting methodology, as well as clarifications on various other related issues.

Financial reporting personnel also attend technical sessions run by external consultancy firms and covering developments in accounting.

Lastly, the Telefónica Group also has an on-line training platform included in the tool Corporate Human Resource management (Success Factor), which includes a finance school providing specific training and refresher courses on financial information, as well as an internal control school providing instruction on auditing, internal control and risk management.

F.2. Risk assessment in financial reporting

Report, at least:

F.2.1 The main characteristics of the risk identification process, including risks of error or fraud, stating whether:

☑ The process exists and is documented.

Given the vast number of processes involved in financial reporting of the Telefónica Group, a model has been developed to select the most significant processes by applying a so-called Scope Definition Model, which is a part of the internal methodology of internal control audit over financial information. This model is applied to the financial information reported by subsidiaries companies. The model selects the significant sections, i.e., those accounts with the largest contribution to the Group's consolidated financial information and then identifies the processes used to generate this information. Once the relevant processes have been identified, an analysis of those that have the most relevant impact on the significant sections is performed, reviewing the effectiveness of the design and the operation of the key controls that address the main risks or the associated "financial information objectives".

2018 Management Report

- The process covers all financial reporting objectives, (existence and occurrence; completeness; valuation; presentation, disclosure and comparability; and rights and obligations), is updated and with what frequency. The procedure for identifying and reviewing key controls covers the objectives of the information financial (also called financial premises) of accuracy, valuation, integrity, cut of operations, existence / occurrence, presentation and comparability, as well as breakdown, and rights and obligations. This identification of the key controls, intended to address the aforementioned premises of the significant headings and relevant processes in the scope, is carried out annually. The analysis process is carried out annually, following up during the year to identify relevant changes that must be duly addressed.

A specific process is in place to define the scope of consolidation, with reference to the possible existence of complex corporate structures, special purpose vehicles, holding companies, etc.

In the process of identifying the consolidation scope, the Finance and Control Areas regularly updates the consolidation scope, verifying additions and removals of companies with the legal and financial departments of the different companies which are part of the Group, including the corporate departments.

- The process addresses other types of risk (operational, technological, financial, legal, fiscal, reputational, environmental, etc.) insofar as they may affect the financial statements.

Telefónica monitors permanently the most significant risks that may affect the main societies comprising the Group. For that, the Company has a Corporate Risk Management Model based on COSO (Committee of Sponsoring Organizations, of the Treadway Commission). Work on the alignment of the Telefónica risk management and control model to the COSO ERM -“Enterprise Risk Management - Integrating with Strategy and Performance”- framework published in September 2017 continues.

The risk management and control process takes as a starting point of reference the strategy and the objectives of the Company, as a basis for the identification of the main risks that may affect its attainment. Once identified, the risks are evaluated in a qualitative and/or quantitative manner with a view to prioritizing their monitoring and response to them, either with mitigation plans or with actions to prevent or transfer those risks.

In order to have an integral model, oriented to the Group needs and its own configuration, the Model of Telefónica contemplates a risk assessment with four complementary perspectives: global (top-down), local (bottom-up) and cross (in projects and by processes).

According to this Model, and based on the references and practices recognized in risk Management, four risk categories have been defined:

Business: possible loss of value or results derived from changes in the business environment, the situation of the competence and the market, changes in the regulations framework or strategic uncertainty.

Operational: possible loss of value or results derived from events caused by the inadequacy or failures from the networks or computing systems, security, customer care, the supply chain, human resources, as well as operating management.

Financial: possible loss of value or results derived from the adverse movements in financial variables, and the inability of the company to face its commitments or liquidate assets. Likewise, risks of a fiscal nature are also included in this category.

Global: possible loss of value or results derived from the events that affect in a cross-cutting manner the Telefónica Group, including sustainability and compliance issues.

Which of the company’s governing bodies is responsible for overseeing the process.

Pursuant to the provisions of Article 22 of the Regulation of the Board of Directors of Telefónica, S.A., the Board of Directors, through the Audit and Control Committee, supervises this process.

2018 Management Report

F.3 Control activities.

Indicate the existence of at least the following components, and specify their main characteristics:

Procedures for reviewing and authorizing the financial information and description of ICFR to be disclosed to the markets, stating who is responsible in each case and documentation and flow charts of activities and controls

F.3.1 (including those addressing the risk of fraud) for each type of transaction that may materially affect the financial statements, including procedures for the closing of accounts and for the separate review of critical judgments, estimates, evaluations and projections.

On March 26, 2003, the Board of Directors of Telefónica, S.A. approved the "Regulations Governing Disclosure and Reporting to the Markets". These regulate the basic principles of operation of the financial disclosure control processes and systems which guarantee that all relevant consolidated financial information of Telefónica, S.A. is communicated to the Company's senior executives and its management team, assigning to the Internal Audit the duty of periodically assessing the functioning of these processes and systems.

Each quarter the Consolidation and Accounting Policies Department submits the periodic financial information to the Audit and Control Committee, highlighting the main events and accounting criteria applied and clarifying any major events which occurred during the period.

Likewise, the Telefónica Group has documented financial processes in place which stipulate common criteria for preparing financial information in all Group companies, as well as any outsourced activities.

The Company also follows documented procedures for preparing consolidated financial information whereby those employees responsible for the different areas are able to verify this information.

Also, and pursuant to the internal regulations, the Executive Chairmen or Chief Executive Officers and the Finance Directors of Group companies must submit a certificate to the Corporate Consolidation and Accounting Policies Department stating that they have reviewed the financial information being presented, that the financial statements give a true and fair view, in all material respects, of the financial position, results and cash position, and that there are no significant risks to the business or unhedged risks which may have a material impact on the Company's equity and financial position.

In relation to the accounting close, the Consolidation and Accounting Policies Department issues mandatory instructions setting out the calendar and contents for the financial reporting period for the preparation of the consolidated annual financial statements.

The Corporate Consolidation and Accounting Policies Department reviews the key judgments, estimates, valuations and forecasts to identify critical accounting policies that require the use of estimates and value judgments. In these cases, the Corporate Consolidation and Accounting Policies Department also establishes the necessary operational co-ordination actions with the rest of the Telefónica Group units for their specific areas of activity and knowledge before presenting them to the Audit and Control Committee. The most relevant are dealt with by the Audit and Control Committee. Senior management defines the format for presenting the annual financial statements prior to approval by the Board.

Lastly, Internal Audit, as part of its annual audit plan, among other actions, sets out work plans every year to assess the internal control of financial reporting model.

Internal control policies and procedures for information systems (including secure access, control of changes, F.3.2. system operation, operational continuity and segregation of duties) giving support to key company processes regarding the preparation and publication of financial information.

The Global Security Policy considers an integral concept of the physical and operational security of human resources the information, technologies, cybersecurity, and material resources that support them to be fundamental assets with the purpose of guaranteeing the corporate protection against potential damage or eventual loss. For this reason, guaranteeing the Group security is considered an essential aspect within the Telefónica strategy, and an essential enabler of the organization's activity.

2018 Management Report

With the approval of this Policy, the Board of Directors expresses its determination and commitment to reaching a level of security that is adequate to the needs of the business and that homogeneously guarantees the protection of the assets in all Telefónica Group companies.

In this context, the Global Security Directorship is responsible of defining and promoting the implementation of security policies and standards applicable in the Telefónica Group, understanding security as an integral concept. These politics and standards are intended to preserve the assets and protect the strategic interests and objectives of the Telefónica Group, in its vertical organization (including its business units) as well as in its cross-cutting dimension (applicable to all its four platforms): (1) infrastructure and network assets, (2) information technologies, (3) products and services, and (4) data; with them confidentiality and integrity of the assets and interests and strategic objectives of the Telefónica Group are guaranteed, protecting them from potential actions that could affect their availability, damage their value, reduce their efficiency or affect their operability. The Global Security Directorship is also in charge of measuring the level of implementation of the Global Security Regulations Framework and supervising the state of the security on an ongoing basis.

The Global Directorship of Networks and Information Systems of the Telefónica Group is responsible of the integral Management of Information Systems for all the Group businesses, defining the technologic strategy and planning and ensuring the compliance with the conditions of service quality, expenditure and security required by the Group. Among its various functions are the development and implementation of systems that improve the efficiency, effectiveness and profitability of the processes in the Group, and the implementation of security policies and standards on applications and infrastructures (defined by the Global Security Directorship), including the internal control model for security in the field of information technologies.

The security activities developed by the different environments, organizational structures, parties responsible for assets, and employees will be governed by the principles of legality, efficiency, co-responsibility, cooperation, and coordination. Any and all adequate promotion, conduction, control, and improvement measures will be established to this end.

Principle of Legality: the necessary compliance of all national and international laws and regulations regarding the matter of security that may be valid at any given time in any of the territories where the Telefónica Group operates, shall be ensured.

Principle of Efficiency: in order to efficiently reach the required level of security, the anticipatory and preventive nature of said actions shall rule over any passive and reactionary nature. To this end, knowledge of potential threats as well as the analysis of potential risks shall be privileged as part of an intelligence process that identifies and understands the most relevant threats that affect the organization. The objective is to get ahead of their action and evolution, and to safeguard the Telefónica Group's global organization from their potentially harmful effects, mitigating these risk's damages down to an acceptable level for the business.

A Global Security Regulations Framework is defined for reaching a standardized level of security. This framework will take into consideration the analyses of risks and threats and will also establish the precise preventive or corrective protection measures.

In addition, strategic plans will be conceived and prepared to identify and prioritize the projects and budgets necessary for reaching those adequate levels of security and auditability, minimizing the security risks identified in the corresponding analyses, and maximizing the effectiveness of the investment made and the resources used.

Principle of Co-responsibility: users must preserve the security of the assets that Telefónica makes available to them in accordance to the security criteria, requirements, procedures, and technologies defined in the Security Regulations Framework, as well as the applicable laws and regulations regarding the matter of security. At the same time, users must exclusively use the assets for the performance of activities that correspond to their workstation and assigned tasks.

Principle of Cooperation and Coordination: to reach the levels of efficiency required by Telefónica business project, the global action and comprehensive concept of security activities shall be preserved together with the aforementioned requirements of anticipation and prevention, cooperation and

2018 Management Report

coordination between all business units and employees will be prioritized, in order to generate the adequate synergies and to jointly reinforce the capabilities.

The Security Organization coordinates the security responsibilities of the different Telefónica Group structures, promoting cooperation between them to guarantee the efficient and joint protection of the assets.

Lastly, Internal Audit unit, within the scope established in its annual audit plan, sets out work plans to verify the efficacy and efficiency of the IT governance model, the information security Policy, suitability of controls and data integrity.

Internal control policies and procedures for overseeing the management of outsourced activities, and of the F.3.3. appraisal, calculation or valuation services commissioned from independent experts, when these may materially affect the financial statements.

If a process or part of a process is outsourced to an independent party, controls are still required to ensure the entire process is adequately controlled. Given the importance of outsourcing services and the impacts that this can have on the opinion about ICFR, measures are taken in the Telefónica Group to demonstrate an appropriate level of control in the independent party. Actions taken to achieve this objective are three-fold:

– Certification of internal control by an independent third party: ISAE3402 and/or SSAE16 certifications.

– Implementation of specific controls: identified, designed, implemented and assessed by the Company.

– Direct assessment: an assessment carried out by Internal Audit, on certain administrative outsourced processes, with the scope established in its annual audit plan.

When Telefónica, S.A. or any of its subsidiaries engage the services of an independent expert whose findings may potentially show impacts on the consolidated financial statements, as part of the selection process the competence, training, credentials and independence of the third party about the methods and main hypothesis used, is verified directly by the area contracting the service and, if applicable with the procurement department. The Finance and Control Department has established control activities geared towards guaranteeing the validity of data, the methods used, and the reasonability of the assumptions used by the third party using regular monitoring of each function's own KPIs (Key Performance Indicators) to ensure compliance of the outsourced process according to the Group's different policies and guidelines.

Likewise, there is an internal procedure for engaging independent experts which requires specific levels of approval.

F.4 Information and communication

Indicate the existence of at least the following components, and specify their main characteristics:

F.4.1 A specific function in charge of defining and maintaining accounting policies (accounting policies area or department) and settling doubts or disputes over their interpretation, which is in regular communication with the team in charge of operations, and a manual of accounting policies regularly updated and communicated to all the company's operating units.

The Consolidation and Accounting Policies Department of the Group is charged with defining and updating the accounting policies used for preparing the consolidated financial information.

Thus, this area publishes IFRS (International Financial Reporting Standards) information Bulletins summarizing the main changes to accounting methodology, as well as clarifications on various other related issues, which are systematically monitored by the Accounting Policies area. These Bulletins are published on a monthly basis.

Also, the Telefónica Group has an Accounting Policies Manual which is updated annually, the last update took place in June 2018. The objectives of this manual are: to align the corporate accounting principles and policies with IFRS; to maintain accounting principles and policies which ensure that the information is comparable within

2018 Management Report

the Group and offers optimum management of the source of information; to improve the quality of the accounting information of the various Group companies and of the Consolidated Group by disclosing, agreeing and introducing accounting principles which are unique to the Group; and to facilitate the accounting integration of acquired and newly-created companies into the Group's accounting system by means of a reference manual.

This Manual is mandatory for all companies belonging to the Telefónica Group and shall be applied to their reporting methods when preparing the consolidated financial statements.

This documentation is regularly sent by email and is available for the entire Group on the Telefónica intranet.

The accounting policies area maintains a constant dialogue with the accounting heads of the Group's main operations, both proactively and reactively. This dialogue is useful not only for resolving doubts or conflicts but also to ensure that accounting criteria in the Group are uniform and for sharing best practices between operators, too.

Mechanisms in standard format for the capture and preparation of financial information, which are applied and used in all units within the entity or group and support its main financial statements and accompanying notes as well as disclosures concerning ICFR.

As stated above, there is a Compliance Manual for Consolidation Reporting which includes specific instructions on preparing the disclosures which comprise the reporting pack reported by all components of the Telefónica Group for the preparation of the Telefónica Group's consolidated financial statements and the consolidated explanatory notes. Likewise, the Telefónica Group has implemented a specific system, through a software, which supports the reporting of the individual financial statements at its various subsidiaries, as well as the necessary notes and disclosures for preparing the consolidated annual financial statements. This tool is also used to carry out the consolidation process and its subsequent analysis. The system is managed centrally, and all components of the Telefónica Group use the same accounts plan.

F.5 System function monitoring

Indicate the existence of at least the following components, describing their main characteristics:

F.5.1 The ICFR monitoring activities undertaken by the Audit Committee and the Company has an internal audit function whose powers include supporting the Audit Committee in its role of monitoring the internal control system, including ICFR. Describe the scope of the ICFR assessment conducted in the year and the procedure for the person in charge to communicate its findings. State also whether the company has an action plan specifying corrective measures for any flaws detected, and whether it has taken stock of their potential impact on its financial information.

As mentioned above, the Corporate Bylaws and Regulations of the Board of Directors state that the primary duty of the Audit and Control Committee shall be to support the Board of Directors in its supervisory duties, being within its remit the supervision of the effectiveness of the Company's internal control system and risk management and control systems and discussing with the Auditors significant or material weaknesses in the internal control system detected during the audit.

Telefónica has an Internal Control Policy that sets that the Board of Directors, via the Audit and Control Committee, supervises the internal control system, with the support of the Internal Audit unit of the Telefónica Group. In that Policy the "internal control" is defined as the process performed by the Board of Directors, the Directorship and the rest of the staff of the Company, being designed with the purpose of providing with a reasonable assurance degree for the attainment of the objectives related to operations, information and compliance. With the purpose of helping to the achievement of its objectives, the Company has an internal control model defined in line with what is set out in the Integrated Framework of Internal Control of the "Committee of Sponsoring Organizations of the Treadway Commission" (COSO).

Likewise, there exists a Policy of Organization of Internal Audit which includes aspects referred to the organization and its functioning of this area.

2018 Management Report

According to what is set in that Policy, Internal Audit is the area in Telefónica in charge of confirming, by means of appropriate evidence, the adequate functioning of the internal control structures and risk management and, being the case, detecting the possible inefficiencies or non-compliance with the control system that the Group establishes in its processes. This manner, Internal Audit becomes an area independent from the Company management that supports the Audit and Control Commission in its competences on assurance, risk management and internal control system.

The Internal Audit function is carried out in accordance with the International Standards for the Professional Practice of Internal Auditing and has been awarded a Quality Certificate from the Institute of Internal Auditors.

With regard to supervision of Internal Control over Financial Reporting (ICFR), Telefónica, S.A. is listed on the New York Stock Exchange and is therefore subject to the regulatory requirements established by the US authorities applicable to all companies trading on this exchange.

Among the said requirements is the aforementioned Sarbanes-Oxley Act and, specifically, Section 404, which stipulates that all listed companies in the US market must evaluate on an annual basis the effectiveness of their ICFR procedures and internal control structure. To fulfil this requirement, the Telefónica Group has an internal control of financial reporting evaluation model, being the Internal Audit responsible of performing the assessment of its effectiveness on an annual basis.

Additionally, as set in this law, the External Auditor issues its own independent opinion on the effectiveness of the internal control over financial information (ICFR).

Review of processes and specific controls

In certain companies, in addition to filling out the self-appraisal questionnaire, taking into account the significance of their contribution to the Group's key economic-financial figures and other risk factors considered, their processes and controls are directly reviewed applying the General Assessment Model of the Telefónica Group, which in turn uses the Definition of Scopes Model, in order to identify the significant accounts of each company of the Telefónica Group in accordance with the previously established criteria for the assessment of the internal control over financial information (ICFR) at the Telefonica Group level.

Once the significant accounts are identified for review, the General Evaluation Model is applied as follows:

• The processes and systems associated with the significant accounts are determined.

• Risks affecting the financial reporting vis-à-vis these processes are identified.

• Checks and, where necessary, process controls are put in place to provide reasonable assurance that the documentation and design of controls over financial reporting are adequate.

• Audit tests are carried out to assess the effectiveness of the design and execution of key control activities, both at process or transaction level and general entity level controls.

Review on IT general controls

The Information Technology General Controls are assessed at least once a year, largely taking into account questions regarding regulations and guidelines applied at global level across the Group.

The supervision of IT general controls systems is designed to review management of changes to programs, data and systems access, and the operation (management of changes to infrastructures, back-ups, scheduled tasks and issues).

Self-assessment Questionnaires

All the subsidiaries of the Group receive annual self-assessment questionnaires, whose answers should be certified by the responsible of the Internal Control Over Financial Reporting (ICFR) System, in each company (Chief Executives or Chief Executive Officer (CEO) and Chief Financial Officer (CFO)). These questionnaires cover those ICFR aspects that are deemed to be minimum requirements to achieve reasonable assurance of the reliability of the financial information reported. A sample of responses is audited by the Internal Audit unit.

2018 Management Report

If any control deficiency or opportunity for improvement is detected while performing the procedures mentioned above, they should be reported to Management through reports prepared by the Internal Audit unit, analysing their impact, both individual and aggregated, on the assessment on the internal control over financial information (ICFR) if applicable. Additionally, for this assessment, it is necessary to consider the existing compensating controls which validate the processes supported in case that the original controls could not be corrected. After receiving the report, the control owners provide action plans for solving the identified control deficiencies, as well as the foreseen implementation dates of those action plans.

These action plans have as main objectives:

- Mitigate the deficiency from the control defined originally so that the control works as expected.
- Prioritize the implementation of improvement opportunities, since improvement opportunities are not internal control deficiencies.

F.5.2 If it has a discussion procedure whereby the auditor (pursuant to TAS), the internal audit function and other experts can report any significant internal control weaknesses encountered during their review of the financial statements or other assignments, to the company's senior management and its Audit Committee or Board of Directors. State also whether the entity has an action plan to correct or mitigate the deficiencies found.

As explained beforehand, the Internal Audit unit also provides support to the Audit and Control Committee in monitoring the correct functioning of the ICFR system.

The Internal Audit unit participates in the Audit and Control Committee meetings and reports regularly on the findings of the performed tasks, as well as action plans established to mitigate and of the degree of implementation thereof.

This includes to communicate significant or material internal control deficiencies which have been identified, as well as the follow up of the action plan linked to them.

Furthermore, the External Auditor participates in the Audit and Control Committee meetings, when called to do so by the Audit and Control Committee, to explain and clarify different aspects of the audit reports and other aspects of its work, including tasks performed to guarantee the effectiveness of the system of internal control over financial reporting (ICFR). The External Auditor is obliged to communicate the significant or material internal control weaknesses identified and, for this purpose, has immediate access to the Senior management and the Chairman of the Audit and Control Committee.

F.6 Other relevant information

Not applicable

F.7 External auditor review

State whether:

F.7.1 The ICFR information supplied to the market has been reviewed by the external auditor, in which case the corresponding report should be attached. Otherwise, explain the reasons for the absence of this review.

Otherwise, explain the reasons for the absence of this review.

As stated above, the attached information on ICFR has been submitted to review by the External Auditor, whose report is attached as an appendix to this document.

2018 Management Report

G. EXTENT OF COMPLIANCE WITH CORPORATE GOVERNANCE RECOMMENDATIONS

Specify the company's level of compliance with recommendations from the Unified Code of Good Governance.

In the event that a recommendation is not followed or only partially followed, a detailed explanation should be included explaining the reasons in such a manner that shareholders, investors and the market in general have enough information to judge the company's actions. General explanations are not acceptable.

That the Articles of Association of listed companies do not limit the maximum number of votes that may be cast by 1. one shareholder or contain other restrictions that hinder the takeover of control of the company through the acquisition of shares on the market.

Explain

In accordance with Article 26 of the Corporate Bylaws, no shareholder may cast a number of votes in excess of 10 percent of the total voting capital existing at any time, regardless of the number of shares held by such shareholder and in full compliance with mandatory requirements of law. In determining the maximum number of votes that each shareholder may cast, only the shares held by each such shareholder shall be computed. It does not include additional votes cast on behalf of other shareholders who may have appointed them as proxy, who are themselves likewise restricted by the 10 percent voting ceiling.

The limitation established in the preceding paragraphs shall also apply to the maximum number of votes that may be collectively or individually cast by two or more shareholder companies belonging to the same group of entities, as well as to the maximum number of votes that may be cast by an individual or corporate shareholder and the entity or entities that are shareholders themselves and which are directly or indirectly controlled by such individual or corporate shareholder.

In addition, Article 30 of the Corporate Bylaws stipulates that no person may be appointed as Director unless they have held, for more than three years prior to their appointment, a number of shares of the Company representing a nominal value of at least 3,000 euros, which the Director may not transfer while in office. These requirements shall not apply to those persons who, at the time of their appointment, are related to the Company under an employment or professional relationship, or when the Board of Directors resolves to waive such requirements with the favorable vote of at least 85 percent of its members.

Article 31 of the Corporate Bylaws establishes that, in order for a Director to be appointed Chairman, Vice-Chairman, Chief Executive Officer or member of the Executive Commission, it shall be necessary for such Director to have served on the Board for at least the three years immediately prior to any such appointment. However, such length of service shall not be required if the appointment is made with the favorable vote of at least 85 percent of the members of the Board of Directors.

The Corporate Bylaws (Article 26) restrict the number of shares that may be cast by a single shareholder or by shareholders belonging to the same group in order to achieve a suitable balance and protect the position of minority shareholders, thus avoiding a potential concentration of votes among a reduced number of shareholders, which could impact on the guiding principle that the General Shareholders' Meeting must act in the interest of all the shareholders. Telefónica believes that this measure does not constitute a blocking mechanism of takeover bids but rather a guarantee that the acquisition of control required the majority support of all shareholders, because, naturally, and as taught by experience, potential offerers may make their offer conditional upon the removal of the defense mechanism.

In relation to the above and in accordance with the provisions of Article 527 of the Spanish Corporations Act, any clauses in the Bylaws of listed corporations that directly or indirectly restrict the number of shares that may

2018 Management Report

be cast by a single shareholder by shareholders belonging to the same group or by any parties acting together with the aforementioned, will rendered null and void when, subsequent to a takeover bid, the offerer has a stake equal to or over 70% of the share capital which confers voting rights, unless the offerer was not subject to neutralization measures to prevent a takeover bid or had not adapted these measures accordingly.

In addition, the special requirements for appointment as Director (Article 30 of the Corporate Bylaws) or as Chairman, Vice-Chairman, Chief Operating Officer or member of the Executive Commission (Article 31 of the Corporate Bylaws) are justified by the desire that access to the management decision-making body and to the most significant positions thereon is reserved to persons who have demonstrated their commitment to the Company and who, in addition, have adequate experience as members of the Board, such that continuity of the management model adopted by the Telefónica Group may be assured in the interest of all of its shareholders and stakeholders. In any event, these special requirements may be waived by broad consensus among the members of the Board of Directors, namely, with the favorable vote of at least 85 percent of its members, as provided by the aforementioned Articles of the Corporate Bylaws.

2. That when the parent company and a subsidiary are listed on the stock market, both should publicly and specifically define:

- a) The respective areas of activity and possible business relationships between them, as well as those of the listed subsidiary with other group companies.
- b) The mechanisms in place to resolve any conflicts of interest that may arise.

Not applicable

3. That, during the course of the ordinary General Shareholders' Meeting, complementary to the distribution of a written Annual Corporate Governance Report, the chairman of the Board of Directors makes a detailed oral report to the shareholders regarding the most material aspects of corporate governance of the company, and in particular:

- a) Changes that have occurred since the last General Shareholders' Meeting.
- b) Specific reasons why the company did not follow one or more of the recommendations of the Code of Corporate Governance and, if so, the alternative rules that were followed instead.

Complies

4. That the company has defined and promoted a policy of communication and contact with shareholders, institutional investors and proxy advisors that complies in all aspects with rules preventing market abuse and gives equal treatment to similarly situated shareholders.

And that the company has made such a policy public through its web page, including information related to the manner in which said policy has been implemented and the identity of contact persons or those responsible for implementing it.

Complies

5. That the Board of Directors should not propose to the General Shareholders' Meeting any proposal for delegation of powers allowing the issuance of shares or convertible securities without pre-emptive rights in an amount exceeding 20% of equity at the time of delegation.

Telefónica, S.A. 212

2018 Management Report

And that whenever the Board of Directors approves any issuance of shares or convertible securities without pre-emptive rights the company immediately publishes reports on its web page regarding said exclusions as referenced in applicable company law.

Complies

That listed companies which draft reports listed below, whether under a legal obligation or voluntarily, publish them 6. on their web page with sufficient time before the General Shareholders' Meeting, even when their publication is not mandatory:

- a) Report regarding the auditor's independence.
- b) Reports regarding the workings of the audit committee and the appointments and remuneration committee.
- c) Report by the audit committee regarding related-party transactions
- d) Report on the corporate social responsibility policy.

Complies

7. That the company reports in real time, through its web page, the proceedings of the General Shareholders' Meetings.

Explain

The Company has not considered it appropriate to transmit, live through its website, the complete celebration of the General Shareholders' Meeting according to organisational reasons and development of the event (the tampering that might have occurred). However, the Chairman's speech at the General Shareholders' Meeting held on June 8, 2018 was broadcast via streaming.

That the audit committee ensures that the Board of Directors presents financial statements in the audit report for the 8. General Shareholders' Meetings which do not have qualifications or reservations and that, in the exceptional circumstances in which qualifications may appear, that the chairman of the audit committee and the auditors clearly explain to the shareholders the content and scope of said qualifications or reservations.

Complies

That the company permanently maintains on its web page the requirements and procedures for certification of share 9. ownership, the right of attendance at the General Shareholders' Meetings, and the exercise of the right to vote or to issue a proxy.

And that such requirements and procedures promote attendance and the exercise of shareholder rights in a non-discriminatory fashion.

Complies

10. That when a verified shareholder has exercised his right to make additions to the agenda or to make new proposals to it with sufficient time in advance of the General Shareholders' Meeting, the company:

2018 Management Report

- a) Immediately distributes the additions and new proposals.
 - b) Publishes the attendance card credential or proxy form or form for distance voting with the changes such that the new agenda items and alternative proposals may be voted upon under the same terms and conditions as those proposals made by the Board of Directors.
 - c) Submits all of these items on the agenda or alternative proposals to a vote and applies the same voting rules to them as are applied to those drafted by the Board of Directors including, particularly, assumptions or default positions regarding votes for or against.
 - d) That after the General Shareholders' Meeting, a breakdown of the results of said additions or alternative proposals is communicated.
- Not applicable

11. That, in the event the company intends to pay for attendance at the General Shareholders' Meeting, it establish in advance a general policy of long-term effect regarding such payments.
- Not applicable

12. That the Board of Directors completes its duties with a unity of purpose and independence, treating all similarly situated shareholders equally and that it is guided by the best interests of the company, which is understood to mean the pursuit of a profitable and sustainable business in the long term, and the promotion of continuity and maximisation of the economic value of the business.

And that in pursuit of the company's interest, in addition to complying with applicable law and rules and in engaging in conduct based on good faith, ethics and a respect for commonly accepted best practices, it seeks to reconcile its own company interests, when appropriate, with the interests of its employees, suppliers, clients and other stakeholders, as well as the impact of its corporate activities on the communities in which it operates and the environment.

Complies

13. That the Board of Directors is of an adequate size to perform its duties effectively and collegially, and that its optimum size is between five and fifteen members.

Explain

In accordance with article 29 of the Telefónica, S.A. corporate bylaws, the Board of Directors shall be composed of a minimum of five and a maximum of twenty members. However, in line with the Good Governance tendencies to reduce the number of Board Members, the General Shareholder's Meeting held on June 9, 2017 approved the establishment of seventeen members as the number of Board of Directors members, based on the recommendation of the Company Board of Directors and the favorable report of the Nominating, Compensation and Corporate Governance Committee.

The complexity of the Telefónica Group organizational structure, given the considerable number of companies it comprises, the variety of sectors it operates in, its multinational nature, as well as its economic and business relevance, justify the fact that the number of members of the Board is adequate to achieve an efficient and operative operation. Likewise, it is important to bear in mind that the Board of Directors of the Company have six Committees (the Executive Commission and five Advisory Committees), which ensures the active participation of all its Directors.

2018 Management Report

14. That the Board of Directors approves a selection policy for directors that:

- a) Is concrete and verifiable.
- b) Ensures that proposals for appointment or re-election are based upon a prior analysis of the needs of the Board of Directors.
- c) Favors diversity in knowledge, experience and gender.

That the resulting prior analysis of the needs of the Board of Directors is contained in the supporting report from the appointments committee published upon a call from the General Shareholders' Meeting submitted for ratification, appointment or re-election of each director.

And that the selection policy for directors promotes the objective that by the year 2020 the number of female directors accounts for at least 30% of the total number of members of the Board of Directors.

The appointments committee will annually verify compliance with the selection policy of directors and explain its findings in the Annual Corporate Governance Report.

Complies

That proprietary and independent directors constitute a substantial majority of the Board of Directors and that the 15. number of executive directors is kept at a minimum, taking into account the complexity of the corporate group and the percentage of equity participation of executive directors.

Complies

That the percentage of proprietary directors divided by the number of non-executive directors is no greater than the 16. proportion of the equity interest in the company represented by said proprietary directors and the remaining share capital.

This criterion may be relaxed:

- a) In companies with a high market capitalization in which interests that are legally considered significant are minimal.
- b) In companies where a diversity of shareholders is represented on the Board of Directors without ties among them.

Explain

The aforementioned recommendation 16 refers to the composition of the group of non executive Directors. As stated in Section C.1.3 of this Annual Corporate Governance Report, at December 31, 2018, the group of non Executive Directors of Telefónica, S.A. was composed of 15 members (of a total of 17 Members), of whom 5 are Proprietary Directors, 9 are Independent Directors and 1 falls under the "Other External Directors" category.

Out of the five Proprietary Directors, two represent or have been proposed by CaixaBank, S.A. (CaixaBank), the holder of 5.01% of the share capital of Telefónica, S.A.; another two represent or have been proposed by Banco Bilbao Vizcaya Argentaria, S.A., holder of 5.28% of the share capital; and one represents or has been proposed by China Unicom (Hong Kong) Limited (China Unicom), holder of 1.24% of the share capital.

Telefónica, S.A. 215

2018 Management Report

Applying the proportional criterion established in Article 243 of the LSC regarding the total number of Directors, the stakes held by CaixaBank and BBVA are sufficient to entitle each entity to appoint a Director.

Moreover, it must be taken into account that recommendation 16 stipulates that this strict proportionality criterion can be relaxed so the weight of Proprietary Directors is greater than would strictly correspond to the total percentage of capital they represent in large cap companies where few or no equity stakes attain the legal threshold for significant shareholdings.

In this regard, Telefónica ranks among the top listed companies on Spanish stock exchanges in terms of stock market capitalization, reaching the figure of 38,105 million euros at December 31, 2018, which means a very high absolute value of the stakes of CaixaBank and BBVA in Telefónica (that of CaixaBank was around 1,909 million euros, and that of BBVA was around 2,012 million euros). This justifies the overrepresentation of these entities on the Board of Directors, rising from one member of the Board each (to which they would strictly have the right in accordance with Article 243 of the Spanish Corporations Act) to two members, i.e. permitting the appointment of just one more Proprietary Director over the strictly legal proportion.

On January 23, 2011, China Unicom and Telefónica, S.A. expanded on their existing strategic alliance and signed an extension to their Strategic Partnership Agreement, in which both companies agreed to strengthen and deepen their strategic cooperation in certain business areas, and committed to investing the equivalent of 500 million US dollars in ordinary shares of the other party. In recognition of China Unicom's stake in Telefónica, approval was given at Telefónica's General Shareholders' Meeting held on May 18, 2011 for the appointment of a board member named by China Unicom. The Director currently representing or appointed by China Unicom was appointed by the Company's General Shareholders' Meeting held on May 12, 2016.

17. That the number of independent directors represents at least half of the total number of directors.

Nonetheless, when the company does not have a high level of market capitalisation or in the event that it is a high cap company with one shareholder or a group acting in a coordinated fashion who together control more than 30% of the company's equity, the number of independent directors represents at least one third of the total number of directors.

Complies

18. That companies publish and update the following information regarding directors on the company website:

a) Professional profile and biography.

b) Any other Boards to which the director belongs, regardless of whether the companies are listed, as well as any other remunerated activities engaged in, regardless of type.

c) Category of directorship, indicating, in the case of individuals who represent significant shareholders, the shareholder that they represent or to which they are connected.

d) The date of their first appointment as a director of the company's Board of Directors, and any subsequent re-election.

e) The shares and options they own.

Complies

19. That the Annual Corporate Governance Report, after verification by the appointments committee, explains the reasons for the appointment of proprietary directors at the proposal of the shareholders whose equity interest is less than 3%. It should also explain, where applicable, why formal requests from shareholders for membership on the Board meeting

2018 Management Report

were not honored, when their equity interest is equal to or exceeds that of other shareholders whose proposal for proprietary directors was honored.

Complies

20. That proprietary directors representing significant shareholders must resign from the Board if the shareholder they represent disposes of its entire equity interest. They should also resign, in a proportional fashion, in the event that said shareholder reduces its percentage interest to a level that requires a decrease in the number of proprietary directors representing this shareholder.

Complies

21. That the Board of Directors may not propose the dismissal of any independent director before the completion of the director's term provided for in the Articles of Association unless the Board of Directors finds just cause and a prior report has been prepared by the appointments committee. Specifically, just cause is considered to exist if the director takes on new duties or commits to new obligations that would interfere with his or her ability to dedicate the time necessary for attention to the duties attendant to his post as a director, fails to complete the tasks inherent to his or her post, or enters into any of the circumstances which would cause the loss of independent status in accordance with applicable law.

The dismissal of independent directors may also be proposed as a result of a public share offer, joint venture or similar transaction entailing a change in the shareholder structure of the company, provided that such changes in the structure of the Board are the result of the proportionate representation criteria provided for in Recommendation 16.

Complies

22. That companies establish rules requiring that directors inform the Board of Directors and, where appropriate, resign from their posts, when circumstances arise which may damage the company's standing and reputation. Specifically, directors must be required to report any criminal acts with which they are charged, as well as the consequent legal proceedings.

And that should a director be indicted or tried for any of the offenses set out in company law legislation, the Board of Directors must investigate the case as soon as possible and, based on the particular situation, decide whether the director should continue in his or her post. And that the Board of Directors must provide a reasoned written account of all these events in its Annual Corporate Governance Report.

Complies

23. That all directors clearly express their opposition when they consider any proposal submitted to the Board of Directors to be against the company's interests. This particularly applies to independent directors and directors who are unaffected by a potential conflict of interest if the decision could be detrimental to any shareholders not represented on the Board of Directors.

2018 Management Report

Furthermore, when the Board of Directors makes significant or repeated decisions about which the director has serious reservations, the director should draw the appropriate conclusions and, in the event the director decides to resign, explain the reasons for this decision in the letter referred to in the next recommendation.

This recommendation also applies in the case of the secretary of the Board of Directors, despite not being a director.
Complies

24. That whenever, due to resignation or any other reason, a director leaves before the completion of his or her term, the director should explain the reasons for this decision in a letter addressed to all the directors of the Board of Directors. Irrespective of whether the resignation has been reported as a relevant fact, it must be included in the Annual Corporate Governance Report.

Complies

25. That the appointments committee ensures that non-executive directors have sufficient time in order to properly perform their duties.

And that the Board rules establish the maximum number of company Boards on which directors may sit.

Complies

26. That the Board of Directors meet frequently enough so that it may effectively perform its duties, at least eight times per year, following a schedule of dates and agenda established at the beginning of the year and allowing each director individually to propose items do not originally appear on the agenda.

Complies

27. That director absences only occur when absolutely necessary and are quantified in the Annual Corporate Governance Report. And when absences occur, that the director appoints a proxy with instructions.

Complies

28. That when directors or the secretary express concern regarding a proposal or, in the case of directors, regarding the direction in which the company is headed and said concerns are not resolved by the Board of Directors, such concerns should be included in the minutes, upon a request from the protesting party.

Complies

2018 Management Report

29. That the company establishes adequate means for directors to obtain appropriate advice in order to properly fulfill their duties including, should circumstances warrant, external advice at the company's expense.

Complies

30. That, without regard to the knowledge necessary for directors to complete their duties, companies make refresher courses available to them when circumstances require

Complies

31. That the agenda for meetings clearly states those matters about which the Board of Directors are to make a decision or adopt a resolution so that the directors may study or gather all relevant information ahead of time. When, under exceptional circumstances, the chairman wishes to bring urgent matters for decision or resolution before the Board of Directors which do not appear on the agenda, prior express agreement of a majority of the directors shall be necessary, and said consent shall be duly recorded in the minutes.

Complies

32. That directors shall be periodically informed of changes in equity ownership and of the opinions of significant shareholders, investors and rating agencies of the company and its group.

Complies

33. That the chairman, as the person responsible for the efficient workings of the Board of Directors, in addition to carrying out his duties required by law and the Articles of Association, should prepare and submit to the Board of Directors a schedule of dates and matters to be considered; organise and coordinate the periodic evaluation of the Board as well as, if applicable, the chief executive of the company, should be responsible for leading the Board and the effectiveness of its work; ensuring that sufficient time is devoted to considering strategic issues, and approve and supervise refresher courses for each director when circumstances so dictate.

Complies

34. That when there is a coordinating director, the Articles of Association or the Board rules should confer upon him the following competencies in addition to those conferred by law: chairman of the Board of Directors in the absence of the chairman and deputy chairmen, should there be any; reflect the concerns of non-executive directors; liaise with investors and shareholders in order to understand their points of view and respond to their concerns, in particular as those concerns relate to corporate governance of the company; and coordinate a succession plan for the chairman.

2018 Management Report

Complies

That the secretary of the Board of Directors should pay special attention to ensure that the activities and decisions of the Board of Directors take into account the recommendations regarding good governance contained in this Code of Good Governance and which are applicable to the company.

Complies

36. That the Board of Directors meet in plenary session once a year and adopt, where appropriate, an action plan to correct any deficiencies detected in the following:

- a) The quality and efficiency of the Board of Directors' work.
- b) The workings and composition of its committees.
- c) Diversity of membership and competence of the Board of Directors.
- d) Performance of the chairman of the Board of Directors and the chief executive officer of the company.
- e) Performance and input of each director, paying special attention to those in charge of the various Board committees.

In order to perform its evaluation of the various committees, the Board of Directors will take a report from the committees themselves as a starting point and for the evaluation of the Board, a report from the appointments committee.

Every three years, the Board of Directors will rely upon the assistance of an external advisor for its evaluation, whose independence shall be verified by the appointments committee.

Business relationships between the external adviser or any member of the adviser's group and the company or any company within its group shall be specified in the Annual Corporate Governance Report.

The process and the areas evaluated shall be described in the Annual Corporate Governance Report.

Complies

37. That if there is an executive committee, the proportion of each different director category must be similar to that of the Board itself, and its secretary must be the secretary of the Board.

Partially complies

The percentage of independent Directors is greater in the Board of Directors than in the Executive Commission. This is mainly due to the re-classification in 2018 of one of the members of the Executive Commission, Mr Peter Erskine, who passed from being considered an Independent Board Member to "other external" once he reached 12 years as Board Member of the Company. The Company has considered that this change in the classification of one of the members of the Commission, by the mere passage of time, does not justify in and of itself the

2018 Management Report

modification of the makeup of the Executive Commission. In addition, the fact that the Executive Commission, as is common practice, has a number of members much smaller than the Board makes the indicated change in the classification have a greater impact in the former, more so than in the latter. In any case, Telefónica considers that all categories of Directors are adequately represented in the Executive Commission, and that the differences in the percentages of participation of independent, executive, and other external Directors do not prevent this Committee from exercising its duties with a similar perspective to that of the Board.

That the Board of Directors must always be aware of the matters discussed and decisions taken by the executive 38. committee and that all members of the Board of Directors receive a copy of the minutes of meetings of the executive committee.

Complies

That the members of the audit committee, in particular its chairman, are appointed in consideration of their 39. knowledge and experience in accountancy, audit and risk management issues, and that the majority of its members be independent directors.

Complies

That under the supervision of the audit committee, there must be a unit in charge of the internal audit function, 40. which ensures that information and internal control systems operate correctly, and which reports to the non-executive chairman of the Board or of the audit committee.

Complies

That the person in charge of the group performing the internal audit function should present an annual work plan to 41. the audit committee, reporting directly on any issues that may arise during the implementation of this plan, and present an activity report at the end of each year.

Complies

42. That in addition to the provisions of applicable law, the audit committee should be responsible for the following:

1. With regard to information systems and internal control:

a) Supervise the preparation and integrity of financial information relative to the company and, if applicable, the group, monitoring compliance with governing rules and the appropriate application of consolidation and accounting criteria.

b) Ensure the independence and effectiveness of the group charged with the internal audit function; propose the selection, appointment, re-election and dismissal of the head of internal audit; draft a budget for this department; approve its goals and work plans, making sure that its activity is focused primarily on material risks to the company; receive periodic

2018 Management Report

information on its activities; and verify that senior management takes into account the conclusions and recommendations of its reports.

c) Establish and supervise a mechanism that allows employees to report confidentially and, if appropriate, anonymously, any irregularities with important consequences, especially those of a financial or accounting nature, that they observe in the company.

2. With regard to the external auditor:

a) In the event that the external auditor resigns, examine the circumstances which caused said resignation.

b) Ensure that the remuneration paid to the external auditor for its work does not compromise the quality of the work or the auditor's independence.

c) Insist that the company file a relevant fact with the CNMV when there is a change of auditor, along with a statement on any differences that arose with the outgoing auditor and, if applicable, the contents thereof.

d) Ensure that the external auditor holds an annual meeting with the Board of Directors in plenary session in order to make a report regarding the tasks accomplished and regarding the development of its accounting and risks faced by the company.

e) Ensure that the company and the external auditor comply with applicable rules regarding the rendering of services other than auditing, proportional limits on the auditor's billing, and all other rules regarding the auditor's independence.

Complies

43. That the audit committee may require the presence of any employee or manager of the company, even without the presence of any other member of management.

Complies

That the audit committee be kept abreast of any corporate and structural changes planned by the company in order
44. to perform an analysis and draft a report beforehand to the Board of Directors regarding economic conditions and accounting implications and, in particular, any exchange ratio involved.

Complies

45. That the risk management and control policy identify, as a minimum:

a) The various types of financial and non-financial risks (among those operational, technological, legal, social, environmental, political and reputational) which the company faces, including financial or economic risks, contingent liabilities and other off balance sheet risks.

b) Fixing of the level of risk the company considers acceptable.

c) Means identified in order to minimize identified risks in the event they transpire.

Telefónica, S.A. 222

2018 Management Report

d) Internal control and information systems to be used in order to control and manage identified risks, including contingent liabilities and other off balance sheet risks.

Complies

That under the direct supervision of the audit committee or, if applicable, of a specialised committee of the Board of Directors, an internal control and management function should exist delegated to an internal unit or department of the company which is expressly charged with the following responsibilities:

- a) Ensure the proper functioning of risk management and control systems and, in particular, that they adequately identify, manage and quantify all material risks that may affect the company.
- b) Actively participate in the creation of the risk strategy and in important decisions regarding risk management.
- c) Ensure that the risk management and control systems adequately mitigate risks as defined by policy issued by the Board of Directors.

Complies

That members of the appointment and remuneration committee -- or of the appointments committee and the remuneration committee if they are separate - are chosen taking into account the knowledge, ability and experience necessary to perform the duties they are called upon to carry out and that the majority of said members are independent directors.

Complies

48. That high market capitalization companies have formed separate appointments and remuneration committees.

Explain

Article 40 of the Bylaws, and Article 23 of the Regulation of the Board of Directors, expressly state, on regulating the Nominating, Compensation and Corporate Governance Committees, that the Board of Directors shall be entitled to set up two Committees, separately giving each of them powers for appointments, and the other the powers for remuneration, while the corporate governance powers may be included in either one of them.

The Board of Directors of Telefónica, S.A. has not considered appropriate, so far, separating the functions of the Nominating, Compensation and Corporate Governance Committee because it believes that by putting the powers to assess Directors and determine their remuneration in the same Committee, is helpful to coordinate and to produce a results-driven remuneration system (pay for performance). Furthermore, it is noted that the Board of Directors currently has five Consultative Committees (Audit and Control Committee, the Nominating, Compensation and Corporate Governance Committee, Regulation and Institutional Affairs Committee, Service Quality and Customer Care Committee and the Strategy and Innovation Committee), in addition to the Executive Commission.

In this context, the separation of the Nominating, Compensation and Corporate Governance Committee would not have been appropriate with the facilitating objective of the reorganization of the Consultative or Committees of the Company, approved by the Board of Directors on April 27, 2016, generating unnecessary inefficiencies and needs for additional allocations.

Telefónica, S.A. 223

2018 Management Report

49. That the appointments committee consult with the chairman of the Board of Directors and the chief executive of the company, especially in relation to matters concerning executive directors.

And that any director may ask the appointments committee to consider potential candidates he or she considers appropriate to fill a vacancy on the Board of Directors.

Complies

50. That the remuneration committee exercises its functions independently and that, in addition to the functions assigned to it by law, it should be responsible for the following:

- a) Propose basic conditions of employment for senior management.
- b) Verify compliance with company remuneration policy.
- c) Periodically review the remuneration policy applied to directors and senior managers, including remuneration involving the delivery of shares, and guarantee that individual remuneration be proportional to that received by other directors and senior managers.
- d) Oversee that potential conflicts of interest do not undermine the independence of external advice rendered to the Board.
- e) Verify information regarding remuneration paid to directors and senior managers contained in the various corporate documents, including the Annual Report on Director Remuneration.

Complies

51. That the remuneration committee consults with the chairman and the chief executive of the company, especially in matters relating to executive directors and senior management.

Complies

That the rules regarding composition and workings of supervision and control committees appear in the rules governing the Board of Directors and that they are consistent with those that apply to mandatory committees in accordance with the recommendations above, including:

- a) That they are comprised exclusively of non-executive directors, with a majority of them independent.
- b) That their chairmen be independent directors.
- c) That the Board of Directors select members of these committees taking into account their knowledge, skills and experience and the duties of each committee; discuss their proposals and reports; and detail their activities and accomplishments during the first plenary session of the Board of Directors held after the committee's last meeting.
- d) That the committees be allowed to avail themselves of outside advice when they consider it necessary to perform their duties.
- e) That their meetings be recorded and the minutes be made available to all directors.

Explain

Telefónica, S.A. 224

2018 Management Report

1. The supervision and control committees which are attributed the powers referred to in recommendation 52 are the Audit and Control Committee and the Nominating, Compensation and Corporate Governance Committee. The composition and operation rules of the two Committees are set out in the Regulation of the Board of Directors (and, also, in the Regulation of the Audit and Control Committee) and are not only consistent with legally dispositions applicable but are also an improvement upon them, in certain areas. For example, according to the Regulation of the Board of Directors, the Nominating, Compensation and Corporate Governance Committee must have a majority of independent members, as opposed to the minimum of two according to prevailing laws. In fact, in practice, the Committee is composed of four independent Directors, and one with the category of "Other external".
2. The Board of Directors has other Consulting Committees which are allocated other functions (Regulation and Institutional Affairs Committee, Service Quality and Customer Service Committee, and Strategy and Innovation Committee), which are strongly linked with the businesses developed by the Company and with management aspects.

These Committees are not expressly regulated in the Regulation of the Board of Directors or they are regulated with fewer details with respect to those that are legally mandatory.

In particular, it has been decided that Committees with powers in matters linked to the Company's businesses and management aspects do not necessarily have to be chaired by independent Directors nor do most of the members of the committees need to have independent directors, but rather it is preferable to take into account the technical knowledge and specific expertise of their members when appointing the Director to chair them and the other Directors who should sit on these committees.

That verification of compliance with corporate governance rules, internal codes of conduct and social corporate responsibility policy be assigned to one or split among more than one committee of the Board of Directors, which 53. may be the audit committee, the appointments committee, the corporate social responsibility committee in the event that one exists, or a special committee created by the Board of Directors pursuant to its powers of self-organization, which at least the following responsibilities shall be specifically assigned thereto:

- a) Verification of compliance with internal codes of conduct and the company's corporate governance rules.
- b) Supervision of the communication strategy and relations with shareholders and investors, including small- and medium-sized shareholders.
- c) The periodic evaluation of the suitability of the company's corporate governance system, with the goal that the company promotes company interests and take into account, where appropriate, the legitimate interests of other stakeholders.
- d) Review of the company's corporate social responsibility policy, ensuring that it is orientated towards value creation.
- e) Follow-up of social responsibility strategy and practice, and evaluation of degree of compliance.
- f) Supervision and evaluation of the way relations with various stakeholders are handled.
- g) Evaluation of everything related to non-financial risks to the company, including operational, technological, legal, social, environmental, political and reputational.

2018 Management Report

h) Coordination of the process of reporting on diversity and reporting non-financial information in accordance with applicable rules and international benchmarks.

Complies

54. That the corporate social responsibility policy include principles or commitments which the company voluntarily assumes regarding specific stakeholders and identifies, as a minimum:

a) The objectives of the corporate social responsibility policy and the development of tools to support it.

b) Corporate strategy related to sustainability, the natural environment and social issues.

c) Concrete practices in matters related to: shareholders, employees, clients, suppliers, social issues, the natural environment, diversity, fiscal responsibility, respect for human rights, and the prevention of unlawful conduct.

d) Means or systems for monitoring the results of the application of specific practices described in the immediately preceding paragraph, associated risks, and their management.

e) Means of supervising non-financial risk, ethics, and business conduct.

f) Communication channels, participation and dialogue with stakeholders.

g) Responsible communication practices that impede the manipulation of data and protect integrity and honor.

Complies

55. That the company reports, in a separate document or within the management report, on matters related to corporate social responsibility, following internationally recognised methodologies.

Complies

56. That director remuneration be sufficient in order to attract and retain directors who meet the desired professional profile and to adequately compensate them for the dedication, qualifications and responsibility demanded of their posts, while not being so excessive as to compromise the independent judgment of non-executive directors.

Complies

57. That only executive directors receive remuneration linked to corporate results or personal performance, as well as remuneration in the form of shares, options or rights to shares or instruments whose value is indexed to share value, or long-term savings plans such as pension plans, retirement accounts or any other retirement plan.

2018 Management Report

Shares may be given to non-executive directors under the condition that they maintain ownership of the shares until they leave their posts as directors. The forgoing shall not apply to shares that the director may be obliged sell in order to meet the costs related to their acquisition.

Complies

58. That as regards variable remuneration, the policies incorporate limits and administrative safeguards in order to ensure that said remuneration is in line with the work performance of the beneficiaries and are not based solely upon general developments in the markets or in the sector in which the company operates, or other similar circumstances.

And, in particular, that variable remuneration components:

- a) Are linked to pre-determined and measurable performance criteria and that such criteria take into account the risk undertaken to achieve a given result.
- b) Promote sustainability of the company and include non-financial criteria that are geared towards creating long term value, such as compliance with rules and internal operating procedures and risk management and control policies.
- c) Are based upon balancing short-, medium- and long-term objectives, permitting the reward of continuous achievement over a period of time long enough to judge creation of sustainable value such that the benchmarks used for evaluation are not comprised of one-off, seldom occurring or extraordinary events.

Complies

59. That a material portion of variable remuneration components be deferred for a minimum period of time sufficient to verify that previously established performance criteria have been met.

Complies

60. That remuneration related to company results takes into account any reservations which may appear in the external auditor's report which would diminish said results.

Not applicable

61. That a material portion of variable remuneration for executive directors depends upon the delivery of shares or instruments indexed to share value.

Complies

62. That once shares or options or rights to shares arising from remuneration schemes have been delivered, directors are prohibited from transferring ownership of a number of shares

2018 Management Report

equivalent to two times their annual fixed remuneration, and the director may not exercise options or rights until a term of at least three years has elapsed since they received said shares.

The forgoing shall not apply to shares which the director may need to sell in order to meet the costs related to their acquisition.

Explain

On December 31, 2018, the Executive Director of the company, Mr. José María Álvarez-Pallete López held a shareholding at Telefónica, S.A., which amounted to 1,351,958 voting rights, which were valued with a price of 7.64 euros per share (according to its average value during 2018), represented 536% of his fixed remuneration. In this regard, it is noted that since his appointment as Executive Chairman, Mr. Álvarez-Pallete, as a demonstration of his commitment with Telefónica, has acquired a total of 798,704 shares.

Likewise, the Chief Operating Officer (C.O.O.), Mr. Ángel Vilá Boix, held a shareholding at Telefónica, S.A., which amounted to 356,998 voting rights, which were valued with the same price per share, represented 170% of his fixed remuneration.

This shareholding owned demonstrate his commitment to Telefónica, and show that his own interests are aligned with the other shareholders' interests.

On the other hand, the Remuneration Policy for the Directors of Telefónica, S.A., approved by the Company's General Shareholders' Meeting on June 8, 2018, introduces, among others, the following novelties:

It involves a new Long-Term Incentive Plan aimed at the Executive Directors, which establishes that at least 25% of the shares delivered derived from the Plan will be subject to a period of retention of no less than one year.

Executive Directors must maintain (directly or indirectly) a number of shares (including those delivered as remuneration) equivalent to two annuities of their gross fixed remuneration, while they continue to remain on the Board of Directors and develop executive functions, establishing a five years period from the commencement of the Policy or, in the case of Executive Directors appointed thereafter, since their appointment, to achieve this objective.

That contractual arrangements include a clause which permits the company to seek reimbursement of variable 63. remuneration components in the event that payment does not coincide with performance criteria or when delivery was made based upon data later deemed to be inaccurate.

Partially complies

The Nominating, Compensation and Corporate Governance Committee is empowered to propose that the Board of Directors cancels a variable remuneration payment in the event of circumstances such as those described in this recommendation. The Nominating, Compensation and Corporate Governance Committee will also assess if exceptional circumstances of this kind may even entail the termination of the relationship with the person responsible, proposing measures which are deemed pertinent to the Board of Directors.

That payments made for contract termination shall not exceed an amount equivalent to two years of total annual 64. remuneration and that it shall not be paid until the company has verified that the director has fulfilled all previously established criteria for payment.

Explain

Telefónica, S.A. 228

2018 Management Report

With regards to the conditions applicable to termination of contracts, the Executive Chairman, Mr. José María Álvarez-Pallete López, and the Chief Operating Officer (C.O.O.), Mr. Ángel Vilá Boix, maintain the conditions of their previous contract which provided for agreed economic compensation for the termination of the employment relationship, where applicable, that can amount to four years' of remuneration at the most. Every annual payment includes the last fixed remuneration and the arithmetic average of the last two variable annual remuneration received according to contract.

Telefónica, S.A. 229

2018 Management Report

H. Further information of interest

1. If there is any aspect regarding corporate governance in the company or other companies in the group that have not been included in other sections of this report, but which are necessary in order to obtain a more complete and comprehensible picture of the structure and governance practices in the company or group, describe them briefly below.

--

2. This section may also be used to provide any other information, explanation or clarification relating to previous sections of the report, so long as it is relevant and not redundant.

Specifically, state whether the company is subject to any corporate governance legislation other than that prevailing in Spain and, if so, include any information required under this legislation that differs from the data requested in this report.

3. The company may also state whether it voluntarily complies with other ethical or best practice codes, whether international, sector-based, or other. In such a case, name the code in question and the date the company began following it. It should be specifically mentioned that the company adheres to the Code of Good Tax Practices of 20 July, 2010

- Note 1 to section A.2.]

On February 6, 2019, BlackRock, Inc. informed to the Securities Exchange Commission that its shareholding on the share capital of Telefónica, S.A. was 5.4%.

On February 1, 2019, BlackRock, Inc. informed to the Spanish National Securities Market Commission (CNMV) that, at January 31, 2019, its shareholding on the share capital of Telefónica, S.A. was 5.077%.

Likewise, and in accordance with the submitted communication by BlackRock, Inc. to the Spanish National Securities Market Commission (CNMV) on June 1, 2018, on June 20, 2018, on November 16, 2018, on January 23, 2019 and on February 1, 2019, the details of the control chain through this entity owns the voting right and/or the financial instruments is the following:

1.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc, BlackRock International Holdings, Inc., BR Jersey International Holdings, L.P., BlackRock (Singapore) Holdco Pte. Ltd., Blackrock HK Holdco Limited, BlackRock Lux Finco S.a.r.l., BlackRock Japan Holdings GK, BlackRock Japan Co., Ltd.

2.- BlackRock, Inc, Trident Merger, LLC, BlackRock Investment Management, LLC.

3.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc, BlackRock International Holdings, Inc, BR Jersey International Holdings, L.P., BlackRock Holdco 3, LLC, BlackRock Cayman 1 LP, BlackRock Cayman West Bay Finco Limited, BlackRock Cayman West Bay IV Limited, BlackRock Group Limited, BlackRock Finance Europe Limited, BlackRock Investment Management (UK) Limited.

4.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc, BlackRock International Holdings, Inc, BR Jersey International Holdings, L.P., BlackRock Australia Holdco Pty. Ltd., BlackRock Investment Management (Australia) Limited.

5.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc, BlackRock International Holdings, Inc, BR Jersey International Holdings, L.P., BlackRock Holdco 3, LLC, BlackRock Cayman 1 LP, BlackRock Cayman West Bay Finco Limited, BlackRock Cayman West Bay IV Limited, BlackRock Group Limited, BlackRock International Limited.

Telefónica, S.A. 230

2018 Management Report

- 6.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc, BlackRock Holdco 4, LLC, BlackRock Holdco 6, LLC, BlackRock Delaware Holdings Inc, BlackRock Institutional Trust Company, National Association.
 - 7.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc, BlackRock Holdco 4, LLC, BlackRock Holdco 6, LLC, BlackRock Delaware Holdings Inc., BlackRock Fund Advisors.
 - 8.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc.
 - 9.- BlackRock, Inc, BlackRock Holdco 2, Inc., BlackRock Financial Management, Inc., BlackRock International Holdings, Inc., BR Jersey International Holdings, L.P., BlackRock (Singapore) Holdco Pte. Ltd., BlackRock HK Holdco Limited, BlackRock Asset Management North Asia Limited.
 - 10.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc, BlackRock International Holdings, Inc, BR Jersey International Holdings, L.P., BlackRock Holdco 3, LLC, BlackRock Cayman 1 LP, BlackRock Cayman West Bay Finco Limited, BlackRock Cayman West Bay IV Limited, BlackRock Group Limited, BlackRock Finance Europe Limited, BlackRock Investment Management (UK) Limited, BlackRock Asset Management Deutschland AG.
 - 11.- BlackRock, Inc, BlackRock Holdco 2, Inc., BlackRock Financial Management, Inc., BlackRock International Holdings, Inc., BR Jersey International Holdings, L.P., Blackrock Holdco 3, LLC, BlackRock Canada Holdings LP, BlackRock Canada Holdings ULC, BlackRock Asset Management Canada Limited.
 - 12.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc, BlackRock Capital Holdings, Inc, BlackRock Advisors, LLC.
 - 13.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc, BlackRock International Holdings, Inc, BR Jersey International Holdings, L.P., BlackRock Holdco 3, LLC, BlackRock Cayman 1 LP, BlackRock Cayman West Bay Finco Limited, BlackRock Cayman West Bay IV Limited, BlackRock Group Limited, BlackRock Finance Europe Limited, BlackRock Advisors (UK) Limited.
 - 14.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc, BlackRock International Holdings, Inc, BR Jersey International Holdings, L.P., BlackRock (Singapore) Holdco Pte. Ltd, BlackRock (Singapore) Limited.
 - 15.- BlackRock, Inc, BlackRock Holdco 2, Inc, BlackRock Financial Management, Inc, BlackRock International Holdings, Inc, BR Jersey International Holdings, L.P., BlackRock Holdco 3, LLC, BlackRock Cayman 1 LP, BlackRock Cayman West Bay Finco Limited, BlackRock Cayman West Bay IV Limited, BlackRock Group Limited, BlackRock Finance Europe Limited, BlackRock (Netherlands) B.V.
- Note 2 to Section A.3.]

The General Shareholders' Meeting held on May 30, 2014 approved a long-term incentive plan intended for members of the Group's management team (including the Executive Directors), also known as the Performance & Investment Plan ("PIP").

The second cycle of that Plan began in 2015 and concluded in October 2018. In accordance with the provisions of its terms and conditions, the delivery of shares did not proceed for second cycle of the Plan (2015-2018), so no shares were delivered to the Executive Directors participating in this cycle.

As for the third cycle of this Plan (2016-2019), the Company's Board of Directors, following a favourable report from the Nominating, Compensation and Corporate Governance Committee, agreed not to execute nor implement the plan as it was not sufficiently aligned with the Telefónica Group's strategic plan, taking into account the circumstances and the macroeconomic situation.

On the other hand, the General Shareholders' Meeting held on June 8, 2018 approved a new Long-Term Incentive Plan ("Performance Share Plan - PSP"), consisting of the delivery of shares in Telefónica, S.A., aimed at Telefónica Group directors, including Telefónica Executive Directors who, complying with the requirements established for this purpose at any time, are invited to participate. The duration of the Plan will be five (5) years and will

2018 Management Report

be divided into three cycles (3) of three (3) years each (i.e., with delivery of the shares corresponding to each cycle after three years from the start of each cycle), independent among them. The first cycle began on January 1, 2018 (with delivery of the shares that correspond in 2021), the second cycle began January 1, 2019 (with delivery of the corresponding shares in 2022), and the third will begin January 1, 2020 (with delivery of the shares that correspond in 2023). In relation to the first cycle of this plan, taking into consideration the average weighted share price of Telefónica, S.A. in 30 trading days prior to January 1, 2018 and their respective fixed annual remuneration in force in 2018, with the maximum possible number of shares in the event of maximum compliance with the established objectives is to be received by Mr José María Álvarez-Pallete López, with 421,000 shares and, by Mr Ángel Vilá Boix, 312,000 shares. In relation to the second cycle of this plan, (whose shares were assigned in February 2019), taking into consideration the average weighted share price of Telefónica, S.A. in 30 trading days prior to January 1, 2019 and their respective fixed annual remuneration in force in 2019, with the maximum possible number of shares in the event of maximum compliance with the established objectives is to be received by Mr José María Álvarez-Pallete López, with 468,000 shares and, by Mr Ángel Vilá Boix, 347,000 shares.

-Note 3 to Section C.1.16.J

Selection and appointment

Telefónica's Bylaws state that the Board of Directors shall be composed of a minimum of five members and a maximum of twenty, to be appointed at the General Shareholders Meeting. Directors are appointed for a period of no longer than four years, and may be re-elected for one or more subsequent periods of no longer than four years at a time. The Board of Directors may, in accordance with the Spanish Corporations Act and the Company Bylaws, provisionally co-opt Directors to fill any vacancies.

The Board of Directors shall have the power to fill, on an interim basis, any vacancies that may occur therein, by appointing, in such manner as is legally allowed, the persons who are to fill such vacancies until the holding of the next General Shareholders Meeting.

Also, in all cases, proposed appointments of Directors must follow the procedures set out in the Company's Bylaws and Regulations of the Board of Directors and be preceded by the appropriate favourable report by the Nominating, Compensation and Corporate Governance Committee and in the case of independent Directors, by the corresponding proposal by the Committee. Proposals for individuals to represent legal entities (companies) have to be made following a report by the Nominating, Compensation and Corporate Governance Committee.

Therefore, in exercise of the powers delegated to it, the Nominating, Compensation and Corporate Governance Committee must assess the skills, knowledge and experience required in the Board of Directors, defining the functions and abilities needed by candidates to cover each vacancy, and evaluating the time and dedication needed for them to efficiently perform their duties. It will also have to escalate proposed appointments of independent Directors to the Board of Directors by co-option or for the decision to be made by the General Shareholders Meeting, as well as proposals for the re-election or removal of said Directors by the General Shareholders Meeting. It will also have to escalate proposed appointments of other Company Directors to the Board of Directors for appointment by co-option or for the design to be made by the General Shareholders Meeting, as well as proposals for the re-election or removal of said Directors by the General Shareholders Meeting.

In line with the provisions of its Regulations, the Board of Directors, exercising the right to fill vacancies by interim appointment and to propose appointments to the shareholders at the General Shareholders Meeting, shall ensure that, in the composition of the Board of Directors, external or non-executive Directors represent an ample majority over executive Directors. Similarly, the Board shall ensure that the total number of independent Directors represents at least one third of the total number of Board members.

The nature of each Director shall be explained by the Board of Directors to the shareholders at the General Shareholders Meeting at which the appointment thereof must be made or ratified. Furthermore, such nature shall be reviewed annually by the Board after verification by the Nominating, Compensation and Corporate Governance Committee, and reported in the Annual Corporate Governance Report.

2018 Management Report

In any event, and in the event of re-election or ratification of Directors by the General Shareholders Meeting, the report of the Nominating, Compensation and Corporate Governance Committee, or, in the case of independent Directors, the proposal of said Committee, will contain an assessment of the work and effective time devoted to the post during the last period in which it was held by the proposed Director.

Both the Board of Directors and the Nominating, Compensation and Corporate Governance Committee shall ensure, within the scope of their respective powers, that those proposed for the post of Director should be persons of recognized caliber, qualifications and experience, who are willing to devote the time and effort necessary to carrying out their functions, and shall take extreme care in the selection of persons to be appointed as independent Directors. The Board of Directors will have to ensure that Board members are selected using procedures that guarantee gender equality and diversity of knowledge and experience, that prevent any underlying bias would could cause any kind of discrimination, and, in particular, that the procedures should favour the selection of female directors.

With respect to this, the Board of Directors approved, at their meeting held on November 25, 2015, a Board Member Selection Policy. Likewise, on December 13, 2017, the Board of Directors approved an update of this Policy to include the Diversity Policy applicable to the Board of Directors. It was therefore renamed the Diversity Policy with respect to the Telefónica, S.A. Board of Directors and the Board Member Selection. It also includes the latest regulatory standards regarding diversity. The aim of this Policy is to ensure that the proposed appointment or re-election of Board Members is based on a preliminary analysis of the needs of the Board of Directors, and favors the diversity of knowledge, education and professional experience, age, and gender, but without implicit biases that could entail any discrimination, specifically based on gender, disability, or any other personal condition.

This Diversity Policy, with respect to the Telefónica, S.A. Board of Directors and Board Member Selection, is available on the corporate website of the Company.

The result of the preliminary analysis of the needs of the Board of Directors will be set out in the report of the Nominating, Compensation and Corporate Governance Committee, which will be published on calling the General Shareholders Meeting at which each Director will be submitted for ratification, appointment or re-election.

Every year, the Nominating, Compensation and Corporate Governance Committee will check that the Director selection policy is complied with, and will report with such information in the Annual Corporate Governance Report.

Re-election

Directors can be re-elected once or several times for the same periods as the initial period.

As with appointments, proposals for the reappointment of Directors must be preceded by the corresponding report by the Nominating, Compensation and Corporate Governance Committee, and in the case of independent Directors, by the corresponding proposal by the Committee.

Appraisal

In accordance with the Regulations of the Board of Directors, the Nominating, Compensation and Corporate Governance Committee has the powers to organize and coordinate, together with the Chairman of the Board of Directors, the regular assessment of said body, after which the Board of Directors approves the assessment of its function and the functioning of its Committees.

In accordance with the above, it should be noted that the Board of Directors and its Committees carry out a periodic evaluation of the operation of the Board of Directors and of the Committees thereof in order to determine the opinion of Directors regarding the workings of these bodies and to establish any proposals for improvements to ensure the optimum working of the company's governing bodies.

2018 Management Report

Removal and dismissal

Directors' shall cease to hold office when the term for which they were appointed expires, or when so resolved by the shareholders at the General Shareholders Meeting in the exercise of the powers legally granted to them.

Directors who give up their place before their tenure expires, should state their reasons in a letter to be sent to all members of the Board of Directors.

The Board of Directors shall not propose the removal of any independent Director prior to the end of the Bylaw-mandated period for which they have been appointed, unless there are due grounds therefore acknowledged by the Board after a report from the Nominating, Compensation and Corporate Governance Committee. Specifically, due grounds shall be deemed to exist when the Director has failed to perform the duties inherent to his position.

The removal of independent Directors may also be proposed as a result of Takeover Bids, mergers or other similar corporate transactions that represent a change in the structure of the Company's capital.

-Note 4 to Section C.2.1.J

The Audit and Control Committee of Telefónica, S.A. is regulated under article 39 of the corporate bylaws of the Company, and under article 22 of the Board of Directors regulations. Likewise, and in order to comply with the recommendations of Technical Guide 3/2017 of the Spanish National Securities Market Commission regarding Audit Committees of Public Interest Companies, the Board of Directors approved the regulations of the Audit and Control Committee of Telefónica, S.A. at their meeting held on December 13, 2017, which regulates the aforementioned Committee under the following terms:

a) Composition.

The Audit and Control Committee shall consist of such a number of members as the Board of Directors determines at any given time, who shall in no case be less than three and shall be appointed by the Board of Directors. All members thereof must be external or non-executive Directors, and most of them must be at least Independent Directors. When appointing its members, and, in particular, when appointing its Chairman, the Board of Directors shall take into account the appointees' knowledge and experience in matters of accounting, auditing or both, as well as in risk management. Overall, the members of the Committee will have the adequate technical knowledge in relation to the Company's sector of activity.

The Chairman of the Audit and Control Committee, who shall in all events be an independent Director, shall be appointed from among its members, and shall be replaced every four years; he may be re-elected after one year from the date when he ceased to hold office.

b) Duties.

Without prejudice to any other tasks that the Board of Directors may assign thereto, the primary duty of the Audit and Control Committee shall be to support the Board of Directors in its supervisory duties. Specifically, it shall have at least the following powers and duties:

1) Report to the General Shareholders Meeting regarding matters addressed in the Committee for which it is responsible, and, in particular, regarding the result of the audit, and explain how the audit has improved the integrity of the financial information and the function played by the Committee in this process.

2) Escalate proposals for selection, appointment, re-election and replacement of the external auditor to the Board of Directors, taking responsibility for the selection process as established in prevailing laws, as well as the recruitment conditions, and regularly gather information from the auditor about the audit plan and its execution, as well as safeguarding its independence in exercising its functions.

3) To supervise internal audit and, in particular:

a) Ensure the independence and efficiency of the internal audit function;

2018 Management Report

- b) Propose the selection, appointment and removal of the person responsible for the internal audit;
 - c) Propose the budget for such service;
 - d) Review the annual internal audit work plan and the annual activities report;
 - e) Receive periodic information on its activities; and
 - f) Verify that the senior executive officers take into account the conclusions and recommendations of its reports.
- 4) Oversee the process of preparing and presenting mandatory financial reporting and submitting recommendations of proposals to the administrative body aimed at safeguarding its integrity. With respect thereto, it shall be responsible for supervising the process of preparation and the completeness of the financial information relating to the Company and the Group, reviewing compliance with regulatory requirements, the proper determination of the scope of consolidation, and the correct application of accounting standards, informing the Board of Directors thereof.
- 5) Monitor the effectiveness of the Company's internal control, internal audit and risk management systems, including fiscal risks, and discuss with the Auditors significant weaknesses in the internal control system detected during the audit, without compromising their independence at any time. For that purposes, if deemed necessary, it can submit recommendations or proposals to the Board of Directors and an appropriate monitoring period. With respect thereto, it shall be responsible for proposing to the Board of Directors a risk control and management policy, which shall identify at least the following:
- a) the types of risk (operational, technological, financial, legal and reputational) facing the company;
 - b) the risk level that the Company deems acceptable; the measures to mitigate the impact of the identified risks, should they materialize; and
 - c) the control and information systems to be used to control and manage these risks.
- 6) Establish and supervise a system that allows employees to confidentially and anonymously report potentially significant irregularities, particularly any financial and accounting irregularities detected within the Company.
- 7) Establish and maintain appropriate relations with the Auditor in order to receive, for review by the Committee, information on all matters that could jeopardize the Auditor's independence, and, when applicable, the authorization of permitted services, according to current legislation, and such other communications as may be provided for in auditing legislation and in technical auditing regulations. In any event, the Audit and Control Committee must receive, on an annual basis, written confirmation from the Auditor of its independence vis-à-vis the entity or entities directly or indirectly related thereto, as well as in-depth and individualized information regarding additional services of any kind provided as well as the fees received to such entities by the Auditor or by the persons or entities related thereto pursuant to the provisions of prevailing legislation.
- 8) Issue on an annual basis, prior to the issuance of the audit report, a report stating an opinion on whether the independence of the Auditor is compromised. This report will focus on the assessment of the provision of each and every one of the additional services referred to in point 7) above, considered individual and in their entirety, other than legal audit, and in relation to the regime of independence or laws regulating auditing activities.
- 9) Analyze and report on economic conditions, the accounting impact, and, if applicable, the proposed exchange ratio in structural and corporative modification transactions which the Company intends to perform, before being submitted to the Board of Directors.
- 10) Preliminary reporting to the Board of Directors regarding all matters set out in prevailing legislation and in the Bylaws, and, in particular, concerning:
- 1. The financial information that the Company must periodically disclose;

2018 Management Report

2. The creation or acquisition of shareholdings in special purpose entities or companies with registered addresses in countries or territories considered to be tax havens; and

3. Related party transactions.

11) Exercise all the pertinent functions of the Audit Committee established at any given time by prevailing laws in regard to Group companies which are considered to be Public Interest Entities (as these are defined in applicable laws), provided that they are fully owned, either directly or indirectly, by the Company pursuant to applicable laws, and whose administration is not attributed to a Board of Directors.

The dispositions of sections 2, 7 and 8 are understood to be without prejudice to general auditing regulations.

c) Operation.

The Audit and Control Committee must have access to appropriate, opportune and enough information, for which:

- The Chairman of the Committee and, if it is considered opportune or is requested, the rest of its members, will maintain regular contact with the key personnel involved in the governance and management of the Company.
- The Chairman of the Committee, through the Secretary of the Committee, shall channel and provide the necessary information and documentation to the rest of the Committee Members, far enough in advance so that they can analyze it before their meetings.

The Audit and Control Committee, the Committee, shall meet at least once a quarter and whenever deemed necessary, with prior notice from their Chairman.

In any case, the Committee shall meet, at a minimum, when annual or intermediate financial information is published, and, in these cases, the meeting shall have the presence of the Internal Auditor and, if any kind of revision is issued, the Account Auditor.

Likewise, in the performance of its duties, the Committee may require the attendance of the Account Auditor, any employee or Company Manager, and the experts deemed necessary at its meetings.

Attendance at formal Committee meetings is preceded by the sufficient dedication of its members to analyze and evaluate the information received.

Likewise, the Committee has a secretary, who has the necessary attendance to plan meetings and agendas, for the drafting of the documents and minutes of the meetings, and for the collection and distribution of information, among other tasks.

In order to have an appropriate scheduling that makes it possible to ensure compliance with the effectively pursued objectives, the Committee establishes an Annual Work Plan.

The meetings are planned by the Chairman of the Committee, who notifies these meeting to the meeting secretary so that its members receive the documentation with enough notice. All of this keeping in mind that the Committee members have mainly supervisory and advisory duties, without intervening in the execution or management, as these are the duties of management.

Most important actions during the year and exercise of its duties.

The main activities and actions carried out by the Audit and Control Committee of the Telefónica, S.A. Board of Directors throughout 2018 have been related to the powers and duties that correspond to this Committee, either by legal requirements or from the interest that arises in each case with respect to the aforementioned powers. Therefore, the Audit and Control Committee has performed, among others, the following jobs:

2018 Management Report

- Regarding finances: i) revision of the financial information of the Company (Annual Account and Management Reports related to 2017, quarterly and semi-annual periodic financial information of Telefónica Group and the Public Interest Companies of the Group, for which this Committee has assumed the duties of the Audit Committee, and Alternative Performance Measurements, included in the Company Financial Information); ii) revision of the financial debt situation of Telefónica Group, and its development throughout the year; iii) revision of the informative brochures presented by the Company before the different supervisory bodies (among others, 20-F Annual Report and several informative brochures for financing operations, shares and debt); and iv) revision of monographic presentations on financial aspects and modifications to the accounting regulations. Likewise, the Committee has reviewed the non-financial and diversity information prepared by the Company in accordance with the current regulation.
- Regarding the external auditor: i) proposal of fees to be received by PwC as the Account Auditor for 2018; and ii) revision of the auditing works and limited revisions made by the external auditor with respect to the aforementioned financial information.
- Regarding internal control: i) revision of the works performed by Internal Auditing regarding the revision of transversal processes, investigations and inspections; and ii) revision of the risk management system.
- Regarding compliance, revision on regulatory compliance, including anti-corruption standards.
- Other relevant issues: i) 2017 Report of the Audit and Control Committee regarding related operations; ii) monthly Report of the Telefónica, S.A. Treasury Stock Management Team Supervisor regarding treasury stock operations; iii) review that the financial information published on the Company website is constantly updated and coincides with that which has been formulated, in each case, by the Board of Directors, and published on the CNMV website; and iv) periodic training to ensure the Committee members are updated on information.

Furthermore, regarding to the Directors of the Audit and Control Committee who have been appointed taking into account their knowledge and experience in accounting, audit or both, are Mr. José Javier Echenique Landiribar and Mr. Ignacio Moreno Martínez.

-Note 5 to Section C.2.1.J

Pursuant to the provisions of Article 25 of the Regulation of the Board of Directors of the Company, the Service Quality and Customer Service Committee is regulated in the following terms:

a) Composition.

The Service Quality and Customer Service Committee shall consist of such a number of members, all of them Directors, as the Board of Directors determines at any given time, who shall in no case be less than three and the majority of whom must be External Directors.

The Chairman of the Service Quality and Customer Service Committee shall be appointed from among its members.

b) Duties.

Without prejudice to any other duties that the Board of Directors may assign thereto, the Service Quality and Customer Service Committee shall have at least the following duties:

1) To periodically examine, review and monitor the quality indices of the principal services provided by the companies of the Telefónica Group.

2) To evaluate levels of customer service provided by the companies of the Group to their customers.

Most important actions during the year and exercise of its duties.

2018 Management Report

In the 4 meetings held by the Service Quality and Customer Service Committee in 2018, it analysed the quality metrics of the main services provided by Telefónica Group companies, while the levels of commercial attention these companies provide to their customers was assessed.

As with the other Board Committees, the relations between the Committee and the Board of Directors are based on a full transparency principle. At the beginning of each one of the monthly meetings of the Board of Directors, the Chairman of the Committee informs about the most important matters addressed, and the activities and tasks performed by the Committee; providing the Directors with the necessary documentation, so that it can take such actions into account when performing its duties.

-Note 6 to Section C.2.1.J

Subject to article 20.b) of the Board of Directors' Regulation, the Board has created the Strategy and Innovation Committee:

a) Composition.

The Board of Directors shall determine the number of members of this Committee.

The Chairman of the Strategy and Innovation Committee shall be appointed from among its members.

b) Duties.

Without prejudice to any other duties that the Board of Directors may assign thereto, the primary duty of the Strategy and Innovation Committee shall be:

- 1) To support the Board of Directors in the analysis and follow up of the global strategy policy of the Telefónica Group.
- 2) To advise and assist in all matters regarding innovation. Its main object is to perform an examination, analysis and periodic monitoring of the Company's innovation projects, to provide guidance and to help ensure its implementation and development across the Group.

Most important actions during the year and exercise of its duties.

The Strategy and Innovation Committee held 10 meetings in the 2018 year, in which it analysed a number of different issues, which mainly concerned the telecommunications sector, in keeping with the strategic policy of the Telefónica Group and its business, and questions relating to these matters.

Likewise, it performed a regular monitoring of the Company's innovation projects, providing guidance and offering its support to help ensure its implementation and development across the Group.

As with the other Board Committees, the relations between the Committee and the Board of Directors are based on a full transparency principle. At the beginning of each one of the monthly meetings of the Board of Directors, the Chairman of the Committee informs about the most important matters addressed, and the activities and tasks performed by the Committee; providing the directors with the necessary documentation, so that it can take such actions into account when performing its duties.

-Note 7 to Section C.2.1.J

Pursuant to the provisions of Article 40 of the Corporate Bylaws of Telefónica, S.A., Article 23 of the Regulations of the Board of Directors of the Company regulates the Nominating, Compensation and Corporate Governance Committee in the following terms:

a) Composition.

The Nominating, Compensation and Corporate Governance Committee shall consist of such a number of members as the Board of Directors determines at any given time, who shall in no case be less than three and

2018 Management Report

shall be appointed by the Board of Directors. All members thereof must be external or non-executive Directors, and most of them must be at least Independent Directors.

The Chairman of the Nominating, Compensation and Corporate Governance Committee, who shall in all events be an Independent Director, shall be appointed from among its members.

b) Duties.

Notwithstanding other duties entrusted it by the Board of Directors, the Nominating, Compensation and Corporate Governance Committee shall have the following duties:

- 1) Assess the skills, knowledge and experience necessary in the Board of Directors. For these purposes, it will define the roles and capabilities required of the candidates to fill each vacancy, and assess the time and dedication necessary for them to efficiently perform their duties.
- 2) Set a target of representation for the least represented gender on the Board of Directors and provide guidelines about how this target might be reached.
- 3) Escalate proposed appointments of independent Directors to the Board of Directors by co-option or for the decision to be made by the General Shareholders Meeting, as well as proposals for the re-election or removal of said Directors by the General Shareholders Meeting.
- 4) Submit proposed appointments of other Company Directors to the Board of Directors for appointment by co-option or for the decision to be made by the General Shareholders Meeting, as well as proposals for the re-election or removal of said Directors by the General Shareholders Meeting. It will also have to escalate proposals for appointments or termination of the Secretary, and, if applicable, of the Deputy Secretary of the Board of Directors, and also proposals for the appointment, re-election and termination of Directors in their subsidiary companies.
- 5) Report on proposals to appoint or to terminate the Senior Management of the Company and their subsidiaries.
- 6) To report on the proposals for appointment of the members of the Executive Commission and of the other Committees of the Board of Directors, as well as the respective Secretary and, if applicable, the respective Deputy Secretary.
- 7) To propose to the Board of Directors the appointment of the Lead Director from among the Independent Directors.
- 8) To organize and coordinate, together with the Chairman of the Board of Directors, a periodic assessment of the Board, pursuant to the provisions of these Regulations.
- 9) To inform on the periodic assessment of the performance of the Chairman of the Board of Directors.
- 10) To examine or organize the succession of the Chairman of the Board of Directors and, if applicable, to make proposals to the Board of Directors so that such succession occurs in an orderly and well-planned manner.
- 11) To propose to the Board of Directors, within the framework established in the Corporate Bylaws, the compensation for the Directors and review it periodically to ensure that it is in keeping with the tasks performed by them, as provided in Article 34 of the Regulations of the Board.
- 12) To propose to the Board of Directors, within the framework established in the Bylaws, the extent and amount of the compensation, rights and remuneration of a financial nature of the Chairman of the Board of Directors, the Executive Directors and the senior executives of the Company, as well as the basic terms of their contracts, for purposes of contractual implementation thereof.
- 13) To prepare and propose to the Board of Directors an annual report regarding the Directors' compensation policy.
- 14) To verify information on the remuneration of Directors and senior management contained in the various corporate documents, including the annual report on Directors' remuneration.
- 15) To supervise compliance with the Company's internal rules of conduct and the corporate governance rules thereof in effect from time to time.

2018 Management Report

16) To exercise other powers assigned to the Nominating, Compensation and Corporate Governance Committee in this Regulation.

c) Operation.

In addition to the meetings provided for in the annual schedule, the Nominating, Compensation and Corporate Governance Committee shall meet whenever the Board of Directors of the Company or the Chairman of the Board of Directors requests the issuance of a report or the making of a proposal within the scope of its powers and duties, provided that, in the opinion of the Chairman of the Committee, it is appropriate for the proper implementation of its duties.

The Nominating, Compensation and Corporate Governance Committee will consult with the Chairman of the Board of Directors particularly when concerning matters relating to executive directors and senior officers.

Most important actions during the year and exercise of its duties.

The main activities and actions carried out by the the Nominating, Compensation and Corporate Governance Committee of the Telefónica, S.A. Board of Directors throughout 2018 have been linked to the powers and duties corresponding to this Committee, either by legal requirements or from the interest that arises in each case with respect to the aforementioned powers. Therefore, the Nominating, Compensation and Corporate Governance Committee has analyzed and reported on, among others, the following issues:

The remuneration policy and system of the Telefónica Group Board Members and Management (fixed and variable remuneration, and action plans).

In particular, the Committee submitted to the Company's Board of Directors, for approval by the Ordinary General Shareholders' Meeting, the proposed remuneration policy for the Directors of Telefónica, S.A., for the three-year period 2019-2021. This remuneration policy was approved by the Company's General Shareholders' Meeting on June 8, 2018.

The main novelties introduced in the new Directors' remuneration policy, which maintains the basic outlines applied in the previous financial years, are as follows:

- Regarding the Annual Variable Remuneration, in the case of targets overachievement, it has been set a new maximum level of 233.10% of Fixed Remuneration (129.5% of the target annual variable remuneration) for the Executive Chairman and 194.25% of Fixed Remuneration (129.5% of the target annual variable remuneration) for the Chief Executive Officer.

- A new Long-Term Incentive Plan is introduced for the Executive Directors, among other members. This Plan features the following:

1. A maximum incentive limit for each cycle of the plan of 250% of the Annual Fixed Remuneration for the Executive Directors.

2. In addition to the economic-financial targets and targets related to creating value for shareholders, the possibility of setting targets linked to sustainability, the environment, society or good governance with a maximum overall weight of 10%.

3. At least the 25% of the shares that are awarded under the Plan will be subject to a retention period of one year.

- The Executive Directors must hold (directly or indirectly) a number of shares (including those awarded as remuneration) equivalent to two years' gross fixed remuneration for as long as they are members of the Board of Directors and perform executive duties.

Proposals for appointments related to the Telefónica, S.A. Board of Directors and its Committees, and with the Boards of subsidiary companies

To this respect, the Nominating, Compensation and Corporate Governance Committee proposed and/or reported, as applicable, the appointment of Telefónica, S.A. Board Members in 2018, addressing

2018 Management Report

the solvency, competency, experience, professional merits and availability of the candidates to dedicate the necessary time and effort for the effective performance their duties, exclusively considering their individual and professional characteristics.

Thus, in its meeting held on January 30, 2018 the Committee favourably informed the appointment by co-option as Proprietary Director, and at the proposal of CaixaBank, S.A., of Mr. Jordi Gual Solé, after the voluntary resignation from its position as Board Member presented by Mr. Antonio Massanell Lavilla. Likewise, at the aforementioned meeting on January 30, 2018, the Committee favourably informed the appointment of the Proprietary Director Mr. Jordi Gual Solé as Member of the Regulation and Institutional Affairs Committee, and of the Strategy and Innovation Committee.

Furthermore, at its meeting held on April 24, 2018, the Committee proposed to the Company's Board of Director the appointment by co-optation of Ms. María Luisa García Blanco, after the voluntary resignation from their positions as Board Members, presented by Ms. Eva Castillo Sanz.

Likewise, at its meeting held on May 29, 2018, the Committee proposed the appointment of the Independent Director Ms. María Luisa García Blanco as Member of the Service Quality and Customer Service Committee, and of the Regulation and Institutional Affairs Committee. Likewise, at the aforementioned meeting on May 29, 2018, the Committee proposed the appointment of the Independent Director Mr. Peter Löscher as Member of the Service Quality and Customer Service Committee.

Additionally, the Committee favorably informed and/or proposed, as the case may be, the re-election and ratification of Telefónica, S.A. board members by the Company General Shareholder's Meeting held on June 8, 2018, after having taken into consideration and evaluated the duties performed and the dedication given by the aforementioned Board Members during his/her year of duty, basing the entirety of the proposals on a preliminary analysis of the needs of the Board of Directors, whose purpose is to favor the diversity of knowledge, experiences and gender.

Thus, the aforementioned Ordinary General Shareholders' Meeting approved, at the proposal of the Company's Board of Directors, the re-election of Mr. Luiz Fernando Furlán, Mr. Francisco Javier de Paz Mancho, and Mr. José María Abril Pérez, as well as the ratification of the appointment by co-optation of Mr. Ángel Vilá Boix, Mr. Jordi Gual Solé, and Ms. María Luisa García Blanco.

Proposals for the appointment of Board Members at the subsidiary companies of the Telefónica Group.

Appointment proposals related with the Senior Management and the organizational structure of the Telefónica Group. Corporate Governance Report and Remuneration Report 2017.

-Note 8 to Section C.2.1.J

Subject to article 20.b) of the Board of Directors' Regulation, the Board has created the Regulation and Institutional Affairs Committee:

a) Composition.

The Board of Directors shall determine the number of members of this Committee.

The Chairman of the Regulation and Institutional Affairs Committee shall be appointed from among its members.

b) Duties.

Without prejudice to any other duties that the Board of Directors may assign thereto, the Regulation and Institutional Affairs Committee shall have, at least, the following duties:

2018 Management Report

- 1) To carry out, through study, analysis and discussion, permanent monitoring of the main matters and themes of the regulatory order that affect the Telefónica Group at all times.
- 2) To provide a channel for communication and information between the management team and the Board of Directors in statutory matters and, when appropriate, to bring to the knowledge of the latter matters that are considered relevant to the Company, or to any of the companies in the Group and on which it may be necessary or convenient to adopt a decision or to establish a specific strategy.
- 3) To review, report and propose to the Board of Directors the principles that must guide the Group's Sponsorship and Patronage policy, monitor such policy and individually approve all sponsorships or patronages that exceed the limit set by the Board, and that have to be approved by the Board.
- 4) To promote the development of the Telefónica Group's Corporate Reputation and Responsibility project and the implementation of the core values of such Group.

The Reputation and Corporate Responsibility strategy is implemented through the Global Responsible Business Plan. This plan includes objectives in aspects such as: ethical behavior, human rights, customer promise, environment, climate change, supply chain, digital trust, talent and diversity, and sustainable innovation, as well as other topics that are identified as risks or opportunities for the company in relation to sustainability. The Commission is also pursuing recurrent issues such as reputation metrics and sustainability and reputation risk mapping.

Most important actions during the year and exercise of its duties.

The Regulation and Institutional Affairs Committee held 11 meetings in the 2018 year, have been analysed and debated:

The regulatory matters of most significance for the Telefónica Group, were set out in the Regulatory Agenda; at global and European Union level, by regions (Europe and Latin America) and by countries. The most significant developments, as set out in the aforementioned Regulatory Agenda, are updated in each meeting, and in the specific documents or reports submitted to the Committee, when deemed advisable.

A continuous monitoring of, on the one hand, the Sponsorship and Patronage Policy, and the Sponsorships presented by the Institutional Relations and Sponsorships area of Telefónica, S.A., and, on the other hand, the Corporate Social Responsibility of the Telefónica Group and of the most significant issues in this field of Sustainability (ethical behavior, sustainable innovation, digital confidence, supply chain, talent and diversity management, customer, environment and climate change), including Responsible Business Plans, and Integrated Annual Report.

The most relevant institutional milestones of the Telefónica Group with regard to the Company's Institutional Relations.

As with the other Board Committees, the relations between this Committee and the Board of Directors are based on a full transparency principle. At the beginning of each one of the monthly meetings of the Board of Directors, the Chairman of the Committee informs about the most important matters addressed, and the activities and tasks performed by the Committee; providing the Directors with the necessary documentation, so that it can take such actions into account when performing its duties.

-Note 9 to Section C.2.1.J

As for the Board itself, at the beginning of each year and in accordance with Article 20 b) 3. of the Regulations of the Board of Directors, all Committees shall prepare an Action Plan detailing the actions to be taken and their timing for each year in each of their fields of action.

All Committees shall also draw up an internal Activities Report (where, in the case of the Audit and Control Committee and the Nominating, Compensation and Corporate Governance Committee, the Operating Report is named), summarizing the main activities and actions taken during the previous year, detailing the issues

2018 Management Report

discussed at its meetings and highlighting certain aspects regarding its powers and duties, composition and operation. As per Article 20 b) 3. of the Regulations of the Board of Directors, in order that it may properly exercise its duties, the Board of Directors is kept fully informed of the issues addressed by the Committees.

-Note 10 to Section C.2.1.J

Mr. Ángel Vilá Boix is the Chief Operating Officer (C.O.O.).

-Note 11 to Section D.6.J

Company policy establishes the following principles governing possible conflicts of interest that may affect Directors, senior executives or significant shareholders:

With respect to Directors, Article 30 of the Regulations of the Board of Directors establishes that Directors shall inform the Board of Directors of any situation of direct or indirect conflict they may have with the interest of the company. In the event of conflict, the Director affected shall refrain from participating in the deliberation to which the conflict refers.

Moreover, and in accordance with the provisions set out in the Regulations of the Board, Directors shall refrain from participating in votes that affect matters in which they or persons related to them have a direct or indirect interest. Likewise, the aforementioned Regulations establish that Directors shall not directly or indirectly enter into professional or commercial transactions with the Company or with any of the companies of the Group, if such transactions are unrelated to the ordinary course of business of the Company or not performed on an arm's length basis, unless the Board of Directors is informed thereof in advance and, on the recommendation of the Nominating, Compensation and Corporate Governance Committee, it approves the transaction upon the affirmative vote of at least 90% of the Directors (present in person or by proxy).

Directors must also report with respect to themselves as well as the persons related thereto (a) the direct or indirect interests held by them and (b) the offices held or duties performed at any company that is in a situation of actual competition with the Company.

For purposes of the provisions of this paragraph, the following shall not be deemed to be in a situation of actual competition with the Company, even if they have the same or a similar or complementary corporate purpose: (i) companies controlled thereby (within the meaning of Article 42 of the Commercial Code); and (ii) companies with which Telefónica, S.A. has established a strategic alliance. Likewise, for purposes of the provisions hereof, proprietary directors of competitor companies appointed at the request of the Company or in consideration of the Company's interest in the capital thereof shall not be deemed to be in a situation of prohibition of competition. Transactions arising from the duty of loyalty and its exemption regime shall also be subject to prevailing laws. Also, Article 38 of the Regulations of the Board of Directors specifically regulates transactions performed with significant shareholders, and establishes that the Board of Directors, based on a favorable report by the Audit and Control Committee, will approve the transactions which the Company or its Group perform with directors, individual or together with others, of a significant shareholding, including shareholders represented in the Board of Directors of the Company or other Group companies or with persons related to them, unless this power is attributable by law to the General Shareholders Meeting.

This approval does not include transactions which, according to prevailing laws, do not require such approval or exemption, i.e. according to Article 529 ter of the Spanish Corporations Act, the transactions which simultaneously fulfill the three following requirements:

Telefónica, S.A. 243

2018 Management Report

- 1.º they are performed by virtue of contracts whose conditions are standardized and are applied on an across-the-board basis to a large number of clients,
- 2.º they are performed at prices or tariffs generally set by the person supplying the goods or services, and
- 3.º their amount is not more than one per cent of the company's annual revenues.

The transactions referred to above shall be assessed from the point of view of equal treatment of shareholders and the arm's-length basis of the transaction, and shall be included in the Annual Corporate Governance Report and in the periodic public information of the Company upon the terms provided by law.

For the transaction to be approved, it will be necessary to ensure that the transaction does not compromise the capital, or, if applicable, that it is performed on an arm's-length basis and that the process is transparent.

With respect to senior executives, the Internal Code of Conduct for Securities Markets Issues sets out the general principles of conduct for the persons subject to the said regulations who are involved in a conflict of interest. The aforementioned Code includes all the Company's management personnel within the concept of affected persons. In accordance with that established in this regulation, the people with management responsibilities, their administrative personnel and the managers or employees of Telefónica Group who have privileged information, or participate or have access to or knowledge of a confidential operation (as defined in the previous terms of the internal conduct regulations regarding Stock Markets) have the obligation to (a) remain loyal to the Group and its shareholders at all times, regardless of his/her own or other's interests; (b) refrain from intervening in or influencing decision making that could affect persons or companies with which there is conflict; and (c) refrain from accessing information classified as confidential that affects said conflict. Additionally, these people (except for the members of the Company Board of Directors who will be governed in terms of communicating conflicts under the standards established in the regulation of the Board of Directors) have the obligation to make the Company Regulatory Compliance Unit aware of these operations that would potentially entail the manifestation of conflicts of interest.

Finally, it should be said that as of the year 2010, Telefónica, S.A. adheres to the Code of Good Fiscal Practices, as approved by the Large Companies' Forum -a body in which major Spanish companies and the Spanish tax authorities participate-, and complies with the content of the same.

Similarly, Telefónica Group is committed to the application of other international regulations and initiatives in the area of sustainability as well as, among others, the Universal Declaration of Human Rights, the United Nations Global Compact, and other conventions and treaties agreed by international bodies such as the Organization for Economic Cooperation and Development and the International Labor Organization.

This annual corporate governance report was approved by the company's Board of Directors at its meeting held on February 20, 2019.

List whether any directors voted against or abstained from voting on the approval of this report.

No

2018 Management Report

APPENDIX TO THE TELEFÓNICA, S.A. 2018 ANNUAL CORPORATE GOVERNANCE REPORT

E.3 Indicate the main risks, including tax risks, which may prevent the company from achieving its targets.

Please refer to section "Risk factors associated with the issuer" within the Management Report 2018.

Telefónica, S.A. 245

2018

Consolidated financial statements (Consolidated annual accounts) and Consolidated management report for 2018
Telefónica, S.A. and subsidiaries composing the Telefónica Group

CONSOLIDATED ANNUAL ACCOUNTS

INDEX

<u>Consolidated statements of financial position</u>	<u>4</u>
<u>Consolidated income statements</u>	<u>5</u>
<u>Consolidated statements of comprehensive income</u>	<u>6</u>
<u>Consolidated statement of changes in equity</u>	<u>7</u>
<u>Consolidated statements of cash flows</u>	<u>9</u>
Consolidated Financial Statements for the year ended December 31, 2018	<u>10</u>
<u>Note 1. Background and general information</u>	<u>10</u>
<u>Note 2. Basis of presentation of the consolidated financial statements</u>	<u>10</u>
<u>Note 3. Accounting policies</u>	<u>21</u>
<u>Note 4. Segment information</u>	<u>32</u>
<u>Note 5. Business combinations and acquisitions of non-controlling interests</u>	<u>39</u>
<u>Note 6. Intangible assets</u>	<u>41</u>
<u>Note 7. Goodwill</u>	<u>43</u>
<u>Note 8. Property, plant and equipment</u>	<u>48</u>
<u>Note 9. Associates and joint ventures</u>	<u>50</u>
<u>Note 10. Related parties</u>	<u>51</u>
Note 11. Financial assets and other non-current assets	<u>53</u>
<u>Note 12. Receivables and other current assets</u>	<u>56</u>
Note 13. Other current financial assets	<u>58</u>
Note 14. Breakdown of financial assets	<u>59</u>
Note 15. Equity	<u>63</u>
Note 16. Financial liabilities	<u>71</u>
<u>Note 17. Derivative financial instruments and risk management policies</u>	<u>75</u>
Note 18. Payables and other non-current liabilities	<u>92</u>
Note 19. Payables and other current liabilities	<u>93</u>
Note 20. Breakdown of contractual assets and liabilities, and capitalized costs	<u>94</u>
Note 21. Provisions	<u>96</u>
Note 22. Income tax matters	<u>106</u>
Note 23. Revenue and expenses	<u>116</u>
Note 24. Share-based payment plans	<u>120</u>

<u>Note 25. Cash flow detail</u>	<u>122</u>
<u>Note 26. Other information</u>	<u>125</u>
<u>Note 27. Finance leases</u>	<u>135</u>
<u>Note 28. Operations classified as held for sale</u>	<u>136</u>
<u>Note 29. Events after the reporting period</u>	<u>137</u>
<u>Note 30. Additional note for English translation</u>	<u>138</u>
Appendix	
<u>Appendix I: Scope of consolidation</u>	<u>139</u>
<u>Appendix II: Board and Senior Management Compensation</u>	<u>152</u>
<u>Appendix III: Debentures and bonds</u>	<u>158</u>
<u>Appendix IV: Financial instruments</u>	<u>162</u>
<u>Appendix V: Interest-bearing debt</u>	<u>171</u>
<u>Appendix VI: Key regulatory issues and concessions and licenses held by the Telefónica Group</u>	<u>172</u>

2018 Consolidated Financial Statements

Telefónica Group

Consolidated statements of financial position at December 31

Millions of euros	Notes	2018	2017
ASSETS			
A) NON-CURRENT ASSETS		90,707	95,135
Intangible assets	(Note 6)	16,856	18,005
Goodwill	(Note 7)	25,748	26,841
Property, plant and equipment	(Note 8)	33,295	34,225
Investments accounted for by the equity method	(Note 9)	68	77
Financial assets and other non-current assets	(Note 11)	7,109	8,167
Deferred tax assets	(Note 22)	7,631	7,820
B) CURRENT ASSETS		23,340	19,931
Inventories		1,692	1,117
Receivables and other current assets	(Note 12)	10,579	10,093
Tax receivables	(Note 22)	1,676	1,375
Other current financial assets	(Note 13)	2,209	2,154
Cash and cash equivalents	(Note 14)	5,692	5,192
Non-current assets classified as held for sale	(Note 28)	1,492	—
TOTAL ASSETS (A+B)		114,047	115,066
	Notes	2018	2017
EQUITY AND LIABILITIES			
A) EQUITY		26,980	26,618
Equity attributable to equity holders of the parent and other holders of equity instruments	(Note 15)	17,947	16,920
Equity attributable to non-controlling interests	(Note 15)	9,033	9,698
B) NON-CURRENT LIABILITIES		57,418	59,382
Non-current financial liabilities	(Note 16)	45,334	46,332
Payables and other non-current liabilities	(Note 18)	1,890	1,687
Deferred tax liabilities	(Note 22)	2,674	2,145
Non-current provisions	(Note 21)	7,520	9,218
C) CURRENT LIABILITIES		29,649	29,066
Current financial liabilities	(Note 16)	9,368	9,414
Payables and other-current liabilities	(Note 19)	15,485	15,095
Current tax payables	(Note 22)	2,047	2,341
Current provisions	(Note 21)	1,912	2,216
Liabilities associated with non-current assets classified as held for sale	(Note 28)	837	—
TOTAL EQUITY AND LIABILITIES (A+B+C)		114,047	115,066

The accompanying notes and appendices are an integral part of these consolidated statements of financial position.

2018 Consolidated Financial Statements

Telefónica Group				
Consolidated income statements for the years ended December 31				
Millions of euros	Notes	2018	2017	2016
Revenues	(Note 23)	48,693	52,008	52,036
Other income	(Note 23)	1,622	1,489	1,763
Supplies		(14,013)	(15,022)	(15,242)
Personnel expenses	(Note 23)	(6,332)	(6,862)	(8,098)
Other expenses	(Note 23)	(14,399)	(15,426)	(15,341)
OPERATING INCOME BEFORE DEPRECIATION AND AMORTIZATION (OIBDA)		15,571	16,187	15,118
Depreciation and amortization	(Note 23)	(9,049)	(9,396)	(9,649)
OPERATING INCOME		6,522	6,791	5,469
Share of income (loss) of investments accounted for by the equity method	(Note 9)	4	5	(5)
Finance income		1,458	1,073	1,770
Exchange gains		3,389	3,958	5,489
Finance costs		(2,690)	(3,363)	(4,476)
Exchange losses		(3,112)	(3,867)	(5,002)
Net financial expense	(Note 17)	(955)	(2,199)	(2,219)
PROFIT BEFORE TAX		5,571	4,597	3,245
Corporate income tax	(Note 22)	(1,621)	(1,219)	(846)
PROFIT FOR THE YEAR		3,950	3,378	2,399
Attributable to equity holders of the Parent		3,331	3,132	2,369
Attributable to non-controlling interests	(Note 15)	619	246	30
Basic and diluted earnings per share attributable to equity holders of the parent (euros)	(Note 23)	0.57	0.56	0.42

The accompanying notes and appendices are an integral part of these consolidated income statements.

2018 Consolidated Financial Statements

Telefónica Group

Consolidated statements of comprehensive income for the years ended December 31

Millions of euros	2018	2017	2016
Profit for the year	3,950	3,378	2,399
Other comprehensive (loss) income	(2,390)	(4,820)	3,363
Gains (losses) from financial assets measured at Fair value through other comprehensive income	9	26	(77)
Income tax impact	(3)	6	22
Reclassification of (gains) losses included in the income statement (Note 17)	—	33	136
Income tax impact	—	—	(19)
Gains (losses) on hedges	6	65	62
Income tax impact	935	62	498
Reclassification of (gains) losses included in the income statement (Note 17)	(243)	6	(120)
Income tax impact	(706)	162	54
Gains (losses) on hedges costs	181	(40)	(14)
Income tax impact	167	190	418
Reclassification of (gains) losses included in the income statement (Note 17)	51	—	—
Income tax impact	(13)	—	—
Reclassification of (gains) losses included in the income statement (Note 17)	(2)	—	—
Income tax impact	1	—	—
Share of (losses) gains recognized directly in equity of associates and others	37	—	—
Income tax impact	(34)	8	(8)
Reclassification of (gains) losses included in the income statement	1	(2)	3
Income tax impact	—	—	—
Translation differences (Note 15)	(33)	6	(5)
Total other comprehensive (loss) income recognized for the year (Items that may be reclassified subsequently to profit or loss)	(2,602)	(5,094)	3,176
Actuarial gains (losses) and impact of limit on assets for defined benefit pension plans	(2,425)	(4,833)	3,651
Income tax impact	203	14	(378)
(Losses) gains from financial assets measured at fair value through comprehensive income	(24)	(1)	90
Income tax impact	179	13	(288)
Total other comprehensive income (loss) recognized for the year (Items that will not be reclassified subsequently to profit or loss)	(133)	—	—
Total comprehensive income (loss) recognized for the year	(11)	—	—
Attributable to:	(144)	—	—
Equity holders of the parent and other holders of equity instruments	35	13	(288)
Non-controlling interests	1,560	(1,442)	5,762

The accompanying notes and appendices are an integral part of these consolidated statements of comprehensive income.

Telefónica, S.A. 6

2018 Consolidated Financial Statements

Telefónica Group

Consolidated statement of changes in equity for the year ended December 31

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	Net income
Financial position at December 31, 2017 (*)	5,192	4,538	(688)	7,518	987	14,732	74	384	37	(15,854)	16,920	9,000
Adjustment on initial application of new reporting (Note 15)	—	—	—	—	—	817	(305)	—	—	—	512	600
Initial impact of hyperinflation in Argentina	—	—	—	—	—	(1,114)	—	—	—	3,147	2,033	—
Financial position at January 1, 2018	5,192	4,538	(688)	7,518	987	14,435	(231)	384	37	(12,707)	19,465	9,000
Profit for the year	—	—	—	—	—	3,331	—	—	—	—	3,331	600
Other comprehensive income (loss) for the year	—	—	—	—	—	181	(138)	176	7	(2,044)	(1,818)	(500)
Total comprehensive income (loss) for the year	—	—	—	—	—	3,512	(138)	176	7	(2,044)	1,513	400
Dividends and distribution of profit (Note 15)	—	—	—	—	51	(2,102)	—	—	—	—	(2,051)	(900)
Net movement in treasury shares	—	—	2	—	—	(1)	—	—	—	—	1	—
Acquisitions and disposals of non-controlling interests and business combinations (Note 5)	—	—	—	—	—	232	—	—	—	—	232	100
	—	—	—	(22)	—	(392)	—	—	—	—	(414)	(100)

Undated deeply subordinated securities and notes mandatorily convertible (Note 15)												
Translation effect of financial statements in hyperinflation economies	—	—	—	—	—	(799	)—	—	—	—	—	(799)—
Other movements	—	—	—	—	—	—	—	—	—	—	—	—
Financial position at December 31, 2018	5,192	4,538	(686	)7,496	1,038	14,885	(369	)560	44	(14,751	)17,947	9

The accompanying notes and appendices are an integral part of these consolidated statements of changes in equity.

(*) The opening balances of "Retained Earnings" and "Translation Differences" have been modified to reflect the change in accounting policy described in Note 2.

Telefónica, S.A. 7

2018 Consolidated Financial Statements

Telefónica Group

Consolidated statements of changes in equity for the years ended December 31

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	Available-for-sale investments	Hedges	Equity of associates and others	Translation difference
Financial position at December 31, 2016 (*)	5,038	3,227	(1,480)	7,803	985	13,928	9	191	31	(11,575)
Profit for the year	—	—	—	—	—	3,132	—	—	—	—
Other comprehensive income (loss) for the year	—	—	—	—	—	16	65	193	6	(4,270)
Total comprehensive income (loss) for the year	—	—	—	—	—	3,148	65	193	6	(4,270)
Dividends and distribution of profit (Note 15)	—	—	—	—	2	(2,021)	—	—	—	—
Net movement in treasury shares	—	—	35	—	—	—	—	—	—	—
Acquisitions and disposals of non-controlling interests and business combinations	—	—	754	—	—	449	—	—	—	(9)
Undated deeply subordinated securities and notes mandatorily convertible (Note 15)	154	1,311	—	(285)	—	(443)	—	—	—	—
Translation effect of financial statements in hyperinflation economies	—	—	—	—	—	(328)	—	—	—	—
Other movements	—	—	3	—	—	(1)	—	—	—	—

Edgar Filing: TELEFONICA S A - Form 6-K

Financial position at December 31, 2017	5,192	4,538	(688	)7,518	987	14,732	74	384	37	(15,854
Financial position at December 31, 2015	4,975	3,227	(1,656	)6,803	984	18,475	(53	)(231	)36	(16,789
Change in accounting policy for the presentation of hyperinflation effects in equity (Note 2)	—	—	—	—	—	(3,141	)—	—	—	3,141
Financial position at January 1, 2016	4,975	3,227	(1,656	)6,803	984	15,334	(53	)(231	)36	(13,648
Profit for the year	—	—	—	—	—	2,369	—	—	—	—
Other comprehensive income (loss) for the year	—	—	—	—	—	(267	)62	422	(5	)2,073
Total comprehensive income (loss) for the year	—	—	—	—	—	2,102	62	422	(5	)2,073
Dividends and distribution of profit (Note 15)	137	—	—	—	1	(2,544)—	—	—	—
Net movement in treasury shares	—	—	(637)—	—	—	—	—	—	—
Acquisitions and disposals of non-controlling interests and business combinations (Note 5)	—	—	—	—	—	—	—	—	—	—
Capital reduction (Note (74 15)	)—	813	—	—	—	(739)—	—	—	—
Undated deeply subordinated securities (Note 15)	—	—	—	1,000	—	(255)—	—	—	—
Translation effect of	—	—	—	—	—	(24)—	—	—	—

financial
statements in
hyperinflation
economies

Other movements	—	—	—	—	—	54	—	—	—	—
Financial position at December 31, 2016	5,038	3,227	(1,480	)7,803	985	13,928	9	191	31	(11,575

The accompanying notes and appendices are an integral part of these consolidated statements of changes in equity.

(* The opening balances of "Retained Earnings" and "Translation Differences" have been modified to reflect the change in accounting policy described in Note 2.

Telefónica, S.A. 8

Edgar Filing: TELEFONICA S A - Form 6-K

2018 Consolidated Financial Statements

Telefónica Group

Consolidated statements of cash flows for the years ended December 31

Millions of euros

	Notes	2018	2017	2016
Cash received from operations	(Note 25)	58,815	63,456	63,514
Cash paid from operations	(Note 25)	(42,891)	(46,929)	(47,384)
Net payments of interest and other financial expenses net of dividends received	(Note 25)	(1,636)	(1,726)	(2,143)
Taxes paid	(Note 25)	(865)	(1,005)	(649)
Net cash flow provided by operating activities	(Note 25)	13,423	13,796	13,338
(Payments on investments)/proceeds from the sale in property, plant and equipment and intangible assets, net	(Note 25)	(8,585)	(8,992)	(9,187)
Proceeds on disposals of companies, net of cash and cash equivalents disposed	(Note 25)	29	40	767
Payments on investments in companies, net of cash and cash equivalents acquired	(Note 25)	(3)	(128)	(54)
Proceeds on financial investments not included under cash equivalents	(Note 25)	1,004	296	489
Payments on financial investments not included under cash equivalents	(Note 25)	(965)	(1,106)	(265)
(Payments)/proceeds on placements of cash surpluses not included under cash equivalents		(202)	(357)	42
Government grants received		37	2	—
Net cash flow used in investing activities	(Note 25)	(8,685)	(10,245)	(8,208)
Dividends paid	(Note 25)	(2,794)	(2,459)	(2,906)
Proceeds from share capital increase	(Note 25)	—	2	—
Proceeds/(payments) of treasury shares and other operations with shareholders and with minority interests	(Note 25)	379	1,269	(660)
Operations with other equity holders	(Note 25)	(561)	646	656
Proceeds on issue of debentures and bonds and other debts	(Note 25)	4,289	8,390	5,693
Proceeds on loans, borrowings and promissory notes	(Note 25)	3,973	4,844	10,332
Repayments of debentures and bonds and other debts	(Note 25)	(4,654)	(6,687)	(6,873)
Repayments of loans, borrowings and promissory notes	(Note 25)	(4,040)	(6,711)	(8,506)
Financed operating payments and investments in property, plant and equipment and intangible assets payments	(Note 25)	(472)	(1,046)	(1,956)
Net cash used in financing activities		(3,880)	(1,752)	(4,220)

Edgar Filing: TELEFONICA S A - Form 6-K

	(Note 25)			
Effect of changes in exchange rates		(244	)(341	)185
Cash reclassified to assets held for sale	(Note 28)	(111)—	—
Effect of changes in consolidation methods and others		(3	)(2	)26
Net increase (decrease) in cash and cash equivalents during the year		500	1,456	1,121
CASH AND CASH EQUIVALENTS AT JANUARY 1	(Note 14)	5,192	3,736	2,615
CASH AND CASH EQUIVALENTS AT DECEMBER 31	(Note 14)	5,692	5,192	3,736
RECONCILIATION OF CASH AND CASH EQUIVALENTS WITH THE STATEMENTS OF FINANCIAL POSITION				
BALANCE AT JANUARY 1	(Note 14)	5,192	3,736	2,615
Cash on hand and at banks		3,990	2,077	1,278
Other cash equivalents		1,202	1,659	1,337
BALANCE AT DECEMBER 31	(Note 14)	5,692	5,192	3,736
Cash on hand and at banks		4,886	3,990	2,077
Other cash equivalents		806	1,202	1,659

The accompanying notes and appendices are an integral part of these consolidated statements of cash flows.

Telefónica, S.A. 9

2018 Consolidated Financial Statements

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

Notes to the consolidated financial statements (consolidated annual accounts) for the year ended December 31, 2018

Note 1. Background and general information

Telefónica, S.A. and its subsidiaries and investees (hereinafter also referred to as “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 fixed 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).

Appendix I lists the main companies composing the Telefónica Group, their corporate purpose, country, functional currency, share capital, the Group’s effective shareholding and their method of consolidation.

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 fixed and wireless telephony services are provided under regulated rate and price systems. Key regulatory issues, and concessions and licenses held by the Telefónica Group are detailed in Appendix VI.

Note 2. Basis of presentation of the consolidated financial statements

The accompanying consolidated financial statements were prepared from the accounting records of Telefónica, S.A. and each of the companies comprising the Telefónica Group, whose separate financial statements were prepared in accordance with the generally accepted accounting principles applicable in the various countries in which they are located, and for purposes of these consolidated financial statements are presented in accordance with the International Financial Reporting Standards (IFRS) adopted by the European Union, which for the purposes of the Telefónica Group are not different from those issued by the International Accounting Standards Board (IASB), to give a true and fair view of the consolidated equity and financial position at December 31, 2018, and of the consolidated results of operations, changes in consolidated equity and the consolidated cash flows obtained and used in the year then ended. The euro is the Group’s reporting currency. The figures in these consolidated financial statements are expressed in millions of euros, unless otherwise indicated, and therefore may be rounded.

The accompanying consolidated financial statements for the year ended December 31, 2018 were approved by the Company’s Board of Directors at its meeting on February 20, 2019 for submission for approval at the General Shareholders’ Meeting, which is expected to occur without modification.

Note 3 contains a detailed description of the most significant accounting policies used to prepare these consolidated financial statements.

Telefónica, S.A. 10

2018 Consolidated Financial Statements

Materiality criteria

These consolidated financial statements do not include certain information or disclosures that, not requiring presentation due to their qualitative significance, were deemed to be immaterial or of no relevance pursuant to the concepts of materiality or relevance defined in the IFRS conceptual framework, insofar as the Telefónica Group's consolidated financial statements, taken as a whole, are concerned.

Comparative information and main changes in the consolidation scope

For comparative purposes, the accompanying consolidated financial statement for 2018 include the figures for 2017, and in the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows, and the notes thereto for the year then ended, on a voluntary basis, they also include those of 2016.

The main events and changes in the consolidation scope affecting comparability of the consolidated information for 2018 and 2017 (see Appendix I for a detailed description of the consolidation scope and the changes during the year) are as listed below.

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 recognizing 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 recognized as an adjustment to the opening balance of retained earnings at the date of initial application January 1, 2018, with a corresponding impact in "Non-controlling interests" (see Note 15).

Accordingly, the 2017 and 2016 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 capitalization and deferral of the incremental costs of obtaining contracts, that under IFRS 15, result in the later recognition of customer acquisition costs.

2018 Consolidated Financial Statements

The impacts of adopting IFRS 15 on the Group's financial statements for the year ended December 31, 2018 are set out below:

Millions of euros	12/31/2018	12/31/2018	12/31/2018
ASSETS	IFRS 15	IAS 18	IFRS 15 impact
A) NON-CURRENT ASSETS	90,707	90,448	259
Intangible assets	16,856	16,856	—
Goodwill	25,748	25,748	—
Property, plant and equipment	33,295	33,295	—
Investments accounted for by the equity method	68	68	—
Financial assets and other non-current assets	7,109	6,823	286
Deferred tax assets	7,631	7,658	(27)
B) CURRENT ASSETS	23,340	22,540	800
Inventories	1,692	1,692	—
Receivables and other current assets	10,579	9,789	790
Tax receivables	1,676	1,666	10
Other current financial assets	2,209	2,209	—
Cash and cash equivalents	5,692	5,692	—
Non-current assets classified as held for sale	1,492	1,492	—
TOTAL ASSETS (A+B)	114,047	112,988	1,059

Millions of euros	12/31/2018	12/31/2018	12/31/2018
EQUITY AND LIABILITIES	IFRS 15	IAS 18	IFRS 15 Impact
A) EQUITY	26,980	26,193	787
Equity attributable to equity holders of the parent and other holders of equity instruments	17,947	17,262	685
Equity attributable to non-controlling interests	9,033	8,931	102
B) NON-CURRENT LIABILITIES	57,418	57,267	151
Non-current financial liabilities	45,334	45,334	—
Payables and other non-current liabilities	1,890	1,903	(13)
Deferred tax liabilities	2,674	2,510	164
Non-current provisions	7,520	7,520	—
C) CURRENT LIABILITIES	29,649	29,528	121
Current financial liabilities	9,368	9,368	—
Payables and other-current liabilities	15,485	15,460	25
Current tax payables	2,047	1,951	96
Current provisions	1,912	1,912	—
Liabilities associated with non-current assets classified as held for sale	837	837	—
TOTAL EQUITY AND LIABILITIES (A+B+C)	114,047	112,988	1,059

2018 Consolidated Financial Statements

Millions of euros	2018	2018	2018
	IFRS 15	IAS 18	IFRS 15
			Impact
INCOME STATEMENTS			
Revenues	48,693	48,728	(35)
OPERATING INCOME BEFORE DEPRECIATION AND AMORTIZATION (OIBDA)	15,571	15,495	76
Depreciation and amortization	(9,049)	(9,049)	—
OPERATING INCOME	6,522	6,446	76
Share of profit (loss) of investments accounted for by the equity method	4	4	—
Net financial expense	(955)	(944)	(11)
PROFIT BEFORE TAX	5,571	5,506	65
Corporate income tax	(1,621)	(1,609)	(12)
PROFIT FOR THE PERIOD	3,950	3,897	53
Attributable to equity holders of the Parent	3,331	3,291	40
Attributable to non-controlling interests	619	606	13
Basic and diluted earnings per share attributable to equity holders of the parent (euros)	0.57	0.56	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 and 2016 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 in the carrying amounts of financial assets and financial liabilities resulting from the adoption of the new requirements is recognized in "retained earnings" as of January 1, 2018 (see Note 15).

The main impact of adopting IFRS 9 on the Group's financial statements resulted in an increase amounting to 221 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 14).

Translation of Telefónica Venezolana's financial statements

Venezuela has been considered a hyperinflationary economy since 2009. We regularly review 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. On August 20, 2018 Venezuela introduced the Bolívar Soberano (VES), which replaced the Bolívar Fuerte (VEF) removing five zeros (1 VES = 100,000 VEF). In light of the economic environment and in the absence of official rates that are representative of the situation in Venezuela, in 2018 the Group maintained its policy for estimating an exchange rate to match the progression of inflation in Venezuela and attempts to reflect the economic and financial position of the Group's Venezuelan operations within its consolidated financial statements more accurately (hereinafter, synthetic exchange rate). Thus, the exchange rate used to translate the financial statements of the Venezuelan subsidiaries as of December 31, 2018 amounts to 7,608 VES/USD (36,115 VEF/USD as of December 31, 2017). The inflation rates applied by the Group to Venezuela for 2018 was 2,106,600% (2,874.1% for 2017).

2018 Consolidated Financial Statements

The official reference exchange rate at December 31, 2018 was 638 VES/USD.

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

Millions of euros	2018	2017
Revenues	18	106
Operating income before depreciation and amortization (OIBDA)	3	34
Depreciation and amortization	(67)	(103)
Financial result (1)	216	81
Profit before tax	152	9
Income tax (2)	(186)	(138)
Result for the period	(34)	(129)
Net cash flow provided by operating activities	7	35
Capital expenditures (CapEx)	2	9
Non-current assets	238	295

(1) The financial result due to the hyperinflation adjustment to the net monetary position and from the exchange differences arising from foreign currency items held by Telefónica Venezolana (see Note 17) amounted to 219 million euros in 2018 (84 million euros in 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.

Change in accounting policy for the presentation of hyperinflation effects in equity

As a result of the consideration of Argentina as a hyperinflationary economy since July 2018 with retrospective effect to January 1 of that year, the Group has revisited its presentation policy for the equity effects of the hyperinflation situation that currently affects the Argentine and Venezuelan (since 2009) economies.

In order to present more relevant and reliable information, the Group includes in a single line item all the equity effects derived from hyperinflation, i.e.: (a) the restatement for inflation of the financial statements of the Group companies operating in hyperinflationary economies, and (b) the effects of translating their respective financial statements into euros using the exchange rate at the end of the period. The Group has decided to show these effects within reserves rather than presenting them under Translation Differences within Other Comprehensive Income, since it considers that this presentation criterion provides more reliable information for several reasons. In a market that operates according to the fundamentals of economic theory, the evolution of the currency exchange rate should offset changes in the purchasing power of the local currency derived from inflation. However, in hyperinflationary economies this is not always the case. For example, in the case of Venezuela, these effects are not offset because the official rates are not representative of the evolution of the country's inflation rates (reason why the Group estimates a synthetic exchange rate that contributes to a faithful presentation of the economic and financial situation of its Venezuelan operations, as explained above). In addition, these equity movements are not generated by the companies' activities, but arise from an accounting restatement, marked in turn by the evolution of the aforementioned economic metrics that are alien to the companies' performance.

This change in the presentation criteria implies a reclassification from Translation Differences to Retained Earnings, and therefore the consolidated net equity remains unchanged. In accordance with IAS 8, financial information from previous years presented for comparative purposes has been restated so that the information is comparable.

Consequently, the Translation Differences line item no longer includes the accumulated effects arising from hyperinflation in Venezuela, which have been reclassified for an amount of 3,141 million euros, 3,165 million euros and 3,493 million euros, at 1 January 2016, 31 December 2016 and 31 December 2017, respectively.

Telefónica, S.A. 14

2018 Consolidated Financial Statements

As this change in accounting policy is a reclassification within equity, the basic and diluted earnings per share figures are not affected in any of the periods presented.

Hyper-inflation in Argentina

In the recent years, the Argentine economy has shown high rates of inflation. Therefore, the Group has periodically assessed the quantitative and qualitative indicators of inflation in the country. Although inflation data has not been consistent in recent years and several indexes have coexisted, inflation in Argentina increased significantly in the second quarter of 2018 and data indicates that the three-year cumulative inflation recently exceeded 100%, which is the quantitative reference established by IAS 29 Financial Reporting in Hyperinflationary Economies. As a result, Argentina is considered a hyperinflationary economy in 2018 and the Group applies hyper-inflation accounting to its companies whose functional currency is the Argentine peso for financial information for periods ended after July 1, 2018.

The main implications are as follows:

Adjustment of the historical cost of non-monetary assets and liabilities and equity items from their date of acquisition, or the date of inclusion in the consolidated statement of financial position, to the end of the year, in order to reflect changes in the currency's purchasing power caused by inflation.

The gain or loss on the net monetary position caused by the impact of inflation in the year is included in the income statement.

Items in the income statement and in the statement of cash flows are adjusted by the inflation index since their origination, with a balancing entry in financial results within the statement of income and a reconciling item in the statement of cash flows, respectively.

All items in the financial statements of the Argentine companies are translated at the closing exchange rate, which at December 31, 2018 was 43.30 Argentine pesos per euro.

Figures for financial years prior to 2018 are not restated.

The main impacts in the consolidated financial statements of the Telefónica Group for the year 2018 of the aforementioned adjustments, are shown below:

Millions of euros	Impact of the application of hyperinflation adjustments in 2018	
Revenues	(313)
Operating income before depreciation and amortization (OIBDA)	(148)
Depreciation and amortization	(160)
Net result	(306)
Capital expenditures (CapEx)	(70)
Total equity	1,750	
Non-current assets	2,012	

Pursuant to the accounting policy described in the previous section, all the equity effects derived from hyperinflationary presented in Retained Earnings. As of 1 January 2018 the total impact in net equity amounts to 2,033 million euros, which includes the transferral of 3,147 million euros of translation differences arisen prior to the consideration of the economy as hyperinflationary, as a consequence of the full retrospective application of IAS 29. Capital increase in Coltel, termination of the operating agreement with the PARAPAT and arbitration award Colombia Telecomunicaciones, S.A. E.S.P. (Coltel) is a company in which Telefónica holds 67.5% and the Colombian Government the remaining 32.5% (see Note 26.c).

2018 Consolidated Financial Statements

On August 29, 2017, the shareholders' meeting of Coltel approved:

a capital increase for an aggregate amount of 4,800,966 million Colombian pesos (capital and premium), 1,384 million euros at the exchange rate of the relevant transaction date, so that Coltel would voluntarily pre-pay the entire amount of Coltel's debt derived from the operating agreement dated August 13, 2003 with Patrimonio Autónomo Receptor de Activos de la Empresa Nacional de Telecomunicaciones (PARAPAT).

The Telefónica Group and the Colombian Government subscribed to the PARAPAT-Capital Increase pro rata to their respective shareholding in Coltel (see Note 15.i). The Telefónica Group disbursed 3,240,652 million Colombian pesos, 934 million euros at the exchange rate of the relevant transaction date. The Colombian Government assumed 32.5% of Coltel's payment obligations with PARAPAT.

The PARAPAT Capital Increase was subscribed to on September 26, 2017 and, on September 27, 2017, Coltel pre-paid all its debt with PARAPAT, whereby acquiring ownership of PARAPAT-related assets.

As part of the early termination of the operating agreement with PARAPAT, Coltel acquired control (see Note 5) of the companies Empresa de Telecomunicaciones de Telebucaramanga S.A. ESP (Telebucaramanga), Metropolitana de Telecomunicaciones S.A. ESP (Metrotel) and Operaciones Tecnológicas y Comerciales S.A.S. (Optecom), for a combined total of 509,975 million Colombian pesos (approximately 147 million euros at the date of the transaction). a capital increase for an aggregate amount of 1,651,012 million Colombian pesos (capital and premium), 470 million euros at the exchange rate on that date.

The proceeds from the Arbitration Award-Capital Increase were used to pay the entire amount set forth in the arbitration award issued in the arbitration proceedings initiated by the ITC in connection with its intention to revert certain assets earmarked for the provisions of mobile voice services under former concessions (see Note 6 and Appendix VI).

The Telefónica Group and the Colombian Government subscribed the Arbitration Award-Capital Increase pro rata to their respective shareholding in Coltel. The Telefónica Group disbursed 1,114,433 million Colombian pesos, 317 million euros at the exchange rate on the relevant transaction date. The Colombian Government assumed and consequently offset a portion of Coltel's debt.

Individual Suspension Plan

In 2015 Telefónica de España, S.A.U., Telefónica Móviles España, S.A.U. and Telefónica Soluciones de Informática y Comunicaciones de España, S.A.U. signed the 1st Collective Bargaining Agreement of Related Companies (CEV), wholly backed by the largest labor unions. One element contemplated in this agreement, was a plan of measures for individual suspension of the employment relationship in 2016 and 2017, applying principles of voluntariness, universality, non-discrimination and social responsibility.

The provision was updated in 2018 and 2017 according to the degree of adhesion to the Plan, which, together with the updated termination plans, entailed an expense of 297 and 165 million euros in the 2018 and 2017 consolidated income statement, respectively (see Note 21).

Court proceedings in favor of Telefónica Brasil which recognizes the right to exclude ICMS (VAT) from the basis of calculation of the contributions to PIS and COFINS

In 2018 two final decisions in favor of Telefónica Brazil were passed, 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).

Once the values were determined, Telefónica Brazil 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 amounted to 6,240 million Brazilian reals (around 1,454 million euros at an average exchange rate

2018 Consolidated Financial Statements

of 2018). The impact on the consolidated income statement amounted to 3,386 million Brazilian reais (789 million euros), reducing the “Taxes” item under “Other expenses” (Note 23), and 2,854 million Brazilian reais (665 million euros) under “Finance Income” (Note 17).

The outstanding credit at December 31, 2018 (Note 11) amounted to 4,915 million Brazilian reais (1,107 million euros at the closing exchange rate for 2018).

Sale of non-controlling interests in Telxius

On July 27, 2018 Telefónica transferred to a company of the Pontegadea Group ("Pontegadea") 16.65% of the share capital of the Telefónica's subsidiary Pontel Participaciones, S.L. ("Pontel") that owns 60% of the share capital of the company Telxius Telecom, S.A. ("Telxius"), for an amount of 378.8 million euros, which entailed a price of 15.2 euros per share of Telxius. This participation of 16.65% in the capital stock of Pontel is equivalent, in economic terms, to an indirect participation of 9.99% in the share capital of Telxius. The impact of this transaction in the equity attributable to equity holders of the parent amounted to 232 million euros, being the impact to non-controlling interest of 139 million euros.

On October 24, 2017, Telefónica transferred 62 million shares of Telxius (representing 24.8% per cent of its share capital) to Taurus Bidco S.à.r.l. (hereinafter, KKR, an entity managed by Kohlberg Kravis Roberts & Co. L.P.) in exchange for 790.5 million euros.

On November 13, 2017, KKR exercised a call option on 38 million shares of Telxius (representing 15.2% of its share capital) in exchange for 484.5 million euros (see Note 5).

Following the closing of this sale of 15.2% of the share capital of Telxius, in December 2017, together with the 24.8% of the share capital acquired in October, the total stake of KKR is 40% of the share capital of Telxius in exchange for an aggregate amount of 1,275 million euros (see Note 25). These transactions had no impact on the consolidated results of the Telefónica Group, since they comprised the sale of minority interests and Telefónica retained control over Telxius. The impact of these transactions in equity attributable to equity holders of the parent was an increase of 570 million euros in retained earnings and a decrease of 9 million euros in translation differences. In addition, there was an increase in equity attributable to non-controlling interests amounting to 690 million euros (see Note 15).

Alternative measures not defined in IFRS

In addition to the measures expressly defined in the IFRS, the Group also uses a series of other measures for decision-making 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 Telefónica Group companies. OIBDA is a commonly reported measure and is widely used among analysts, investors and other stakeholders in the telecommunications industry. However, it is not a measure expressly defined in the IFRS and therefore it 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 years ended December 31, 2018, 2017 and 2016:

Millions of euros	2018	2017	2016
OIBDA	15,571	16,187	15,118
Depreciation and amortization	(9,049)	(9,396)	(9,649)
Operating income	6,522	6,791	5,469

2018 Consolidated Financial Statements

The following table presents the reconciliation of OIBDA to operating income for each business segment for the years ended December 31, 2018, 2017 and 2016. The segment's detail of the last two years has been revised because of the inclusion of Telefónica Hispam Norte and Telefónica Hispam Sur (see Note 4):

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
OIBDA	4,763	1,865	1,834	4,311	793	1,719	286	15,571
Depreciation and amortization	(1,650)	(943)	(2,071)	(1,990)	(967)	(1,167)	(261)	(9,049)
Operating income	3,113	922	(237)	2,321	(174)	552	25	6,522

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
OIBDA	4,952	1,639	1,821	4,191	1,263	2,275	46	16,187
Depreciation and amortization	(1,688)	(1,047)	(1,954)	(2,228)	(992)	(1,198)	(289)	(9,396)
Operating income	3,264	592	(133)	1,963	271	1,077	(243)	6,791

2016 (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
OIBDA	4,403	1,709	1,771	3,702	1,113	2,360	60	15,118
Depreciation and amortization	(1,827)	(1,090)	(2,200)	(2,036)	(1,112)	(1,075)	(309)	(9,649)
Operating income	2,576	619	(429)	1,666	1	1,285	(249)	5,469

Telefónica, S.A. 18

2018 Consolidated Financial Statements

Debt indicators

As calculated by the Group net financial debt includes:

i. current and non-current financial liabilities in our consolidated statement of financial position (including liability derivatives), and

ii. other current and non-current liabilities 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. Other 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", "Tax receivables" 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 handset sales classified as short term, and "Financial assets and other non-current assets" includes derivatives, installments for the long-term sales of handsets to customers and other long-term financial assets.

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 thereof. Gross commitments related to employee benefits are current and non-current provisions recorded for certain employee benefits such as termination plans, post-employment defined benefit plans and other benefits.

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. 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 December 31, 2018 and 2017 to the Telefónica Group's gross financial debt as indicated in the consolidated statement of financial position.

2018 Consolidated Financial Statements

Millions of euros	12/31/2018	12/31/2017
Non-current financial liabilities	45,334	46,332
Current financial liabilities	9,368	9,414
Gross financial debt	54,702	55,746
Cash and cash equivalents	(5,692)	(5,192)
Other current financial assets	(2,209)	(2,154)
Cash and other current financial assets included in "Non-current assets classified as held for sale" (Note 28)	(165)	—
Positive mark-to-market value of long-term derivative instruments (Note 11)	(2,776)	(2,812)
Other liabilities included in "Payables and other non-current liabilities"	800	708
Other liabilities included in "Payables and other current liabilities"	111	111
Other assets included in "Financial assets and other non-current assets"	(1,593)	(1,516)
Other assets included in "Receivables and other current assets"	(867)	(661)
Other current assets included in "Tax receivables" (Note 11)	(568)	—
Financial liabilities included in "Liabilities associated with non-current assets classified as held for sale" (Note 28)	42	—
Net financial debt	41,785	44,230
Gross commitments related to employee benefits	5,940	6,578
Value of associated long-term assets	(704)	(749)
Tax benefits	(1,390)	(1,533)
Net commitments related to employee benefits	3,846	4,296
Net financial debt plus commitments (*)	45,631	48,526

(*) Includes assets and liabilities considered to be "net financial debt plus commitments" for Antares (see Note 21), Guatemala and El Salvador, which are classified as non-current assets held for sale and liabilities for non-current assets held for sale.

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 from government grants and deducting dividends paid to minority interests. The cash used to pay for commitments related to employee benefits (included in the Net cash flow provided by operating activities) is added back since it represents the payments of principal of the debt incurred with those employees.

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 (which is why free cash flows do not consider payments to minority interests). 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 cash flows presented in the consolidated statements of cash flows.

2018 Consolidated Financial Statements

The following table presents the reconciliation between the 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 2018, 2017 and 2016:

Millions of euros	2018	2017	2016
Net cash flow provided by operating activities	13,423	13,796	13,338
(Payments on investments)/Proceeds from the sale of property, plant and equipment and intangible assets, net (Note 25)	(8,585)	(8,992)	(9,187)
Government grants received	37	2	—
Dividends paid to minority shareholders (Note 25)	(746)	(555)	(511)
Payments related to cancellation of commitments (Note 25)	775	696	738
Free cash flow	4,904	4,947	4,378

Note 3. Accounting policies

As stated in Note 2, the Group's consolidated financial statements have been prepared in accordance with IFRSs and interpretations issued by the International Accounting Standards Board (IASB) and the IFRS Interpretations Committee (IFRIC) as endorsed by the European Commission for use in the European Union (IFRSs - EU).

Accordingly, only the most significant accounting policies used in preparing the accompanying consolidated financial statements, in light of the nature of the Group's activities, are set out below, as well as the accounting policies applied where IFRSs permit a policy choice, and those that are specific to the sector in which the Group operates.

a) Hyperinflationary economies

Venezuela is considered as a hyperinflationary economy since 2009. The inflation rates used to prepare the financial information are the "Índice Nacional de Precios al Consumidor de Venezuela", published by the Central Bank of Venezuela, or the best estimate in case the final index is not available. On an annual basis, these rates are 2,106,600%, 2,874.1% and 511.1% for 2018, 2017 and 2016, respectively.

The exchange rate used to translate inflation-adjusted bolivar-denominated items is the exchange rate as of the closing date of each reporting period, amounting to 7,608 bolivars per U.S. dollar (synthetic exchange rate, see Note 2), 36,115.28 bolivars per U.S. dollar (synthetic exchange rate) and 673.762 bolivars per U.S. dollar (DICOM) as of December 31, 2018, 2017 and 2016, respectively.

For the first time in 2018 Argentina is considered a hyperinflationary economy (see Note 2). In order to restate its financial statements, the Company uses the the series of indices defined by resolution JG No. 539/18 issued by the Federación Argentina de Consejos Profesionales de Ciencias Económicas (FACPCE), based on the National Consumer Price Index (IPC) published by the Instituto Nacional de Estadística y Censos (INDEC) of the Argentine Republic and the Wholesale Internal Price Index (IPIM) published by FACPCE. The cumulative index at 31 December 2018 is 184.85%, while on an annual basis the index for 2018 is 48%.

The exchange rate used to translate inflation-adjusted items denominated in Argentine pesos in the 2018 financial statements is the closing exchange rate as of December 31, which was 43.30 pesos per euro.

b) Translation methodology

The income statements and statements of cash flows of the Group's foreign subsidiaries (except Venezuela and Argentina) were translated into euros at the average exchange rates for the year, as a rate that approximates the exchange rates at the dates of the transactions.

2018 Consolidated Financial Statements

c) Goodwill

After initial recognition, goodwill is carried at cost, less any accumulated impairment losses. Goodwill is recognized as an asset denominated in the currency of the company acquired and is tested for impairment annually or more frequently, if there are certain events or changes indicating the possibility that the carrying amount may not be fully recoverable. The potential impairment loss is determined by assessing the recoverable amount of the cash generating unit (or group of cash generating units) to which the goodwill is allocated from the acquisition date.

d) Intangible assets

Intangible assets are carried at acquisition or production cost, less any accumulated amortization or any accumulated impairment losses.

Intangible assets are amortized on a straight-line basis according to the following:

Licenses granted to the Telefónica Group by various public authorities to provide telecommunications services and the value allocated to licenses held by certain companies at the time they were included in the Telefónica Group (“Service concession arrangements and licenses”) are amortized on a straight-line basis over the duration of related licenses from the moment commercial operation begins.

The allocation of acquisition costs attributable to customers acquired in business combinations, as well as the acquisition value of this type of assets in a third-party transaction for consideration (“Customer base”) are amortized on a straight-line basis over the estimated period of the customer relationship. The term length is between 5 to 14 years, based on the customer segment (residential, business, etc.) and the business model (prepaid, postpaid, etc.).

Software is amortized on a straight-line basis over its useful life, generally estimated to be between two and five years.

e) Property, plant and equipment

Property, plant and equipment is carried at cost less any accumulated depreciation and any accumulated impairment in value.

Cost includes, among others, direct labor used in installation and the allocable portion of the indirect costs required for the related asset. The latter two items are recorded as revenue under the concept “Own work capitalized” of the line item “Other income”.

Interest and other financial expenses incurred and directly attributable to the acquisition or construction of qualifying assets are capitalized. Qualifying assets for the Telefónica Group are those assets that require a period of at least 18 months to bring the assets to the condition necessary for their intended use or sale.

The Group’s subsidiaries depreciate their property, plant and equipment, from the time they can be placed in service, amortizing the cost of the assets, net of their residual values on a straight-line basis over the assets’ estimated useful lives, which are calculated in accordance with technical studies that are revised periodically in light of technological advances and the rate of dismantling, as follows:

	Years of estimated useful life
Buildings	25 – 40
Plant and machinery	10 – 15
Telephone installations, networks and subscriber equipment	5 – 20
Furniture, tools and other items	2 – 10

2018 Consolidated Financial Statements

f) Impairment of non-current assets

Non-current assets, including goodwill and intangible assets are assessed at each reporting date for indicators of impairment. Whenever such indicators exist, or in the case of assets which are subject to an annual impairment test, the recoverable amount is estimated. An asset's recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future post-tax cash flows deriving from the use of the asset or its cash generating unit, as applicable, are discounted to their present value using a post-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset, whenever the result obtained is the same that would be obtained by discounting pre-tax cash flows at a pre-tax discount rate.

The Group bases the calculation of impairment on the approved business plans of the various cash generating units to which the assets are allocated. The projected cash flows, based on the approved strategic business plans, cover a period of five years. Starting with the sixth year, an expected constant growth rate is applied.

g) Lease agreements

The determination of whether an arrangement is, or contains a lease is based on the substance of the agreement and requires an assessment of whether the fulfillment of the arrangement is dependent on the use of a specific asset and the agreement conveys a right to the use of the asset.

Leases where the lessor does not transfer substantially all the risks and benefits of ownership of the asset are classified as operating leases.

Leases are classified as finance leases when the terms of the lease transfer substantially all the risks and rewards incidental to ownership of the leased item to the Group.

h) Investment in associates and joint arrangements

The Group assesses whether it has significant influence not only on the basis of its ownership percentage but also on the existence of qualitative factors such as representation on the board of directors of the investee, its participation in decision-making processes, interchange of managerial personnel and access to technical information.

The Group assesses rights and obligations agreed to by the parties to a joint arrangement and, when relevant, other facts and circumstances in order to determine whether the joint arrangement in which it is involved is a joint venture or a joint operation.

i) Financial assets and liabilities

Financial Assets

All regular way purchases and sales of financial assets are recognized in the statement of financial position on the trade date, i.e. the date that the Company commits to purchase or sell the asset.

The Group applies an impairment model for financial assets based on expected credit losses, using a simplified method for certain short- and long-term assets (commercial receivables, lease receivables and contractual assets). Under this simplified approach, credit impairment is recognized by reference to expected losses over the life of the asset.

Derivative financial instruments and hedge accounting

The accounting treatment of any gain or loss resulting from changes in the fair value of a derivative depends on whether the derivative in question meets all the criteria for hedge accounting and, if appropriate, on the nature of the hedge.

Changes in fair value of derivatives that qualify as fair value hedging instruments are recognized in the income statement, together with changes in the fair value of the hedged asset or liability attributable to the risk being hedged.

2018 Consolidated Financial Statements

Changes in the fair value of derivatives that qualify and have been designated as cash flows hedges, which are highly effective, are recognized in equity. The ineffective portion is recognized immediately in the income statement. Fair value changes recognized in equity arising from hedges that relate to firm commitments or forecast transactions that result in the recognition of non-financial assets or liabilities are included in the initial carrying amount of those assets or liabilities. Otherwise, changes in fair value previously recognized in equity are recognized in the income statement in the period in which the hedged transaction affects profit or loss.

An instrument designated to hedge foreign currency exposure from a net investment in a foreign operation is accounted for in a similar manner to cash flow hedges.

When the Group chooses not to apply hedge accounting criteria, gains or losses resulting from changes in the fair value of derivatives are taken directly to the income statement. In this respect, transactions used to reduce the exchange rate risk of income contributed by foreign subsidiaries are not treated as hedging transactions.

j) Inventories

Materials stored for use in investment projects and inventories for consumption and replacement are valued at the lower of weighted average cost and net realizable value.

k) Pensions and other employee obligations

Provisions required to cover the accrued liability for defined-benefit pension plans are determined using “the projected unit credit” actuarial valuation method. The calculation is based on demographic and financial assumptions determined at a country level, and in consideration of the macroeconomic environment. The discount rates are determined based on high quality market yield curves. Plan assets are measured at fair value.

Provisions for post-employment benefits (e.g. early retirement or other) are calculated individually based on the terms agreed with the employees. In some cases, these may require actuarial valuations based on both demographic and financial assumptions.

l) Revenue and expenses

The Telefónica Group revenues are derived principally from providing the following telecommunications services: traffic, connection fees, regular (normally monthly) network usage fees, interconnection, network and equipment leasing, handset sales and other digital services such as Pay TV and value-added services or maintenance. Products and services may be sold separately or bundled in promotional packages.

Revenues from calls carried on Telefónica’s networks (traffic) entail an initial call establishment fee plus a variable call rate, based on call length, distance and type of service. Both fixed and wireless traffic is recognized as revenue as service is provided. For prepaid calls, the amount of unused traffic generates a deferred revenue presented in “Contractual liabilities” on the statement of financial position. Prepaid cards generally expire within 12 months and any deferred revenue from prepaid traffic is recognized directly in the income statement when the card expires as the Group has no obligation to provide service after expiry date.

Revenues from traffic sales and services at a fixed rate over a specified period of time (flat rate) are recognized on a straight-line basis over the term covered by the rate paid by the customer.

Installation fees are taken to the income statement on a straight-line basis over the related period. Equipment leases and other services are taken to profit or loss as they are consumed.

Interconnection revenues from fixed-wireless and wireless-fixed calls and other customer services are recognized in the period in which the calls are made.

Revenues from handset and equipment sales are recognized once the sale is considered complete, i.e., generally when delivered to the end customer.

For bundled packages that include multiple elements sold in the fixed, wireless, Internet and television businesses it is determined whether it is necessary to separate the separately identifiable elements and apply

2018 Consolidated Financial Statements

the corresponding revenue recognition policy to each element. Total package revenue is allocated among the identified elements based on their respective standalone selling prices.

As connection or initial activation fees, or upfront non-refundable fees, are not separately identifiable elements in these types of packages, any revenues received from the customer for these items are allocated to the remaining elements.

Expenses relating to customer contracts are recognized as an asset to the extent that they are incremental and are expected to be recovered, with subsequent amortization over the same term as the revenue associated with such contract, unless the expected amortization period is one year or less, in which case they are expensed as incurred.

m) Use of estimates

The key assumptions concerning the future and other relevant sources of uncertainty in estimates at the reporting date that could have a significant impact on the consolidated financial statements within the next financial year are discussed below.

A significant change in the facts and circumstances on which these estimates and related judgments are based could have a material impact on the Group's results and financial position. Accordingly, sensitivity analyzes are disclosed for the most relevant situations (see Notes 7 and 21).

Property, plant and equipment, intangible assets and goodwill

The accounting treatment of investments in property, plant and equipment and intangible assets entails the use of estimates to determine the useful life for depreciation and amortization purposes and to assess fair value at their acquisition dates for assets acquired in business combinations.

Determining useful life requires making estimates in connection with future technological developments and alternative uses for assets. There is a significant element of judgment involved in making technological development assumptions, since the timing and scope of future technological advances are difficult to predict.

The decision to recognize an impairment loss involves developing estimates that include, among others, an analysis of the causes of the potential impairment, as well as its timing and expected amount. Furthermore, additional factors, such as technological obsolescence, the suspension of certain services and other circumstantial changes, which highlight the need to evaluate a possible impairment, are taken into account.

The Telefónica Group evaluates its cash-generating units' performance regularly to identify potential goodwill impairments. Determining the recoverable amount of the cash-generating units to which goodwill is allocated also entails the use of assumptions and estimates and requires a significant element of judgment.

Deferred income taxes

The Group assesses the recoverability of deferred tax assets based on estimates of future earnings, and of all the options available to achieve an outcome, it considers the most efficient one in tax terms within the legal framework the Group is subject to. Such recoverability ultimately depends on the Group's ability to generate taxable earnings over the period for which the deferred tax assets remain deductible. This analysis is based on the estimated schedule for reversing deferred tax liabilities, as well as estimates of taxable earnings, which are sourced from internal projections that are continuously updated to reflect the latest trends.

The recognition of tax assets and liabilities depends on a series of factors, including estimates as to the timing and realization of deferred tax assets and the projected tax payment schedule. Actual Group company income tax receipts and payments could differ from the estimates made by the Group as a result of changes in tax legislation, the outcome of underway tax proceedings or unforeseen future transactions that could affect tax balances.

2018 Consolidated Financial Statements

Provisions

Provisions are recorded when, at the end of the period, we have a present obligation as a result of past events, whose settlement requires an outflow of resources that is considered probable and can be measured reliably. This obligation may be legal or constructive, arising from, but not limited to, regulation, contracts, common practice or public commitments, which have created a valid expectation for third parties that we will assume certain responsibilities. The amount recorded is the best estimation performed by the management in respect of the expenditure that will be required to settle the obligations, considering all the information available at the closing date, including the advice of external experts, such as legal advisors or consultants.

Should we be unable to reliably measure the obligation, no provision would be recorded and information would then be presented in the notes to the Consolidated Financial Statements.

Because of the inherent uncertainties in this estimation, actual expenditures may be different from the originally estimated amount recognized.

Revenue recognition

Bundled offers

Bundled offers that combine different elements are assessed to determine whether it is necessary to separate the different identifiable components and apply the corresponding revenue recognition policy to each element. Total package revenue is allocated among the identified elements based on their respective standalone selling prices. Determining standalone selling prices for each identified element requires estimates that are complex due to the nature of the business.

A change in estimates of standalone selling prices could affect the apportionment of revenue among the elements and, as a result, the timing of recognition of revenues.

Exchange rate and inflation rates used to translate the financial statements of our Venezuelan subsidiaries

We review, on a regular basis, the economic conditions in Venezuela and the specific circumstances of our Venezuelan operations. In light of the worsening of the economic and political crisis in Venezuela and in the absence of official rates that are representative of the situation in such country, at December 31, 2018 the Group maintains 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.

Assessment of the exchange rate that best reflects the economics of Telefónica's business activities in Venezuela relies on several factors and is performed considering all the information available at the closing date, and entails the use of assumptions and estimates and significant management judgment.

Due to inherent uncertainties in the estimates required to determine the appropriate exchange rate for the conversion of Venezuelan bolivar-denominated financial statements, actual cash flows denominated in such currency may differ from the amounts currently recognized on the basis of our estimates, as a result of changes in currency laws or changes in exchange mechanisms or published exchange rates that may have an impact on the conversion rate used for our Venezuelan subsidiaries' financial statements, affecting the net monetary position of Venezuelan bolivar-denominated assets (liabilities).

In addition to this, Venezuela is considered as a hyperinflationary economy since 2009. Telefónica recognizes the effects of inflation by restating the financial information of its Venezuelan operation using the "Indice Nacional de Precios al Consumidor de Venezuela" issued by the Central Bank of Venezuela, or the best estimate in case the final index is not available.

Significant management judgment is required to determine the appropriate inflation rate where the official rate is not available. The estimates and underlying assumptions are based on careful consideration of factors that are considered to be relevant and rely on all the information available at the closing date. Actual results

2018 Consolidated Financial Statements

may differ from these estimates as a result of changes in circumstances and assumptions about future developments in Venezuela due to evolving market conditions, uncertainty about currency and operating restrictions or other circumstances arising beyond the control of the Company.

n) New IFRS and interpretations of the IFRS Interpretations Committee (IFRIC)

The accounting policies applied in the preparation of the consolidated financial statements for the year ended December 31, 2018 are consistent with those used in the preparation of the Group's consolidated annual financial statements for the year ended December 31, 2017, with the exception of the following new standards and amendments to existing standards issued by the IASB and adopted by the European Union for application in Europe, which are mandatory for annual periods beginning on or after 1 January 2018:

IFRS 9 Financial Instruments

IFRS 9 sets out the requirements for recognizing 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: amortized 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.
- 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 upon initial recognition of financial assets.
- 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.

IFRS 15 Revenues from Contracts with Customers

IFRS 15 establishes a comprehensive framework for determining when to recognize revenue and how much revenue to recognize. The core principle is that an entity should recognize 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 fixed, 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 recognized when (or as) the obligation is satisfied, regardless of whether there are undelivered items. This 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 recognized from the sale of handsets and other equipment, generally recognized 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 recognized as a contract asset on the statement of financial position.

2018 Consolidated Financial Statements

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 amortized 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 amortization period is one year or less.

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.

IFRS 15 requires separate recognition of significant financing components in contracts with customers. The Group does not consider significant the financing component where the period between the transfer of goods or services to the customer and payment by the customer does not exceed one year.

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

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

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;
- b. 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 consolidated financial position or results.

Amendments to IAS 40, Transfers of Investment Property

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 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 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 recognizes 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

2018 Consolidated Financial Statements

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 consolidated financial position or results.

New standards and amendments to standards issued but not effected as of December 31, 2018.

At the date of preparation of the consolidated financial statements, the following IFRS 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
Amendments to References to the Conceptual Framework in IFRS Standards	January 1, 2020
Amendments to IFRS 3 Definition of a Business	January 1, 2020
Amendments to IAS 1 and IAS 8 Definition of Material	January 1, 2020
IFRS 17 Insurance Contracts	January 1, 2021
Amendments to IFRS 10 and IAS 28 Sale or Contribution of Assets between an Investor and its Associate or Joint Venture	Deferred Indefinitely

Based on the assessment conducted to date, the Group estimates that the application of the new standard on leases, IFRS 16 Leases, issued but not yet effective, could have a significant impact on the Group's consolidated financial statements upon initial adoption and prospectively.

With respect to the other standards, amendments and interpretations that are issued but not effective, based on the analyzes performed to date, the Group considers that their application 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 recognize assets and liabilities arising from all leases in the statement of financial position.

A lessee may elect not to apply the general requirements to short-term leases and leases of low-value assets.

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 recognized generally on a straight-line basis over the contract term.

The project to implement the new requirements in the Group is highly complex due to factors such as the high number of contracts affected and the diversity of data source systems, as well as the need to make certain estimates. These include the estimation of the lease term, based on the non-cancelable period and the periods covered by options to extend the lease, when the exercise depends only on Telefónica and where such exercise

2018 Consolidated Financial Statements

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 must make assumptions to calculate the discount rate, which will be based mainly on the incremental borrowing rate of interest for the estimated term. On the other hand, the Group shall not recognize non-lease components separately from lease components for those classes of assets in which non-lease components are not significant with respect to the total value of the arrangement.

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 recognized at the date of initial application. The Group shall adopt the latter transition method; therefore, the Group will recognize the cumulative effect of initial application as an adjustment to retained earnings in the year of initial application of IFRS 16. Moreover, the Group will apply the practical expedient that allows not reassessing whether a contract is or contains a lease on the date of initial application of IFRS 16 but directly apply the new requirements to all those contracts identified as leases under the current accounting standard. 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 following practical expedients will be adopted by the Group on transition to the new requirements:

Right of use asset measurement: for a vast majority of leases previously classified as an operating lease the group shall recognize a right-of-use asset at the date of initial application measured at an amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognized in the statement of financial position immediately before the date of initial application.

Discount rates: a lessee may apply a single discount rate to a portfolio of leases with reasonably similar characteristics such as lease term, class of underlying asset, currency and economic environment.

Leases expiring in 2019: the Group will use the practical exemption from application of the new requirements to leases whose lease term ends within 12 months of the date of initial application.

Initial direct costs: the Group will exclude initial direct costs from the measurement of the right-of-use asset at the date of initial application.

The Group expects that the changes introduced by IFRS 16 will have a significant impact on its financial statements from the date of adoption. Based on the assessment performed to date, the Group expects that the opening balance sheet at the date of initial application will show an increase in assets and liabilities between 7,400 and 8,100 million euro in connection with the rights of use and payment obligations arising from the majority of contracts that are classified as operating leases under the current lease standard. The impact expected in equity is not significant at 1 January 2019. 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 recognized 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: a significant portion of the lease payments recognized as cash flows from operating activities in the statement of cash flows under the current lease standard, will be classified as cash flows from financing activities upon application of the new lease accounting requirements. In addition to this, the Group's Financial Statements will include broader disclosures with relevant information regarding lease contracts.

Regarding the lease commitments disclosed in the Group's annual financial statements (see Note 23), the Company estimates that the main differences with respect to the new lease liability measurement will relate to, among others: Differences relating to the contract population considered: lease liabilities do not include short-term leases or leases of low-value or intangible assets, while those are included in the expected payment schedule. On the other hand, payments relating to contracts that can be canceled without penalty are not included within lease payment commitments, but they are included in the lease liability.

2018 Consolidated Financial Statements

Differences in the lease term: extension options that are reasonably certain are part of the measurement of the lease liability, whereas they are not taken into consideration in the estimated payments schedule for operating leases.

Discount rate differences: to the extent that there are differences in lease terms, the discount rates used are different as a consequence of such differences.

Estimated adoption impacts are based on the assessments conducted to date. Actual impacts at 1 January 2019 could be different because the Group is currently assessing the impacts of the initial application of the new requirements testing the new systems considering the multiple alternatives available in transition, the estimations required and the high number of contracts affected. The new accounting policies will not be final until the Group presents its first financial statements subsequent to the effective date of IFRS 16.

Telefónica, S.A. 31

2018 Consolidated Financial Statements

Note 4. Segment information

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

Following the Board of Directors' resolution on January 31, 2018, Telefónica Hispanoamérica was split into two new segments in order to more effectively manage the different market situations: Telefónica Hispam Norte, encompassing the operations in Colombia, Mexico, Central America, Ecuador and Venezuela, and Telefónica Hispam Sur, encompassing operations in Argentina, Chile, Peru and Uruguay.

Due to the implementation of the new organizational structure referred to above, the comparative results of the segments of the Group for 2017 and 2016 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.

In the 2017 consolidated financial statements, the 2016 comparative segment results had been revised, reflecting the integration within Telxius of the mobile telecommunications towers transferred from the Telefónica Spain, Telefónica Germany, Telefónica Brazil and Telefónica Hispanoamérica segments and the international submarine fiber optic cable, the inclusion of the companies Telefónica Studios and Telefónica Servicios Audiovisuales in the Telefónica Spain segment and the inclusion of the results of the data center business in Spain and Chile in the Telefónica Spain and Telefónica Hispanoamérica segments, respectively.

The segments referred to above include the information related to the fixed, wireless, cable, data, Internet and television businesses and other digital services provided in each country.

Information relating to other Group companies not specifically included in these segments (see the section "Other companies" of Appendix I) is reported under "Other companies and eliminations", which includes Telxius, holding companies, companies whose main purpose is to provide cross-sectional services to Group companies and other companies.

Revenues of Telxius in 2018 amounted to 792 million euros (730 million euros in 2017), of which 458 million euros correspond to inter-segment revenues (449 million euros in 2017). OIBDA of Telxius in 2018 amounted to 370 million euros (346 million euros in 2017). The capital expenditures in 2018 in Telxius amounted to 181 million euros (203 million euros in 2017). Fixed assets of Telxius at December 31, 2018 amounted to 1,116 million euros (1,093 million euros at December 31, 2017).

External revenues of the companies included in "Other companies and eliminations" in 2018, excluding Telxius, amounted to 1,139 million euros (1,222 million euros in 2017).

The Group centrally manages borrowing activities, mainly through Telefónica, S.A. and other companies included in "Other companies" (see Note 17, Appendix III and Appendix V), so most of the Group's financial assets and liabilities are reported under "Other companies and eliminations". In addition, Telefónica, S.A. is the head of the Telefónica tax group in Spain (see Note 22). Therefore, a significant part of the deferred tax assets and liabilities is included under "Other companies and eliminations". For these reasons, 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 were eliminated from the operating results of each Group segment. These adjustments had no impact on the Group's consolidated results. In addition, segment reporting considers the impact of the purchase price allocation to the assets acquired and the liabilities assumed by the companies included in each segment. The assets and liabilities presented in each segment are those managed by the heads of each segment, regardless of their legal structure.

2018 Consolidated Financial Statements

The following table presents income and CapEx information (capital expenditures in intangible assets and property, plant and equipment (see Notes 6 and 8) regarding the Group's operating segments:

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	12,706	6,790	7,320	10,126	4,075	6,677	999	48,693
External revenues	12,461	6,757	7,281	10,105	3,986	6,630	1,473	48,693
Inter-segment revenues	245	33	39	21	89	47	(474))—
Other operating income and expenses	(7,943)	)(4,925)	)(5,486)	)(5,815)	)(3,282)	)(4,958)	)(713)	)(33,122)
OIBDA	4,763	1,865	1,834	4,311	793	1,719	286	15,571
Depreciation and amortization	(1,650)	)(943)	)(2,071)	)(1,990)	)(967)	)(1,167)	)(261)	)(9,049)
Operating income	3,113	922	(237)	)2,321	(174)	)552	25	6,522
Capital expenditures (CapEx)	1,719	1,464	966	1,910	668	1,116	276	8,119
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	12,653	6,540	7,296	12,019	4,331	8,218	951	52,008
External revenues	12,364	6,505	7,252	11,994	4,220	8,170	1,503	52,008
Inter-segment revenues	289	35	44	25	111	48	(552))—
Other operating income and expenses	(7,701)	)(4,901)	)(5,475)	)(7,828)	)(3,068)	)(5,943)	)(905)	)(35,821)
OIBDA	4,952	1,639	1,821	4,191	1,263	2,275	46	16,187
Depreciation and amortization	(1,688)	)(1,047)	)(1,954)	)(2,228)	)(992)	)(1,198)	)(289)	)(9,396)
Operating income	3,264	592	(133)	)1,963	271	1,077	(243)	)6,791
Capital expenditures (CapEx)	1,683	827	951	2,225	1,264	1,414	333	8,697

Telefónica, S.A. 33

2018 Consolidated Financial Statements

2016 (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	12,815	6,861	7,503	11,090	4,711	7,870	1,186	52,036
External revenues	12,512	6,821	7,460	11,060	4,515	7,822	1,846	52,036
Inter-segment revenues	303	40	43	30	196	48	(660))—
Other operating income and expenses	(8,412)	)(5,152)	)(5,732)	)(7,388)	)(3,598)	)(5,510)	)(1,126)	)(36,918)
OIBDA	4,403	1,709	1,771	3,702	1,113	2,360	60	15,118
Depreciation and amortization	(1,827)	)(1,090)	)(2,200)	)(2,036)	)(1,112)	)(1,075)	)(309)	)(9,649)
Operating income	2,576	619	(429)	)1,666	1	1,285	(249)	)5,469
Capital expenditures (CapEx)	1,852	931	1,107	2,137	878	1,737	286	8,928

Telefónica, S.A. 34

2018 Consolidated Financial Statements

The following table presents main segment assets and liabilities:
2018

Millions of euros	Telefónica Spain	Telefónica United Kingdom	Telefónica Germany	Telefónica Brazil	Telefónica Hispan Norte	Telefónica Hispan Sur	Other companies and eliminations	Total Group
Fixed assets	15,347	9,646	13,520	21,230	4,971	9,041	2,144	75,899
Investments accounted for by the equity method	2	8	—	2	1	—	55	68
Financial assets and other non-currents assets	163	304	377	1,718	363	469	3,715	7,109
Deferred tax assets	2,084	2	204	335	1,063	165	3,778	7,631
Other current financial assets	31	79	9	88	68	145	1,789	2,209
Total allocated assets	23,622	12,609	16,837	27,402	8,672	12,043	12,862	114,047
Non-current financial liabilities	649	1,077	2,004	1,058	1,101	1,618	37,827	45,334
Deferred tax liabilities	189	102	236	693	134	397	923	2,674
Current financial liabilities	1,683	—	145	334	1,083	339	5,784	9,368
Total allocated liabilities	14,328	4,633	6,287	7,204	5,096	5,396	44,123	87,067

Telefónica, S.A. 35

2018 Consolidated Financial Statements

2017 (revised)

Millions of euros	Telefónica Spain	Telefónica United Kingdom	Telefónica Germany	Telefónica Brazil	Telefónica Hispan Norte	Telefónica Hispan 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
Financial assets and other non-currents assets	154	309	292	1,944	313	387	4,768	8,167
Deferred tax assets	2,151	41	162	235	1,339	273	3,619	7,820
Other current financial assets	30	59	17	106	39	185	1,718	2,154
Total allocated assets	22,722	11,610	17,225	30,229	9,194	11,009	13,077	115,066
Non-current financial liabilities	1,929	—	1,268	1,371	1,210	1,712	38,842	46,332
Deferred tax liabilities	204	108	87	296	158	152	1,140	2,145
Current financial liabilities	819	801	637	766	1,061	260	5,070	9,414
Total allocated liabilities	13,391	4,063	5,889	8,130	5,118	5,611	46,246	88,448

Telefónica, S.A. 36

2018 Consolidated Financial Statements

The composition of segment revenues, detailed by the main countries in which the Group operates, is as follows:

Country by segments	2018			2017 (revised)			2016 (revised)			Total		
	Fixed	Mobile and Others elims.	Total	Fixed	Mobile and Others elims.	Total	Fixed	Mobile and Others elims.	Total			
Spain (*)			12,706			12,653			12,815			
United Kingdom (**)	—	6,390	400	6,790	—	6,216	324	6,540	—	6,572	289	6,861
Germany	767	6,539	14	7,320	862	6,415	19	7,296	981	6,498	24	7,503
Brazil	3,754	6,372	—	10,126	4,659	7,360	—	12,019	4,427	6,663	—	11,090
Hispan Norte	732	3,343	—	4,075	736	3,595	—	4,331	831	3,881	(1)	4,711
Colombia	574	894	—	1,468	554	909	—	1,463	548	861	—	1,409
Mexico	—	1,175	—	1,175	—	1,336	—	1,336	—	1,410	—	1,410
Remaining operators and segment eliminations	158	1,274	—	1,432	182	1,350	—	1,532	283	1,610	(1)	1,892
Hispan Sur	2,712	3,965	—	6,677	3,225	4,993	—	8,218	3,173	4,697	—	7,870
Argentina	818	1,497	—	2,315	1,216	2,279	—	3,495	1,133	1,867	—	3,000
Chile	864	1,215	—	2,079	926	1,259	—	2,185	926	1,237	—	2,163
Peru	1,037	1,038	—	2,075	1,092	1,226	—	2,318	1,126	1,373	—	2,499
Remaining operators and segment eliminations	(7)	215	—	208	(9)	229	—	220	(12)	220	—	208
Other and inter-segment eliminations			999	999			951	951			1,186	1,186
Total Group			48,693					52,008				52,036

Note: In the countries of the Telefónica Hispan Norte and Telefónica Hispan Sur segment with separate fixed and mobile operating companies, intercompany revenues were not considered.

(*) The detail of revenues for Telefónica Spain is shown in the table below.

(**) Telefónica United Kingdom mobile revenues include MVNO revenues since 1 January 2017, which were previously accounted as "others". Comparative figures for 2016 were revised accordingly.

2018 Consolidated Financial Statements

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

Millions of euros

Telefónica Spain	2018	2017
Mobile handset sale	386	379
Ex-Mobile handset sale	12,320	12,274
Consumer	6,689	6,602
Corporate	3,462	3,401
Others	2,169	2,271
Total	12,706	12,653

Telefónica, S.A. 38

2018 Consolidated Financial Statements

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

Business combinations

Finalization of the purchase price allocation by Coltel of control over Telebucaramanga, Metrotel and Optecom On 30 September 2017, as part of the early termination agreement regarding the contract with PARAPAT (refer to Note 2), Colombia Telecomunicaciones, S.A. ESP (Coltel) acquired control of 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.

At the date of authorization for issuer of the 2017 consolidated financial statements of the Telefónica Group the purchase price allocation was provisional. In 2018 the preliminary allocation was reviewed within the twelve-month period from the acquisition date. The following table summarizes the consideration, the final fair values of the assets and liabilities identified on acquisition and the generated goodwill.

Millions of euros

Consideration paid for the acquisition of control ⁽¹⁾	147
Fair value of the prior stake	41
Fair value of the minority stake	3
Consideration	191
Intangible assets	13
Customer relationships	13
Other intangible assets	—
Property, plant and equipment	147
Deferred tax assets	7
Other non-current assets	16
Cash and cash equivalents	13
Other current assets	18
Deferred tax liabilities	(23)
Other non-current liabilities	(100)
Current liabilities	(26)
Fair value of net assets	65
Goodwill	126

⁽¹⁾ Excluding the proportion assumed by the non-controlling shareholder and the cash and cash equivalents contributed by the companies at the moment of its inclusion in the consolidation scope, the impact in the consolidated cash flow amounted to 85 million euros (see Note 25).

Transactions with non-controlling interests

2018

Sale of 9.99% of the total share capital of Telxius

On July 27, 2018, Telefónica transferred to a subsidiary of the Pontegadea Group 16.65% of the share capital of the Telefónica's subsidiary Pontel Participaciones, S.L. ("Pontel"), which owns 60% of the share capital of Telxius Telecom, S.A. ("Telxius"), for an amount of 378.8 million euros, resulting in a price of 15.2 euros per

2018 Consolidated Financial Statements

share of Telxius. This participation of 16.65% in the capital stock of Pontel is equivalent, in economic terms, to an indirect participation of 9.99% in the share capital of Telxius. The impact of this transaction on the equity attributable to equity holders of the parent amounted to 232 million euros and being the impact on equity attributable to non-controlling interest amounted to 139 million euros.

2017

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 15). This transaction thus entailed no cash movements.

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. The impact in the consolidated statement of changes in equity was a decrease in net equity attributable to minority interests amounting to 671 million euros (Note 15.h), an increase in treasury shares amounting to 754 million euros and a decrease in retained earnings amounting to 83 million euros.

As a result of this agreement, Telefónica increased its shareholding in Telefonica Deutschland from 63.2% to 69.2%. Sale of 24.8% and 15.2% of the total share capital of Telxius

On February 20, 2017, Telefónica reached an agreement for the sale of up to 40% of the total share capital in Telxius Telecom, S.A. to KKR, for a total amount of 1,275 million euros (12.75 euros per share).

The aforementioned agreement included a purchase agreement for the sale of 62 million shares (representing 24.8% of the share capital) of Telxius Telecom, S.A. for 790.5 million euros, and options on over 38 million shares (representing 15.2% of the share capital) for a price of at least 484.5 million euros.

These options corresponded to a call option exercisable by KKR and to a put option exercisable by Telefónica upon maturity of the call option.

On October 24, 2017, after obtaining all the relevant regulatory approvals, Telefónica transferred 62 million shares of Telxius (representing 24.8% of its share capital) to KKR in exchange for 790.5 million euros (12.75 euros per share).

On November 13, 2017, KKR exercised the call option contemplated in the Agreement on over 38 million shares of Telxius (representing 15.2% of its share capital) in exchange for 484.5 million euros (12.75 euros per share).

Following the closing of this sale of 15.2% of the share capital in Telxius in December 2017, together with 24.8% of the share capital acquired on October 24, 2017, KKR had acquired 40% of the share capital of Telxius in exchange for an aggregate amount of 1,275 million euros (see Note 25).

These transactions had no impact on the consolidated results of the Telefónica Group as it consisted of the sale of minority interests, with Telefónica retaining control over Telxius. The impact on the consolidated statement of changes in equity was an increase in net equity attributable to minority interests amounting to 690 million euros (Note 15.i), an increase in retained earnings amounting to 570 million euros, and a decrease in translation differences of 9 million euros.

2018 Consolidated Financial Statements

Note 6. Intangible assets

The composition of and movements in net intangible assets in 2018 and 2017 are as follows:

2018

Millions of euros	Balance at 12/31/2017	Additions	Amortization	Disposals	Transfers and others	Translation differences and hyperinflation adjustments	Exclusion of companies	Balance at 12/31/2018
Service concession arrangements and licenses	10,785	509	(1,221)	)—	(9	)(69	)—	9,995
Software	2,987	632	(1,450)	)(19	)876	(86	)—	2,940
Customer base	2,731	—	(539)	)—	(5	)(49	)—	2,138
Trademarks	780	—	(58)	)—	—	(32	)—	690
Other intangible assets	86	22	(30)	)—	4	(2	)(3	)77
Intangible assets in process	636	815	—	—	(412	)(23	)—	1,016
Total intangible assets	18,005	1,978	(3,298)	)(19	)454	(261	)(3	)16,856

2017

Millions of euros	Balance at 12/31/16	Additions	Amortization	Disposals	Transfers and others	Translation differences and hyperinflation adjustments	Inclusion of companies	Balance at 12/31/2017
Service concession arrangements and licenses	11,594	493	(1,234)	)—	852	(920	)—	10,785
Software	2,892	640	(1,441)	)—	1,109	(216	)3	2,987
Customer base	3,435	—	(639)	)—	1	(87	)21	2,731
Trademarks	912	—	(74)	)—	—	(58	)—	780
Other intangible assets	127	18	(55)	)2	(5	)(4	)3	86
Intangible assets in process	1,558	667	—	—	(1,559	)(30	)—	636
Total intangible assets	20,518	1,818	(3,443)	)2	398	(1,315	)27	18,005

Telefónica, S.A. 41

2018 Consolidated Financial Statements

The gross cost, accumulated amortization and impairment losses of intangible assets at December 31, 2018 and 2017 are as follows:

Balance at 12/31/2018

Millions of euros	Gross cost	Accumulated amortization	Impairment losses	Intangible assets
Service concession arrangements and licenses	21,145	(11,150)	)—	9,995
Software	17,153	(14,213)	)—	2,940
Customer base	6,766	(4,628)	)—	2,138
Trademarks	1,853	(1,163)	)—	690
Other intangible assets	1,022	(942)	)(3)	)77
Intangible assets in process	1,016	—	—	1,016
Intangible assets	48,955	(32,096)	)(3)	)16,856

Balance at 12/31/2017

Millions of euros	Gross cost	Accumulated amortization	Impairment losses	Intangible assets
Service concession arrangements and licenses	21,333	(10,548)	)—	10,785
Software	16,407	(13,420)	)—	2,987
Customer base	6,931	(4,200)	)—	2,731
Trademarks	1,909	(1,129)	)—	780
Other intangible assets	1,081	(993)	)(2)	)86
Intangible assets in process	636	—	—	636
Intangible assets	48,297	(30,290)	)(2)	)18,005

The main acquisitions of radio spectrum in 2018 are as follows:

In Telefónica United Kingdom, the acquisition of 40 Mhz in band of 2.3 Ghz for 230 million euros, and 40 Mhz in band of 3.4 Ghz amounting to 358 million euros registered as intangible assets in process.

In Telefónica Spain, the acquisition of the purchase of spectrum in the band 3.7 Ghz amounting to 108 million euros.

In Telefónica Hispam Norte, the acquisition by Telefónica Móviles México of 2.5 Ghz blocks for 33 million euros and the renewal of spectrum in the band of 1900 Mhz for 102 million euros.

In Telefónica Hispam Sur, the acquisition of spectrum in 2.6 GHz band by Telefónica Argentina for 21 million euros.

"Transfers and others" in 2018 includes the reclassification of the intangible assets of Telefónica Móviles Guatemala and Telefónica Móviles El Salvador amounting to 44 and 30 million euros, respectively, recorded in "Non-current assets classified as held for sale" of the statements of financial position (see Note 28).

Appendix VI contains the details of the main concessions and licenses with which the Group operates.

The result of the translation to euros of the intangible assets by the companies of the Group in Argentina and Venezuela, together with the effect of the hyperinflation adjustments (see Note 2) are shown in the column "Translation differences and hyperinflation adjustments". The hyperinflation adjustment at January 1, 2018

2018 Consolidated Financial Statements

corresponding to the intangible assets of the Group companies in Argentina totaled 483 million euros (mainly 458 million euros for service concession arrangements and licenses and 24 million euros for software).

On July 25, 2017, Coltel and another telecom operator were notified of the arbitration award issued in the arbitration proceedings initiated by the MinTIC. The arbitration award was not favorable to the co-defendants and as a consequence the shareholders' meeting of Coltel approved a capital increase for an aggregate amount of 1,651,012 million Colombian pesos (approximately 470 million euros) to pay the entire amount set forth in the arbitration award (see Note 2). Both ColTel and Telefónica have initiated legal actions (see Appendix VI). The payment of the sum awarded was recognized in 2017 as an additional cost of the license since this cost was mandatory and unavoidable in order to continue using the license.

“Inclusion of companies” in 2017 mainly corresponded to Coltel acquiring control over the companies Telebucaramanga, Metrotel and Optecom.

Note 7. Goodwill

The movement in goodwill assigned to each Group segment was as follows:

2018

Millions of euros	Balance at 12/31/2017	Transfer to Non-currents assets held for sale	Write-offs	Exchange rate impact and other	Balance at 12/31/2018
Telefónica Spain	4,310	—	—	—	4,310
Telefónica Brazil	10,057	—	—	(1,066)	)8,991
Telefónica Germany	4,815	—	—	—	4,815
Telefónica United Kingdom	4,648	—	—	(37)	)4,611
Telefónica Hispam Norte	1,002	(183	)(350	)(5	)464
Telefónica Hispam Sur	1,907	—	—	555	2,462
Others	102	—	(6	)(1	)95
Total	26,841	(183	)(356	)(554	)25,748

2017(*)

Millions of euros	Balance at 12/31/2016	Additions	Write-offs	Exchange rate impact and other	Balance at 12/31/2017
Telefónica Spain	4,306	—	—	4	4,310
Telefónica Brazil	11,565	—	—	(1,508)	)10,057
Telefónica Germany	4,787	28	—	—	4,815
Telefónica United Kingdom	4,824	—	—	(176)	)4,648
Telefónica Hispam Norte	957	147	—	(102)	)1,002
Telefónica Hispam Sur	2,083	—	—	(176)	)1,907
Others	164	—	—	(62)	)102
Total	28,686	175	—	(2,020)	)26,841

(*) The movement in 2017 has been restated to reflect the spin off process of the Telefónica Hispanoamérica segment of Telefónica Hispam Norte and Telefónica Hispam Sur (see Note 4).

2018 Consolidated Financial Statements

The goodwill transferred to Non-current assets held for sale in 2018 corresponds to Telefónica Móviles Guatemala and Telefónica Móviles El Salvador (see Note 28).

In 2018, an impairment loss was recognized for the total value of the goodwill assigned to Telefónica Móviles México, amounting to 350 million euros, with a balancing entry in "Other expenses" (see Note 23). In 2018, changes occurred in Mexico's macroeconomic and financial conditions, which were reflected in the risk premiums that compute in the calculation of the cost of capital. In this context, the estimated WACC increased to 10.6% (from the 9.5% used in the valuation at the end of the 2017 financial year). On top of the macroeconomic situation, there was also increased market competition in 2018, mainly in prepay. Against this background, the latest available business plans, approved by the Company in November 2018, show a slowdown in the expected growth for the main operating variables.

In addition, goodwill of 6 million euros from the sale of Tokbox Inc was derecognized (see Note 23 and Appendix I). As explained in Note 2, in 2018 Telefónica Group applied inflation adjustments to its companies whose functional currency is the Argentine peso. The adjustment for inflation at January 1, 2018, of the goodwill recognized in relation to the Group's operators in Argentina was 858 million euros, recorded in the column "Exchange rate impact and other" of Telefónica Hispam Sur.

Additions of Telefónica Hispam Norte in 2017 relate to the acquisition of control by Coltel of the companies Empresa de Telecomunicaciones de Telebucaramanga S.A. ESP, Metropolitana de Telecomunicaciones S.A. ESP and Operaciones Tecnológicas y Comerciales S.A.S. In 2018 the preliminary allocation of goodwill was reviewed within the twelve-month period from the acquisition date (see Note 5). Additions of Telefónica Germany relate to Minodes GmbH and Co-Trade GmbH (see Appendix I).

In order to test for impairment, goodwill was allocated to the different cash-generating units (CGUs), which are grouped into the following reportable operating segments:

	12/31/2018	12/31/2017
Telefónica Spain	4,310	4,310
Telefónica Brazil	8,991	10,057
Telefónica Germany	4,815	4,815
Telefónica United Kingdom	4,611	4,648
Telefónica Hispam Norte	464	1,002
Colombia	192	222
Mexico	—	339
Central America	144	319
Ecuador	128	122
Telefónica Hispam Sur	2,462	1,907
Chile	906	978
Peru	744	739
Argentina	785	161
Uruguay	27	29
Others	95	102
TOTAL	25,748	26,841

Goodwill is tested for impairment at the end of the year using the business plans (approved by the Board of Directors) of the cash-generating units to which the goodwill is assigned. The business plans cover a four years period, including the closing year. Therefore, in order to complete the five years of cash flows after the closing year, an additional two-year normalization period is added to the business plans based on the operating ratios until the terminal parameters are reached. The analysts consensus' forecasts are used as a reference. For specific

Telefónica, S.A. 44

2018 Consolidated Financial Statements

cases, extended business plans are used to cover the five-year period of cash flows, when the normalization period does not properly reflect the expected evolution of the business. Finally, to determine the terminal value of each CGU, a constant free cash flows growth over time is assumed, applying a terminal growth rate. The model used is similar to the dividend discount model developed by Gordon-Shapiro, internationally recognized for business valuations.

The process of preparing the CGUs' business plans considers the current market condition of each CGU, analyzing the macroeconomic, competitive, regulatory and technological environments, as well as the growth opportunities of the CGUs, and the differentiation capabilities compared to the competition based on market projections. A growth target is therefore defined for each CGU, based on the appropriate allocation of operating resources and the capital investments required to achieve the target. In addition, operating efficiency improvements are defined, in line with the strategic transformation initiatives, in order to increase the forecasted operating cash flow. In this process, the Group considers the compliance with business plans in the past.

Main assumptions used in calculating value in use

CGUs' Value in use are calculated based on the approved business plans. Certain variables are then considered, including the OIBDA margin and Capital Expenditure ratio (expressed as a percentage of revenue), which are considered the key operating variables to measure business performance and to set financial targets. Finally, the discount rates and the perpetuity growth rates are considered.

In terms of revenue, the plan is in line with the average three-year analyst consensus, which reflects a stability or improvement trend. This trend is based on the quality and the differentiation of the products and services offered by the Group, increasing the high-value customer portfolio and the monetization of the growing data consumption, despite the strong competition in certain segments.

Therefore, revenues in Spain reflect the increase in the penetration of convergent products and services, offered over a network with differential quality. In Germany, the strong growth of high-value mobile data customers. In Brazil, the strength of Telefónica's leadership driven by its differential quality and the optimization of integration synergies. In the United Kingdom, the attractive momentum of mobile data.

The main variables considered for each CGU with significant goodwill (Brazil, Spain, United Kingdom and Germany), are described below.

The OIBDA margin and long-term Capital Expenditure (CapEx) ratio

The values obtained, described in the previous paragraphs, are compared with the available data on competitors in the geographic markets where Telefónica Group operates. With regard to Europe, the long-term OIBDA margin for operations in Spain is 40%, though it is much lower in Germany (28%) and the United Kingdom (27%). The long-term OIBDA margin is therefore in line with analysts' forecasts over a three-year horizon, with Spain estimated at 40%, Germany at 27% and the United Kingdom at 26%.

Regarding the ratio of CapEx over revenues, forecasted in the business plans, the Group's European operators invest at a percentage of revenue aligned with the range for peers in the region. However, the valuations performed for the impairment tests for Spain, Germany and United Kingdom consider the opinions of Telefónica Group's analysts with regard to investment needs (around 12% for the three countries).

The OIBDA margin for Brazil is 42%, within the range of analysts' long-term forecasts (between 37% and 43%). Over the term of the business plans, the operator will invest a percentage in line with the investment needs forecasted by analysts (18%).

Discount rate

The discount rate, applied to measure cash flows, is the weighted average cost of capital (WACC), determined by the weighted average cost of equity and debt according to the finance structure established for each CGU.

2018 Consolidated Financial Statements

This rate is calculated using the capital asset pricing model (CAPM), which considers the asset's systemic risk, and impact of risks on cash flows not generated internally such as country risk, business-specific credit risk, currency risk and price risk specific to the financial asset.

In the UK, the uncertainty surrounding the Brexit process continues to generate an adverse impact on certain financial indicators and lower economic growth that it should be. For this reason, the cost of capital used in the valuation continues to be stressed, through a higher than implied market premium.

The most significant components of WACC are summarized as follows:

Risk-Free Rate: defined as the interest rate offered by long-term sovereign bonds. The rate is determined using current market data and equilibrium level estimates (according to standard econometric models) between which the interest rates should fall, thus adjusting the return in low rates because of the high influence of public debt purchased by central banks.

Political Risk Premium: adds the country's insolvency risk due to political and/or financial events; calculation is based on the quoted prices of credit default swaps for each country or, the EMBI+ index published by JP Morgan based on the information available and the liquidity conditions of these swaps.

Equity Risk Premium (ERP): the return in excess that equity assets are expected to yield over the risk-free rate. It is determined using a combination of historical approaches (ex post) backed by external publications and studies based on historical market returns series, and prospective approaches (ex ante), based on market publications, considering the medium- and long-term profit expectations based on the degree of maturity and development of each country.

Beta Coefficient: a measure of the volatility, or systematic risk, of an equity asset in comparison to the entire market. It is estimated based on a series of historical share prices of comparable companies listed on the stock exchange, to estimate the correlation between the company shares' returns and the stock market returns, of the country where the company is listed. The main underlying data used in these calculations are obtained from independent and renowned external information sources.

The main underlying data used in these calculations are obtained from independent and renowned external information sources.

The discount rates applied to the cash flow projections in 2018 and 2017 for the main CGUs are as follows:

Discount rate in local currency	2018		2017		
	Before tax	After-tax	Before tax	After-tax	
Spain	8.3	% 6.4	% 7.7	% 5.9	%
Brazil	14.4	% 11.2	% 14.0	% 10.9	%
United Kingdom	7.5	% 6.3	% 7.5	% 6.3	%
Germany	6.9	% 5.2	% 6.2	% 4.7	%

Perpetuity growth rate

Cash flow projections from the sixth year are calculated using an expected constant growth rate (g), considering the analyst consensus estimates for each business and country, based on the maturity of the industry and technology, and the degree of development of each country. Each indicator is compared to the forecasted long-term real and nominal GDP growth of each country and growth data from external sources, adjusting any particular case with specific characteristics related with the business evolution.

2018 Consolidated Financial Statements

The perpetuity growth rates applied to the cash flow projections in 2018 and 2017 for the main CGUs are as follows:

Perpetuity growth rate in local currency	2018	2017	
Spain	0.9	%0.8	%
Brazil	4.5	%4.5	%
United Kingdom	0.8	%0.8	%
Germany	1.0	%1.0	%

There were no significant changes in the perpetuity growth rates for 2018 compared to 2017. Europe remains around 1%.

In Brazil, the perpetuity growth rate is in line with the Brazilian Central Bank's medium-term inflation target (4%, within a range of ± 1.5 percentage points) and is aligned with the analyst consensus for the business plans horizon (below 4.5%) yet below the forecasted nominal GDP growth rate (which oscillates around 6.5%). A conservative outlook was maintained in line with analysts' expectations.

Sensitivity to changes in assumptions

The Group performs a sensitivity analysis of the impairment test by considering reasonable changes in the main assumptions used in the test. For the main CGU, the following maximum increases or decreases, expressed in percentage points (percentage points), were assumed:

Changes in key assumptions, In percentage points (percentage points)	Spain	United Kingdom	Germany	Brazil
Financial variables				
Discount rate	+/- 0.5	+/- 1	+/- 0.5	+/- 1
Perpetuity growth rates	+/- 0.25	+/- 0.5	+/- 0.25	+/- 0.5
Operating variables				
OIBDA Margin	+/- 2	+/- 1.25	+/- 1.25	+/- 2
Ratio of CapEx/Revenues	+/- 1	+/- 0.63	+/- 0.63	+/- 1

For the sensitivity analysis of the valuation of Telefónica United Kingdom, the threshold of the reasonable variations of financial assumptions has been increased, due to the uncertainty of Brexit (to ± 1 percentage points in the discount rate and ± 0.5 percentage points in the perpetuity growth rate). In the case of the reasonable variations of the operating variables, there is also a significant gap between these valuations and the carrying value. Although the final result of Brexit could have a negative effect on Telefónica United Kingdom, it must be pointed out that, since the Brexit referendum took place in 2016, the company has not experienced any worsening of its operating variables, recording growth in revenue, OIBDA and OIBDA margin in the last two years in local currency (see Note 4). The sensitivity analysis revealed a comfortable gap between the recoverable value and carrying amount for the rest of CGU at December 31, 2018.

In the case of Telefónica Argentina, an increase of 200 basis points (21.2% to 23.2%) in its WACC, would generate a negative impact through impairment of goodwill of approximately 13 million euros. This increase in WACC, combined with a lower terminal growth rate of 0.75 percentage points, would increase this negative impact to 95 million euros. In turn, a 1.25 percentage points drop in the OIBDA margin and a 0.63 percentage points increase in the investment/sales ratio would have no impact on the carrying value of this goodwill.

2018 Consolidated Financial Statements

Note 8. Property, plant and equipment

The composition of and movement in the items constituting net “Property, plant and equipment” in 2018 and 2017 were as follows:

2018

Millions of euros	Balance at 12/31/17	Additions	Depreciation	Disposals	Transfers and others	Translation differences and hyperinflation adjustments	Balance at 12/31/18
Land and buildings	4,383	42	(368	)(29	)77	205	4,310
Plant and machinery	25,297	1,305	(4,905	)(6	)4,204	(549	)25,346
Furniture, tools and other items	1,267	134	(478	)(21	)340	(41	)1,201
PP&E in progress	3,278	4,660	—	(15	)(5,401	)(84	)2,438
Total PP&E	34,225	6,141	(5,751	)(71	)(780	)(469	)33,295

2017

Millions of euros	Balance at 12/31/16	Additions	Depreciation	Disposals	Transfers and others	Translation differences and hyperinflation adjustments	Inclusion of companies	Balance at 12/31/17
Land and buildings	4,858	64	(391	)(14	)139	(293	)20	4,383
Plant and machinery	26,770	2,096	(5,062	)4	3,455	(2,039	)73	25,297
Furniture, tools and other items	1,426	223	(500	)(4	)230	(117	)9	1,267
PP&E in progress	3,339	4,496	—	(8	)(4,237	)(323	)11	3,278
Total PP&E	36,393	6,879	(5,953	)(22	)(413	)(2,772	)113	34,225

The gross cost, accumulated depreciation and impairment losses of property, plant and equipment at December 31, 2018 and 2017 were as follows:

Balance at December 31, 2018

Millions of euros	Gross cost	Accumulated depreciation	Impairment losses	PP&E
Land and buildings	11,949	(7,636	)(3	)4,310
Plant and machinery	102,615	(77,222	)(47	)25,346
Furniture, tools and other items	7,137	(5,931	)(5	)1,201
PP&E in progress	2,453	—	(15	)2,438
Total PP&E	124,154	(90,789	)(70	)33,295

Balance at December 31, 2017

Millions of euros	Gross cost	Accumulated depreciation	Impairment losses	PP&E
Land and buildings	11,344	(6,958	)(3	)4,383
Plant and machinery	96,335	(70,969	)(69	)25,297
Furniture, tools and other items	6,900	(5,624	)(9	)1,267
PP&E in progress	3,289	—	(11	)3,278

Edgar Filing: TELEFONICA S A - Form 6-K

Total PP&E	117,868	(83,551)(92)34,225
------------	---------	---------	------	---------

Telefónica, S.A. 48

2018 Consolidated Financial Statements

Investment by Telefónica Spain in property plant and equipment in 2018 and 2017 amounted to 1,387 and 1,451 million euros, respectively. Rapid fiber optic rollout, exceeding 21 million premises passed by the end of 2018, as well as investments in LTE network, reaching 96% population coverage.

Investment by Telefónica United Kingdom in property plant and equipment in 2018 and 2017 amounted to 777 and 727 million euros, respectively. The investment has been focused on increasing LTE experience, achieving 99% population coverage by the end of 2018, and also pursuing the improvement of network- capacity and quality.

Investment by Telefónica Germany in property plant and equipment in 2018 and 2017 amounted to 697 and 675 million euros, respectively. The company continued its dedication to extend LTE coverage, achieving a coverage of 88% by year-end 2018.

Investment by Telefónica Brazil in property plant and equipment in 2018 and 2017 amounted to 1,625 and 1,842 million euros, respectively. The investment was mainly dedicated to extend the coverage and capacity of LTE mobile networks, the deployment and connection of fiber network, the improvement of network quality, the extension of fiber network in the fixed business, as well as network simplification and digitalization of processes and systems.

Investment by Telefónica Hispam Norte in property plant and equipment in 2018 and 2017 amounted to 460 and 658 million euros, respectively. This investment has been mainly focused on improving the coverage and capacity of LTE networks, deployment of ultra-broadband fixed capabilities (fiber / HFC) in Colombia, as well as processes and systems simplification and digitalization in the region.

Investment by Telefónica Hispam Sur in property plant and equipment in 2018 and 2017 amounted to 997 and 1,268 million euros, respectively. This investment has been mainly focused on improving the coverage and capacity of LTE networks and ultra-broadband fixed capabilities (fiber / HFC).

"Transfers and others" in 2018 includes the reclassification of property, plant and equipment of Telefónica Móviles Guatemala and Telefónica Móviles El Salvador amounting to 157 and 91 million euros, respectively, recorded in "Non-current assets classified as held for sale" of the statements of financial position (see Note 28).

The result of the translation to euros of property, plant and equipment by the companies of the Group in Argentina and Venezuela, together with the effect of the hyperinflation adjustments (see Note 2) are shown in the column "Translation differences and hyperinflation adjustments". The hyperinflation adjustment at January 1, 2018 corresponding to property, plant and equipment of the Group companies in Argentina totaled 1,029 million euros (mainly 623 million euros for plant and machinery and 298 million euros for buildings).

"Inclusion of companies" in 2017 mainly corresponds to the control that Coltel acquired over the companies Tebucaramanga, Metrotel and Optecom.

Telefónica Group companies purchased insurance policies to reasonably cover the possible risks to which their property, plant and equipment used in operations are subject, with suitable limits and coverage. Additionally, as part of its commercial activities and network deployment, the Group maintains several property acquisition commitments. The timing of scheduled payments in this regard is disclosed in Note 23.

Property, plant and equipment deriving from finance leases amounted to 190 million euros at December 31, 2018 (254 million euros at December 31, 2017).

2018 Consolidated Financial Statements

Note 9. Associates and joint ventures

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

Millions of euros	12/31/2018	12/31/2017
Investments accounted for by the equity method	68	77
Loans to associates and joint ventures	—	16
Receivables from associates and joint ventures for current operations (Note 12)	33	32
Financial debt, associates and joint ventures	104	10
Payables to associates and joint ventures (Note 19)	520	491

Millions of euros	2018	2017	2016
Share of income (loss) of investments accounted for by the equity method	4	5	(5)
Revenue from operations with associates and joint ventures	233	218	213
Expenses from operations with associates and joint ventures	14	20	32
Financial revenues with associates and joint ventures	1	—	—
Financial expenses with associates and joint ventures	—	—	2

The detail of the movement in investments in associates in 2018 and 2017 was as follows:

Investments accounted for by the equity method	Millions of euros	
Balance at 12/31/16	76	
Additions	8	
Translation differences and other comprehensive income (loss)	(1)
Income (loss)	5	
Dividends	(11)
Balance at 12/31/17	77	
Additions	5	
Disposals	(4)
Translation differences and other comprehensive income (loss)	2	
Income (loss)	4	
Dividends	(14)
Transfers and others	(2)
Balance at 12/31/18	68	

2018 Consolidated Financial Statements

Note 10. 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 5.28%, 5.01% and 5.08%, respectively.

During 2018 and 2017, the Group carried out no significant transactions with Blackrock, Inc. other than the corresponding dividends paid.

The following is a summary of significant transactions between the Telefónica Group and BBVA and la Caixa companies, carried out at market prices:

Millions of euros

2018	BBVA	La Caixa
Finance costs	37	9
Receipt of services	6	6
Purchase of goods	—	60
Other expenses	3	—
Total costs	46	75
Finance income	42	—
Dividends received ⁽¹⁾	11	N/A
Services rendered	26	60
Sale of goods	3	48
Other income	2	—
Total revenue	84	108
Finance arrangements: loans and capital contributions (borrower)	368	368
Finance arrangements: loans and capital contributions (lessee)	—	10
Guarantees	202	104
Commitments	—	94
Finance arrangements: loans and capital contributions (lender)	595	891
Dividends paid	124	105
Factoring operations	643	300

⁽¹⁾ At December 31, 2018, Telefónica holds a 0.66% stake (0.66% stake at December 31, 2017) in the share capital of Banco Bilbao Vizcaya Argentaria, S.A. (see Note 11).

The nominal value of outstanding derivatives held with BBVA and la Caixa in 2018 amounted to 17,962 and 543 million euros, respectively (21,749 million held with BBVA and 404 million euros held with La Caixa in 2017). As explained under Derivatives policy in Note 17, 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 is 428 and -10 million euros, respectively at December 31, 2018 (390 and -28 million euros, respectively, at December 31, 2017). Additionally, at December 31, 2018, collateral guarantees on derivatives from BBVA and la Caixa have been received, amounting to 8 and 6 million euros, respectively (at December 31, 2017, there were collateral guarantees on derivatives provided to BBVA amounting to 286 million).

2018 Consolidated Financial Statements

Millions of euros

2017	BBVA	La Caixa
Finance costs	35	5
Receipt of services	2	9
Purchase of goods	—	56
Other expenses	7	—
Total costs	44	70
Finance income	28	—
Contracts of management	1	—
Dividends received	11	N/A
Services rendered	38	71
Sale of goods	4	43
Total revenue	82	114
Finance arrangements: loans and capital contributions (borrower)	1,038	292
Finance arrangements: loans and capital contributions (lender)	—	14
Guarantees	222	51
Commitments	—	85
Finance arrangements: loans and capital contributions (lessee)	1,209	414
Dividends	128	104
Factoring operations	—	250

On the other hand, in July 2018, there was a non-extinguishing modifying novation of the investment and agreement between shareholders related to Telefónica Consumer Finance, E.F.C., S.A. signed between Telefónica, S.A., CaixaBank Consumer Finance, E.F.C., S.A. (formerly Finconsum, E.F.C., S.A.) and CaixaBank, S.A. on September 6, 2013, adhered to by Telefónica Consumer Finance, E.F.C., S.A. on February 6, 2014 (the "Novation of the Agreement of Investment and Contract between Shareholders"), in order to implement as an activity of Telefónica Consumer Finance, E.F.C., S.A. the granting of financing products from users from the universe of customers of the Telefónica Group in Spain, as well as for the corporate governance of Telefónica Consumer Finance, E.F.C., S.A. to adapt to the new regulatory framework applicable to the Financial Credit Institutions.

Similarly, in September 2018, a statement of intent was signed between Telefónica Digital España, S.L.U. and Banco Bilbao Vizcaya Argentaria, S.A., in order to explore a potential partnership to offer financing to consumers, the self-employed and small companies in Argentina, Colombia, Peru and Mexico.

Likewise, in December 2018, a financial collaboration agreement was signed between Telefónica, S.A. and Banco Bilbao Vizcaya Argentaria, S.A., with special conditions for employees, pensioners and early-retirees of the Telefónica Group.

Other related parties

The most significant balances and transactions with associates and joint ventures are detailed in Note 9.

During 2018, the Directors and senior executives performed no transactions with Telefónica, S.A. or any Telefónica Group company other than those in the Group's normal trading activity and business. Compensation and other benefits paid to members of the Board of Directors and senior executives are detailed in Note 26.g and Appendix II.

Telefónica contracted a civil liability insurance scheme (D&O) for Directors, managers and staff with similar functions in the Telefónica Group, with standard conditions in these type of insurance and a premium

2018 Consolidated Financial Statements

attributable to 2018 of 1,916,210 euros (1,943,007 euros in 2017). This scheme provides coverage for Telefónica, S.A. and its subsidiaries in certain cases.

Certain Telefónica Group subsidiaries performed transactions in 2018 with Global Dominion Access Group, related to the Group's ordinary course of business, mainly in Telefónica de España amounting to 25 million euros (23 million euros in 2017).

A representative from Telefónica remains on China Unicom's board of directors, and vice versa (see Note 11), as well as an industrial alliance with this company. In 2015 a "joint venture" with China Unicom was incorporated, for the development of Big Data Services in China, using the "Smart Steps" technology developed by Telefónica.

Telefónica's stake in this Company is 45% through Telefónica Digital España, S.L., with China Unicom Big Data Limited Corporation owning the remaining 55% stake. In 2018 this company obtained a turnover equivalent to 10 million euros. Similarly, the operation consisting of the entry of the company Beijing Jingdong Financial Technology Holding Co., Ltd., controlled by JD.com, in the aforementioned "joint venture" was approved in December 2018, which will result in a capital increase fully to subscribe by Beijing Jingdong Financial Technology Holding Co., Ltd. (17%, approximately) with the consequent dilution of the current shareholders (Telefónica will held about 33%, approximately).

Note 11. Financial assets and other non-current assets

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

Millions of euros	12/31/2018	12/31/2017
Non-current financial assets (Note 14)	6,393	7,771
Investments	573	650
Credits and others financial assets	1,050	1,183
Deposits and guarantees	1,624	2,625
Trade receivables	488	638
Impairment of trade receivables	(118)	(137)
Derivative financial assets (Note 17)	2,776	2,812
Other non-current assets	716	396
Contractual assets (Note 20)	108	—
Deferred expenses (Note 20)	191	—
Prepayments	417	396
Total	7,109	8,167

Telefónica, S.A. 53

2018 Consolidated Financial Statements

Non-current financial assets

The movement in investments, credits and others financial assets, deposits and guarantees, trade receivables and impairment of trade receivables in 2018 and 2017, is as follows:

Millions of euros	Investments	Credits and other financial assets	Deposits and guarantees	Trade receivables	Impairment of trade receivables	
Balance at 12/31/16	825	1,177	1,938	593	(154)
Acquisitions	16	358	955	602	(12)
Disposals	(155	)(173	)(156	)(59	)41	
Translation differences	(7	)(41	)(258	)(40	)16	
Fair value adjustments and financial updates	5	4	84	(5)—	
Transfers and other	(34	)(142	)62	(453	)(28)
Balance at 12/31/17	650	1,183	2,625	638	(137)
First application of IFRS 9 impact	—	—	—	(201	)17	
Acquisitions	65	2,077	66	662	(21)
Disposals	(24	)(663	)(728	)(148	)10	
Translation differences	(5	)(43	)(149	)(12	)1	
Fair value adjustments and financial updates	(115	)23	18	(4)—	
Transfers and other	2	(1,527	)(208	)(447	)12	
Balance at 12/31/18	573	1,050	1,624	488	(118)

Investments

"Investments" includes the fair value of investments in companies where Telefónica exercises no significant control and for which there is no specific short-term disposal plan (see Note 3.i).

Additionally, the Telefónica Group's shareholding in BBVA amounted to 205 million euros (314 million euros at December 31, 2017), representing 0.66% of its share capital at December 31, 2018 (same percentage at December 31, 2017).

At December 31, 2018, Telefónica maintained a 0.59% stake in the share capital of China Unicom (Hong Kong) Limited, valued at 169 million euros (same percentage at December 31, 2017, valued at 205 million euros).

In 2017, shares of China Unicom (Hong Kong) Limited were sold representing 0.24% of its share capital for 72 million euros, that had a negative impact in Net financial expense of 4 million euros.

At December 31, 2018, Telefónica maintained a 9.44% stake in the share capital of Promotora de Informaciones, S.A. (Prisa), valued at 93 million euros (11.78% at December 31, 2017 valued at 27 million euros). In 2018 Telefónica subscribed the capital increase of PRISA, acquiring 42.2 million new shares and selling the rest of the preferred subscription rights. The net amount of the transaction was 49 million euros.

With the application of IFRS 9, the shares described above, classified as financial available-for-sale assets at December 31, 2017, have been reclassified as of January 1, 2018 to the categories of financial assets at fair value thought other comprehensive income, equity instruments (see Note 14).

In June 2017, Telefónica sold its entire shareholding in Mediaset Premium (representing 11.1%), which had a negative impact on net financial expense of 76 million euros.

"Transfers and other" in 2017 primarily includes the prior stake in Colombian companies Telebucaramanga, Metrotel y Optecom (see Note 5).

2018 Consolidated Financial Statements

Long-term credits and other financial assets

The composition of long-term credits is as follows:

Millions of euros	12/31/2018	12/31/2017
Long-term receivables for indirect taxes	731	189
Other long-term credits	319	994
Total	1,050	1,183

In 2018 two final decisions in favor of Telefónica Brazil were passed, 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). These decisions cover the period from September 2003 to June 2017, and the period from July 2004 to June 2013.

Once the values were determined, Telefónica Brazil 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, recorded as additions of Credits and other financial assets in the table above, amounted to 6,240 million Brazilian reais (around 1,454 million euros at an average exchange rate of 2018). The impact on the consolidated income statement amounted to 3,386 million Brazilian reais (789 million euros), reducing the “Taxes” item under “Other expenses” (Note 23), and 2,854 million Brazilian reais (665 million euros) under “Finance Income”.

In August 2018 Telefónica Brazil started compensating the credits. In October 2018 the competent authority in Brazil filed a review of the supporting documentation with the purpose of approving the PIS and COFINS credits. This review is still ongoing at the date of approval of these consolidated financial statements. Telefónica Brazil met all the requests of this procedure and it continues compensating the credits, in line with the favorable decision issued by the court.

The outstanding credit at December 31, 2018 amounted to 4,915 million Brazilian reais (1,107 million euros at the closing exchange rate for 2018). “Long-term receivables for indirect taxes” includes the amount expected to be offset in more than 12 months, off 539 million (568 million euros at short-term, see Note 22).

The Company is still engaged in three other lawsuits of the same nature (including the lawsuits of the companies GVT and Telemig, currently incorporated in Telefónica Brazil). According to the company’s estimates, the contingent assets for these processes, which comprise various periods between December 2001 and June 2017, lie in a range between 1,700 and 2,200 million Brazilian reais (between 383 and 496 million euros at the year-end exchange rate for 2018). “Other long-term credits” at December 31, 2017 included long-term financial assets of the subsidiary Seguros de Vida y Pensiones Antares, S.A., fundamentally fixed-income securities, amounting to 692 million euros. At December 31, 2018, these long-term financial assets amounted to 634 million euros and were reclassified as non-current assets classified as held for sale (see Note 28). These assets are mainly intended to cover obligations from the defined benefit plans of Telefónica de España (ITP and Survival) but do not qualify as “plan assets” under Employee Benefits (IAS 19) (see Note 21). Likewise, this line item includes long-term financial assets of Telefónica Germany amounting to 62 and 58 million euros at December 31, 2018 and 2017, respectively, that are mainly intended to cover obligations from the defined benefit plan of Telefónica Germany but do not represent “plan assets” in accordance with IAS 19 (see Note 21).

The vast majority of long-term credits, recognized at amortized cost (Note 14), are considered to be low credit risk assets, therefore the impairment analysis was carried out on the basis of expected credit losses in the next 12 months.

2018 Consolidated Financial Statements

Deposits and guarantees

Telefónica Brazil has non-current judicial deposits amounting to 810 million euros (see Note 21) at December 31, 2018 (1,598 million euros at December 31, 2017).

At December 31, 2018, there were deposits related to the collateral guarantees on derivatives signed by Telefónica, S.A. and its counterparties for the credit risk management of derivatives amounting to 687 million euros of which 276 million euros cross currency swap (902 million euros at December 31, 2017 that included 701 million euros related to cross currency swap).

In addition, 120,000 bonds issued by Telefónica Emisiones, S.A.U. are deposited in a securities account of Telefónica SA linked to these collateral contracts as guarantee for a nominal amount of 105 million euros.

The vast majority deposits and guarantees recognized at amortized cost (Note 14), are considered to be low credit risk assets, therefore the impairment analysis was carried out on the basis of expected credit losses in the next 12 months.

Note 12. Receivables and other current assets

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

Millions of euros	12/31/2018	12/31/2017
Receivables (Note 14)	8,419	8,727
Trade receivables	10,666	10,891
Impairment of trade receivables	(2,657)	(2,563)
Receivables from associates and joint ventures (Note 9)	33	32
Other receivables	377	367
Other current assets	2,160	1,366
Contractual assets (Note 20)	341	—
Capitalized costs (Note 20)	566	—
Prepayments	1,253	1,366
Total	10,579	10,093

Public-sector net trade receivables at December 31, 2018 and 2017 amounted to 345 million euros and 346 million euros, respectively.

2018 Consolidated Financial Statements

The movement in impairment of trade receivables in 2018 and 2017 is as follows:

	Millions of euros	
Impairment provision at December 31, 2016	2,795	
Allowances	998	
Inclusion of companies	14	
Amounts applied	(1,019))
Translation differences and other	(225))
Impairment provision at December 31, 2017	2,563	
Adjustment on initial application of NIIF 9 (Note 14)	126	
Allowances	853	
Transfers	(10))
Amounts applied	(768))
Translation differences and other	(107))
Impairment provision at December 31, 2018	2,657	

The detail of the age of the accounts receivable balances from customers and their corrections for impairment as of December 31, 2018 and 2017 is as follows:

Millions of euros	12/31/2018		12/31/2017	
	Trade receivables	Impairment	Trade receivables	Impairment
Trade receivables pending billing	2,682	(25)	3,015	(16)
Amount not overdue invoiced	3,508	(195)	3,446	(166)
Less than 90 days	1,532	(164)	1,566	(83)
Between 90 and 180 days	519	(168)	455	(228)
Between 180 and 360 days	364	(212)	385	(244)
More than 360 days	2,061	(1,893)	2,024	(1,826)
Total	10,666	(2,657)	10,891	(2,563)

Telefónica, S.A. 57

2018 Consolidated Financial Statements

Note 13. Other current financial assets

The other current financial assets include the following items:

Derivative financial assets with a short-term maturity or not used to hedge non-current items in the consolidated statement of financial position amounted to 922 million euros at December 31, 2018 (845 million euros at December 31, 2017, see Note 17).

Short-term investments in financial instruments recognized at fair value to cover commitments undertaken by the Group's insurance companies, amounted to 87 million euros at December 31, 2018 (130 million euros at December 31, 2017) and were recorded at fair value. At December 31, 2017 Antares amounted to 60 million euros. At December 31, 2018 Antares amounting to 52 million euros that were reclassified as non-current assets classified as held for sale (see Note 28).

Short-term deposits and guarantees amounted to 95 million euros at December 31, 2018 (125 million euros at December 31, 2017) which includes current judicial deposits amounting to 71 million euros (see Note 21) constituted by Telefónica Brazil (82 million euros at December 31, 2017).

Short-term credits, net of impairment provisions, amounted to 1,102 million euros at December 31, 2018 (877 million euros at December 31, 2017). At December 31, 2018, this amount included bank deposits with a maturity between three and twelve months formalized by Telefónica, S.A. which amounted to 972 million euros (700 million euros at December 31, 2017).

The vast majority of short-term credits, deposits and guarantees recognized at amortized cost and at fair value with changes in "Other comprehensive income" (Note 14) are considered to be low credit risk assets.

Current financial assets that are highly liquid and have maturity periods of three months or less from the date contracted, and present an insignificant risk of value changes, are recorded under "Cash and cash equivalents" on the accompanying consolidated statement of financial position.

Telefónica, S.A. 58

2018 Consolidated Financial Statements

Note 14. Breakdown of financial assets

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		Available for sale	Hedges	Measurement hierarchy			Held to maturity investments	Rest of financial assets at amortized cost	Total carrying amount	Total fair value
	Held for trading	Fair value option			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 11)	1,074	250	1,117	1,738	822	3,339	18	—	3,592	7,771	7,771
Investments	—	—	650	—	567	83	—	—	—	650	650
Credits and other financial assets	—	250	467	—	86	613	18	—	466	1,183	1,183
Deposits and guarantees	—	—	—	—	—	—	—	—	2,625	2,625	2,625
Derivative instruments	1,074	—	—	1,738	169	2,643	—	—	—	2,812	2,812
Trade receivables	—	—	—	—	—	—	—	—	638	638	501
Impairment of trade receivables	—	—	—	—	—	—	—	—	(137)	(137)	—
Current financial assets	163	60	66	731	105	915	—	169	14,884	16,073	16,073
Trade receivables (*) (Note 12)	—	—	—	—	—	—	—	—	11,290	11,290	8,727
Impairment of trade receivables (*) (Note 12)	—	—	—	—	—	—	—	—	(2,563)	(2,563)	—
Other financial assets (Note 13)	163	60	66	731	105	915	—	169	965	2,154	2,154

Edgar Filing: TELEFONICA S A - Form 6-K

Cash and cash equivalents	—	—	—	—	—	—	—	—	5,192	5,192	5,192
Total	1,237	310	1,183	2,469	927	4,254	18	169	18,476	23,844	23,844

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

Telefónica, S.A. 59

2018 Consolidated Financial Statements

The opening balance as of January 1, 2018, after the impacts of the first application of IFRS 9 (see Notes 2 and 3), is 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		Measurement hierarchy				
			Held for trading	Fair value option	Debt instruments	Equity instruments	Hedges	Level 1 (Quoted prices)	Level 2 (Other directly observable market inputs)	Level 3 (Inputs not based on observable market data)	Amortized cost
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	(201	)—	—	69	—	—	—	69	—	368
Impairment of trade receivables	(137	)17	—	—	—	—	—	—	—	—	(120
Current financial assets	16,073	(37	)803	60	488	—	731	105	1,977	—	13,95
Trade receivables	11,290	89	575	—	487	—	—	—	1,062	—	10,31
Impairment of trade receivables	(2,563	)126	)—	—	—	—	—	—	—	—	(2,68
Other current financial assets	2,154	—	228	60	1	—	731	105	915	—	1,134
Cash and cash equivalents	5,192	—	—	—	—	—	—	—	—	—	5,192
Total	23,844	(221	)1,921	310	999	631	2,469	927	5,385	18	17,29

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

Impact of 221 million euros (with counterparty in reserves net of tax impact) corresponding to the increase of impairment of trade receivables classified at amortized cost (200 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

Telefónica, S.A. 60

2018 Consolidated Financial Statements

other comprehensive income and fair value through profit or loss amounting to 556 and 596 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 201 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 these assets are presented in the short-term at 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). This choice of valuation is based on the Group's management objectives in relation to its investments. 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.

2018 Consolidated Financial Statements

The breakdown of financial assets of the Telefónica Group at December 31, 2018 is as follows:

December 31, 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 11)	860	—	70	545	1,950	660	2,765	—	2,968	6,393	6,393
Investments	28	—	—	545	—	492	81	—	—	573	573
Credits and other financial assets	6	—	—	—	—	6	—	—	1,044	1,050	1,050
Deposits and guarantees	—	—	—	—	—	—	—	—	1,624	1,624	1,624
Derivative instruments	826	—	—	—	1,950	162	2,614	—	—	2,776	2,776
Trade receivables	—	—	70	—	—	—	70	—	418	488	370
Impairment of trade receivables	—	—	—	—	—	—	—	—	(118)	(118)	—
Current financial assets	961	—	681	—	660	154	2,148	—	14,018	16,320	16,320
Trade receivables (Note 12)	580	—	680	—	—	—	1,260	—	9,816	11,076	8,419
Impairment of trade receivables (Note 12)	—	—	—	—	—	—	—	—	(2,657)	(2,657)	—
Other current financial assets (Note 13)	381	—	1	—	660	154	888	—	1,167	2,209	2,209
Cash and cash	—	—	—	—	—	—	—	—	5,692	5,692	5,692

equivalents

Total	1,821	—	751	545	2,610	814	4,913	—	16,986	22,713	22,713
-------	-------	---	-----	-----	-------	-----	-------	---	--------	--------	--------

The calculation of the fair values of the Telefónica Group's debt instruments required an estimate, for each currency and counterparty, of a credit spread curve using the prices of the Group's bonds and credit derivatives.

Telefónica, S.A. 62

2018 Consolidated Financial Statements

Note 15. Equity

a) Share capital and share premium

2018

At December 31, 2018, Telefónica, S.A.'s share capital amounted to 5,192,131,686 euros and consisted of 5,192,131,686 fully paid ordinary shares of a single series, par value of 1 euro, all recorded by the book-entry system and traded on the Spanish electronic trading system ("Continuous Market"), where they form part of the "Ibex 35" Index, on the four Spanish Stock Exchanges (Madrid, Barcelona, Valencia and Bilbao) and listed on the London and Buenos Aires Stock Exchanges, and on the New York and Lima Stock Exchanges, through American Depositary Shares ('ADSs').

2017

On September 20, 2017, the public deed evidencing the conversion of bonds, share capital increase and amortization of bonds was registered, whereby issuing 154,326,696 new ordinary shares of a nominal value of 1 euro each within the framework of the conversion of the bonds mandatorily convertible into shares of Telefónica, S.A. that were issued by its wholly owned subsidiary, Telefónica Participaciones, S.A.U., on September 24, 2014, guaranteed by Telefónica, S.A. As a result of the aforementioned conversion and the referred capital increase, the share capital of Telefónica, S.A. was set at 5,192,131,686 euros, divided into 5,192,131,686 ordinary shares of the same class and series, with a nominal value of 1 euro each.

At December 31, 2017, Telefónica, S.A.'s share capital amounted to 5,192,131,686 euros and comprised 5,192,131,686 fully paid ordinary shares of a single series, par value of 1 euro.

Authorizations by Shareholders' Meeting

With respect to share capital-related authorizations, on June 12, 2015, authorization was given at the Annual Shareholders' Meeting of Telefónica, S.A. for the Board of Directors, at its discretion and in accordance with the Company's needs, to increase the Company's capital, once or several times, within a maximum five years period from that date, up to a maximum nominal increase of 2,469,208,757 euros, equivalent to half of Telefónica, S.A.'s share capital at that date, by issuing and placing new shares, with or without a share premium, and, in all cases, in exchange for cash, expressly considering the possibility that the new shares may not be fully subscribed. The Board of Directors was also empowered to exclude, partially or fully, pre-emptive subscription rights under the terms of article 506 of the Spanish Corporate Enterprises Act. However, the power to exclude pre-emptive rights is limited to 20% of the Company's share capital on the date of adoption of this resolution. Pursuant to the aforementioned authorizations, as of December 31, 2018, the Board of Directors may increase the share capital up to the maximum nominal amount of 2,469,208,757 euros.

In addition, at the June 9, 2017 Shareholders' Meeting of Telefónica, S.A., authorization was given for the Board of Directors to issue debentures, bonds, promissory notes and other fixed-income securities and hybrid instruments, including preferred shares, in all cases be they simple, tradable, and/or convertible and/or granting the holders thereof a share in the earnings of the company, as well as warrants, with the power to exclude the pre-emptive rights of shareholders. The issuance of the aforementioned securities may be conducted at one or several times, at any time, within a maximum five-year period from that date. These securities may be in the form of debentures, bonds, promissory notes or any other kind of fixed-income security, or debt instruments of similar category or hybrid instruments in any legally admitted form (including yet not restricted to preferred shares), plain or, in the case of debentures, bonds and hybrid instruments convertible into shares of the Company and/or exchangeable for shares of any of the Group companies, or any other company and/or giving the holders thereof a share in the earnings of the Company. This delegation also includes warrants or other similar securities that might give the right to directly or indirectly subscribe or acquire shares, whether newly issued or outstanding, and which may be paid for by physical delivery or by offset. The aggregated amount of the issuance(s) of securities approved under this delegation of powers may not exceed the sum of 25,000 million euros or the equivalent in another currency at any time. For promissory notes, the outstanding balance of promissory notes issued under this authorization will be calculated for the purpose of the aforementioned limit.

Telefónica, S.A. 63

2018 Consolidated Financial Statements

Likewise, for the sake of the aforementioned limit, in the case of warrants, the sum of the premiums and exercise prices of the warrants for each issuance approved under this delegation shall be taken into account.

Furthermore, on June 8, 2018, shareholders voted to authorize the acquisition by the Board of Directors of Telefónica, S.A. treasury shares, up to the limits and pursuant to the terms and conditions established at the Shareholders' Meeting, within a maximum five-year period from that date. However, it specified that in no circumstances could the par value of the shares acquired, added to that of the treasury shares already held by Telefónica, S.A. and by any of its controlled subsidiaries, exceed the maximum legal percentage at any time (currently 10% of Telefónica, S.A.'s share capital).

b) Dividends

Dividends distribution in 2018

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 was made on December 20, 2018 amounting to 1,026 million euros.

Dividends distribution in 2017

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 was made on December 14, 2017 amounting to 1,025 million euros.

Dividends distribution in 2016 and capital increase

Approval was given at the General Shareholders' Meeting of May 12, 2016 to pay a dividend with a charge to unrestricted reserves of a fixed gross 0.40 euros per outstanding share carrying dividend rights. The dividend was paid in full on May 19, 2016 and the total amount paid was 1,906 million euros.

On November 11, 2016 the Executive Commission of Telefónica, S.A.'s Board of Directors approved to pay a scrip dividend amounting to approximately 0.35 euros per share, consisting of the assignment of free allotment rights with an irrevocable purchase commitment by the Company, and a subsequent capital increase with a charge to reserves by such amount as may be determined pursuant to the terms and conditions of the resolution, by means of the issue of new ordinary shares having a par value of one euro, to fulfill said allotments. The payment was made on December 7, 2016 with an impact in equity amounting to 500 million euros.

Additionally, the shareholders of 70.01% of the free-of-charge allotment rights were entitled, therefore, to receive new shares of Telefónica, S.A. Thus, the final number of shares issued in the capital increase was 137,233,781 shares with a nominal value of 1 euro each.

Proposed distribution of profit attributable to equity holders of the parent

Telefónica, S.A. generated 3,014 million euros of profit in 2018.

The Company's Board of Directors will submit the following proposed distribution of 2018 profit for approval at the Shareholders' Meeting:

	Millions of euros
Legal reserve	—
Other reserves	3,014
Total	3,014

2018 Consolidated Financial Statements

c) Other equity instruments

Undated deeply subordinated securities

Unless specified otherwise, undated deeply subordinated securities were issued by Telefónica Europe, B.V.

The characteristic of undated deeply subordinated securities are as follows (millions of euros):

Issue date	Annual Fix	Variable	Exercisable by issuer	12/31/2017	Tender Offer	Amount repurchased	Redemption	12/31/2018
		from 12/04/23 rate						
03/22/18	3	% SWAP + spread incremental	2023	—	—	—	—	1,250
		from 09/22/26 rate						
	3.875	% SWAP + spread incremental	2026	—	—	—	—	1,000
		from 06/07/23 rate						
12/07/17	2.625	% SWAP + spread incremental	2023	1,000	—	—	—	1,000
		from 03/15/22 rate						
09/15/16	3.750	% SWAP + spread incremental	2022	1,000	—	—	—	1,000
		from 03/30/20 rate						
03/30/15(*)	8.50	% SWAP + spread incremental	2020	452	—	—	—	452
		from 12/04/19 rate						
12/04/14	4.20	% SWAP + spread incremental	2019	850	850	(145)	)—	705
		from 03/31/20 rate						
03/31/14	5	% SWAP + spread incremental	2020	750	750	(158)	)—	592
		from 03/31/24 rate						
	5.875	% SWAP + spread incremental	2024	1,000	1,000	—	—	1,000
		from 11/26/20 rate						
11/26/2013(**)	6.75	% SWAP + spread incremental	2020	716	716	(511)	)—	205
		from 09/18/18 rate						
09/18/13	6.5	% SWAP + spread incremental	2018	1,125	1,125	(652)	) (473))—
		from 09/18/21 rate						
	7.625	% SWAP + spread incremental	2021	625	625	(333)	)—	292
				7,518				7,496

(*) Issued by Colombia Telecomunicaciones, S.A. ESP (500 million U.S. dollars)

(**) Tender offer over 600 million pounds of undated deeply subordinated securities of which 428 million pounds were accepted (equivalent to 511 million euros at the rate of exchange at the date of the issuance).

In all issuances of undated deeply subordinated securities, the issuer has an option to defer the payment of coupons and holders of such securities cannot call for payment.

As the repayment of principal and the payment of coupons depend solely on Telefónica's decision, these undated deeply subordinated securities are equity instruments and are presented under "Other equity instruments" in the accompanying consolidated statement of changes in equity.

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.

On September 18, 2018, Telefónica Europe, B.V. exercised the issue call option of 1,125 million euros of undated deeply subordinated securities issued on September 18, 2013 with the subordinated guarantee of Telefónica.

Telefónica, S.A. 65

2018 Consolidated Financial Statements

Through the exercise of this option, the company proceeded to repurchase, at par, and amortize all of the outstanding securities at the date of this issuance, in an aggregate principal amount of 473 million euros.

In 2018, the payment of the coupons related to the undated deeply subordinated securities, in an aggregate amount, net of tax effects, of 392 million euros (263 million and 255 million euros in 2017 and 2016, respectively), was recorded as “Retained earnings” in the consolidated statements of changes in equity. In 2018, the coupons related to the undated deeply subordinated securities has been impacted by the premium of the tender offer amounting to 139 million euros, net of tax effects.

Notes mandatorily convertible into shares of Telefónica, S.A.

On September 24, 2014, Telefónica Participaciones, S.A.U. issued 1,500 million euros of notes mandatorily convertible into new and/or existing shares of Telefónica, S.A. at a nominal fixed interest rate of 4.9%, due on September 25, 2017, guaranteed by Telefónica, S.A. At maturity of the notes, Telefónica, S.A. delivered a total of 154,341,669 shares of Telefónica, S.A. on behalf of Telefónica Participaciones, S.A.U. at a conversion price of 9.7174 euros per share (minimum conversion price after the standard adjustments included in the terms of the notes). To meet the conversion of the notes, Telefónica, S.A. issued 154,326,696 new shares in execution of a capital increase and delivered 14,973 treasury shares.

These mandatorily convertible notes were compound instruments split into two components, namely a debt component amounting to 215 million euros, corresponding to the present value of the coupons; and an equity component for the remaining amount, since the issuer opted to convert the treasury shares at a fixed ratio, as included in the heading “other equity instruments”. The third coupon was paid in 2017 and amounted to 74 million euros (74 million euros in 2016).

d) Legal reserve

According to the consolidated text of the Spanish Corporate Enterprises Act, companies must transfer 10% of profit for the year to a legal reserve until this reserve reaches at least 20% of share capital. The legal reserve can be used to increase capital by the amount exceeding 10% of the increased share capital amount. Except for this purpose, until the legal reserve exceeds the limit of 20% of share capital, it can only be used to offset losses, if there are no other reserves available. At December 31, 2017, after the capital increase carried forward in 2017, the Company needed to increase the legal reserve by an additional 51 million euros, until the legal reserve was fully constituted. The proposed distribution of 2017 profit included a corresponding allocation of 51 million euros. At December 31, 2018 the Company had duly set aside 1,038 million euros to comply with legal reserve requirements.

e) Retained earnings

These reserves include undistributed profits of companies constituting the consolidated Group less interim dividends paid against profit for the year, actuarial gains and losses, the impact of the asset ceiling on defined benefit plans and the payment of coupons related to subordinated securities, if applicable.

In addition, these reserves include equity effects derived from the restatement for inflation of the financial statements of the Group companies operating in Venezuela and Argentina, and the translation differences generated upon translating their respective financial statements into euros using the exchange rate at the end of the period (see Note 2).

These reserves also include revaluation reserves and the reserve for canceled share capital. These reserves are regulated by some restrictions for their distribution.

Revaluation reserves

The balance of “Revaluation reserves” arose as a result of the revaluation made pursuant to Spanish Royal Decree-Law 7/1996 of June 7, and may be used, free of tax, to offset any losses incurred in the future and to increase capital. It may also be allocated to unrestricted reserves, provided that the capital gain has been realized.

2018 Consolidated Financial Statements

The capital gain will be deemed to have been realized in respect of the portion on which the depreciation was recorded for accounting purposes or when the revalued assets were transferred or recognized. In this respect, 6 million euros were reclassified to “Retained earnings” in 2018 (6 million euros in 2017 and 8 million euros in 2016), corresponding to revaluation reserves subsequently considered to be unrestricted. At December 31, 2018, this reserve amounted to 72 million euros (78 million euros at December 31, 2017).

Reserve for canceled share capital

In accordance with Section 335.c) of the Spanish Corporate Enterprises Act and to render null and void the right of opposition provided for in Section 334 of the same Act, whenever the Company decreases capital, should record a reserve for canceled share capital for an amount equal to the par value of the canceled shares, which can only be used upon satisfaction of the same requirements as those applicable to the reduction of share capital. In 2018 and 2017, no amount was recorded in this account. In 2016, the reserve for canceled share capital amounted to 75 million euros, the same amount as the capital reduction made in the year. The cumulative amount at December 31, 2018 and 2017 was 731 million euros each, respectively.

f) Translation differences

The breakdown of the accumulated contribution of translation differences attributable to equity holders of the parent at December 31 is as follows:

Millions of euros	2018	2017	2016
Brazilian real	(10,603)	(8,710)	(5,999)
Pound sterling	(3,266)	(3,223)	(2,918)
Other currencies	(882)	(3,921)	(2,658)
Total Group	(14,751)	(15,854)	(11,575)

Translation differences for 2017 and 2016 have been revised due to the change in the presentation policy for hyperinflation effects in equity, which affects the translation differences accumulated in each of the periods of the subsidiaries in Venezuela (see Note 2).

g) 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 a net impact on total equity amounting to -165 million euros and 743 million euros, respectively, with the following detail:

Millions of euros	IFRS 9	IFRS 15	Total
Gross impact on equity	(221)	1,006	785
Tax effect	56	(263)	(207)
Impact on equity	(165)	743	578
Attributable to equity holders	(142)	654	512
Attributable to non-controlling interest	(23)	89	66

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 14).

h) Treasury share instruments

Telefónica, S.A. held the following treasury shares at December 31, 2018, 2017 and 2016:

2018 Consolidated Financial Statements

	Number of shares	Euros per share		Market value(*)	%
		Acquisition price	Trading price		
Treasury shares at 12/31/18	65,496,120	10.48	7.34	481	1.26145 %
Treasury shares at 12/31/17	65,687,859	10.48	8.13	534	1.26514 %
Treasury shares at 12/31/16	141,229,134	10.48	8.82	1,246	2.80339 %

(*) Millions of euros

The following transactions involving treasury shares were carried out in 2018, 2017 and 2016:

	Number of shares
Treasury shares at 12/31/15	141,639,159
Acquisitions	77,087,297
Employee share option plan	(2,869,334)
Capital reduction	(74,627,988)
Treasury shares at 12/31/16	141,229,134
Acquisitions	—
Employee share option plan	(3,518,795)
Capital reduction	(72,022,480)
Treasury shares at 12/31/17	65,687,859
Acquisitions	—
Employee share option plan	(191,739)
Other movements	—
Treasury shares at 12/31/18	65,496,120

There were no treasury shares purchases in 2018 and 2017 (668 million euros in 2016).

The most significant transaction with treasury shares in 2017 was the swap with Koninklijke KPN NV (hereinafter, KPN) by which 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, amounting to 754 million euros (see Note 5).

On September 30, 2017, and September 30, 2018, the first and second cycles, respectively, of the Telefónica, S.A. long-term incentive plans called “Performance and Investment Plan 2014-2019” (PIP 2014-2019) and “Talent for the Future Share Plan (TFSP)” ended, which did not entail the delivery of any shares (see Note 24).

On July 31, 2017, the Global Employee Share Plan III matured and 3,187,055 treasury shares were delivered to the Group employees who met the requirements (see Note 24).

On June 30, 2016, the third phase of the Telefónica, S.A. long-term incentive plan called “Performance and Investment Plan 2011-2016” (PIP 2011-2016) ended, which did not entail the delivery of any shares to Telefónica Group managers.

On October 13, 2016, pursuant to the resolution of the share capital reduction, by the cancellation of treasury shares, as adopted by the Annual General Shareholders’ Meeting of Telefónica held on May 12, 2016, the public deed of this share capital reduction was registered. Therefore, 74,627,988 of the treasury shares of Telefónica, S.A. totaling 813 million euros were canceled.

The Company maintains a derivative financial instrument subject to net settlement on a notional equivalent of 21.7 million of Telefónica shares in 2018 (35.2 million shares in 2017), recognized under “Current financial liabilities” in the consolidated financial statements for both fiscal years.

2018 Consolidated Financial Statements

i) Equity attributable to non-controlling interests

“Equity attributable to non-controlling interests” represents the share of non-controlling interests in the equity and income or loss for the year of fully consolidated Group companies. The movements in this balance for the 2018, 2017 and 2016 consolidated statements of financial position are as follows:

Millions of euros	Balance at 12/31/17	Sales of non-controlling interests and inclusion of companies	Acquisitions of non-controlling interests and exclusion of companies	Dividends paid	Profit/(loss) for the year	Change in translation differences	Other movements	Balance at 12/31/18
Telefônica Brasil, S.A.	5,018	—	—	(406)	556	(550)	(14)	4,604
Telefónica Deutschland Holding, A.G.	3,114	—	—	(238)	(88)	—	85	2,873
Colombia Telecomunicaciones, S.A., ESP	523	—	—	—	41	(19)	(22)	523
Telefónica Centroamericana Inversiones, S.L.	307	—	—	(28)	30	7	—	316
Telxius Telecom, S.A.	694	139	—	(231)	80	5	(10)	677
Other	42	—	1	(3)	—	(1)	1	40
Total	9,698	139	1	(906)	619	(558)	40	9,033

Millions of euros	Balance at 12/31/16	Sales of non-controlling interests and inclusion of companies	Acquisitions of non-controlling interests and exclusion of companies	Dividends paid	Profit/(loss) for the year	Change in translation differences	Other movements	Balance at 12/31/17
Telefônica Brasil, S.A.	5,756	25	—	(320)	336	(772)	(7)	5,018
Telefónica Deutschland Holding, A.G.	4,150	—	(671)	(229)	(140)	—	4	3,114
Colombia Telecomunicaciones, S.A., ESP	(88)	605	—	—	26	(4)	(16)	523
Telefónica Centroamericana Inversiones, S.L.	354	—	—	(22)	18	(43)	—	307
Telxius Telecom, S.A.	—	690	—	—	7	(3)	—	694
Other	56	—	—	(12)	(1)	(2)	1	42
Total	10,228	1,320	(671)	(583)	246	(824)	(18)	9,698

Millions of euros	Balance at 12/31/15	Sales of non-controlling interests and inclusion of companies	Acquisitions of non-controlling interests and exclusion of companies	Dividends paid	Profit/(loss) for the year	Change in translation differences	Other movements	Balance at 12/31/16
-------------------	---------------------	---	--	----------------	----------------------------	-----------------------------------	-----------------	---------------------

Edgar Filing: TELEFONICA S A - Form 6-K

Telefônica Brasil, S.A.	4,644	—	—	(232)	257	1,099	(12)	5,756
Telefónica Deutschland Holding, A.G.	4,638	—	—	(263)	(217)	—	(8)	4,150
Colombia Telecomunicaciones, S.A., ESP	(30)	—	—	—	(32)	(7)	(19)	(88)
Telefónica Centroamericana Inversiones, S.L.	354	—	—	(28)	19	8	1	354
Other	59	1	(8)	(1)	3	3	(1)	56
Total	9,665	1	(8)	(524)	30	1,103	(39)	10,228

Telefónica, S.A. 69

2018 Consolidated Financial Statements

Note 4 contains the revenues, OIBDA, capital expenditure and the main items of the statement of financial position for the main segments of the Telefónica Group with non-controlling interests, namely Telefónica Brazil and Telefónica Germany. The detail of these figures for Colombia Telecomunicaciones is as follows:

Millions of euros

Colombia Telecomunicaciones	2018	2017	2016
Revenues	1,468	1,462	1,409
OIBDA	556	482	464
Depreciation and amortization	(385)	(357)	(296)
Operating income	171	125	168
Capital Expenditure	192	796	330
Fixed Assets	1,950	2,221	1,710
Total allocated assets	3,073	3,246	2,788
Total allocated liabilities	1,615	1,790	3,226

The statements of cash flows of these companies are as follows:

Millions of euros

Telefónica Brazil	2018	2017	2016
Net cash flow provided by operating activities	3,599	3,710	3,123
Net cash flow used in investing activities	(2,012)	(2,285)	(2,039)
Net cash flow used in financing activities	(1,660)	(1,653)	(1,218)
	(73)	(228)	(134)

Millions of euros

Telefónica Germany	2018	2017	2016
Net cash flow provided by operating activities	1,898	1,942	2,154
Net cash flow used in investing activities	(1,137)	(1,223)	(1,252)
Net cash flow used in financing activities	(569)	(706)	(1,323)
	192	13	(421)

Millions of euros

Colombia Telecomunicaciones	2018	2017	2016
Net cash flow provided by operating activities	344	324	198
Net cash flow used in investing activities	(167)	(684)	(278)
Net cash flow used in financing activities	(229)	407	70
	(52)	47	(10)

In 2018, “Sales of non-controlling interests and inclusion of companies” reflects the effect of the sale of 16.65% of the total share capital of Pontel to a subsidiary of the Pontegadea Group amounting to 378.8 million euros. This participation is equivalent to an indirect participation of 9.99% in the share capital of Telxius (see Note 5).

In 2017 “Sales of non-controlling interests and inclusion of companies” reflects the effect of the capital increase in Colombia Telecomunicaciones (see Note 2) and the sale of 40% of the total share capital of Telxius Telecom, S.A.U. to KKR amounting to 1,275 million euros. The swap agreement with KPN is particularly noteworthy, whereby 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 (see Note 5).

2018 Consolidated Financial Statements

Note 16. Financial liabilities

The breakdown of financial liabilities at December 31, 2018 and the corresponding maturities schedule is as follows:
Millions of euros

Maturity	Current					Non-current		Total
	2019	2020	2021	2022	2023	Subsequent years	Non-current total	
Debentures and bonds	4,234	5,161	4,821	4,958	2,316	19,686	36,942	41,176
Promissory notes & commercial paper	1,979	113	—	—	117	245	475	2,454
Total Issues	6,213	5,274	4,821	4,958	2,433	19,931	37,417	43,630
Loans and other payables	2,925	515	876	525	849	2,865	5,630	8,555
Derivative instruments (Note 17)	230	628	300	224	138	997	2,287	2,517
Total	9,368	6,417	5,997	5,707	3,420	23,793	45,334	54,702

The estimate of future payments for interest on these financial liabilities at December 31, 2018 is as follows: 1,624 million euros in 2019, 1,399 million euros in 2020, 1,171 million euros in 2021, 1,021 million euros in 2022, 836 million euros in 2023 and 8,320 million euros in years after 2023. For floating rate financing, the Group mainly estimates future interest using the forward curve of the various currencies at December 31, 2018.

Derivative instruments consider the fair value of derivatives classified as financial liabilities, i.e. when they have a negative mark-to-market, yet excluding the fair value of derivatives classified as current financial assets (922 million euros) and non-current (2,776 million euros), i.e. when they have a positive mark-to-market.

In 2017 and 2018, the Group entered into agreements to extend payment terms with various suppliers, and with factoring companies when such payments are discounted. When the new extended payment terms exceed customary payment terms in the industry, trade liabilities are reclassified to other financial liabilities and the deferred payments made are recognized in net cash flow used in financing activities (see Note 25). At December 31, 2018 the corresponding amount pending payment, recognized in “Loans and other payables”, was 210 million euros (153 million euros at December 31, 2017). The deferred payments made in relation to this item during the year amounted to 428 million euros (717 million euros in 2017).

The composition of these financial liabilities by category at December 31, 2018 and 2017 is as follows:

December 31, 2018

Millions of euros	Fair value through profit or loss		Measurement hierarchy				Liabilities at amortized cost	Total carrying amount	Total fair value
	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)			
Issues	—	—	—	—	—	—	43,630	43,630	44,939
Loans and other payables	—	—	—	—	—	—	8,555	8,555	8,517
Derivative instruments	870	—	1,647	71	2,446	—	—	2,517	2,517
Total financial liabilities	870	—	1,647	71	2,446	—	52,185	54,702	55,973

2018 Consolidated Financial Statements

December 31, 2017

Millions of euros	Fair value through profit or loss		Measurement hierarchy				Liabilities at amortized cost	Total carrying amount	Total fair value
	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)			
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 financial liabilities	1,180	—	1,972	80	3,072	—	52,594	55,746	59,328

The calculation of the fair values of the Telefónica Group's debt instruments required an estimate of the credit spread curve for each currency and corresponding subsidiary using the prices of the Group's bonds and credit derivatives. At December 31, 2018, some of the financing arranged by Telefónica Group companies in Latin America (Brazil, Panama, Ecuador and Guatemala), which amounted to approximately 2% of the Telefónica Group's gross debt, was subject to compliance with certain financial covenants. To date, these covenants are being met. Due to the absence of cross-defaults, breach of the covenants would not affect the debt at Telefónica, S.A. level.

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

Issues, promissory notes, commercial paper, loans and other payables

The movement in changes in issues, promissory notes, commercial paper, loans and other payables in 2018 and 2017 arising from financial activities is as follows:

Millions of euros	Balance at 12/31/17	Cash used in financing activities		Translation differences and exchange gains and losses	Fair value adjustment and financial updates	Other movements	Balance at 12/31/18
		Cash received	Cash paid				
Issues	41,288	4,289	(4,654)	)533	(280)	)—	41,176
Promissory notes and commercial paper	2,406	299	(255)	)4	—	—	2,454
Loans and other payables	8,900	3,465	(4,161)	)80	10	261	8,555

Telefónica, S.A. 72

2018 Consolidated Financial Statements

Millions of euros	Balance at 12/31/16	Cash used in financing activities		Translation differences and exchange gains and losses	Fair value adjustment and financial updates	Other movements	Balance at 12/31/17
		Cash received	Cash paid				
Issues	42,084	8,390	(6,687)	(2,178)	(296)	(25)	41,288
Promissory notes and commercial paper	3,360	60	(1,008)	(6)	—	—	2,406
Loans and other payables	11,397	4,209	(6,241)	(699)	(16)	(250)	8,900
Debentures and bonds							

At December 31, 2018, the nominal amount of outstanding debentures and bonds issues is 39,709 million euros (39,581 million euros at December 31, 2017). Appendix III presents the characteristics of all outstanding debentures and bond issues at the year-end of 2018, and the significant issues made during the year.

On July 24, 2017, the mandatory exchangeable bonds convertible into ordinary shares of Telecom Italia, S.p.A., issued by Telefónica, S.A. on July 24, 2014, for 750 million euros, matured. At the maturity date, the Company fulfilled its commitments to deliver the shares with the vesting of the equity swap instrument arranged for that purpose.

Telefónica, S.A. has a full and unconditional guarantee on issues made by Telefónica Emisiones, S.A.U., Telefónica Finanzas México, S.A. de C.V., Telefónica Europe, B.V. and Telefónica Participaciones, S.A.U., all of which are directly or indirectly fully-owned subsidiaries of Telefónica, S.A.

Promissory notes and commercial paper

The main programs for issuance of promissory notes and commercial paper are the following:

At December 31, 2018, Telefónica Europe, B.V. had a commercial paper issuance program guaranteed by Telefónica, S.A. for up to 5,000 million euros. The outstanding balance of commercial paper issued under this program at December 31, 2018 was 1,666 million euros, issued at an average interest rate of -0.23% for 2018 (1,850 million euros issued in 2017 at an average rate of -0.17%).

At December 31, 2018, Telefónica, S.A. had a corporate promissory note program for 500 million euros, which can be increased to 2,000 million euros, with an outstanding balance at December 31, 2018 of 181 million euros (204 million euros in 2017).

Interest-bearing debt

The average interest rate on outstanding loans and other payables at December 31, 2018 was 1.70% (2.01% in 2017). This percentage does not include the impact of hedges arranged by the Group.

The main financing transactions included under “Interest-bearing debt” outstanding at December 31, 2018 and 2017 and their nominal amounts are provided in Appendix V.

2018 Consolidated Financial Statements

Interest-bearing debt arranged or repaid in 2018 mainly includes the following:

Description	Limit 12/31/2018 (million euros)	Currency	Outstanding balance 12/31/2018 (million euros)	Arrangement date	Maturity date	Drawdown 2018 (million euros)	Repayment 2018 (million euros)
Telefónica, S.A.							
Syndicated facility ⁽¹⁾	5,500	EUR	—	03/15/2018	03/15/2023	—	—
Bilateral loan	100	EUR	100	11/24/2017	01/30/2026	100	—
Bilateral loan	100	EUR	100	12/28/2017	10/22/2020	100	—
Bilateral loan	385	EUR	385	12/20/2017	07/22/2019	385	—
Loan ⁽²⁾	—	EUR	—	03/08/2016	09/28/2018	—	(300)
Bilateral loan ⁽³⁾	1,000	EUR	1,000	06/26/2014	06/26/2019	—	(500)
Telxius Telecom, S.A.							
Syndicated facility ⁽⁴⁾	300	EUR	300	12/01/2017	12/01/2023	300	—
Telefónica Europe, B.V.							
Structured financing ^(*)	—	EUR	1,500	11/28/2016	11/28/2024	750	—

On March 15, 2018, 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

⁽²⁾ On September 28, 2018, an early repayment was made by Telefónica, S.A. for the 300 million euros loan originally scheduled to mature on March 8, 2021

⁽³⁾ On July 17, 2018, an early repayment was made by Telefónica, S.A. for 500 million euros originally scheduled to mature on June 26, 2019

⁽⁴⁾ On December 1, 2018, Telxius Telecom, S.A. extended for 12 months its syndicated facility signed in December 2017

^(*) Facility with amortization schedule, showing the undrawn amount in the column "Limit".

At December 31, 2018, the Telefónica Group presented availabilities of financing from different sources that amounted to approximately 12,219 million euros (13,531 million euros at December 31, 2017), of which 11,887 million euros will mature in more twelve months.

Loans by currency

The breakdown of "Loans and other payables" by currency at December 31, 2018 and 2017, and the equivalent value of foreign-currency loans in euros, is as follows:

Currency	Outstanding balance (in millions)			
	Local Currency		Euros	
	12/31/18	12/31/17	12/31/18	12/31/17
Euro	5,114	4,682	5,114	4,682
U.S. dollar	2,413	2,936	2,106	2,448
Brazilian real	2,964	3,939	668	993

Edgar Filing: TELEFONICA S A - Form 6-K

Colombian peso	1,031,005	1,398,550	277	391
Pounds sterling	100	106	112	120
Peruvian nuevo sol	525	462	136	119
Other currencies			142	147
Total Group			8,555	8,900

Telefónica, S.A. 74

2018 Consolidated Financial Statements

Note 17. Derivative financial instruments and risk management policies

The Telefónica Group is exposed to various financial market risks as a result of: (i) its ordinary business activity, (ii) debt incurred to finance its business, (iii) its investments in companies, and (iv) other financial instruments related to the above commitments.

The main market risks affecting the Group companies are as follows:

Exchange rate risk: arises primarily from: (i) Telefónica's international presence, through its investments and businesses in countries that use currencies other than the euro (primarily in Latin America, but also in the United Kingdom), (ii) debt denominated in currencies other than that of the country where the business is conducted or the home country of the company incurring such debt, and (iii) for those trade receivables or payables in foreign currency related to the company with the transaction registered.

Interest rate risk: arises primarily in connection with changes in interest rates affecting: (i) financial expenses on floating rate debt (or short-term debt likely to be renewed), due to changes in interest rates and (ii) the value of long-term liabilities at fixed interest rates.

Share price risk: arises primarily from changes in the value of the equity investments (that may be bought, sold or otherwise involved in transactions), from changes in the value of derivatives associated with such investments, from changes in the value of treasury shares and from changes in the value of equity derivatives.

Liquidity risk: the Telefónica Group is also exposed to liquidity risk if a mismatch arises between its financing needs (including operating and financial expenses, investment, debt redemptions and dividend commitments) and its sources of finance (including revenues, divestments, credit lines from financial institutions and capital market transactions).

The cost of finance could also be affected by movements in the credit spreads (over benchmark rates) demanded by lenders.

Country risk: refers to the possible decline in the value of assets, cash flows generated or cash flows returned to the parent company as a result of political, economic or social instability in the countries where the Telefónica Group operates, especially in Latin America.

Credit risk: appears when a counterparty fails to meet or delays its payment obligations in accordance with the agreed terms, driving an impairment in an asset due to: (i) solvency issues, or (ii) no intention to pay.

Risk management

The Telefónica Group actively manages these risks through the use of derivatives (primarily on exchange rates, interest rates, share prices and commodities) and by incurring debt in local currencies, where appropriate, with a view to optimize the financial cost and to stabilizing cash flows, the income statement and investments. In this way, it attempts to protect the Telefónica Group's solvency, facilitate financial planning and take advantage of investment opportunities.

The Telefónica Group manages its exchange rate risk and interest rate risk in terms of net financial debt plus commitments and net financial debt as calculated by the Group. The Telefónica Group believes that these parameters are more appropriate to understanding its debt position. Net financial debt and net financial debt plus commitments take into account the impact of the Group's cash balance and cash equivalents including derivatives positions with a positive value linked to liabilities. Neither net financial debt nor net financial debt plus commitments as calculated by the Telefónica Group should be considered as a substitute for gross financial debt (the sum of current and non-current interest-bearing debt).

2018 Consolidated Financial Statements

For a more detailed description on reconciliation of net financial debt and net financial debt plus commitments to gross financial debt, see Note 2.

Exchange rate risk

The fundamental objective of the exchange rate risk management policy is that, in event of depreciation in foreign currencies relative to the euro, any potential losses in the value of the OIBDA generated by the businesses in such currencies, caused by depreciation in exchange rates of a foreign currency relative to the euro, are offset (to some extent) by savings from the reduction in the euro value of debt denominated in such currencies. This objective is also reflected on the decrease of the sensitivity to exchange rate variations of the net debt to OIBDA ratio, in order to protect the Group solvency. The degree of exchange rate hedging varies depending on the type of investment and may easily and actively be adjusted. For transactions of purchase or sale of business in currencies other than euro, additional hedges can be made on the estimate prices of the transactions or on estimated cash flows and OIBDA. At December 31, 2018, the net financial debt in Latin American currencies was equivalent to approximately 4,209 million euros (4,689 million euros in 2017). However, the Latin American currencies in which this debt is denominated is not distributed in proportion to the OIBDA generated in each currency. The future effectiveness of the strategy described above as a hedge of exchange rate risks therefore depends on which currencies depreciate relative to the euro.

Telefónica occasionally takes out dollar-denominated debt to hedge the euro-dollar intermediate component in the relation Euro-Latin American currencies, either in Spain (where such debt is associated with an investment as long as it is considered to be an effective hedge) or in the country itself, where the market for local currency financing or hedges may be inadequate or non-existent. At December 31, 2018, the Telefónica Group's net financial debt denominated in dollars to hedge that component was equivalent to 458 million euros (146 million euros in 2017). At December 31, 2018, the net financial debt in pounds sterling was approximately 1.97 times the value of the business' operating income before depreciation and amortization (OIBDA) in 2018 for Group companies in the United Kingdom, which is in line with the previous years policy of 2 times the OIBDA ratio. At December 31, 2018, the net financial debt denominated in pounds sterling was equivalent to 3,566 million euros, which is more than the 3,089 million euros at December 31, 2017.

The Telefónica Group also manages exchange rate risk by seeking to reduce the negative impact of any exchange rate exposure on the income statement, as a result of transactions recognized on the balance sheet and highly probable transactions, regardless of whether there are open positions. Such open position exposure can arise for any of three reasons: (i) a thin market for local derivatives or difficulty in sourcing local currency finance which makes it impossible to arrange a low-cost hedge (as in Argentina and Venezuela), (ii) financing through intra-group loans, where the accounting treatment of exchange rate risk is different from that for financing through capital contributions, and (iii) as the result of a deliberate policy decision, to avoid the high cost of hedges that are not warranted by expectations or high risk of depreciation.

The main transactions that generate or may generate exchange rate risk (regardless of whether or not they have an impact on the income statement) are, among others, as follows: issues in currencies other than the functional currency of the Group company, highly probable transactions in other currencies, future cash inflows in other currencies, investments and divestments, provisions for collections or payments in foreign currency, the actual value of the investments (subsidiaries) in currencies other than the euro.

In 2018, net negative foreign exchange results (excluding monetary correction) amounted to 963 million euros (419 million euros in 2017), mainly due to the conversion of the Venezuelan Bolivar "Fuerte" from 36,115 to 7,608 Bolivar Soberano per US dollar (see Note 2), that resulted in exchange losses of 954 million euros (426 million euros in 2017).

The following table illustrates the sensitivity of foreign currency gains and sensitivity losses and of equity to changes in exchange rates, where: a) in calculating the impact on the income statement, the exchange rate position affecting the income statement at the end of 2018 was considered constant during 2019; b) in calculating

Telefónica, S.A. 76

2018 Consolidated Financial Statements

the impact on equity, only monetary items have been considered, namely debt and derivatives such as hedges of net investment and loans to subsidiaries related to the investment, breakdown of which is considered constant in 2019 and identical to that existing at the end of 2018. In both cases, Latin American currencies are assumed to change their value against the dollar and the rest of the currencies against the euro by 10%.

Millions of euros

Currency	Change	Impact on the consolidated income statement	Impact on consolidated equity
All currencies vs EUR	10%	1	(541)
USD	10%	(2	)(101)
European currencies vs EUR	10%	1	(350)
Latin American currencies vs USD	10%	2	(90)
All currencies vs EUR	(10%)	(1	)541
USD	(10%)	2	101
European currencies vs EUR	(10%)	(1	)350
Latin American currencies vs USD	(10%)	(2	)90

The Group's monetary position in Venezuela at December 31, 2018 is a net debt position of 1,375,524 million Venezuelan bolivars equivalent to -158 million euros (7,358,790 million Venezuelan bolivars equivalent to -170 million euros at December 31, 2017). The net monetary position exposure in 2018 has been a debtor position, which led to a higher financial income of 1,173 million euros due to the effect of the monetary correction for inflation during the year (510 million euros in 2017).

Interest rate risk

The main objective of the interest rate risk management policy is to bring the Company's financing costs in line with the budget for financial expenses for the current year, as well as the current strategic plan. In accordance with this objective, Telefónica decided to actively adjust the exposure of its debt to interest rates, i.e., the amount of debt that would accrue interest at fixed rates and variable rates.

In order to meet this target, Telefónica mainly carried out the following:

- The interest rate of borrowings tied to a variable interest rate was set.
- Interest rate fluctuations of debt tied to a variable interest rate were reduced.
- Fixed rate debt instruments were converted into variable market rate debt instruments.

These transactions may be carried out against an existing underlying asset or those that are highly likely to take place in the future (for example, a highly probable future issue of debt).

The Telefónica Group's financial expenses are exposed to changes in interest rates. In 2018 the Euribor, the Brazilian SELIC, the dollar Libor, the pound sterling Libor, the Mexican UDI and the Colombian UVR were the short term rates that accounted for most of the exposure. In nominal terms, at December 31, 2018, 73.6% of Telefónica's net financial debt plus commitments was pegged to fixed interest rates for a period greater than one year, compared to 71.0% in 2017. Of the remaining 26.4% (net debt at floating rates or at fixed rates maturing within one year), 0.9 percentage points had interest rates bounded in a period over one year, versus 0.8 percentage points of net debt at floating rates or with fixed rates maturing within one year at December 31, 2017.

2018 Consolidated Financial Statements

In addition, early retirement and Individual Suspension Plan liabilities (see Note 21) were discounted to present value over the year, based on the curve for instruments with very high credit quality. The increase in interest rates during the year has led to a decrease in the market value of these liabilities. However, this decrease was nearly completely offset by the decrease in the market value of the hedges on these positions.

Net financial results amounted to 955 million euros in 2018, 1,244 million lower than the previous year, on one hand thanks to the positive impacts on the financial statements associated with the before mentioned favorable court ruling in Brazil and on the other hand thanks to the reduction in both debt and average cost of debt.

To illustrate the sensitivity of the Company's net financial expense to fluctuations in short-term interest rates, on one hand a 100 basis point increase in interest rates in all currencies in which Telefónica has financial positions at December 31, 2018, and a 100 basis point decrease in all currencies has been assumed, and on the other hand a constant position equal to the position at year-end has been considered.

To calculate the sensitivity of equity to fluctuations in interest rates, on one hand a 100 basis point increase in interest rates in all currencies and in all periods on the yield curve in which Telefónica has financial positions at December 31, 2018, and a 100 basis point decrease in all currencies and all periods was assumed, and on the other hand only positions with cash flow hedges were considered, which are basically the only positions in which changes in market value due to interest rate fluctuations are recognized in equity.

Millions of euros

Change in basis points (bp)	Impact on consolidated income statement	Impact on consolidated equity
+100bp	(102	)317
-100bp	88	(317)

Share price risk

The Telefónica Group is exposed to changes in the value of equity investments, derivatives associated with such investments, convertible or exchangeable instruments issued by Telefónica Group, Share-based payments plans, treasury shares and equity derivatives over treasury shares.

According to the Share-based payments plans (see Note 24) the shares to be delivered to employees under such plan may be either Telefónica S.A. treasury shares, acquired by itself or any of its Group companies; or newly-issued shares. The possibility of delivering shares to beneficiaries of the plan in the future, implies a risk since there could be an obligation to hand over a maximum number of shares at the end of each phase, whose acquisition (in the event of acquisition in the market) in the future could imply a higher cash outflow than required on the start date of each phase if the share price is above the corresponding price on the phase start date. In the event that new shares are issued for delivery to the beneficiaries of the plan, there would be a dilutive effect for ordinary shareholders of Telefónica as a result of the higher number of shares delivered under such plan outstanding.

In 2018, the General Shareholder's Meeting approved a Long-Term Incentive Plan consisting of the delivery of shares of Telefónica, S.A. allocated to Senior Executive Officers of the Telefónica Group. The Plan will have a total duration of five years and will be divided into three mutually exclusive cycles of three years each. The first cycle commenced in 2018 (see Note 24). Additionally, the Shareholder's Meeting approved a Global Employee Incentive Share Purchase Plan for shares of Telefónica, S.A. for the Employees of the Telefónica Group, which at the end of 2018 has not yet been implemented.

To reduce the risk associated with variations in share price under these plans, Telefónica could acquire instruments that hedge the risk profile of some of these plans.

In addition, the Group may use part of the treasury shares of Telefónica, S.A. held at December 31, 2018 to cover shares deliverable under the new Plans. The net asset value of the treasury shares could increase or decrease depending on variations in Telefónica, S.A.'s share price.

2018 Consolidated Financial Statements

Liquidity risk

The Telefónica Group seeks to match the schedule for its debt maturity payments to its capacity to generate cash flows to meet these maturities, while allowing for some flexibility. In practice, this has been translated into two key principles:

The Telefónica Group's average maturity of net financial debt is intended to stay above 6 years, or be restored above that threshold in a reasonable period of time if it eventually falls below it. This principle is considered as a guideline when managing debt and access to credit markets, but not a rigid requirement. When calculating the average maturity for the net financial debt, a portion of the undrawn credit lines can be considered as offsetting the shorter debt maturities, and extension options on some financing facilities may be considered as exercised, for calculation purposes.

The Telefónica Group must be able to pay all commitments over the next 12 months without accessing new borrowing or tapping the capital markets (drawing upon firm credit lines arranged with banks), assuming budget projections are met.

At December 31, 2018, the average maturity of net financial debt (41,785 million euros) was 8.98 years (liquidity included).

At December 31, 2018, gross financial debt scheduled to mature in 2019 amounted to 9,368 million euros. These maturities are lower than the amount of funds available, calculated as the sum of: a) cash and cash equivalents and current financial assets; b) annual cash generation projected for 2019, and c) undrawn credit facilities arranged with banks whose original maturity is over one year (an aggregate of 11,887 million euros at December 31, 2018), providing flexibility to the Telefónica Group with regard to accessing capital or credit markets in the next 2 years. For a further description of the Telefónica Group's liquidity and capital resources in 2018, see Note 16 and Appendix V.

Country risk

The Telefónica Group managed or mitigated country risk by pursuing two lines of action (in addition to its normal business practices):

1. Partly matching assets to liabilities (those not guaranteed by the parent company) in the Telefónica Group's Latin American companies such that any potential asset impairment would be accompanied by a reduction in liabilities; and
2. Repatriating funds generated in Latin America that are not required for the pursuit of new, profitable business development opportunities in the region.

Regarding the first point, at December 31, 2018, the Telefónica Group's Latin American companies had net financial debt not guaranteed by the parent company of 1,857 million euros, which represents 4% of net financial debt of the Group. Nevertheless, in certain countries, such as Venezuela, there is a net cash balance (instead of a net liability balance).

Regarding the net repatriation of funds to Spain, 778 million euros from Latin America companies have been received in 2018, of which 823 million euros was from dividends and on the other hand cash outflows of 46 million euros, mainly, due to capital increases of Group companies.

Credit risk

The Telefónica Group trades in derivatives with creditworthy counterparties. Therefore, Telefónica, S.A. generally trades with credit entities whose "senior debt" ratings are of at least "A-" or in case of Spanish entities in line with the credit rating of Kingdom of Spain. In Spain, where most of the Group's derivatives portfolio is held, there are netting agreements with financial institutions, with debtor or creditor positions offset in case of bankruptcy, limiting the risk to the net position. In addition, the CDS (Credit Default Swap) of all the counterparties with which Telefónica, S.A. operates is monitored at all times in order to assess the maximum

2018 Consolidated Financial Statements

allowable CDS for operating at any given time. Transactions are generally only carried out with counterparties whose CDS is below the threshold.

Net CVA (CVA+DVA) or Credit Valuation Adjustment is the method used to measure credit risk for both counterparties and Telefónica in order to determine the fair value of the derivatives portfolio. This adjustment reflects the probability of default or the deterioration of the credit quality of both Telefónica and its counterparties. The simplified formula to calculate CVA is Expected Exposure times Probability of Default times Loss Given Default. In order to calculate these variables standard market practices are used.

When managing credit risk, Telefónica considers the use of CDS, novations, derivatives with Break Clauses and signing CSA's under certain conditions.

For other subsidiaries, particularly those in Latin America, assuming a stable sovereign rating provides a ceiling which is below "A", trades are with local financial entities whose rating by local standards is considered to be of high creditworthiness.

Meanwhile, with credit risk arising from cash and cash equivalents, the Telefónica Group places its cash surpluses in high quality and highly liquid money-market assets. These placements are regulated by a general framework, revised annually. Counterparties are chosen according to criteria of liquidity, solvency and diversification based on the conditions of the market and countries where the Group operates. The general framework sets: the maximum amounts to be invested by counterparty based on its rating (long-term debt rating); and the instruments in which the surpluses may be invested (money-market instruments).

The Telefónica Group considers customer credit risk management as a key element to achieve its business and customer base growth targets in a sustainable way. This management approach relies on the active evaluation of the risk-reward balance within the commercial operations and on the adequate separation between the risk ownership and risk management functions.

Formal delegation of authority procedures and management practices are implemented in the different Group companies, taking into account benchmark risk management techniques but adapted to the local characteristics of each market. Commercial debtors that may cause a relevant impact on the Telefónica Group consolidated financial statements and increased risk profile products - due to customer target, term, channels or other commercial characteristics - are subject to specific management practices in order to mitigate the exposure to credit risk.

This customer credit risk management model is embedded in the day-to-day operational processes of the different companies, where the credit risk assessment guides both the product and services available for the different customers and the collection strategy.

The Telefónica Group's maximum exposure to credit risk is initially represented by the carrying amounts of the financial assets (see notes 11 to 14) and the guarantees given by the Telefónica Group.

Several Telefónica Group companies provide operating guarantees granted by external counterparties, which are offered during their normal commercial activity, in bids for licenses, permits and concessions, and spectrum acquisitions. At December 31, 2018, these guarantees amounted to approximately 5,328 million euros (5,144 million euros at December 31, 2017).

Capital management

Telefónica's corporate finance department takes into consideration several factors for the evaluation of the Telefónica's capital structure, with the aim of maintaining the solvency and creating value to the shareholders.

2018 Consolidated Financial Statements

The corporate finance department estimates the cost of capital on a continuous basis through the monitoring of the financial markets and the application of standard industry approaches for calculating weighted average cost of capital, or WACC, so that it can be applied in the valuation of businesses in course and in the evaluation of investment projects. In addition, Telefónica also uses as reference a net financial debt (excluding items of a non-recurring or exceptional nature) that allows for a comfortable investment grade credit rating as assigned by credit rating agencies, aiming at protecting credit solvency and making it compatible with alternative uses of cash flow that could arise at any time.

These general principles are refined by other considerations and the application of specific variables, such as country risk in the broadest sense, or the volatility in cash flow generation that are considered, when evaluating the financial structure of the Telefónica Group and its different areas.

Derivatives policy

At December 31, 2018, the nominal value of outstanding derivatives with external counterparties amounted to 138,102 million euros equivalent, a 5% decrease from December 31, 2017 (145,166 million euros equivalent). This figure is inflated by the use in some cases of several levels of derivatives applied to the nominal value of a single underlying liability. For example, a foreign currency loan can be hedged into floating rate, and then each interest rate period can be fixed using a fixed rate hedge, or FRA (forward rate agreement). The high volume is also due to the fact that when a derivative transaction is canceled, the company may either cancel the derivative or take the opposite position, which cancels out the variability thereof. The second option is usually chosen in order to cut costs. Even using such techniques to reduce the position, it is still necessary to take extreme care in the use of derivatives to avoid potential problems arising through error or a failure to understand the real position and its associated risks. The main principles in the management of derivatives are detailed as follow:

1) Derivatives based on a clearly identified hedged items.

Telefónica's derivatives policy emphasizes the following points:

Acceptable underlyings include assets and liabilities, profits, revenues and cash flows in either a company's functional currency or another currency. These flows can be contractual (debt and interest payments, settlement of foreign currency payables, etc.), reasonably certain or foreseeable (PP&E purchases, future debt issues, commercial paper programs, etc.). The acceptability of an underlying asset in the above cases does not depend on whether it complies with accounting rules requirements for hedge accounting, as is required in the case of certain intragroup transactions, for instance. Parent company investments in subsidiaries with functional currencies other than the euro also qualify as acceptable underlying assets.

Economic hedges are hedges that have a designated underlying asset and that, under certain circumstances, may offset the changes in the value of the underlying asset. These economic hedges may not always meet the requirements to be treated as hedges for accounting purposes. The decision to arrange these hedges if they do not meet certain requirements will depend on the marginal impact on the income statement and, therefore, on how far this may compromise the goal of having a stable income statement. In any case, the changes are recognized in the income statement.

2) Matching of the hedged item to one side of the derivative.

This matching basically applies to foreign currency debt and derivatives hedging foreign currency payments by Telefónica Group subsidiaries. The aim is to eliminate the risk arising from changes in foreign currency interest rates. Nonetheless, even when the aim is to achieve perfect hedging for all cash flows, the lack of liquidity in certain markets, especially in Latin American currencies, has meant that historically there have been mismatches between the terms of the hedges and those of the debts they are meant to hedge. The Telefónica Group intends to reduce these mismatches, provided that doing so does not involve disproportionate costs. In this regard, if adjustment does prove too costly, the financial timing of the underlying asset in foreign currency will be modified in order to minimize interest rate risk in foreign currency.

In certain cases, the timing of the underlying as defined for derivative purposes may not be exactly the same as the timing of the contractual underlying.

Telefónica, S.A. 81

2018 Consolidated Financial Statements

3) Matching the company contracting the derivative and the company that owns the hedged item.

Generally, the aim is to ensure that the hedging derivative and the hedged asset or liability belong to the same company. Sometimes, however, the holding companies (Telefónica, S.A. and Telefónica Latinoamérica Holding, S.L.) have arranged hedges on behalf of a subsidiary that owns the underlying asset. The main reasons for separating the hedge and the underlying asset were possible differences in the legal validity of local and international hedges (as a result of unforeseen legal changes) and the different credit ratings of the counterparties (of the Telefónica Group companies as well as those of the banks).

4) Ability to measure the derivative's fair value using the valuation systems available to the Telefónica Group. Telefónica uses several tools to evaluate and manage the risk involved in derivatives and debt. These tools most notably include the Kondor+ system, licensed by Reuters, for extended use among various financial institutions, as well as the specialized libraries in the MBRM financial calculation, both of which are widespread throughout the market and have shown proven reliability. In order to perform these calculations, customary market techniques are used when configuring the calculation methods and information from money market curves is used on a daily basis as market inputs (swaps, depots, FRA, etc.) for interest rates, official fixings for exchange rates and the interest rates and volatility matrices for interest and exchange rates that are listed in the multi-contributor systems, Reuters and Bloomberg. For those yield curves that are less liquid or whose prices published in Reuters and Bloomberg are considered not to adequately reflect the market situation, these curves will be requested from relevant banks in these markets.

5) Sale of options only when there is an underlying exposure.

Telefónica considers the sale of options when: i) there is an underlying exposure (on the consolidated statement of financial position or associated with a highly probable cash outflow) that would offset the potential loss for the year if the counterparty exercised the option. This exposure does not have to be treated as a purchased option, but rather it can be another type of hedged item (in these cases, hedge accounting does not apply since this hedging instrument does not meet the criteria required by accounting standards to treat the sale of options as hedging instruments), or ii) the option is part of a structure in which another derivative offsets any loss. The sale of options is also permitted in option structures where, at the moment they are taken out, the net premium is either positive or zero.

For instance, it would be possible to sell short-term options on interest rate swaps that entitle the counterparty to receive a certain fixed interest rate, below the level prevailing at the time the option was sold. This would mean that if rates fell and the counterparty exercised its option, the Group would swap part of its debt from floating rate to a lower fixed rate, having received a premium.

6) Hedge accounting.

The main risks that may qualify for hedge accounting are as follows:

- Variations in market interest rates (either money-market rates, credit spreads or both) that affect the value of the underlying asset or the measurement of the cash flows.
- Variations in exchange rates that change the value of the underlying asset in the company's functional currency and affect the measurement of the cash flow in the functional currency.
- Variations in the valuation of any financial asset, particularly shares of companies included in the portfolio of "Available-for-sale financial assets".
- Variations in the price of commodities related to contracts that the Group has with third parties.

Regarding the underlying:

• Hedges can cover all or part of the value of the underlying.

• The risk to be hedged can be for the whole period of the transaction or for only part of the period.

2018 Consolidated Financial Statements

The underlying may be a highly probable future transaction, or a contractual underlying (loan, foreign currency payment, investment, financial asset, etc.) or a combination of both that defines an underlying with a longer term.

The main coverage instruments used are:

Forwards / NDF: they are used mainly for exchange rate hedges related to commercial positions in foreign currency. They can also be used to hedge financing in foreign currency and net investment hedge in foreign currency.

Exchange Rate Options: in some cases, this type of instruments can be used linked to future capex and opex operations and investments and divestments in foreign currency.

Spots: for purchases and sales of currencies that are made same day value or two days' value. Generally used for operational needs or for divestments of operations in foreign currency.

Currency swaps: this type of transaction is generally executed to hedge bonds issuance or loans issued in foreign currency or net investment hedge.

Interest Swaps / Interest Rate Options: these instruments are used to manage the interest rate of the debt portfolio. The use of them is ruled by the Financial Expenses Budget with the objective of its fulfillment. Both the volume to be contracted and the maturity of these products is determined by the underlying assets to be hedged.

It is possible that in several markets the maturity, as well as the low liquidity, does not allow to contract a "perfect" hedge, but this circumstance will have to be analyzed case by case.

CDS: in order to manage the counterparty credit risk or CVA / DVA, CDS operations can be arranged to mitigate this risk.

Derivatives of Commodities: supporting the business lines that may need it and always hedging the commercial risks of the signed contracts. They would be settled by differences, this is, in a non-deliverable format.

Equity Derivatives: these are derivatives that address strategic decisions or hedging needs, either to hedge future investments or hedge existing risks. They protect Telefónica from the potential appreciation or depreciation in the price of the shares they hold as underlying.

Between the hedged item and the hedging instrument there is an economic relationship, this is, in general terms they move in opposite directions due to the same risk or risk covered. In other words, there must be an expectation that the value of the hedging instrument and the value of the hedged item will change systematically in opposite directions in response to the movements of one of the following elements:

the same underlying item; or

Underlying items that are economically related in such sense that they respond similarly to the risk that is being hedged.

Depending on the complexity of the hedge relationship and the way in which the hedge has been structured, a quantitative or qualitative analysis will have to be performed to demonstrate that there is an economic relationship between the hedged item and the hedging instrument.

This may on occasion mean that the hedging instruments have longer terms than the related contractual underlying.

This happens when the Telefónica Group enters into long-term swaps, caps or collars to protect

2018 Consolidated Financial Statements

ourselves against interest rate rises that may raise the financial expense of its promissory notes, commercial paper and some floating rate loans which mature earlier than their hedges. These floating rate financing programs are highly likely to be renewed and Telefónica commits to this by defining the underlying asset in a more general way as a floating rate financing program whose term coincides with the maturity of the hedge. In those cases in which the underlying assets representing the risk hedged are canceled or refinanced early, and if there is an open risk with similar characteristics as the underlying asset that was canceled or refinanced early, either because there is new financing or because there is an underlying asset with similar characteristics and risk profile, the hedge may remain in force with the derivatives assigned thereto and the risk will be subject to the hedge arranged in the aforementioned refinancing. When either of these situations occurs, the effectiveness of the hedge will be reviewed taking into account the new situation.

Hedges can be of three types:

• Fair value hedges.

Cash flow hedges. Such hedges can be set at any value of the risk to be hedged (interest rates, exchange rates, etc.) or for a defined range (interest rates between 2% and 4%, above 4%, etc.). In this last case, the hedging instrument used is options.

Hedges of net investment in consolidated foreign subsidiaries. Generally, such hedges are arranged by Telefónica S.A. and the other Telefónica holding companies. Wherever possible, these hedges are implemented through real debt in foreign currency. Often, however, this is not always possible as many Latin American currencies are non-convertible, making it impossible for non-resident companies to issue local currency debt. It may also be that, due to the debt market deepness, the debt in the currency concerned is not enough to accommodate the required hedge, or that an acquisition is made in cash with no need for market financing. In these circumstances derivatives, either forwards or cross-currency swaps are mainly used to hedge the net investment.

When using options, forwards or cross-currency swaps as hedging instruments, the exclusion of the time value of the option, the element at maturity of the forward and the currency spread of the cross-currency swap of the hedging relationship are evaluated on a case by case basis, in order to be treated as hedge costs.

Hedges can comprise a combination of different derivatives.

Management of accounting hedges is not static, and the hedging relationship may change before maturity. The interruption of the hedge accounting is possible within the framework of the management of financial risks and described in the internal document of “financial risks management and hedging strategy under IFRS 9”. To gauge the efficiency of transactions defined as accounting hedges, the Group analyzes the extent to which the changes in the fair value or in the cash flows attributable to the hedged item would offset the changes in fair value or cash flows attributable to the hedged risk using a linear regression model prospectively. To evaluate the effectiveness of hedges, under IFRS 9, there is no numerical range under which it is accepted that a hedge is effective and hence the hedge accounting standards are applicable. Therefore, Telefónica considers that if there is an economic relationship, not dominated by changes in credit risk and if the appropriate hedging rationale has been designated, the requirements for effectiveness are met. However, at the moment when ineffectiveness arises, Telefónica will evaluate whether there is still an economic relationship or whether the designated hedging rationale is appropriate. The possible sources of ineffectiveness that Telefónica can have when designing a hedging relationship and that will be considered when establishing the hedging rationale are:

• The hedging instrument and the hedged item have different maturity dates, initial dates, contract dates, repricing dates, etc.

• The hedging instrument starts with initial value and a financing effect is produced.

• When a cross-currency swap is designated as a hedging instrument on a foreign currency bond and the currency basis spread remains within the coverage.

• When the underlying items have different sensitivity and are not homogeneous, for example EURIBOR 3M versus EURIBOR 6M.

Telefónica, S.A. 84

2018 Consolidated Financial Statements

The main guiding principles for risk management are laid down by Telefónica's Finance Department and implemented by company financial officers (who are responsible for balancing the interests of each company and those of the Telefónica Group). The Corporate Finance Department may allow exceptions to this policy where these can be justified, normally when the market is too thin for the volume of transactions required or on clearly limited and small risks. New companies joining the Telefónica Group as a result of mergers or acquisitions may also need time to adapt.

7) Cancellation of derivatives.

When a derivative transaction is canceled, the company may:

• Cancel the derivative and pay its market value.

• Take the opposite position which cancels out the variability thereof, if cancellation costs are high or if it is recommended for operating or business reasons.

The breakdown of the financial results recognized in 2018, 2017 and 2016 is as follows:

Millions of euros	2018	2017	2016
Interest income	234	638	723
Dividends received	15	16	19
Other financial income	826	17	38
Subtotal	1,075	671	780
Changes in fair value of asset derivatives at fair value through profit or loss	202	35	438
Changes in fair value of liability derivatives at fair value through profit or loss	(190)	(97)	(463)
Changes in the fair value of debt instruments and other assets at fair value to profit or loss	(3)	—	—
Transfer from equity of results of cash flow hedges - future cash flows that are not longer expected to happen	(7)	—	—
Transfer from equity to profit and loss from available-for-sale assets and others	n.a.	(33)	(136)
(Loss)/Gain on fair value hedges	(223)	(150)	(26)
Gain/(loss) on adjustment to items hedged by fair value hedges	271	194	(6)
Subtotal	50	(51)	(193)
Interest expenses	(1,715)	(2,137)	(2,463)
Ineffective portion of cash flow hedges	(29)	(10)	1
Accretion of provisions and other liabilities	(410)	(453)	(466)
Other financial expenses	(203)	(310)	(365)
Subtotal	(2,357)	(2,910)	(3,293)
Net finance costs excluding foreign exchange differences and hyperinflation adjustments	(1,232)	(2,290)	(2,706)

n.a.: not applicable.

Interest expenses includes transfers from equity from cash flow hedges of interest rate amounting to +68 million euros in 2018 (-162 million euros and -238 million euros in 2017 and 2016, respectively).

At December 31, 2018 in other financial income include 665 million euros from Telefónica Brazil corresponding to the default interest derivatives of the final decision in favor about the right to deduct the ICMS from the calculation basis of PIS/COFINS (see Note 11).

2018 Consolidated Financial Statements

Evolution of derivative instruments

The movement of the net position of derivatives during the years ended December 31, 2018 and 2017 is as follows:

Millions of euros	Movement in 2018	Movement in 2017
Opening balance of assets/(liabilities)	505	3,401
Financing payments	52	179
Financing proceeds	(209)	(574)
Interest (proceeds)/payments	(126)	(298)
Other (proceeds)/payments	(28)	(101)
Fair value adjustments through other comprehensive income	999	(47)
Movements with counterparty in the income statement	2	(1,909)
Translation differences	(70)	(87)
Other movements	56	(59)
Closing balance of assets/(liabilities)	1,181	505

The variation in 2018 represents an increase of 676 million euros of asset (reduction of 2,896 million euros in 2017) mainly due to the evolution of the EUR/USD exchange rate. These variations are offset mainly by the variation of the different Telefónica Group issues and loans performed in dollars.

In 2017, variations in cash flow hedges, the impact of which coincided with the period of the profit or loss generated by the respective hedged items, were directly recognized in the income statement, offsetting the profit or loss of the hedged items without including them in the statement of comprehensive income, presenting these variations under the heading "Movements with counterparty in the income statement" in the table above.

In 2018, taking into consideration IFRS 9, it was decided to modify the presentation of these variations, with them being included in the statement of comprehensive income and recycled to profit and loss for the same period. These variations are recognized in the line "Fair value Adjustments recognized against other comprehensive income" in the table above. This change to the presentation of these variations has no impact on the income statement or on other comprehensive income.

2018 Consolidated Financial Statements

The breakdown of Telefónica's detail of hedges and other derivative instruments at December 31, 2018, their fair value at year-end and the expected maturity schedule is as set forth in the table below:

Millions of euros	Notional amount - Maturities (*)					Book value of the derivative and no-derivative instruments (**)				
	2019	2020	2021	Later	Total	Non-current asset	Current asset	Non-current liabilities	Current liabilities	Total
Derivate instruments of accounting hedges	(4,443)	4,743	2,799	7,471	10,570	(1,950)	(660)	1,447	200	(963)
Interest rate risk	(686)	1,746	(299)	(86)	675	(398)	(186)	270	9	(305)
Cash flow hedges	(607)	1,567	46	1,269	2,275	(154)	(2)	228	4	76
Fair value hedges	(79)	179	(345)	(1,355)	(1,600)	(244)	(184)	42	5	(381)
Exchange rate risk	(4,718)	2,219	1,102	5,980	4,583	(835)	(183)	939	70	(9)
Cash flow hedges	341	2,219	1,102	5,980	9,642	(834)	(76)	939	10	39
Fair value hedges	50	—	—	—	50	(1)	(45)	—	14	(32)
Net investments hedges	(5,109)	—	—	—	(5,109)	—	(62)	—	46	(16)
Interest rate and exchange rate risk	961	778	1,996	1,577	5,312	(717)	(291)	238	121	(649)
Cash flow hedges	962	801	2,001	1,736	5,500	(541)	(291)	238	121	(473)
Fair value hedges	(1)	(23)	(5)	(159)	(188)	(176)	—	—	—	(176)
Derivate instruments of no-accounting hedges	(4,318)	(321)	(531)	(2,551)	(7,721)	(826)	(262)	840	30	(218)
Other derivatives of interest rate	(3,571)	(321)	(531)	(2,551)	(6,974)	(826)	(128)	830	3	(121)
Other derivatives of exchange rate	(747)	—	—	—	(747)	—	(134)	—	25	(109)
Other derivatives	—	—	—	—	—	—	—	10	2	12
Total derivative instruments	(8,761)	4,422	2,268	4,920	2,849	(2,776)	(922)	2,287	230	(1,181)
No derivatives instruments of accounting hedges (***)	—	56	56	858	970	—	—	996	—	996
Exchange rate risk	—	56	56	858	970	—	—	996	—	996
Fair value hedges	—	—	—	—	—	—	—	—	—	—
Net investments hedges	—	56	56	858	970	—	—	996	—	996

(*) For interest rate hedges, the positive amount is in terms of fixed "payment." For foreign currency hedges, a positive amount means payment in functional vs. foreign currency.

(**) Positive amounts indicate payables.

(***) Of the hedging instruments that are not derivatives, 243 million euros correspond to "Loans and other debts" and 753 million euros to "Obligations and bonds" (see Note 16).

2018 Consolidated Financial Statements

Net financial debt as of December 31, 2018 includes a positive value of the derivatives portfolio for a net amount of 1,181 million euros (see Note 2). This amount includes a positive value of 535 million euros due to hedges (cross currency swaps) to transfer financial debt issued in foreign currency to local currency (a negative value of 104 million euros at December 31, 2017).

The calculation of the fair values of the Telefónica Group's debt instruments required an estimate, for each currency and counterparty, of a credit spread curve using the prices of the Group's bonds and credit derivatives.

The derivatives portfolio was measured through the techniques and models normally used in the market, based on money market curves and volatility prices available in the markets. Additionally, the credit valuation adjustment or net CVA per counterparty (CVA+DVA) is calculated on that measurement as the method used to measure the credit risks of the counterparties and also Telefónica for the purpose of adjusting the fair value valuation of the derivatives. This adjustment reflects the possibility of bankruptcy or credit rating impairment of the counterparty and Telefónica. Derivatives arranged by the Group at December 31, 2018 are detailed in Appendix IV.

The breakdown of Telefónica's derivatives at December 31, 2017, their fair value at year-end and the expected maturity schedule are as set forth in the table below:

2017

Millions of euros	Fair value (**)	Notional amount Maturities (*)				Total
		2018	2019	2020	Subsequent years	
Derivatives						
Interest rate hedges	(285)	(1,596)	(901)	1,563	1,701	767
Cash flow hedges	140	(1,015)	(658)	1,399	3,778	3,504
Fair value hedges	(425)	(581)	(243)	164	(2,077	)(2,737)
Exchange rate hedges	339	(220)	547	2,219	4,720	7,266
Cash flow hedges	344	1,700	621	2,219	4,720	9,260
Fair value hedges	(5)	(1,920)	(74)	—	—	(1,994)
Interest and exchange rate hedges	(546)	344	963	952	4,419	6,678
Cash flow hedges	(422)	344	963	800	3,744	5,851
Fair value hedges	(124)	—	—	152	675	827
Net investment Hedges	—	(140)	—	—	—	(140)
Other Derivatives	(13)	(2,431)	1,840	(495)	(2,451	)(3,537)
Interest rate	(109)	(3,035)	1,840	(495)	(3,051	)(4,741)
Exchange rate	26	(209)	—	—	—	(209)
Others	70	813	—	—	600	1,413

(*) For interest rate hedges, the positive amount is in terms of fixed "payment." For foreign currency hedges, a positive amount means payment in functional vs. foreign currency.

(**) Positive amounts indicate payables.

The fair value of the Telefónica Group derivatives at December 31, 2017 amounted to a positive MTM (accounts receivable) of 505 million euros.

2018 Consolidated Financial Statements

The detail of hedged items by fair value hedges at December 31, 2018, is as follows:

Millions of euros	Hedged items carrying amount			Total	Accumulated amount in the hedged item adjusted by fair value hedge (*)			Total	Of which: accumulated amount of any hedge item that have ceased to be adjusted for gains and losses
	Interest rate risk	Exchange rate risk	Interest rate and exchange rate risk		Interest rate risk	Exchange rate risk	Interest rate and exchange rate risk		
Assets	—	371	—	371	—	(29)	)—	(29))—
Financial assets and other non-current assets	—	143	—	143	—	—	—	—	—
Receivables and other current assets	—	213	—	213	—	(34)	)—	(34))—
Other current financial assets	—	15	—	15	—	5	—	5	—
Liabilities	2,445	1,111	6,429	9,985	236	(11)	) (141)	)84	197
Non-current financial liabilities	1,729	670	6,062	8,461	357	15	(146)	)226	199
Payables and other non-current liabilities	530	—	—	530	(121)	)—	—	(121))—
Current financial liabilities	186	9	367	562	—	—	5	5	1
Payables and other current liabilities	—	432	—	432	—	(26)	)—	(26)	) (3)

(*) Accumulated amount adjusted by fair value hedge is shown with negative sign when it reduces the value (lowest liability or lowest asset) and vice versa.

2018 Consolidated Financial Statements

The evolution of hedges in equity at December 31, 2018 is as follows:

Million euros	Derivate instruments				No derivate instruments		Total Gross amount	Tax effect	Total hedges in equity
	Derivates - Cash flow hedges	Derivates - Cash flow hedges interest rate risk	Cash flow hedges - Exchange rate risks	Derivates - Net investment hedges	No Derivates - Net investment hedges	Total			
Balance at 12/31/2017	(394)	(357)	(179)	1,502	—	572	(188)	384	
Changes in the fair value registered in equity	(52)	584	392	33	(5)	952	(243)	709	
Transfer to the initial value of hedged item	—	—	(1)	—	—	(1)	—	(1)	
Transfer to the income statement of the period - the hedged future cash flows are no longer expected to happen	7	—	—	—	—	7	(2)	5	
Transfer to the income statement of the period - the hedged item has affected profit or loss	144	(574)	(290)	—	—	(720)	184	(536)	
Total translation differences	—	(1)	—	—	—	(1)	—	(1)	
Balance at 12/31/2018	(295)	(348)	(78)	1,535	(5)	809	(249)	560	
Amounts remaining in equity for continuing hedges	(176)	(377)	14	1,534	(5)	990			
Amounts remaining in equity from any hedging relationship for which hedge accounting is no longer applied	(119)	29	(92)	1	—	(181)			
Balance at 12/31/2018	(295)	(348)	(78)	1,535	(5)	809			

The total amount of "Transfer to the income statements of the period - the hedged item has affected profit or loss" has impacted in financial results, reported under "Interest expenses" amounted to +68 million euros (see detail of "Net finance costs excluding foreign exchange differences and hyperinflation adjustments" in this note) and in exchange differences amounted to +645 million euros.

2018 Consolidated Financial Statements

The evolution of cost of hedging in equity is as follows:

Million euros	Exchange rate risk Forward element / CBS A time-period related hedge item	Total gross amount	Tax effect	Total cost of hedging in equity	
Balance at 12/31/2017	—	—	—	—	
Changes in the fair value registered in equity	51	51	(13	)38
Transfer to the income statement of the period - the hedged item has affected profit or loss	(2)2)1	(1)
Balance at 12/31/2018	49	49	(12	)37

The detail of ineffective portion of accounting hedges with impact on the income statement is as follows:

Million euros	Changes in fair value of the hedging instrument	Changes in the fair value of hedges item for the hedged risk	Ineffective portion hedged registered in the income statement	
Interest rate risk	(53	)53)—	
Cash flow hedges	(27	)27)—	
Fair value hedges	(26	)26)—	
Exchange rate risk	622	651	(29)
Cash flow hedges	605	634	(29)
Net investment hedges	17	17	—	
Interest rate and exchange rate risk	377	377	—	
Cash flow hedges	377	377	—	
Total	946	975	(29)

Telefónica, S.A. 91

2018 Consolidated Financial Statements

Note 18. Payables and other non-current liabilities

The composition of “Payables and other non-current liabilities” of the Telefónica Group at December 31, 2018 and December 31, 2017 is as follows:

Millions of euros	12/31/2018	12/31/2017
Payables	856	900
Trade payables	87	86
Payables to suppliers of property, plant and equipment	9	5
Debt for spectrum acquisition	662	569
Other payables	98	240
Other non-current liabilities	1,034	787
Contractual liabilities (Note 20)	613	—
Deferred revenue	283	774
Current tax payables	138	13
Total	1,890	1,687

At December 31, 2018, “Debt for spectrum acquisition” comprised the deferred portion of the payment for acquiring the spectrum use license in Mexico in 2010, for an equivalent of 530 million euros (526 million euros at December 31, 2017, see Note 19), and the pending payment portion for spectrum acquisition in Spain in 2018, amounting to 102 million euros (see Note 6).

In addition, this section also includes the deferred portion of the payment for reframing the radioelectric spectrum acquired in 2014 by Telefónica Brazil for an equivalent of 28 million euros (29 million euros at December 31, 2017, see Note 19 and Appendix VI).

Payments for financed licenses for the years 2018 and 2017 amounted to 44 and 329 million euros, respectively (see Note 25).

“Deferred revenues” primarily included at December 31, 2017 the amount of deferred revenues from rights of use on the cable network and activation fees not yet recognized in the income statement. At December 31, 2018 these items are included in contractual liabilities (see Note 20). At December 31, 2018 grants are included, amounted to 97 million euros (72 million euros at December 31, 2017).

2018 Consolidated Financial Statements

Note 19. Payables and other current liabilities

The composition of "Payables and other current liabilities" at December 31, 2018 and December 31, 2017 is as follows:

Millions of euros	12/31/2018	12/31/2017
Payables	13,868	13,536
Trade payables	8,457	7,943
Payables to suppliers of property, plant and equipment	3,237	3,580
Debt for spectrum acquisition	251	172
Other payables	1,092	1,115
Dividends pending payment	311	235
Associates and joint ventures payables (Note 9)	520	491
Other current liabilities	1,617	1,559
Contract liabilities (Note 20)	1,335	—
Deferred revenue	106	1,387
Advances received	176	172
Total	15,485	15,095

At December 31, 2018, "Debt for spectrum acquisition" comprised the deferred portion of the current pending payment for acquiring the spectrum in Mexico for an equivalent of 79 million euros (72 million at December 31, 2017, see Note 18) and the pending payment portion for the acquisition in 2018 of spectrum by Telefónica Mexico for 107 million euros (see Note 6).

At December 31, 2017 it also included the current pending payment portion for reframing the radioelectric spectrum acquired in 2014 by Telefónica Brazil for an equivalent of 36 million euros (see Note 18).

"Deferred revenue" primarily included at December 31, 2017 the amount of deferred revenue from sales of prepaid cards, handsets transferred to the distributor, rights of use on the cable network and activation fees not yet recognized in the income statement. At December 31, 2018 these items are included in contractual liabilities (see Note 20). At December 31, 2018 grants are also included and amounted to 16 million euros (15 million euros at December 31, 2017).

The composition of current "Other payables" at December 31, 2018 and December 31, 2017 is as follows:

Millions of euros	12/31/2018	12/31/2017
Accrued employee benefits	611	696
Other non-financial non-trade payables	481	419
Total	1,092	1,115

"Other non-financial non-trade payables" at December 31, 2018 included the pending payment of 49 million euros corresponding to Telefónica, S.A.'s irrevocable commitment acquired in 2015 to pay a 325 million euros donation to Fundación Telefónica as part of the financing needed to implement the social programs and activities it currently performs or could initiate in the short and medium terms to fulfill its purpose as a foundation (145 million euros at December 31, 2017).

2018 Consolidated Financial Statements

Information on average payment period to suppliers. Third additional provision, "Information requirement" of Law 15/2010 of July 5.

In accordance with the aforementioned Law, the following information corresponding to the Spanish companies of the Telefónica Group is disclosed:

	2018	2017
Number of days		
Weighted average maturity period	49	53
Ratio of payments	50	54
Ratio of outstanding invoices	44	41
Millions of euros		
Total payments	6,7706,703	
Outstanding invoices	1,190847	

The Telefónica Group's Spanish companies adapted their internal processes and payment schedules to the provisions of Law 15/2010 (amended by Law 31/2014) and Royal Decree-Law 4/2013, amending Law 3/2004, which establishes measures against late payment in commercial transactions. Engagement conditions with commercial suppliers in 2018 included payment periods of up to 60 days, according to the terms agreed between the parties.

For efficiency purposes and in line with general business practices, Telefónica Group companies in Spain have agreed payment schedules with suppliers, whereby most of the payments are made on set days of each month. Invoices falling due between two payment days are settled on the following payment date in the schedule.

Payments to Spanish suppliers in 2018 surpassing the established legal limit were the result of circumstances or incidents beyond the payment policies, mainly the delay in issuing invoices (legal obligation of the supplier), the closing of agreements with suppliers over the delivery of goods or rendering of services, or occasional processing issues.

The average payment period to suppliers of the Telefónica Group's companies in Spain in 2018, calculated in accordance with the only additional provision of the Resolution of the Instituto de Contabilidad y Auditoría de Cuentas (Spanish Accounting and Audit Institute) of January 29, 2016, amounted to 49 days (53 days in 2017).

Note 20. Breakdown of contractual assets and liabilities, and capitalized costs

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

Millions of euros	Balance at 12/31/17	First application of new IFRS impacts	Additions	Disposals	Transfers	Translation differences and hyperinflation adjustments	Balance at 12/31/18	
Long-term contractual assets— (Note 11)	—	68	153	(2	)(110	)(1	)108
Contractual assets	—	71	156	(2	)(110	)(1	)114
Impairment losses	—	(3)(3)—	—	—	(6)
Short-term contractual assets— (Note 12)	—	332	761	(856	)113	(9	)341
Contractual assets	—	354	764	(857	)113	(10	)364
Impairment losses	—	(22)(3)1	—	1	(23)
Total	—	400	914	(858	)3	(10	)449

Telefónica, S.A. 94

2018 Consolidated Financial Statements

Once the amounts recognized as contract assets become receivables, which normally occurs when they are invoiced, they are transferred to the "Trade receivables" heading. In this regard, the balance of the contract assets account basically represents amounts not yet due.

The movement of the deferred expenses in 2018 is as follows:

Millions of euros	Balance at 12/31/17	First application of new IFRS impacts	Additions	Disposals	Transfers	Translation differences and hyperinflation adjustments	Balance at 12/31/18
Non-current capitalized costs (Note 11)	—	172	366	(1)	(343)	(3)	191
Of obtaining a contract	—	170	349	(1)	(338)	(2)	178
Of fulfilling a contract	—	2	17	—	(5)	(1)	13
Impairment losses	—	—	—	—	—	—	—
Current capitalized costs (Note 12)	—	540	437	(746)	(342)	(7)	566
Of obtaining a contract	—	522	400	(713)	(337)	(5)	541
Of fulfilling a contract	—	18	37	(33)	(5)	(2)	25
Impairment losses	—	—	—	—	—	—	—
Total	—	712	803	(747)	(1)	(10)	757

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

Millions of euros	Balance at 12/31/17	First application of new IFRS impacts	Additions	Disposals	Transfers	Translation differences and hyperinflation adjustments	Balance at 12/31/18
Long-term contractual liabilities (Note 18)	—	106	558	(295)	(240)	4	613
Short-term contractual liabilities (Note 19)	—	98	7,561	(7,631)	(1,317)	(10)	1,335
Total	—	204	8,119	(7,926)	(1,557)	(6)	1,948

The "transfers" column shows amounts relating to contractual liabilities reclassified from the "Deferred revenue" (see Notes 18 and 19) 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 recognized as revenues within 24 months and up to 10 years.

The maturity schedule of contractual liabilities at December 31, 2018 is as follows:

Millions of euros	2019	2020	2021	Subsequent years	Total
Contractual liabilities, activation fees	158	5	3	11	177
Contractual liabilities, sales of prepaid cards	552	—	—	—	552
Contractual liabilities, services	315	30	3	13	361

Edgar Filing: TELEFONICA S A - Form 6-K

Contractual liabilities, sales of handsets	75	3	—	—	78
Contractual liabilities, irrevocable rights to use	26	24	24	183	257
Other contractual liabilities	209	121	115	78	523
Maturity of performance obligations	1,335	183	145	285	1,948

Telefónica, S.A. 95

2018 Consolidated Financial Statements

Note 21. Provisions

The amounts of provisions in 2018 and 2017 are as follows:

Millions of euros	12/31/2018			12/31/2017		
	Current	Non-current	Total	Current	Non-current	Total
Employee benefits	886	4,499	5,385	912	5,666	6,578
Termination plans	441	805	1,246	515	1,282	1,797
Post-employment defined benefit plans	9	389	398	9	1,030	1,039
Other benefits	436	3,305	3,741	388	3,354	3,742
Desmantling of assets	125	784	909	85	888	973
Other provisions	901	2,237	3,138	1,219	2,664	3,883
Total	1,912	7,520	9,432	2,216	9,218	11,434

a) Employee benefits

Termination plans

The movement in provisions for termination plans in 2018 and 2017 is as follows:

Millions of euros	Total
Provisions for termination plans at 12/31/16	2,394
Additions	179
Retirements/amount applied	(759)
Transfers	(8)
Translation differences and accretion	(9)
Provisions for termination plans at 12/31/17	1,797
Additions	140
Retirements/amount applied	(579)
Transfers	(109)
Translation differences, hyperinflation adjustments and accretion	(3)
Provisions for termination plans at 12/31/18	1,246

The reclassification of provision for termination plans of the entity Seguros de Vida y Pensiones Antares, S.A. to the line "Liabilities associated with non-current assets held for sale" of the statement of financial position is recorded under "Transfers" for the 2018, amounted to 109 million euros (see Note 28).

Telefónica Spain

The 2003-2007 labor force reduction plan in Telefónica de España concluded with 13,870 participating employees and the provisions recorded at December 31, 2018 and 2017 amounted to 46 million euros and 83 million euros, respectively. The amount for this provision classified as current totaled 20 million euros at December 31, 2018.

The 2011-2013 labor force reduction plan in Telefónica de España, concluded with 6,830 participating employees and the provisions recorded at December 31, 2018 and 2017 amounted to 797 million euros and 1,061 million euros, respectively. The amount for this provision classified as current totaled 275 million euros at December 31, 2018.

2018 Consolidated Financial Statements

The companies bound by these commitments calculated provisions required at 2018 and 2017 year-end using actuarial assumptions pursuant to current legislation, including the PERM/F- 2000C mortality tables and a high quality credit market based interest rate.

The discount rate used for these provisions at December 31, 2018 was 0.41% with an average plan length of 1.75 years.

Telefónica Germany

Within the context of the transformation of Telefónica Deutschland following the purchase of E-Plus in a bid to increase profitability by securing operational synergies, a provision of 321 million euros was made in 2014 for employee restructuring. An additional provision of 19 million euros was made in 2018 (compared with the additional 44 million euros in 2017).

This provision stood at 48 million euros at December 31, 2018 (65 million euros at December 31, 2017).

Telefónica, S.A.

With respect to the simplification and transformation process of the Telefónica Group, Telefónica, S.A. launched in 2015 a voluntary termination plan ending in December 2017 for the employees who met the requirements defined by the plan regarding age and seniority in the Company, among others. Following this transformation and simplification framework, the Company has, on one hand, extended the plan termination till 2018 and on the other hand, it has set up in December 2016 a new voluntary program aimed at employees who met certain requirements related to seniority in the Company. In 2017 the last program had been extended. The provision for this concept at December 31, 2018 totaled 100 million euros (159 million euros in 2017).

Post-employment defined benefit plans

The Group has a number of defined benefit plans in the countries where it operates. The following tables present the main data of these plans:

12/31/2018

Millions of euros	United Kingdom	Germany	Brazil	Hispan Norte	Hispan Sur	Others	Total
Obligation	1,548	239	749	68	6	18	2,628
Assets	(1,570)	(90)	(848)	—	—	(12)	(2,520)
Net provision before asset ceiling	(22)	(149)	(99)	(68)	6	6	108
Asset ceiling	—	—	249	—	—	—	249
Total	(22)	(149)	150	68	6	6	357
Net provision	4	157	153	72	6	6	398
Net assets	26	8	3	4	—	—	41

Telefónica, S.A. 97

2018 Consolidated Financial Statements

12/31/2017

Millions of euros	Spain (Antares)	United Kingdom	Germany	Brazil	Hispan Norte	Hispan Sur	Others	Total
Obligation	490	1,828	235	734	72	8	16	3,383
Assets	—	(1,651)	)(84	)(835	)—	—	(9	)(2,579)
Net provision before asset ceiling	490	177	151	(101	)72	8	7	804
Asset ceiling	—	—	—	232	—	—	—	232
Total	490	177	151	131	72	8	7	1,036
Net provision	490	177	151	134	72	8	7	1,039
Net assets	—	—	—	3	—	—	—	3

The movement in the present value of obligations in 2018 and 2017 is as follows:

Millions of euros	Spain (Antares)	United Kingdom	Germany	Brazil	Hispan Norte	Hispan Sur	Other	Total
Present value of obligation at 12/31/16	533	1,834	233	737	18	7	16	3,378
Translation differences	—	(67	)—	(109	)(13	)(2	)(2	)(193)
Current service cost	6	—	9	3	2	—	1	21
Interest cost	6	46	4	73	5	1	1	136
Actuarial losses and gains	(9	)60	(8	)85	7	1	—	136
Benefits paid	(46	)(46	)(3	)(55	)(3	)—	(1	)(154)
Inclusion of companies	—	—	—	—	61	—	—	61
Other movements	—	1	—	—	(5	)1	1	(2)
Present value of obligation at 12/31/17	490	1,828	235	734	72	8	16	3,383
Translation differences	—	(12	)—	(81	)(3	)(3	)1	(98)
Current service cost	6	—	9	4	1	—	1	21
Interest cost	7	44	4	65	5	2	1	128
Actuarial losses and gains	4	(260	)(6	)68	(2	)1	—	(195)
Benefits paid	(41	)(50	)(3	)(41	)(5	)(2	)(1	)(143)
Transfers	(466	)—	—	—	—	—	—	(466)
Other movements	—	(2	)—	—	—	—	—	(2)
Present value of obligation at 12/31/18	—	1,548	239	749	68	6	18	2,628

The reclassification of provision for post-employment plans of the entity Seguros de Vida y Pensiones Antares, S.A. to the line "Liabilities associated with non-current assets held for sale" of the statement of financial position is recorded under "Transfers" of the 2018 movement, and amounted to 466 million euros (see Note 28).

2018 Consolidated Financial Statements

Movements in the fair value of plan assets in 2018 and 2017 are as follows:

Millions of euros	United Kingdom	Germany	Brazil	Other	Total
Fair value of plan assets at 12/31/16	1,662	128	982	8	2,780
Translation differences	(61	)—	(130	)(1	)(192)
Interest income	42	2	99	1	144
Actuarial losses and gains	55	—	(64	)—	(9)
Company contributions	—	6	1	1	8
Benefits paid	(46	)(2	)(52	)(1	)(101)
Other movements	(1	)(50	)(1	)1	(51)
Fair value of plan assets at 12/31/17	1,651	84	835	9	2,579
Translation differences	(13	)—	(92	)—	(105)
Interest income	40	1	74	—	115
Actuarial losses and gains	(57	)1	69	1	14
Company contributions	(2	)—	—	1	(1)
Participants contributions	—	3	—	—	3
Benefits paid	(49	)(2	)(38	)—	(89)
Other movements	—	3	—	1	4
Fair value of plan assets at 12/31/18	1,570	90	848	12	2,520

"Other movements" of Telefónica Germany in 2017 relate to the reclassification of long-term financial assets that do not qualify as plan assets under IAS 19 amounting to 50 million euros (see Note 11).

The Group's main defined-benefit plans are:

Antares

a) ITP

Telefónica Spain reached an agreement with its employees whereby it recognized supplementary pension payments for retired employees as of June 30, 1992 equal to the difference between the pension payable by the social security system and pension that would be paid to them by ITP (Institución Telefónica de Previsión). Once the aforementioned supplementary pension payments had been quantified, they became fixed, lifelong and non-updatable, with 60% of the payments transferable to the surviving spouse, recognized as such as of June 30, 1992, and underage children. The amount for this provision totaled 206 million euros at December 31, 2018 (233 million euros at December 31, 2017).

b) Survival

Serving employees who did not join the defined pension plan are still entitled to receive survivorship benefits at the age of 65.

The amount for this provision totaled 260 million euros at December 31, 2018 (257 million euros at December 31, 2017).

These provisions have been reclassified to "Liabilities associated with non-current assets classified as held for sale" of the statement of financial position. The long-term financial assets to cover the obligations of these two defined benefit plans amounting to 634 million euros (see Note 11) have been also reclassified to "Non-current assets classified as held for sale" of the statement of financial position (see Note 28).

2018 Consolidated Financial Statements

The average length of the plans is 7.42 years. The main actuarial assumptions used in valuing these plans are as follows:

	Survival		ITP		
	12/31/2018	12/31/2017	12/31/2018	12/31/2017	
Discount rate	1.32	% 1.45	% 1.29	% 1.37	%
Expected rate of salary increase	0%-0.5%	0%-0.5%	–	–	
Mortality tables	PERM/F 2000P OM77	PERM/F 2000P OM77	90%PERM 2000C/98% PERF 2000C	90%PERM 2000C/98% PERF 2000C	

Telefónica United Kingdom Pension Plan

The Telefónica United Kingdom Pension Plan provides pension benefits to the various companies of the Telefónica Group in United Kingdom coming from the O2 Group. The Plan comprises a defined contribution and defined benefit sections. The defined benefit sections were closed to future accrual starting from February 28, 2013. The companies continued providing retirement benefits through the defined contribution sections of the plan.

The number of beneficiaries of these plans at December 31, 2018 and 2017 were 4,456 and 4,491 respectively. At December 31, 2018, the weighted average duration of the plan was 23 years.

The main actuarial assumptions used in valuing the plan are as follows:

	12/31/2018	12/31/2017	
Nominal rate of pension payment increase	3.05	% 3.15	%
Discount rate	2.85	% 2.45	%
Expected inflation	3.20	% 3.30	%
Mortality tables	95% S2NA, CMI 2017 1% 7.5	95% S2NA, CMI 2016 1% 7.5	

Fair value of Plan assets is as follows:

Millions of euros 12/31/2018 12/31/2017

Bonds	1,570	1,651
Total	1,570	1,651

So long as other assumptions remained constant, at December 31, 2018, reasonably possible changes to one of the following actuarial assumptions would have affected the defined benefit obligation by the amounts shown below:

Millions of euros	Increase in defined benefit obligation
Discount rate (0.25% decrease)	97
Expected inflation (0.25% increase)	93
Life expectancy (1 year longer)	38

2018 Consolidated Financial Statements

Telefónica Brazil pension plans

Telefónica Brazil sponsors the following post-employment benefit plans:

Plans	Management entity	Sponsor
Health plans		
Plano de Assistência Médica ao Aposentado y Programa de Coberturas Especiais (PAMA/PCE)	Fundação Sistel de Seguridade Social	Telefônica Brasil, jointly and severally with other companies resulting from the privatization of Telebrás (Telecomunicações Brasileiras, S.A.)
Assistencia médica – Lei 9.656/98	Telefônica Brasil	Telefônica Brasil, Terra Networks and TGLog
Pension plans		
PBS Assistidos (PBS-A)	Fundação Sistel de Seguridade Social	Telefônica Brasil, jointly and severally with other companies resulting from the privatization of Telebrás (Telecomunicações Brasileiras, S.A.)
CTB	Telefônica Brasil	Telefônica Brasil
Telefônica BD	Visão Prev	Telefônica Brasil
Planes VISAO	Visão Prev	Telefônica Brasil, Terra Networks and TGLog

The main actuarial assumptions used in valuing these plans are as follows:

	12/31/2018	12/31/2017
Discount rate	8.96% - 9.27%	9.46% - 9.88%
Nominal rate of salary increase	5.67	% 5.93
Long term inflation rate	4.00	% 4.25
Growth rate for medical costs	7.12	% 7.38
Mortality tables	AT 2000 M/F	AT 2000 M/F

The discount rate and growth rate for medical costs are considered to be the most significant actuarial assumptions with a reasonable possibility of fluctuations depending on demographic and economic changes and may significantly change the amount of the post-employment benefit obligation. The sensitivity to changes in these assumptions is shown below:

	Present value of the discounted obligation at the current discount rate	Present value of the obligation by increasing the discount rate by 0.5%	Present value of the obligation by reducing the discount rate by 0.5%
Pension plans	453	436	472
Health plans	296	275	320
Total obligation	749	711	792

2018 Consolidated Financial Statements

	Present value of the obligation at the current growth rate for medical costs	Present value of the obligation by increasing the rate by 1%	Present value of the obligation by reducing the rate by 1%
Pension plans	453	453	453
Health plans	296	346	256
Total obligation	749	799	709
Other benefits			

Telefónica de España, Telefónica Móviles España and Telefónica Soluciones Individual Suspension Plan

In 2015 Telefónica de España, S.A.U., Telefónica Móviles España, S.A.U. and Telefónica Soluciones de Informática y Comunicaciones de España, S.A.U. signed the 1st Collective Bargaining Agreement of Related Companies (CEV), wholly backed by the largest labor unions. This agreement considered elements that included a plan of measures for individual suspension of the employment relationship in 2016 and 2017, applying principles of voluntariness, universality, non-discrimination and social responsibility. In December 2016, the Collective Bargaining Agreement of Related Companies was extended until 2018 by virtue of the provisions thereof.

This plan is based on mutual agreement between the company and employees and entails the possibility of voluntarily suspending the employment relationship for an initial three-year period, renewable for consecutive three-year periods until the retirement age. Employees who meet the age and seniority requirements may enter the Individual Suspension Plan (PSI) in the periods opened for this purposes.

At the end of each period, the current value of the forecast payment flows to meet the commitments of this program (applying certain hypotheses regarding estimated number of accessions and future reintegration ratio) is recognized. This figure was calculated using actuarial criteria (PERM/F-2000C tables, combined with the invalidity table published in the 1977 ministerial order) and a high quality credit market based interest rate.

The corresponding provision is recognized under “Other benefits” in the above table. The provision at December 31, 2018 amounted to 3,588 million euros (3,580 million euros at December 31, 2017).

The discount rate used for these provisions at December 31, 2018 was 0.9% with an average plan length of 4.7 years. The table below shows the sensitivity of the value of termination, post-employment and other obligations, including the Individual Suspension Plan of Telefónica Group companies in Spain to changes in the discount rate:

-100 b.p.		+100 b.p.	
Impact on value	Impact on income statement	Impact on value	Impact on income statement
(184	) (184	) 171	171

A 100 b.p. increase in the discount rate would reduce the value of the liabilities by 171 million euros and have a positive impact on the income statement of 171 million euros before tax. On the other hand, a 100 b.p. decrease in the discount rate would increase the value of the liabilities by 184 million euros and have a negative impact on the income statement of 184 million euros before tax.

The Telefónica Group actively manages this position and has arranged a derivatives portfolio to significantly reduce the impact of changes in the discount rate (see Note 17).

2018 Consolidated Financial Statements

b) Provisions for dismantling of assets

The movement of provision for dismantling of assets in 2018 and 2017 is as follows:

	Millions of euros	
Dismantling of assets at 12/31/16	1,001	
Additions and accretion	91	
Retirements/amount applied	(53)
Translation differences and other	(66)
Dismantling of assets at 12/31/17	973	
Additions and accretion	96	
Retirements/amount applied	(83)
Translation differences and other	(77)
Dismantling of assets at 12/31/18	909	

The detail by segments of provision for dismantling of assets in 2018 and 2017 is as follows:

Millions of euros	12/31/2018	12/31/2017
Telefónica Spain	7	14
Telefónica Germany	421	450
Telefónica Brazil	152	146
Telefónica United Kingdom	85	91
Telefónica Hispam Norte	26	40
Telefónica Hispam Sur	76	89
Other companies	142	143
Total	909	973

c) Other provisions

The movement in "Other provisions" in 2018 and 2017 is as follows:

	Millions of euros	
Other provisions at December 31, 2016	3,943	
Additions and accretion	1,406	
Retirements/amount applied	(1,074)
Translation differences and other	(392)
Other provisions at December 31, 2017	3,883	
Additions and accretion	911	
Retirements/amount applied	(1,276)
Transfers	(89)
Translation differences and other	(291)
Other provisions at December 31, 2018	3,138	

2018 Consolidated Financial Statements

The reclassification of other provisions of the entity Seguros de Vida y Pensiones Antares, S.A. to the line "Liabilities associated with non-current assets held for sale" of the statement of financial position is recorded under "Transfers" of the 2018 movement, amounted to 81 million euros (see Note 28).

The Group is exposed to risks of claims and litigation, mainly relating to tax and regulatory proceedings, and labor and civil claims.

Given the nature of the risks covered by these provisions, no reliable schedule of potential payments, if any, can be determined.

Telefónica Brasil

Telefônica Brasil, S.A. and its subsidiaries are party to administrative and judicial proceedings and labor, tax and civil claims filed in different courts. The Telefónica Group management based on the opinion of its legal counsel, recognized provisions for proceedings for which an unfavorable outcome is considered likely.

The balance of these provisions at December 31, 2018 and December, 31 2017 is shown in the following table:

Millions of euros	12/31/2018	12/31/2017
Provisions for tax proceedings	440	902
Provisions for regulatory proceedings	230	278
Provisions for labor claims	176	247
Provisions for civil proceedings	226	266
Total	1,072	1,693

Additionally, Telefónica Brasil recognized contingent liabilities according to IFRS 3 generated on acquisition of the controlling interest of Vivo Participações in 2011 and GVT in 2015. These contingent liabilities amounted to 186 million euros at December 31, 2018 (213 million euros at December 31, 2017).

The detail of provisions for tax proceedings by nature of risk is as follows:

Millions of euros	12/31/2018	12/31/2017
Federal taxes	119	127
State taxes	205	58
Municipal taxes	8	8
FUST, FISTEL and EBC	108	709
Total	440	902

The provision corresponding to the litigation in relation to the Social Security contribution rate of Empresa Brasileira de Comunicaciones (EBC) and Fondo de Fiscalización de las Telecomunicaciones (FISTEL) was reduced in 2018 by the amount of the judicial deposits accepted as payment in judicial proceedings, which in the case of the litigation related to EBC remain in the courts at December 31, 2018.

2018 Consolidated Financial Statements

The breakdown of changes in provisions for tax proceedings in 2018 and 2017 is as follows:

	Millions of euros
Balance at 12/31/2016	911
Movements with a counterparty in judicial deposits	26
Movements with a counterparty in the income statement	43
Write-offs due to payment	(47)
Monetary updating	97
Translation differences	(134)
Other movements	6
Balance at 12/31/2017	902
Movements with a counterparty in judicial deposits	(569)
Movements with a counterparty in the income statement	105
Write-offs due to payment	(12)
Monetary updating	97
Translation differences	(83)
Balance at 12/31/2018	440

Group management and legal counsel understand that losses are possible from tax contingencies in federal, state, municipal and other taxes for an aggregated amount of 8,136 million euros (8,919 million euros as of 31 December 2017). Noteworthy state tax-related contingencies include the "ICMS" tax (see Note 22), while the federal taxes include corporate income tax (see Note 22). Moreover, Telefónica Brasil presently has different open proceedings regarding the Fundo de Universalização de Serviços de Telecomunicações (FUST, refer to Note 26).

With regard to regulatory proceedings, Telefónica Brasil is party to administrative proceedings against Agencia Nacional de Telecomunicações (ANATEL) based on an alleged failure to meet sector regulations and judicial proceedings to contest sanctions applied by ANATEL at the administrative level. At December 31, 2018, consolidated provisions totaled 230 million euros (278 million euros at December 31, 2017). In addition, Group management and legal counsel understand that losses are possible from regulatory contingencies amounting to 1,379 million euros at December 31, 2018 (1,277 million euros at December 31, 2017).

In some situations, in connection with a legal requirement or presentation of guarantees, judicial deposits are made to secure the continuance of the claims under discussion. The judicial deposits by nature of risk at December 31, 2018 and December 31, 2017 are as follows:

Millions of euros	12/31/2018	12/31/2017
Tax proceedings	435	1,066
Labor claims	118	223
Civil proceedings	262	304
Regulatory proceedings	47	51
Garnishments	19	36
Total	881	1,680
Current (see Note 13)	71	82
Non-current (see Note 11)	810	1,598

2018 Consolidated Financial Statements

Telefónica del Perú

In 2015, the Group established a provision of 1,521 million Peruvian soles (approximately 431 million euros) in relation to tax claims involving Telefónica Peru (see Note 22). At December 31, 2018 this provision amounted to 439 million euros (425 million euros at December 31, 2017).

Telefónica, S.A.

The Group has continued provisioning the amount of the goodwill amortized for tax purposes (see Note 22), for a total of 283 million euros at December 31, 2018 (215 million euros at December 31, 2017).

Note 22. Income tax matters

Pursuant to a Ministerial Order dated December 27, 1989, Telefónica, S.A. files consolidated tax returns in Spain for certain Group companies. The consolidated tax group comprised 44 companies at December 31, 2018 (45 companies at December, 31 2017).

This tax consolidation regime applies indefinitely providing the companies continue to meet the requirements set down in prevailing legislation, and that application of the regime is not expressly waived.

Group companies resident in Spain that are not part of this consolidation regime and non-resident companies file individual or aggregated tax returns under the tax law applicable in each country.

Deferred taxes movement

The movements in deferred taxes in the Telefónica Group in 2018 and 2017 are as follows:

Millions of euros	Deferred tax assets	Deferred tax liabilities
Balance at December 31, 2017	7,820	2,145
Additions	1,866	916
Disposals	(1,844)	(320)
Transfers	(79)	(204)
Translation differences and hyperinflation adjustments	(127)	130
Company movements and others	(5)	7
Balance at December 31, 2018	7,631	2,674
Millions of euros	Deferred tax assets	Deferred tax liabilities
Balance at December 31, 2016	8,229	2,395
Additions	1,702	579
Disposals	(1,711)	(413)
Transfers	(196)	(391)
Translation differences and hyperinflation adjustments	(211)	(70)
Company movements and others	7	45
Balance at December 31, 2017	7,820	2,145

2018 Consolidated Financial Statements

Main changes registered in 2018

In Spain, tax credits for loss carryforwards amounting to 791 millions of euros were capitalized in 2018, and tax credits from deductions of 477 million euros were reversed, mainly due to the effect of the ruling of the Central Economic-Administrative Court notified on January 22, 2019, partially upholding the Company's position (as shown in the section "Inspections of the Spanish tax group" in this present Note to the financial statements) in the expected schedule of realization of deferred tax assets and liabilities (see "Expected realization of deferred tax assets and liabilities" below).

Telefónica Móviles México derecognized deferred tax assets for temporary differences amounting to 327 million euros (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.

After the completion of a deferred tax asset recoverability analysis, based in Colombia Telecomunicaciones, S.A. ESP financial projections, tax losses carryforwards amounting to 106 million euros were capitalized. Furthermore, this company applied tax loss carryforwards in 2018 amounting to 57 million euros.

Telefónica Brasil recognized tax credits for loss carryforwards amounting to 160 million euros, mainly generated in the year. On the other hand, the evolution of temporary differences resulted in additions and disposals of deferred tax assets amounting to 184 million euros and 271 million euros, respectively. In addition, Telefónica Brazil recognized deferred tax liabilities amounting to 415 million euros, mainly related to the tax amortization of goodwill.

Given that Venezuela is considered a hyperinflationary economy, the financial statements of Telefónica Venezolana are adjusted for inflation (see Note 3.a). The hyperinflation adjustment is not deductible according to the present tax regime in Venezuela, thus it generates deferred taxes for the differences between the accounting value and the tax value of the net assets. These deferred taxes do not represent a cash outflow and the net impact in equity will be neutral when the assets are totally amortized. The movement of these deferred taxes in 2018 generated a tax expense of 186 million euros (see Note 2).

The additions of deferred tax assets included tax credits recognized in the amount of 84 million euros by the German company Group 3G UMTS Holding GmbH. Furthermore, this company applied tax loss carryforwards in 2018 amounting to 77 million euros.

In 2018 the additions of deferred tax assets recognized in the amount of 101 million euros were the result of the provisions recognized during the year in relation to the various workforce restructuring plans and other obligations with employees of the companies included in the group in Spain (see Note 21). Likewise, disposals of deferred tax assets in 2018 include the impact of the recognition of these provisions, amounting to 215 million euros.

Furthermore, in compliance with the sixteenth transitional provision of this amended Royal Decree-Law, which requires the inclusion of one-fifth of the investment portfolio impairment losses which had been deductible in the tax base before January 1, 2013, the Group reclassified 206 million euros of deferred tax liabilities in order to recognize a higher tax payable to the Spanish tax authorities, corresponding to one-fifth of the tax losses affected by this law.

The impact of initial application of IFRS 15 was a decrease of 27 million euros of deferred tax assets and increase of 164 million euros in deferred tax liabilities (see Note 2).

The movements relating deferred tax recognized directly in equity in 2018 amounted to 89 million euros of additions (net position of more deferred tax liabilities) and 13 million euros of disposals (net position of more deferred tax assets).

Main changes registered in 2017

After the early termination of the contract with PARAPAT (refer to Note 2), Colombia Telecomunicaciones, S.A. ESP derecognized tax credits due to temporary differences associated with the debt with PARAPAT amounting to 324 million euros, and recognized tax credits for negative tax bases and temporary differences of 233 million

2018 Consolidated Financial Statements

euros and 63 million euros, respectively. Besides, after the completion of a deferred tax asset recoverability analysis, tax losses carryforwards amounting to 163 million euros were also capitalized.

Telefónica Brasil recognized tax credits for loss carryforwards amounting to 198 million euros, mainly generated in the year. On the other hand, the evolution of temporary differences resulted in additions and disposals of deferred tax assets amounting to 258 million euros and 281 million euros, respectively. In addition, Telefónica Brazil recognized deferred tax liabilities amounting to 317 million euros, mainly related to the tax amortization of goodwill.

After the merger through absorption of its subsidiary Telefónica Móviles Chile, S.A., Inversiones Telefónica Móviles Holding, S.A. recognized deferred tax assets totaling 193 million euros.

The deferred tax assets of Telefónica Germany decreased from 427 million euros at December 31, 2016 to 162 million euros at December 31, 2017, mainly due to the evolution of temporary differences for the tax amortization of intangible assets.

The movement of deferred taxes of Telefónica Venezolana in 2017 generated a tax expense of 138 million euros (see Note 2).

The additions of deferred tax assets included tax credits recognized in the amount of 82 million euros by the German company Group 3G UMTS Holding GmbH. Furthermore, this company applied tax loss carryforwards in 2017 amounting to 78 million euros.

In 2017 the additions of deferred tax assets recognized in the amount of 84 million euros were the result of the provisions recognized during the year in relation to the various workforce restructuring plans of the companies included in the tax group in Spain (see Note 21).

The disposals of deferred tax assets in 2017 also included the impact of the Group's labor force reduction plans in Spain, amounting to 192 million euros.

Furthermore, in compliance with the sixteenth transitional provision of this amended Royal Decree-Law, which requires the inclusion of one-fifth of the investment portfolio impairment losses which had been deductible in the tax base before January 1, 2013, the Group reclassified 229 million euros of deferred tax liabilities in order to recognize a higher tax payable to the Spanish tax authorities, corresponding to one-fifth of the tax losses affected by this law.

The companies in the Spanish tax group recognized on disposals deferred tax assets totaling 134 million euros in 2017, as a result of the limit placed on deductible financial expenses.

The movements relating deferred tax recognized directly in equity in 2017 amounted to 24 million euros of additions and 96 million euros of disposals.

Expected realization of deferred tax assets and liabilities

The Group assesses the recoverability of deferred tax assets based on the future activities carried out by the different companies, on tax regulations in the different countries in which these companies operate, and on the strategic decisions affecting the companies. The schedule in Spain, with respect to carryforward tax losses, temporary differences and deductions, has been calculated at 2018 year end, considering the effects of the resolution notified on January 22, 2019, issued by the Central Economic-Administrative Court (TEAC) which partially upheld the claims made by Telefónica in connection with the tax inspections for the years 2008 to 2011, which allows the use of tax credits, mainly tax losses carryforward for years, 2008, 2009 and 2010. Under the assumptions made, considering the TEAC resolution, the estimated realization of deferred tax assets and liabilities recognized in the consolidated statement of financial position in 2018 and 2017 is as follows:

2018 Consolidated Financial Statements

Millions of euros

12/31/2018	Total	Less than 1 year	More than 1 year
Deferred tax assets	7,631	1,736	5,895
Deferred tax liabilities	2,674	(9)	)2,683

Millions of euros

12/31/2017	Total	Less than 1 year	More than 1 year
Deferred tax assets	7,820	922	6,898
Deferred tax liabilities	2,145	(86)	)2,231

Deferred tax assets less than one year mainly come from the Tax Group in Spain (1,461 million euros in 2018 and 558 million euros in 2017).

Deferred tax assets in the accompanying consolidated statements of financial position include the tax loss carryforwards, unused tax credits recognized and deductible temporary differences recognized at the end of the reporting period.

Millions of euros	12/31/2018	12/31/2017
Tax credits for loss carryforwards	3,828	2,776
Unused tax deductions	1,422	1,858
Deferred tax assets for temporary differences	2,381	3,186
Total deferred tax assets	7,631	7,820

Tax credits for loss carryforwards

The movements in Tax credits for loss carryforwards in the Telefónica Group in 2018 and 2017 are as follows:

Location of the company (Millions of euros)	Balance at 12/31/2017	Additions	Reversals	Perimeter changes	Translation differences and other	Balance at 12/31/2018
Spain	1,500	791	(11)	)—	(8)	)2,272
Germany	472	185	(77)	)—	—	580
Hispanoamérica	799	292	(69)	)—	(46)	)976
Other countries	5	—	(4)	)—	(1))—
Total tax credits for loss carryforwards	2,776	1,268	(161)	)—	(55)	)3,828

Location of the company (Millions of euros)	Balance at 12/31/2016	Additions	Reversals	Perimeter changes	Translation differences and other	Balance at 12/31/2017
Spain	1,617	—	(114)	) (1)	) (2)	) 1,500
Germany	550	82	(160)	)—	—	472
Hispanoamérica	321	675	(53)	)—	(144)	) 799
Other countries	25	—	(20)	)—	—	5
Total tax credits for loss carryforwards	2,513	757	(347)	) (1)	) (146)	) 2,776

Telefónica, S.A. 109

2018 Consolidated Financial Statements

The Spanish tax group had unused tax loss carryforwards at December 31, 2018 amounting to 11,045 million euros:

Million of euros	Total	Less than 1 year	More than 1 year
Tax loss carryforwards generated in the tax group	8,040	3,322	4,718
Tax loss carryforwards generated before consolidation in the tax group	3,005	—	3,005

In 2017, as a result of the testing on the recoverability of deferred tax assets, carried out by the Group under the new legislative framework, were derecognized deferred tax assets relating to tax loss carryforwards amounting to 98 million euros.

In 2018 total tax credits for loss carryforwards in Spain in the statement of financial position at December 31, 2018 amounted to 2,272 million euros (1,500 million euros at December 31, 2017). These tax credits do not expire. In 2018, tax credits for loss carryforwards amounting to 791 millions of euros were capitalized, mainly due to the effect of the ruling of the Central Economic-Administrative Court of January 22, 2019, partially upholding the Company's position (as shown in the section "Inspections of the Spanish tax group" in this present Note to the financial statements) in the expected schedule of realization of deferred tax assets and liabilities. Total unrecognized tax credits for loss carryforwards of the Spanish tax group amounted to 622 million euros. These tax credits do not expire.

The Group companies in Germany have recognized 580 million euros of tax credits for loss carryforwards at December 31, 2018. Total unrecognized tax credits for loss carryforwards of these companies amount to 6,478 million euros. These tax credits do not expire.

Recognized tax credits in the consolidated statement of financial arising from the Latin American subsidiaries at December 31, 2018 amounted to 976 million euros. Total unrecognized tax credits for tax loss carryforwards in Latin America amount to 240 million euros.

Deductions

The Group has recognized 1,422 million euros at December 31, 2018, mainly of the tax group in Spain, generated primarily from export activity, R+D+i, double taxation and donations to non-profit organizations.

In Spain tax credits from deductions of 477 million euros were reversed, as a consequence of the review in the expected schedule of realization of deferred tax assets and liabilities. In 2017, tax credits from deductions were recognized, in the amount of 71 million euros.

2018 Consolidated Financial Statements

Temporary differences

The sources of deferred tax assets and liabilities from temporary differences recognized at December 31, 2018 and 2017 are as follows:

Millions of euros	12/31/2018	12/31/2017
Goodwill and intangible assets	724	1,044
Property, plant and equipment	742	1,139
Personnel commitments	1,397	1,562
Provisions	895	1,079
Investments in subsidiaries, associates and other shareholdings	6	4
Inventories and receivables	254	301
Other	572	746
Total deferred tax assets for temporary differences	4,590	5,875
Deferred tax assets and liabilities offset	(2,209)	(2,689)
Total deferred tax assets for temporary differences registered in the statement of financial position	2,381	3,186

Millions of euros	12/31/2018	12/31/2017
Goodwill and intangible assets	1,981	2,192
Property, plant and equipment	1,307	1,168
Personnel commitments	19	35
Provisions	19	42
Investments in subsidiaries, associates and other shareholdings	780	1,015
Inventories and receivables	185	53
Other	592	329
Total deferred tax liabilities for temporary differences	4,883	4,834
Deferred tax assets and liabilities offset	(2,209)	(2,689)
Total deferred tax liabilities for temporary differences registered in the statement of financial position	2,674	2,145

Deferred tax assets and liabilities are offset if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

The heading "Other" includes, among others, the difference between the accounting and tax values created by the value of financial derivatives at year end (see Note 17).

2018 Consolidated Financial Statements

Tax payables and receivables

Current tax payables and receivables at December 31, 2018 and 2017 are as follows:

Millions of euros	Balance at 12/31/2018	Balance at 12/31/2017
Taxes payable		
Tax withholdings	98	154
Indirect taxes	781	1,030
Social security	123	151
Current income taxes payable	580	580
Other	465	426
Total	2,047	2,341

Millions of euros	Balance at 12/31/2018	Balance at 12/31/2017
Tax receivables		
Indirect tax	1,073	618
Current income taxes receivable	456	618
Other	147	139
Total	1,676	1,375

Reconciliation of book profit before taxes to taxable income

The reconciliation between book profit before tax and the income tax expense from continuing operations for 2018, 2017 and 2016 is as follows:

Millions of euros	2018	2017	2016
Accounting profit before tax	5,571	4,597	3,245
Tax expense at prevailing statutory rate	1,544	1,310	897
Permanent differences	133	(186)	(42)
Changes in deferred tax charge due to changes in tax rates	6	19	1
(Capitalization)/reversal of tax deduction and tax relief	371	(79)	(762)
(Capitalization)/reversal of loss carryforwards	(1,067)	(123)	714
(Increase)/decrease in tax expense arising from temporary differences	569	157	(8)
Other	65	121	46
Income tax expense	1,621	1,219	846
Breakdown of current/deferred tax expense			
Current tax expense	1,122	968	1,012
Deferred tax expense/(benefit)	499	251	(166)
Total income tax expense	1,621	1,219	846

2018 Consolidated Financial Statements

Tax deductibility of financial goodwill in Spain

The tax regulations added article 12.5 to the Corporate Income Tax Law, which came into force on January 1, 2002. The article regulated the deductibility of tax amortization of financial goodwill arising from the acquisition of non-Spanish companies, which could be amortized over 20 years at 5% per annum. Following the entry into force of the Laws 9/2011 of August 19, 2011 and 16/2013 of October 29, 2013, the amount of goodwill amortization deductible for tax purposes under article 12.5 for the years 2011 to 2015 was reduced from 5% to 1%. The effect is temporary because the 4% not amortized during five years (20% in total) will be recovered extending the deduction period from the initial 20 years to 25 years.

The Telefónica Group, under this regulation, has been amortizing for tax purposes the financial goodwill from its investments, both direct and indirect, in O2, BellSouth and Coltél (prior to December 21, 2007) and Vivo (acquired in 2010). The positive accumulated effect in the corresponding settlements of corporate income tax from 2004 to the closing of December 31, 2018, was 1,389 million euros.

In relation to this tax incentive, the European Commission (EC) has in recent years commenced three proceedings against the Spanish State as it deems that this tax benefit could constitute an example of state aid. Although the EC itself acknowledged the validity of its first two decisions for those investors that invested in European companies (for operations carried out before December 21, 2007 in the first decision, and before May 21, 2011 for investments in other countries in the second decision), in its third decision from October 15, 2014 it calls into question the applicability of the principle of legitimate expectations in the application of the incentive for indirect acquisitions, whatever the date of acquisition may have been.

As of the date of these consolidated financial statements, the three decisions continue to be subject to a final ruling. The first two were annulled by two judgments of the General Court of the European Union, which were appealed by the EC before the Court of Justice of the European Union and sent again to the General Court by the Judgment dated December 21, 2016, to reassess the tax incentive. In its ruling of November 15, 2018, the General Court confirmed the applicability of the legitimate expectations principle, but considered the "goodwill amortization" as state aid not compatible with the common market. This ruling has been appealed before the Court of Justice of the European Union.

Furthermore, there are doubts in the Spanish courts regarding the classification of the incentive as a deduction and if this deduction would remain in the case of a subsequent transfer of the relevant stake.

The Group has continued provisioning the amount of the goodwill amortized for tax purposes, corresponding mainly to the purchase of Vivo, for a total of 283 million euros at December 31, 2018 (215 million euros at December 31, 2017).

Inspections of the tax group in Spain

In 2012, tax inspections for all taxes for the years 2005 to 2007 were completed, with the Company signing off a corporate income tax assessment of 135 million euros, which was paid in 2012, whilst disputing other adjustments with which it disagreed. Although the settlement agreement for the disputed tax assessment did not give rise to any tax payment, since the adjustments proposed were offset by unused tax loss carryforwards, the Company filed an appeal with the Central Economic-Administrative Court against these adjustments in May 2015, regarding the tax treatment of the "juros sobre el capital propio" (interest on own capital) as dividends.

In July 2015 tax inspections for all taxes for the years 2008 to 2011 were completed, with the Company signing off certain corporate income tax assessments and disputing others. This resulted in 2015 in an expense amounting to 206 million euros. However, this did not require any tax payment, as the adjustments arising from the inspection were offset by unused tax loss carryforwards, at the corresponding tax rate for each period.

Although the settlement agreement for the disputed tax assessment did not give rise to any tax payment, in July 2015 the Company filed an appeal with the Central Economic-Administrative Court against the adjustments it disputes, regarding the tax treatment of the "juros sobre el capital propio" (interest on own capital) as dividends, and the criteria to use tax loss carryforwards in the years subject to settlement.

Telefónica, S.A. 113

2018 Consolidated Financial Statements

In June 2017 the Company received an order of the Audiencia Nacional extending the effects of its ruling from February 27, 2014 from another tax payer to the individual legal status of Telefónica, in connection with the “Juros sobre el capital propio” (interest on own capital). As a consequence of the aforementioned, the Audiencia Nacional voided the corporate income tax assessment for the years 2005 to 2007 and 2008 to 2011 related to “Juros sobre el capital propio” settled by the tax authorities.

With respect to the use of tax loss carryforwards in the years subject to settlement during the inspection 2008 to 2011, still under litigation, in November 2017 the Company brought a judicial appeal to the Audiencia Nacional, against the alleged dismissal of the claim in the absence of a reply from the authorities. On January 22, 2019, Telefónica was notified of a resolution issued by the Central Economic-Administrative Court which partially upheld the claims made by Telefónica in connection with the tax inspections for the years 2008 to 2011. Telefónica intends to appeal this resolution (which is pending execution) in respect of such matters that were not resolved in favor of Telefónica. At 2018 year end, it is not expected that there is any need to recognize additional liabilities for the outcome of this litigation.

Tax litigation in Telefónica Brazil

State taxes

The Telefónica Group is involved in a range of tax litigation in Brazil over direct and indirect taxes (including those relating to GVT). This includes a number of appeals relating to ICMS tax (a tax similar to VAT, levied on telecommunications services). There is a dispute with the Brazilian tax authorities over which services should be subject to settlement of this tax.

To date the most significant issues have focused on the requirement to collect ICMS on penalties charged to customers for non-compliance, Internet advertising services, and complementary or additional services to the basic telecommunications services such as value-added services, modem rental, and the application of this tax on the basic fee (assinatura básica). In the case of the latter (assinatura básica), a case is still pending before the Supreme Court including Oi, which could affect other companies of the telecommunications sector.

All related procedures are being contested in all instances (administrative and court proceedings). The aggregate amount of the relevant proceedings, updated to take into account interest, fines and other items, is approximately 16,295 million Brazilian reais (approximately 3,672 million euros, see Note 21 to the Consolidated Financial Statements). Telefónica Brazil has obtained independent expert reports supporting its position, i.e. that the aforesaid services are not subject to ICMS.

Federal taxes

Regarding the income tax (federal tax) the tax authorities proposed adjustments in relation to the tax amortization in the period from 2011 to 2014 of the goodwill generated by Telefônica Brasil's acquisition and merger with Vivo. The tax inspections were conducted from 2016 to 2018 and the accumulated amount at December 31, 2018 was 8,654 million Brazilian reais (approximately 1,950 million euros). These proceedings are at the administrative stage and no provisions have been made since the potential risk associated with them has been classified as "not probable" and Telefónica Brazil has received independent expert reports that support this view.

Tax litigation in Telefónica del Perú

With regard to tax matters in Peru, litigation continues over corporate income tax for 2000 and 2001, payments on account in respect of the year 2000, recoverable balances for 1998 and 1999, and the interest and penalties that should apply to these.

In August 2015, the court of second instance handed down a ruling partially upholding the position of Telefónica del Perú, ruling in its favor on three of the five objections filed by the tax authorities and appealed against to the courts, relating, inter alia, to corporate income tax for 2000-2001 (among others). This dispute accounts for more than 75% of the total amount under litigation, with the objections relating to insolvency provisions,

2018 Consolidated Financial Statements

interest on borrowing and leases of space for public telephones. Both the tax authorities and the company have filed appeals against the decision in higher courts.

The settlements carried out by SUNAT for 2000 and 2001 are in the final stage of the legal process (under review by the Supreme Court) and a ruling has not yet been released. In connection with these proceedings in Peru, the Group and its legal advisors consider that the Group's position continues to be based on robust legal arguments.

In January 2019, Telefónica was notified that the Supreme Court has handed down a ruling partially upholding its position in relation to certain matters relating to 1998. In particular, on one hand, it has made a final ruling in favor of Telefónica in matters relating to the lease of space for public telephones, and on the other, it has resolved the matter relating to insolvency provisions by annulling the ruling of the court of second instance and returning the case to the court of first instance for it to pass judgment on the matter again.

In parallel to the aforementioned court proceedings, the tax authorities proceeded to collect corporate income tax due for the years 2000-2001 and payments on account of corporate income tax in respect of the year 2000. There were successive reductions to the sums claimed in the two cases following appeals filed by Telefónica del Perú against the settlements and due to the precautionary measures imposed. The company paid out 286 million Peruvian soles (approximately, 80 million euros) in 2012 and 2013 pending the final rulings.

In the context of these execution processes, in June 2015 the tax authorities issued Compliance Resolutions demanding payment of 1,521 million Peruvian soles (approximately 431 million euros). An appeal was filed against this with the Tax Court, and the adoption of precautionary suspension measures duly requested from the legal authorities (as a definitive court ruling on these cases is currently pending). No ruling was made in relation to these appeals in 2018, whilst in January 2018 the Tax Court suspended payment until the final ruling of the Supreme Court. Given the sentences and rulings handed down in June and August 2015, the Group recognized a provision in the consolidated financial statements, that at December 31, 2018 amounted to 1,697 million Peruvian soles (approximately 439 million euros). See Note 21 to the Consolidated Financial Statements.

Years open for inspection in the Group companies

The years open for review by the tax inspection authorities for the main applicable taxes vary from one consolidated company to another, based on each country's tax legislation, taking into account their respective statute-of-limitations periods. In Spain the taxes from 2013 onwards are open to inspection.

In the other countries in which the Telefónica Group has a significant presence, the years open for inspection by the relevant authorities are generally as follows:

- The last fourteen years in Germany.
- The last nine years in United Kingdom.
- The last seven years in Argentina.
- The last five years in Brazil, Mexico, Uruguay and the Netherlands.
- The last six years in Colombia (except in respect of years in which there were tax losses that are then used to offset tax charges, in which case the period is extended to 12 years).
- The last four years in Peru, Guatemala, Nicaragua and Costa Rica.
- From 2015 onwards. Since 2016, the statute of limitation is six years in Venezuela.
- The last three years in Chile, Ecuador, El Salvador, the United States and Panama.

The tax inspection of the open years is not expected to give rise to additional material liabilities for the Group.

2018 Consolidated Financial Statements

Note 23. Revenue and expenses

Revenues

The breakdown of "Revenues" is as follows:

Millions of euros	2018	2017	2016
Rendering of services	43,085	47,175	47,321
Sales	5,608	4,833	4,715
Total	48,693	52,008	52,036

Sales mainly include the sale of mobile terminals.

The breakdown of Revenues by segments is detailed in Note 4.

Other income

The breakdown of "Other income" is as follows:

Millions of euros	2018	2017	2016
Own work capitalized	815	863	867
Gain on disposal of companies	21	3	228
Gain on disposal of other assets	241	176	130
Government grants	22	23	28
Other operating income	523	424	510
Total	1,622	1,489	1,763

"Gain on disposal of companies" in 2018 mainly includes the gain on disposal of Tokbox Inc (see Appendix I). In 2016, this heading included the gain on disposal of Telefónica Media Argentina, S.A. and Atlántida Comunicaciones, S.A., holding companies of the Group's stake in Televisión Federal, S.A. (Telefé), amounting to 199 million euros.

"Gain on disposal of other assets" includes gains from the sale of telephone towers of 53 million euros, 7 million euros and 1 million euros in 2018, 2017 and 2016, respectively.

"Other operating income" in 2018 includes gains from changes in the fair value of equity instruments in the amount of 24 million euros.

2018 Consolidated Financial Statements

Other expenses

The breakdown of "Other expenses" is as follows:

Millions of euros	2018	2017	2016
Leases included in "Other expenses"	1,071	1,069	1,076
Advertising	1,029	1,211	1,256
Other external services	10,398	10,445	10,436
Taxes other than income tax	365	1,285	1,136
Change in trade provisions	748	863	799
Losses on disposal of fixed assets and changes in provisions for fixed assets	35	44	71
Goodwill impairment (Note 7)	350	—	215
Other operating expenses	403	509	352
Total	14,399	15,426	15,341

The favorable court rulings obtained by Telefónica Brazil in relation to the right to exclude the state tax on goods and services (ICMS) from the tax base for PIS and COFINS contributions, reduced the "Taxes" item by 789 million euros in 2018 (see Note 11).

"Other operating expenses" in 2018 includes losses from changes in the fair value of equity instruments in the amount of 3 million euros and the impairment of trade receivables measured at fair value through OCI in the amount of 46 million euros.

Estimated payment schedule

The estimated payment schedule in millions of euros for the next few years on operating leases and purchase and other contractual commitments (non-cancelable without penalty cost) are as follows:

12/31/2018	Total	Less than 1 year	1 to 3 years	3 to 5 years	More than 5 years
Telefónica Brazil	2,338	446	760	555	577
Telefónica Germany	2,151	436	667	432	616
Telefónica Hispam Norte	1,347	271	479	265	332
Telefónica Hispam Sur	446	112	186	86	62
Telefónica Spain	534	114	191	136	93
Telefónica United Kingdom	578	177	189	103	109
Others	491	93	165	99	134
Operating lease obligations ⁽¹⁾	7,885	1,649	2,637	1,676	1,923
Purchase and other contractual obligations ⁽²⁾	12,881	4,864	4,990	1,801	1,226

(1) This item includes definitive payments (non-cancelable without penalty cost). Our operating lease obligations have in some cases extension options conditioned on the applicable law of each country. Accordingly, we have included only those amounts that represent the initial contract period.

(2) This item includes definitive payments (non-cancelable without penalty cost) due for agreements to purchase goods (such as network equipment) and services.

At December 31, 2018, the present value of future payments for Telefónica Group operating leases was 7,229 million euros (1,962 million euros in Telefónica Brazil, 2,153 million euros in Telefónica Germany, 1,083 million euros in Telefónica Hispam Norte, 410 million euros in Telefónica Hispam Sur, 545 million euros in Telefónica Spain, 594 million euros in Telefónica United Kingdom and 482 million euros in other companies classified as "Others" on the table above).

2018 Consolidated Financial Statements

The main finance lease transactions are described in Note 27.

Headcount

The table below presents the breakdown of the Telefónica Group's average number of employees by segment (see Note 4) in 2018, 2017 and 2016, together with total headcount at December 31 each year. The comparative figures have been restated to reflect the division of the Telefónica Hispanoamérica segment in Telefónica Hispam Norte and Telefónica Hispam Sur (see note 4).

	2018		2017		2016	
	Average	Year-end	Average	Year-end	Average	Year-end
Telefónica Spain	26,712	25,305	28,084	27,291	30,214	28,772
Telefónica United Kingdom	6,732	7,188	6,776	6,687	7,454	7,075
Telefónica Germany	8,366	8,203	8,653	8,535	8,341	8,517
Telefónica Brazil	34,068	33,499	33,991	34,125	34,247	33,782
Telefónica Hispam Norte	12,254	12,156	12,620	12,354	13,214	13,150
Telefónica Hispam Sur	24,883	24,673	25,378	25,095	25,674	25,751
Other companies	8,838	9,114	9,869	8,631	12,976	10,276
Total	121,853	120,138	125,371	122,718	132,120	127,323

Of the final headcount at December 31, 2018, approximately 37.7% are women (37.7% at December 31, 2017).

At December 31, 2018, the number of employees with disabilities is 955 (217 in Spain).

Depreciation and amortization

The breakdown of "Depreciation and amortization" on the consolidated income statement is as follows:

Millions of euros	2018	2017	2016
Depreciation of property, plant and equipment (Note 8)	5,751	5,953	5,951
Amortization of intangible assets (Note 6)	3,298	3,443	3,698
Total	9,049	9,396	9,649

Earnings per share

Basic earnings per share amounts are calculated by dividing (a) the profit for the year attributable to equity holders of the parent, adjusted for the net coupon corresponding to the undated deeply subordinated securities (see Note 15) and for the interest cost accrued in the period in relation to the debt component of the mandatorily convertible notes of the parent company (which matured on September 25, 2017, see note 15) by (b) the weighted average number of ordinary shares outstanding during the year plus the weighted average number of ordinary shares that would be issued upon the conversion of the said mandatorily convertible notes from the date of their issuance.

Diluted earnings per share amounts are calculated by dividing the net profit for the year attributable to ordinary equity holders of the parent, adjusted as described above, by the weighted average number of ordinary shares adjusted as described in the preceding paragraph, plus the weighted average number of ordinary shares that would be issued on the conversion of all the dilutive potential ordinary shares into ordinary shares.

2018 Consolidated Financial Statements

Both basic and diluted earnings per share attributable to equity holders of the parent are calculated based on the following data:

Millions of euros	2018	2017	2016
Profit attributable to ordinary equity holders of the parent from continuing operations	3,331	3,132	2,369
Adjustment for the coupon corresponding to undated deeply subordinated securities	(540)	(374)	(348)
Tax effect	138	97	91
Adjustment for the financial expense of the debt component of the mandatorily convertible notes	—	1	1
Total profit attributable to ordinary equity holders of the parent for basic and diluted earnings per share from continuing operations	2,929	2,856	2,113

Thousands	2018	2017	2016
Number of shares			
Weighted average number of ordinary shares (excluding treasury shares) for basic earnings per share	5,126,575	5,110,188	4,909,254
Adjustment for mandatorily convertible notes	—	—	151,265
Adjusted number of shares for basic earnings per share (excluding treasury shares)	5,126,575	5,110,188	5,060,519
Telefónica, S.A. share option plans	663	—	2,716
Weighted average number of ordinary shares outstanding for diluted earnings per share	5,127,238	5,110,188	5,063,235

For the purposes of calculating the earnings per share (basic and diluted) of 2016, the weighted average number of shares outstanding was retrospectively adjusted for the bonus share issues carried out to meet the scrip dividends paid in 2016 (see Note 15) as if such transaction has occurred at the beginning of the period, since the number of shares outstanding changed without a corresponding change in equity.

Thus, basic and diluted earnings per share attributable to equity holders of the parent are as follows:

Figures in euros	2018	2017	2016
Basic earnings per share	0.57	0.56	0.42
Diluted earnings per share	0.57	0.56	0.42

2018 Consolidated Financial Statements

Note 24. Share-based payment plans

Long-term incentive plan based on Telefónica, S.A. shares: Performance Share Plan 2018-2022

At the General Shareholders' Meeting held on June 8, 2018, a long-term incentive plan was approved, consisting of the delivery of shares of Telefónica, S.A. aimed at senior executive officers of the Telefónica Group, including the Executive Directors of Telefónica, S.A. The plan consists of the delivery to the participants of a certain number of shares of Telefónica, S.A. based on compliance with the objectives established for each of the cycles into which the plan is divided.

In the first cycle of the plan, the number of shares to deliver will depend (i) 50% on achievement of the total shareholder return ("TSR") objective for shares of Telefónica, S.A. and (ii) 50% on the generation of free cash flow of the Telefónica Group ("FCF").

For each of the remaining cycles, the Board of Directors of Telefónica, S.A. may introduce new objectives linked to sustainability, the environment or corporate governance, as well as vary the relative weight accorded to each of them. The plan will have a total duration of five years and will be divided into three cycles of three years each. The first cycle commenced in 2018 and will be finalized on December 31, 2020, with delivery of the respective shares in 2021. The maximum number of shares assigned to this cycle of the plan was 8,466,996 shares and the outstanding shares at December 31, 2018 8,451,511, with the following breakdown:

First cycle	No. of shares assigned	Outstanding shares at 12/31/2018	Unit fair value
TSR Objective	4,233,498	4,225,755.5	4.52
FCF Objective	4,233,498	4,225,755.5	6.46

Long-term incentive plan based on Telefónica, S.A. shares: "Performance and Investment Plan 2014-2019"

The Telefónica, S.A. General Shareholders' Meeting on May 30, 2014 approved a new installment of the long-term share-based incentive "Performance and Investment Plan" for certain senior executives and members of the Group's management team, operational on completion of the first "Performance and Investment Plan".

The term of the plan was a total of five years divided into three cycles. The initial and the second share allocations took place on October 1, 2014, and on October 1, 2015, respectively. Regarding the third cycle of this 2016-2019 Plan, the Company's Board of Directors, following a favorable report from the Nomination, Compensation and Corporate Governance Committee, resolved not to execute or implement it, after having decided that it was not sufficiently in line with the Telefónica Group's strategic plan, taking into account the circumstances and macroeconomic environment.

The first cycle expired on September 30, 2017. The maximum number of shares assigned to this cycle of the plan was 6,927,953 shares assigned on October 1, 2014, with a fair value of 6.82 euros per share. The second cycle expired on September 30, 2018. The maximum number of shares assigned to this cycle was 6,775,445 shares assigned on October 1, 2015, with a fair value of 6.46 euros per share. Delivery of shares was not required at the end of each of these cycles according to the general conditions of the plan; therefore, managers did not receive any shares.

Long-term incentive plan based on Telefónica, S.A. shares: "Talent for the Future Share Plan 2014-2019" (TFSP)

At the General Shareholders' Meeting held on May 30, 2014, a long-term share-based incentive plan called "Talent for the Future Share Plan" was approved for certain Telefónica Group employees.

The plan consisted of the delivery of a certain number of shares of Telefónica, S.A. to participants selected by the Company who had opted to take part in the scheme and had met the requirements and conditions stipulated to this end.

2018 Consolidated Financial Statements

The term of the plan was five years and it was divided into three cycles. The initial and the second share allocations took place on October 1, 2014, and on October 1, 2015, respectively. Regarding the third cycle of this 2016-2019 Plan, the Company's Board of Directors, following a favorable report from the Nomination, Compensation and Corporate Governance Committee, resolved not to execute or implement it, after having decided that it was not sufficiently in line with the Telefónica Group's strategic plan, taking into account the circumstances and macroeconomic environment.

The first cycle expired on September 30, 2017. The maximum number of shares assigned to this phase of the plan was 556,795 shares assigned on October 1, 2014, with a fair value of 6.82 euros per share. The second cycle expired on September 30, 2018. The maximum number of shares assigned to this phase of the plan was 618,000 shares assigned on October 1, 2015, with a fair value of 6.46 euros per share. Delivery of shares was not required at the end of each of these cycles according to the general conditions of the plan.

Long-term incentive plan based on Telefónica, S.A. shares: "Talent for the Future Share Plan 2018-2022" (TFSP) The Telefónica, S.A.'s Board of Directors, at its meeting on June 8, 2018, agreed the launch of a new installment of the long-term incentive plan "Talent for the Future Share Plan".

The term of this new plan is also five years and it is divided into three cycles. As in the case of the Performance Share Plan described above, in the first cycle of the plan the number of shares to deliver will depend (i) 50% on achievement of the total shareholder return ("TSR") objective for shares of Telefónica, S.A. and (ii) 50% on the generation of free cash flow of the Telefónica Group ("FCF").

The first cycle commenced in 2018 and will be finalized on December 31, 2020, with delivery of the respective shares in 2021. The maximum number of shares assigned to this cycle of the plan was 787,500 shares and the outstanding shares at December 31, 2018 785,750, with the following breakdown:

First cycle	No. of shares assigned	Outstanding shares at 12/31/2018	Unit fair value (euros)
TSR Objective	393,750	392,875	4.52
FCF Objective	393,750	392,875	6.46

Telefónica, S.A. global share plans

The Telefónica, S.A. Ordinary General Shareholders' meeting on May 30, 2014 approved a new voluntary plan for incentivised purchases of shares of Telefónica, S.A. for the employees of the Group, with certain exceptions. Under this Plan, employees were offered the option to acquire Telefónica, S.A. shares during a twelve-month period (the acquisition period), with the company undertaking to deliver a certain number of free shares to participants, subject to certain requirements. Each employee was limited to buying a maximum of 1,800 euros in Telefónica, S.A. shares, subject to a minimum of 300 euros. The employees that remained part of the Telefónica Group and held on to the shares for one year following the acquisition period (the shareholding period), were entitled to receive one free share for each share they acquired and retained throughout the shareholding period.

The acquisition period commenced in July 2015 and ended in June 2016. The share holding period ended in August 2017. 27,018 employees on the scheme were rewarded with a total of 3,187,055 Telefónica shares, valued at approximately 33 million euros at the time they were delivered.

In addition, at the General Shareholders' Meeting held on June 8, 2018, a new global employee incentive share purchase plan for shares of Telefónica, S.A. was approved, aimed at employees of the Telefónica Group, that will be launched in 2019. The total number of free shares to be delivered for the whole plan may never exceed 0.1% of the share capital of Telefónica, S.A.

2018 Consolidated Financial Statements

Note 25. Cash flow detail

Net cash flow provided by operating activities

The detail of net cash flow provided by operating activities is the following:

Millions of euros	2018	2017	2016
Cash received from operations	58,815	63,456	63,514
Cash paid from operations	(42,891)	(46,929)	(47,384)
Cash paid to suppliers	(37,044)	(40,508)	(40,831)
Cash paid to employees	(5,072)	(5,725)	(5,815)
Payments related to cancellation of commitments	(775)	(696)	(738)
Net payments of interest and other financial expenses net of dividends received	(1,636)	(1,726)	(2,143)
Net interest and other financial expenses paid	(1,664)	(1,755)	(2,187)
Dividends received	28	29	44
Taxes paid	(865)	(1,005)	(649)
Net cash flow provided by operating activities	13,423	13,796	13,338

Net cash flow used in investing activities

The detail of (Payments on investments)/proceeds from the sale in property, plant and equipment and intangible assets, net is the following:

Millions of euros	2018	2017	2016
Proceeds from the sale in property, plant and equipment and intangible assets	192	148	134
Payments on investments in property, plant and equipment and intangible assets	(8,777)	(9,140)	(9,321)
(Payments on investments)/proceeds from the sale in property, plant and equipment and intangible assets, net	(8,585)	(8,992)	(9,187)

Spectrum license payments in 2018 totaled 674 million euros, mainly due to the payment of 588 million euros for the spectrum auction in the United Kingdom (see Note 6).

Spectrum license payments totaled 352 million euros in 2017, notably in Group companies in Coltelt, related to the arbitration award amounting to 317 million euros (see Note 2).

The detail of proceeds on disposals of companies, net of cash and cash equivalents disposed and payments on investments in companies, net of cash and cash equivalents acquired is the following:

Millions of euros	2018	2017	2016
Sale of Televisión Federal, S.A. (Telefé) (see Note 23)	—	—	306
Proceeds arising from hedges associated with Telefónica United Kingdom	—	—	399
Sale of Telefónica Telecomunicaciones Públicas, S.A.U.	—	28	2
Sale of Axonix Ltd and Telefónica Digital Inc.	29	—	—
Others	—	12	60
Proceeds on disposals of companies, net of cash and cash equivalents disposed	29	40	767
Acquisition of DTS	—	—	(36)
Acquisition of Coltelt affiliates (Note 5)	—	(85)	—
Acquisition of Minodes GmbH	—	(9)	—
Acquisition of Co-trade GmbH	—	(20)	—
Others	(3)	(14)	(18)
Payments on investments in companies, net of cash and cash equivalents acquired	(3)	(128)	(54)

2018 Consolidated Financial Statements

The detail of proceeds on financial investments not included under cash equivalents and payments on financial investments not included under cash equivalents is the following:

Millions of euros	2018	2017	2016
Sale of stake in Indra	—	—	85
Sale of stake in China Unicom (Hong Kong) Limited (see Note 11)	—	72	322
Investments of Seguros de Vida y Pensiones Antares, S.A.	78	49	—
Sale of stake in Shortcut I GmbH & Co. KG	21	—	—
Collateral guarantees on derivatives	806	72	—
Others	99	103	82
Proceeds on financial investments not included under cash equivalents	1,004	296	489
Legal deposits	(54)	(75)	(104)
Investment in Mediaset Premium	—	—	(20)
Long term deposits	—	(150)	—
Collateral guarantees on derivatives	(754)	(781)	—
Others	(157)	(100)	(141)
Payments on financial investments not included under cash equivalents	(965)	(1,106)	(265)

Payments and proceeds on placements of cash surpluses not included under cash equivalents in 2018 and 2017 largely relate to placements made by Telefónica, S.A.

Net cash flow used in financing activities

The detail of dividends paid, proceeds from issue of share capital increase, payments and proceeds of treasury shares and other operations with shareholder and minority interest, and operations with other equity holders is the following:

Millions of euros	2018	2017	2016
Dividends paid by Telefónica, S.A. (*)	(2,048)	(1,904)	(2,395)
Payments to non-controlling interests of Telefônica Brasil, S.A.	(245)	(290)	(216)
Payments to non-controlling interests of Telefónica Deutschland Holding, A.G.	(238)	(229)	(263)
Payments to non-controlling interests of Telefónica Centroamérica Inversiones	(28)	(23)	(27)
Payments to non-controlling interests of Telxius Telecom, S.A. y Pontel Participaciones, S.L.	(231)	—	—
Others	(4)	(13)	(5)
Dividends paid (see Note 15)	(2,794)	(2,459)	(2,906)
Proceeds from share capital increase	—	2	—
Transactions with Telefónica, S.A. treasury shares (see Note 15)	—	—	(645)
Sale of 40% of Telxius Telecom, S.A. to Taurus Bidco S.à.r.l. (Note 2)	—	1,275	—
Sale of 16,65% of Pontel Participaciones, S.L. (Note 2)	379	—	—
Others	—	(6)	(15)
(Payments)/proceeds of treasury shares and other operations with shareholders and with minority interests	379	1,269	(660)
Issuance of undated deeply subordinated securities (Note 15)	2,250	1,000	1,000
Acquisition of undated deeply subordinated securities (Note 15)	(1,779)	—	—
Payment of undated deeply subordinated securities (Note 15)	(473)	—	—
Payment of the coupon related to the issuances of undated deeply subordinated securities issued (See Note 15)	(559)	(354)	(344)
Operations with other equity holders	(561)	646	656

(*) This amount differs from that indicated in Note 15 because of withholding taxes deducted in the payment to certain major shareholders.

Telefónica, S.A. 123

2018 Consolidated Financial Statements

The detail of proceeds on issue of debentures and bonds, and other debts, proceeds on loans, borrowings and promissory notes, amortization of debentures and bonds, and other debts, repayments of loans, borrowings and promissory notes and financed operating payments and investments in property, plant and equipment and intangible assets payments is the following:

Millions of euros	2018	2017	2016
Issued under the EMTN program of Telefónica Emisiones, S.A.U. (see Appendix III) (*)	2,000	3,517	4,900
Issued of non-dilutive convertible debentures in Telefónica Participaciones, S.A.U. (Appendix III)	—	—	600
Issued under the SHELF program of Telefónica Emisiones, S.A.U. (see Appendix III) (*)	1,746	3,335	—
Issuance of Telefônica Brasil, S.A.	—	756	—
Issuance of O2 Telefónica Deutschland Finanzierungs, GmbH (Appendix III)	600	—	—
Others	(57)	)782	193
Proceeds on issue of debentures and bonds, and other debts	4,289	8,390	5,693
Syndicated loan of 3,000 million euros by Telefónica, S.A.	—	—	3,070
Syndicated loan of 3,000 million euros by Telefónica, S.A.	—	—	1,280
Structured financing (see Note 16)	750	750	—
Disposal bilateral loans of Telefónica, S.A. (see Note 16)	585	—	—
Syndicated loan of 750 million euros by Telefónica Germany GmbH	—	650	—
Syndicated loan of Telxius Telecom, S.A. (see Note 16)	289	—	—
Settlement of nominal value of gross debt hedging derivatives	209	575	1,017
Others	2,140	2,869	4,965
Proceeds on loans, borrowings and promissory notes (see Appendix V)	3,973	4,844	10,332
Repayments of debentures and bonds, and other debts	(4,654)	(6,687)	(6,873)
Syndicated loan of 3,000 million euros by Telefónica, S.A.	—	—	(3,070)
Syndicated loan of 2,500 million euros by Telefónica, S.A.	—	(550)	—
Syndicated loan of 3,000 million euros by Telefónica, S.A.	—	—	(1,980)
Loans paid by GVT	—	—	(93)
Syndicated loan of 750 million euros by Telefónica Germany GmbH	—	(700)	—
Amortization bilateral loans of Telefónica, S.A. (see Note 16)	(800)	—	—
Settlement of nominal value of amortized debt hedging derivatives	(52)	(179)	(616)
Others	(3,188)	(5,282)	(2,747)
Repayments of loans, borrowings and promissory notes (see Appendix V)	(4,040)	(6,711)	(8,506)
Financed spectrum licenses payments (Note 18)	(44)	(329)	(198)
Payments to suppliers with extended payment terms (Note 16)	(428)	(717)	(1,758)
Financed operating payments and investments in property, plant and equipment and intangible assets payments	(472)	(1,046)	(1,956)

(*) Data converted at the exchange rate at the end of each of the corresponding periods. The impact of the exchange rate with respect to the date of the transaction is included in the "Others" line within the same sub-heading.

2018 Consolidated Financial Statements

Note 26. Other information

a) Litigation and arbitration

Telefónica and its group companies are party to several legal proceedings which are currently in progress in the courts of law and the arbitration bodies of the various countries in which we are present.

Based on the advice of our legal counsel it is reasonable to assume that these legal proceedings will not materially affect the financial condition or solvency of the Telefónica Group.

The contingencies arising from the litigation and commitments described below were evaluated (see Note 3.m) when the consolidated financial statements for the year ended December 31, 2018 were prepared. The provisions recorded in respect of the commitments taken as a whole are not material.

The following unresolved legal proceedings or those underway in 2018 are highlighted (see Note 22 for details of tax-related cases):

Appeal against the decision by Agencia Nacional de Telecomunicações (“ANATEL”) regarding the inclusion of interconnection and network usage revenues in the Fundo de Universalização de Serviços de Telecomunicações (“FUST”)

Vivo Group operators (currently Telefônica de Brasil), together with other cellular operators, appealed ANATEL’s decision of December 16, 2005, to include interconnection and network usage revenues and expenses in the calculation of the amounts payable into the FUST (Fundo de Universalização de Serviços de Telecomunicações) –a fund which pays for the obligations to provide Universal Service– with retroactive application from 2000. On March 13, 2006, Regional Federal Court no. 1. granted a precautionary measure which stopped the application of ANATEL’s decision. On March 6, 2007, a ruling in favor of the wireless operators was issued, stating that it was not appropriate to include the revenues received by transfer from other operators in the taxable income for the FUST’s calculation and rejecting the retroactive application of ANATEL’s decision. On January 26, 2016, ANATEL filed an appeal to overturn this decision with Brasília Regional Federal Court no. 1, which was also dismissed. On May 10, 2017 ANATEL appealed to the higher courts on the merits of the case.

At the same time, Telefônica Brasil and Telefónica Empresas, S.A., together with other wireline operators through ABRAFIX (Associação Brasileira de Concessionárias de Serviço Telefônico Fixo Comutado) appealed ANATEL’s decision of December 16, 2005, also obtaining the precautionary measures requested. On June 21, 2007, Federal Regional Court no. 1 ruled that it was not appropriate to include the interconnection and network usage revenues in the FUST’s taxable income and rejected the retroactive application of ANATEL’s decision. ANATEL filed an appeal to overturn this ruling on April 29, 2008, before Brasília Federal Regional Court no. 1, which was dismissed on May 10, 2016. ANATEL filed an appeal against this dismissal.

The fixed operators filed an appeal to clarify that revenues obtained through interconnection and dedicated line operation should not be included in the calculation of the amounts payable to the FUST. In addition, the court was also requested to rule on two grounds which had not been analyzed in the initial decision: (i) that the FUST has become obsolete, among other reasons, by the advance of mobile telephony; and (ii) that amounts collected are not applied to the purpose for which the FUST was created, since only a very low percentage of the revenues collected by the FUST is used to finance fixed telephony. Although the petition for clarification was dismissed on August 23, 2016, the court noted that the FUST should not be funded with revenues from interconnection and dedicated line operation. ABRAFIX appealed to the higher courts on these two elements that had not been analyzed. ANATEL appealed all the holdings of the ruling to the higher courts.

The amount of the claim is quantified at 1% of the interconnection revenues.

Appeal against the Decision of the European Commission dated January 23, 2013, to sanction Telefónica for the infringement of Article 101 of the Treaty on the functioning of the European Union

On January 19, 2011, the European Commission initiated formal proceedings to investigate whether Telefónica, S.A. (Telefónica) and Portugal Telecom SGPS, S.A. (Portugal Telecom) had infringed European Union anti-trust

Telefónica, S.A. 125

2018 Consolidated Financial Statements

laws with respect to a clause contained in the sale and purchase agreement of Portugal Telecom's ownership interest in Brasilcel, N.V., a joint venture in which both were venturers and which was the owner of the Brazilian company Vivo.

On January 23, 2013, the European Commission passed a ruling on the formal proceedings. The ruling imposed a fine on Telefónica of 67 million euros, as the European Commission ruled that Telefónica and Portugal Telecom committed an infraction of Article 101 of the Treaty on the Functioning of the European Union for having entered into the agreement set forth in Clause Nine of the sale and purchase agreement of Portugal Telecom's ownership interest of Brasilcel, N.V.

On April 9, 2013, Telefónica filed an appeal for annulment of this ruling with the European Union General Court. On August 6, 2013, the European Union General Court notified Telefónica of the response issued by the European Commission, in which the European Commission reaffirmed the main arguments of its ruling and, specially, that Clause Nine includes a competition restriction. On September 30, 2013, Telefónica filed its reply. On December 18, 2013, the European Commission filed its appeal.

A hearing was held on May 19, 2015, at the European Union General Court.

On June 28, 2016, the European Union General Court ruled. Although it declares the existence of an infringement of competition law, it annuls Article 2 of the contested Decision and requires the European Commission to reassess the amount of the fine imposed. The General Court considers that the European Commission has not neutralized the allegations and evidences provided by Telefónica on services in which there was not potential competition or were outside the scope of Clause Nine.

Telefónica understands that there are grounds for believing that the ruling does not suit at law; consequently, it filed an appeal to the Court of Justice of the European Union, on September 11, 2016.

On November 23, 2016, the European Commission filed its response against the Telefónica's appeal. On January 30, 2017, Telefónica filed its response. On March 9, 2017, the European Commission filed its rejoinder.

On December 13, 2017, the General Court dismissed the appeal filed by Telefónica. The European Commission must issue a new resolution in accordance with the judgment of the General Court of June 2016, which urged the Commission to recalculate the amount of the fine.

Claim of consumers association "FACUA" against Telefónica de España, S.A.U in connection with the increase of the price of Movistar Fusión

On September 5, 2016, notification was given to Telefónica de España of a claim filed against it by the consumers association ("FACUA"). Through such claim, the association exercises an action to protect consumers' and users' collective interests stipulated in articles 11 of the Civil Procedure Act (Ley de Enjuiciamiento Civil) and 24.1 of the Consumer and Users Protection Act (Ley General de Defensa de los Consumidores y Usuarios) on the basis of alleged disloyalty towards the consumers, arising from the raising of the prices of the product "Movistar Fusión" from May 5, 2015, by an amount of 5 euros per month. The claim contains a declaratory statement stating that disloyalty arises from misleading advertising regarding the price rise, and a prohibitory injunction requesting that Telefónica de España be ordered not to apply such price rise and to prohibit its future application to all customers who became customers of Movistar Fusión prior to May 5, 2015. It contains, besides, a third statement, requesting Telefónica de España to be condemned to repay the excess amounts collected as a result of the rise in prices to those customers who have chosen to maintain the service contracted, together with accrued interest on such amount.

The claim was filed for an undetermined amount, given the impossibility of determining a priori the total amount of the claim. On October 28, 2016, Telefónica de España filed its response.

On April 5, 2017, the Court ruled in favor of Telefónica de España, upholding the objection of unsuitable action and ordering the dismissal of the action. FACUA appealed that ruling.

On September 21, 2018, the Court of Appeals dismissed the appeal filed by FACUA, confirming the first instance resolution in favor of Telefónica.

Telefónica, S.A. 126

2018 Consolidated Financial Statements

Decision by the High Court regarding the acquisition by Telefónica of shares in Český Telecom by way of tender offer Venten Management Limited ("Venten") and Lexburg Enterprises Limited ("Lexburg"), were minority shareholders of CESKY TELECOM. In September 2005 both companies sold their shares to Telefónica in a mandatory tender offer. Subsequently Venten and Lexburg, in 2006 and 2009, respectively, filed actions against Telefónica claiming a higher price than the price for which they sold their shares in the mandatory tender offer.

On August 5, 2016, the hearing before the High Court in Prague took place in order to decide the appeal against the second decision of the Municipal Court, which had been favorable to Telefónica's position (as was also the case with the first decision of the Municipal Court). At the end of the hearing, the High Court announced the Second Appellate Decision by which it reversed the second decision of the Municipal Court and ordered Telefónica to pay 644 million Czech koruna (approximately 23 million euros) to Venten and 227 million Czech koruna (approximately 8 million euros) to Lexburg, in each case plus interest.

On December 28, 2016, the decision was notified to Telefónica. Telefónica filed an extraordinary appeal, requesting the suspension of the effects of the decision.

In March 2017, Telefónica was notified of the decision of the Supreme Court, which ordered the suspension of the effects of the unfavorable decision to Telefónica issued by the High Court.

Venten and Lexburg filed with the Supreme Court a motion to partially abolish the suspension of enforceability of the Decision of the High Court in Prague. On January 17, 2018, Telefónica filed its response seeking dismissal of such motion for lack of legal basis.

On February 14, 2019, notification was given to Telefónica of the resolution of the Supreme Court which, based on the extraordinary appeal filed by Telefonica, abolished the decision of the High Court in Prague dated August 5, 2016 and remanded the case back to the High Court.

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

In 1999, Entel (the National Telecommunications Company of Argentina before its privatization) sued Telefónica de Argentina, S.A. ("TASA"), who was the licensee of the telecom service after the privatization process, seeking detailed and documented accounting and reimbursement of the amounts that it received from and on behalf of Entel after assuming the telecom service as a licensee, and of the amounts deducted as commissions.

In general terms, the items in dispute were the amounts that TASA charged on behalf of Entel soon after having taken possession as a licensee of the telecom service (i.e.; the consumptions charges for telecom services from prior customers of Entel, either billed or unbilled, but pending payment at the time of the privatization). Entel also challenged the commissions that TASA discounted to Entel in exchange for the service of collection of fees on behalf of Entel. Additionally, Entel also claimed several credits received by TASA, which allegedly belonged to Entel and had not been transferred to TASA in the privatization process.

TASA replied arguing the inadmissibility of the accountability request, since such liquidations had previously been submitted to the Entel Liquidating Commission without being timely challenged.

In 2010, the Court of First Instance ruled in favor of Entel and held TASA accountable to Entel.

After exhausting all legal appeals available, TASA submitted the requested accounting to Entel, which was challenged by the national government on behalf of the liquidated Entel.

Several accounting drafts and cross-claims between the parties followed, with the intervention of a court-appointed expert accountant. After several court decisions, the intervening judge rejected TASA's objections to the accounting presented by the national government and adopted the calculations made by Entel and the court-appointed expert.

Although this judicial decision was appealed, TASA's appeal was dismissed by the Court of Appeals in October 2017, confirming, to a large extent, the accounting of Entel and the court-appointed expert, but also ordering Entel to recalculate interests. Specifically, the resolution of the Court accepted certain concepts that TASA had

2018 Consolidated Financial Statements

questioned and the application of a "judicial" interest rate (average passive rate), which implies a daily capitalization component, in detriment of the rate set forth in the privatization specifications which set a simple annual interest of 8% (which had even been used by the court-appointed expert and Entel in their calculations).

On February 22, 2018, Entel submitted the new principal and interest calculations required by the judge, claiming an amount of 1,689 million Argentine pesos (approximately 39 million euros).

The resolution of the Court of Appeals exhausted the ordinary remedies available. TASA filed an extraordinary appeal, which was rejected in November 2017. TASA has submitted an exceptional appeal before the Argentine Supreme Court, although this appeal does not suspend the potential execution by Entel of prior rulings against TASA.

Appeal against the resolution of ANATEL to sanction Telefônica Brasil for breaches of the Fixed Telephony Regulation

In May 2018, Telefónica filed a judicial action for annulment against a resolution issued by ANATEL (National Telecommunications Agency of Brazil) in March 2018 concluding the PADO ("Processo Administrativo para Apuração de Descumprimento de Obrigações" or Administrative Process for Determination of Non-compliance with Obligations) investigating alleged infractions of the Fixed Telephony Regulation by Telefônica Brasil.

This PADO investigation had been suspended during the negotiations of the TAC ("Termo de Ajustamento de Conduta" or Conduct Adjustment Term) between Telefónica and ANATEL relating to this and certain other PADO investigations. Since the negotiations concluded without agreement, the suspended PADO sanctioning procedures were reactivated and finalized.

In its resolution of March 2018, ANATEL considered that Telefônica Brasil committed several infractions, in particular those related to the inadequate notice of suspension of services to defaulting users, the terms of reactivation of services after payment of outstanding amounts by defaulting users and the disagreement with the terms of refunds claimed by users of the services.

The fine imposed by ANATEL and appealed by Telefônica Brasil is approximately 211 million reals (approximately 48 million euros), which amounted to approximately 482 million reals after currency value updates and accrued interests as of December 31, 2018 (approximately 109 million euros).

Telefônica Brasil has appealed the fine imposed by ANATEL based, fundamentally, on the following arguments: (i) ANATEL should have considered a smaller universe of users to determine the fine and (ii) the calculation of the fine is disproportionate and based on insufficient grounds.

Telefônica Brasil has not yet paid the fine, although Telefônica Brasil has guaranteed its payment through a guarantee insurance submitted to the court.

The procedure is in the first instance and a date has not yet been set for the conciliation hearing.

b) Other proceedings

Telefónica is currently conducting internal investigations covering various countries regarding possible violations of applicable anti-corruption laws. Telefónica continues to cooperate with governmental authorities and continues with the ongoing investigations. Although it is not possible at this time to predict the scope or duration of these matters or their likely outcome, Telefónica believes that, considering the size of the Group, any potential penalty as a result of the resolution of these investigations would not materially affect the Group's financial condition.

c) Commitments

Agreement related to the Sale of Customer Relationship Management ("CRM") Business, Atento

As a result of the sale agreement of Atento by Telefónica, announced on October 12, 2012, and ratified on December 12, 2012, both companies signed a Master Service Agreement which regulates Atento's relationship with the Telefónica Group as a service provider for a period of nine years and which was amended on May 16,

2018 Consolidated Financial Statements

2014, on November 8, 2016 and on May 11, 2018. This period was extended only for Spain and Brazil in November 2016, for two additional years until 2023.

By virtue of this agreement, Atento became Telefónica's preferred Contact Center and Customer Relationship Management ("CRM") service provider, stipulating annual commitments in terms of turnover which is updated based on inflation and deflation that vary from country to country, pursuant to the volume of services Atento has been providing to the entire Group. Effective January 1, 2017, the minimum volume commitments that Telefónica must comply with have significantly decreased for Brazil.

Failure to meet the annual turnover commitments in principle results in the obligation to the counterparty, to pay additional amounts, which would be calculated based on the difference between the actual amount of turnover and the predetermined commitment, applying a percentage based on the Contact Center's business margin to the final calculation.

Notwithstanding the above, as a consequence of the amendment signed with the Atento Group on May 11, 2018, starting on January 1, 2018 the payment obligation for failure to meet the annual turnover commitment will be calculated for each year of the agreement but will only be liquidated upon termination of the agreement. Such payment will only be due if the balance is in favor of Atento after adding certain amounts agreed between the parties and deducting an annual percentage of the Atento Group's sales to the Telefónica Group.

The Master Agreement sets forth a reciprocal arrangement, whereby Atento assumes similar commitments to subscribe its telecommunications services to Telefónica.

Telefónica Latinoamérica Holding, S.L. as strategic partner of Colombia Telecomunicaciones, S.A. ESP

Pursuant to amendment n° 2 of the Framework Investment Agreement executed as of September 21, 2017, after the closing of the merger between Colombia Telecomunicaciones, S.A. ESP and Telefónica Móviles Colombia, S.A., the Colombian Government may, at any time, offer to Telefónica all or part of the shares it holds in the company, the latter being obliged to acquire them, (directly or via one of its subsidiaries) in the event that the increase in Colombia Telecomunicaciones, S.A. ESP's EBITDA (CAGR) is less than 5.75% in the measurement periods, and provided that during the twelve (12) months following the ordinary shareholders' meetings during which the measurement was made, at least one of the following occurs: 1) Colombia Telecomunicaciones S.A. ESP has paid a brand fee or any other type of payment to the Strategic Partner for the use of its brands; or 2) Colombia Telecomunicaciones S.A. ESP orders and/or pays dividends with the favorable vote of the Strategic Partner.

Pursuant to the exercise by Colombian Government of its right to require Telefónica to vote in favor of the register of the shares of Colombia Telecomunicaciones, S.A. ESP in the National Securities and Issuer's Registry and in the Colombia Stock Exchange, on March 22, 2018, and upon request of the Government of Colombia, the General Shareholders Meeting of Colombia Telecomunicaciones, S.A. ESP approved to apply for the register of the shares of Colombia Telecomunicaciones, S.A. ESP in the National Securities and Issuer's Registry and in the Colombia Stock Exchange. Telefónica is under no obligation whatsoever to purchase or transfer any of its shares in Colombia Telecomunicaciones, S.A. ESP, either as a result of the shareholders' resolution, or a result of the register in the National Securities and Issuer's Registry or in the Colombia Stock Exchange. Following the registration in the National Securities and Issuer's Registry on May 10, 2018, the Colombia Stock Exchange approved the conditional registration of the shares of Colombia Telecomunicaciones, S.A. ESP on May 23, 2018, subject to the effective fulfillment by the Colombian Government of the issuance of a first public tender offer to the so-called solidarity sector ("sector solidario") pursuant to Law 226 of 1995 (December 20), which develops article 60 of the Colombian Constitution on the disposal of national property in share capital, the adoption of measures to democratize such property and other relevant provisions. On August 2, 2018, the Nation - Ministry of Finance and Public Credit, as shareholder of Colombia Telecomunicaciones, S.A. ESP, published a notice of public offering of the shares of its property in Colombia Telecomunicaciones, S.A. ESP to the solidary sector in accordance with Law 226 of 1995. Thus, resulting from said publication, Colombia Telecomunicaciones, S.A. ESP and its ordinary shares were registered in the Colombian Stock Exchange. Through Informative Document No. 242 of October 3, 2018, the Colombian Stock Exchange informed that the first stage of the sale program of the shares owned by the Nation -

Ministry of Finance and Public Credit in Colombia Telecomunicaciones, S.A.

Telefónica, S.A. 129

2018 Consolidated Financial Statements

ESP, aimed at the solidarity sector, was declared inconclusive as no acceptances at all were received during the term of the offer.

In addition, the Framework Investment Agreement provides that (a) if Telefónica decides to dispose or transfer of all or part of its shareholding in Colombia Telecomunicaciones, S.A. ESP to third parties, Telefónica commits that: (i) the acquirer or transferee will be obliged to adhere to the Framework Investment Agreement; and (ii) that the acquirer or transferee will be obliged to present an offer to purchase all of the shares in Colombia Telecomunicaciones, S.A. ESP held by the Colombian Government (that amounts to 32.5% of the share capital) at the same price and under the same terms and conditions negotiated with Telefónica, through the legally-established procedure for disposal of shares held by public entities and, (b) if the Colombian Government transfer its shares in Colombia Telecomunicaciones, S.A. ESP under certain circumstances, the Strategic Partner shall subscribe with the acquirer of the shares a new shareholders agreement which will have to be then negotiated by the parties and which, as the case may be, will include some of the rights currently held by the Colombian Government under the Framework Investment Agreement currently in force.

Communications Investment Platform ("CIP")

On May 8, 2015, Telefónica Open Future, S.L.U. ("TOF") signed a Limited Partnership Agreement (and related agreements) with Coral Group, L.L.C. (and affiliates thereof) ("Coral") pursuant thereto, TOF has committed to undertake investments up to 200 million U.S. dollar over a 7 year period (expandable up to two additional years) in technology companies that fall within the strategic priorities jointly agreed with Telefónica.

As a result of the addition of an additional Strategic Investor to the CIP in 2017, on October 25, 2017, TOF and Coral entered into a new Amended and Restated Limited Partnership Agreement, which retains TOF's original capital commitment, but also amends certain terms and conditions to provide TOF with certain early termination and capital commitment reduction rights upon certain events.

On August 1, 2018, TOF notified Coral its rightful early termination of the aforementioned agreement, and was therefore immediately released from any further investment commitments. As a result of the foregoing, on October 31, 2018 the Coral/Telefónica CIP Limited Partnership incorporated on May 7, 2015 was finally dissolved.

Agreement for the sale of the shares of Telefónica Gestión de Servicios Compartidos España, S.A.U., Telefónica Gestión de Servicios Compartidos Argentina, S.A. and T-Gestiona Servicios Contables y Capital Humano, S.A.C.

On March 1, 2016, a share purchase agreement between, on one hand, Telefónica, S.A., Telefónica Servicios Globales, S.L.U. and Telefónica Gestión de Servicios Compartidos Perú, S.A.C. (as sellers), and, on the other hand, IBM Global Services España, S.A., IBM del Perú, S.A.C., IBM Canada Limited and IBM Americas Holding, LLC (as purchasers) for the sale of the companies Telefónica Gestión de Servicios Compartidos España, S.A.U., Telefónica Gestión de Servicios Compartidos Argentina, S.A. and T-Gestiona Servicios Contables y Capital Humano, S.A.C., for a total price of approximately 22 million euros, was ratified before Notary Public. This share purchase agreement was subscribed on December 31, 2015.

Following the aforementioned share purchase agreement and in connection with the latter transaction, also, on December 31, 2015, Telefónica subscribed a master services agreement with IBM for the outsourcing of economic-financial and HR activities and functions to be provided to the Telefónica Group during a period of ten years, for a total amount of approximately 450 million euros. Most of the Telefónica Group's subsidiary companies have already adhered to that master services agreement.

Commitments derived from the agreements reached for the acquisition of football (soccer) related rights

On June 25, 2018, Telefónica was provisionally awarded with the broadcasting rights for all football (soccer) matches of the Spanish First Division Football League National Championship in the residential subscribers market for exploitation on pay television for the 2019-2022 cycle (packages 4 and 5 of the auction called by the Professional Football League). The definitive agreements were signed on July 5.

The award was granted for a total amount of 2,940 million euros, at an identical price of 980 million euros for each of the three seasons, which represents a slight decrease compared to the last season of the previous cycle.

Telefónica, S.A. 130

2018 Consolidated Financial Statements

Telefónica, as the operator of these broadcasting rights for the 2019-2022 cycle, will have the right to decide, design and develop the broadcasting contents, which will carry the Movistar hallmark for the 2019-2020 season. Additionally, on June 28, 2018, Telefónica Audiovisual Digital, S.L.U. ("Telefónica") and Mediaproducción, S.L.U. ("Mediapro"), reached an agreement whereby Telefónica acquired the pay television rights of football (soccer) matches of the "UEFA Champions League" and "UEFA Europa League" competitions corresponding to the three seasons 2018/19, 2019/20 and 2020/21. Such matches may be included in thematic channels produced by Telefónica and be sold to private or residential clients. Telefónica will have the right to exploit such license on an exclusive basis with the exception of certain matches of the "UEFA Europa League" competition that Mediapro has reserved for its free-to-air television broadcast along with highlights programs covering both competitions. The total consideration agreed for the three seasons was 1,080 million euros (360 million euros for each of the three seasons). Telefónica may sublicense the related thematic channels to other operators interested in this content. Mediapro will have the right to receive a share of advertising revenues from the new channels that Telefónica intends to launch. These channels will carry the Movistar hallmark. The aforementioned license was subject to UEFA's approval, which was granted in August 2018.

On December 21, 2018, Telefónica was provisionally awarded with the broadcasting rights for all football (soccer) matches of the Spanish Second Division Football League National Championship in the residential subscribers market for exploitation on pay television for the 2019-2022 cycle (package 6 of the auction called by the Professional Football League). No other bids were submitted for such package during the first round of the auction called by the Professional Football League. The award was granted for a total amount of 105 million euros (i.e., 35 million euros for each of the three seasons).

Agreement for the sale of Telefónica El Salvador

On January 24, 2019, Telefónica Centroamérica Inversiones, S.L. (a subsidiary of Telefónica 60% of which is owned, directly or indirectly, by Telefónica and 40% of which is owned, directly or indirectly, by Corporación Multi Inversiones, S.A.) reached an agreement with América Móvil, S.A.B de C.V. for the sale of 99.3% of Telefónica Móviles El Salvador, S.A., a company providing fixed and mobile communications services in El Salvador, for an amount (enterprise value) of 315 million USD, 277 million euros as of the date of the agreement.

The closing of the transaction is subject to the pertinent regulatory approvals. As of the date of the issuance of these Financial Statements, such conditions have not been met.

d) Environmental matters

Environmental strategy is the responsibility of the Board of Directors, which approves the environmental Policy and objectives, within the framework of the Global Responsible Business Plan of the Group.

Telefónica acts at different levels in alignment with the business strategy:

- Environmental management under ISO 14001:2015.

- Internal eco-efficiency.

- Promotion of the circular economy.

- Decarbonization of the activities.

- Development of products and services that provide solutions for environmental problems.

The environment is a central issue throughout the Company, involving the areas of operations and management, as well as business and innovation.

Telefónica has a global multidisciplinary team spread out across different countries that is responsible for carrying out this strategy at different levels of responsibility.

2018 Consolidated Financial Statements

Currently 99.4% of the Company has Environmental Management Systems (EMS) in accordance with Regulation ISO 14001, certified by an external body, which contribute to the proper management of its environmental aspects and to extending a culture of environmental responsibility across the whole supply chain.

On February 5, 2019, Telefónica Emisiones, S.A.U. issued notes in the Euro market (see Note 29) guaranteed by Telefónica, S.A., amounting to 1,000 million euros. The net proceeds of the notes are to be allocated towards projects aiming to improve energy efficiency in the network transformation from copper to fiber optic in Spain.

e) Auditors' fees

Principal Auditor

The expenses accrued in respect of the fees for services rendered to the various member firms of the PwC international organization, of which PricewaterhouseCoopers Auditores, S.L. (the auditors of the Telefónica Group) forms part, amounted to 19.11 million euros and 19.78 million euros in 2018 and 2017, respectively.

The detail of these amounts is as follows:

Millions of euros	2018	2017
Audit services	18.41	18.33
Audit-related services	0.70	0.49
Tax services	—	0.20
All other services (consulting, advisory, etc.)	—	0.76
Total	19.11	19.78

Audit services: mainly audit services of the annual and reviews of interim financial statements, services related to the issuance of comfort letters, work to comply with the requirements of the Sarbanes-Oxley Act (Section 404), the work in connection with the 20-F report to file with the US Securities and Exchange Commission (SEC) and the issuance of comfort letters.

Audit-related services: services related to the review of the information required by regulatory authorities, agreed financial reporting procedures not requested by legal or regulatory bodies, review of Corporate Social Responsibility Reports issued in the Group and Telefónica, S.A.'s verification Statement of Non Financial Information - Digital responsibility and well-being.

Tax Services: permitted services by the applicable independence regulation, basically, they are tax advice and studies of transference prices.

All other services: permitted services by the applicable independence regulation, mainly advisory services on migration questions to expatriates' employees.

In particular, the auditor of the Telefónica Group, PricewaterhouseCoopers Auditores, SL, during the year 2018 has provided services related to the issuance of the following reports: audit of the financial statements (includes SOX and 20-F), limited reviews of the intermediate periods, comfort letters, agreed procedures and corporate social responsibility.

2018 Consolidated Financial Statements

Other auditors

The expenses accrued in respect of the fees for services rendered by other auditors in 2018 and 2017 amounted to 58.35 million euros and 40.50 million euros, respectively, as follows:

Millions of euros	2018	2017
Audit services	1.52	2.80
Audit-related services	1.01	0.48
Tax services	7.83	5.75
All other services (consulting, advisory, etc.)	47.99	31.47
Total	58.35	40.50

f) Trade and other guarantees

The Company is required to issue trade guarantees and deposits for concession and spectrum tender bids (see Note 16) and in the ordinary course of its business. No significant additional liabilities in the accompanying consolidated financial statements are expected to arise from guarantees and deposits issued.

g) Directors' and Senior Executives' compensation and other benefits

The compensation of the members of Telefónica's Board of Directors is governed by article 35 of the Company's By-Laws, which provides that the annual amount of the compensation to be paid thereby to all of the Directors in their capacity as such, i.e., as members of the Board of Directors and for the performance of the duty of supervision and collective decision-making inherent in such body, shall be fixed by the shareholders at the General Shareholders' Meeting. The Board of Directors shall determine the exact amount to be paid within such limit and the distribution thereof among the Directors, taking into account the duties and responsibilities assigned to each Director, their membership on Committees within the Board of Directors and other objective circumstances that it deems relevant. Furthermore, Executive Directors shall receive such compensation as the Board determines for the performance of executive duties delegated or entrusted to them by the Board of Directors. Such compensation shall conform to the Director compensation policy approved by the shareholders at the General Shareholders' Meeting.

In accordance with the foregoing, the shareholders acting at the Ordinary General Shareholders' Meeting held on April 11, 2003 set at 6 million euros the maximum amount of annual gross compensation to be received by the Board of Directors as a fixed allotment and as attendance fees for attending the meetings of the Advisory or Control Committees of the Board of Directors. Thus, as regards fiscal year 2018, the total amount of compensation accrued by the Directors of Telefónica, in their capacity as such, was 2,838,067 euros for the fixed allocation and for attendance fees.

The compensation of the Directors of Telefónica in their capacity as members of the Board of Directors, of the Executive Commission and/or of the Advisory or Control Committees consists of a fixed amount payable monthly and of attendance fees for attending the meetings of the Advisory or Control Committees.

Set forth below are the amounts established in fiscal year 2018 as fixed amounts for belonging to the Board of Directors, the Executive Commission and the Advisory or Control Committees of Telefónica and the attendance fees for attending meetings of the Advisory or Control Committees of the Board of Directors:

2018 Consolidated Financial Statements

Compensation of the Board of Directors and of the Committees thereof
Amounts in euros

Position	Board of Directors	Executive Commission	Advisory or Control Committees (*)
Chairman	240,000	80,000	22,400
Vice chairman	200,000	80,000	—
Executive Member	—	—	—
Proprietary Member	120,000	80,000	11,200
Independent Member	120,000	80,000	11,200
Other external	120,000	80,000	11,200

(*) In addition, the amount of the attendance fee for each of the meetings of the Advisory or Control Committees is 1,000 euros.

In this regard, it is noted that the current Executive Chairman, Mr. José María Álvarez-Pallete López, has waived the receipt of the above amounts (i.e., 240,000 euros as Chairman of the Board of Directors and 80,000 euros as Chairman of the Executive Commission).

Likewise, the fixed remuneration, for their executive roles, of 1,923,100 euros that the Executive Chairman, Mr. José María Álvarez-Pallete López, has established for the 2019 financial year is equal to the one received in the years 2018, 2017 and 2016, which was set in his capacity as Chief Operating Officer, remaining invariably after his appointment as Chairman. This compensation is a 13.8% lower to the compensation established for the position of Executive Chairman prior to his appointment as such.

The fix remuneration, for their executive roles, of 1,600,000 euros that the Chief Operating Officer (C.O.O.), Mr. Ángel Vilá Boix, has established for the 2019 financial year is equal to the one received in the year 2018.

Individualized description

Annex II provides an individual breakdown by item of the compensation and benefits that the members of the Board of Directors and of the Senior Management of the Company have accrued and/or received from Telefónica, S.A. and from other companies of the Telefónica Group during fiscal year 2018. Likewise, the compensation and benefits accrued and/or received, during such year, by the members of the Company's Senior Management are broken down.

2018 Consolidated Financial Statements

Note 27. Finance leases

The main finance leases at the Telefónica Group are as follows:

a) Future minimum lease payment commitments in relation to finance leases at Telefónica Brazil companies

The payment schedule of finance leases of Telefónica Brazil at December 31, 2018, is as follows:

Millions of euros	Present value	Revaluation	Pending payment
Within one year	12	2	14
From one to five years	33	14	47
More than five years	44	69	113
Total	89	85	174

At December 31, 2018 there are net assets under finance lease agreements amounting to 61 million euros recognized under property, plant and equipment.

Additionally, Telefónica Brazil acts as a lessor in financial leases. The minimum lease payment receivables at December 31, 2018 are scheduled as follows:

Millions of euros	Present value	Revaluation	Pending receivables
Within one year	60	3	63
From one to five years	57	9	66
Total	117	12	129
Accumulated allowance	(44)	
Total after accumulated allowance	73		

b) Future minimum lease payment commitments in relation to finance leases at Telefónica Germany companies

The payment schedule of finance leases of Telefónica Germany at December 31, 2018, is as follows:

Millions of euros	Present value	Revaluation	Pending payment
Within one year	8	—	8
From one to five years	22	1	23
Total	30	1	31

At December 31, 2018 there are net assets under finance lease agreements amounting to 76 million euros recognized under property, plant and equipment.

2018 Consolidated Financial Statements

Note 28. Operations classified as held for sale

The breakdown of non-current assets classified as held for sale and liabilities associated at December 31, 2018 is as follows:

Million of euros	Non-current assets as held for sale	Liabilities associated to non-current assets as held for sale
Antares	793	661
Telefónica Móviles Guatemala	376	105
Telefónica Móviles El Salvador	234	71
Other companies	89	—
Total	1,492	837

On November 8, 2018, Telefónica reached an agreement with Grupo Catalana Occidente for the sale of 100% of Antares, for a total amount of 161 million euros. At December 31, 2018, the assets corresponding to Antares were classified as non-current assets held for sale and the liabilities as liabilities associated with non-current assets classified as held for sale (see Note 29).

In addition, on January 24, 2019, Telefonica Centroamérica Inversiones, S.L., 60% of which is owned by Telefónica and 40% by Corporación Multi Inversiones, reached an agreement with América Móvil, S.A.B. of C.V. for the sale of the entire share capital of Telefónica Móviles Guatemala and 99.3% of Telefónica Móviles El Salvador (see Note 29).

The breakdown of non-current assets classified as held for sale and liabilities associated of Antares, Telefónica Móviles Guatemala and Telefónica Móviles El Salvador at December 31, 2018 is as follows:

Million of euros	Antares	T. Guatemala	T. El Salvador
Non-current assets	635	326	184
Intangible assets	1	44	30
Goodwill	—	123	60
Property, plant and equipment	—	157	91
Financial assets and other non-current assets	634	2	2
Deferred tax assets	—	—	1
Current assets	158	50	50
Inventories	—	9	7
Receivables and other current assets	10	25	30
Tax receivables	—	9	3
Other current financial assets	52	—	2
Cash and cash equivalents	96	7	8
Non-current liabilities	656	45	11
Non-current financial liabilities	—	19	—
Payable and other non-current liabilities	—	—	1
Deferred tax liabilities	1	13	5
Non-current provisions	655	13	5
Current liabilities	5	60	60
Current financial liabilities	—	5	18
Payables and other current liabilities	4	52	39
Tax payables	—	3	3
Current provisions	1	—	—

2018 Consolidated Financial Statements

Note 29. Events after the reporting period

The following events regarding the Telefónica Group took place between December 31, 2018 and the date of authorization for issue of the accompanying consolidated financial statements:

On January 23, 2019, Telefónica announced that Telefónica UK Limited had agreed non-binding heads of terms with Vodafone Limited to strengthen their existing network sharing partnership in the United Kingdom. The parties plan to extend the term of their existing network sharing partnership and include 5G capacity at joint radio network sites, and to upgrade transmission networks to support 5G technology. They also intend to devolve more activities to their joint venture company, Cornerstone Telecommunications Infrastructure Limited (CTIL), which manages passive tower infrastructure.

On January 23, 2019, Telefónica announced that it was notified of a resolution issued by the Spanish Central Economic-Administrative Tax Court (Tribunal Económico-Administrativo Central) partially upholding the claims filed against the assessments relating to the 2008-2011 Corporate Income Tax Audit. Final implementation of this resolution will most likely lead to a tax refund related to overpayments made by the company in those tax years. At this point of time, it is not possible to quantify the exact amount of the expected refund since, as pointed out by the Central Economic-Administrative Court's resolution, the final amount shall only be settled once the resolution is duly executed by the Spanish Tax Authorities.

On January 23, 2019, Telefónica, S.A. made a repayment of 100 million euros on its bilateral loan signed on December 20, 2017.

On January 24, 2019, Telefonica Centroamérica Inversiones, S.L. (60% of which is owned, directly and indirectly, by Telefonica and 40% of which is owned by Corporación Multi Inversiones), reached an agreement with América Móvil, S.A.B. of C.V. for the sale of the entire share capital of Telefónica Móviles Guatemala, S.A. and 99.3% of Telefónica Móviles El Salvador, S.A. de C.V. The closing of the Telefónica El Salvador sale is subject to applicable regulatory conditions while the sale of Telefónica Móviles Guatemala was completed on such date.

The aggregate consideration for both companies (enterprise value) is 648 million US dollars (approximately 570 million euros at the exchange rate on the date of the agreement, 293 million of which correspond to Telefónica Móviles Guatemala and 277 million of which correspond to Telefónica Móviles El Salvador).

On January 25, 2019, Telefónica Emisiones, S.A.U. redeemed 150 million euros of its notes issued on January 25, 2017. The notes were guaranteed by Telefónica, S.A.

On February 5, 2019, Telefónica Emisiones, S.A.U. issued under its Guaranteed Euro Program for the Issuance of Debt Instruments ("EMTN Program") notes in the Euro market guaranteed by Telefónica, S.A., amounting to 1,000 million euros. These notes are due on February 5, 2024, pay an annual coupon of 1.069% and were issued at par (100%). The net proceeds of the notes are to be allocated towards projects aiming to improve energy efficiency in the network transformation from copper to fiber optic in Spain.

On February 14, 2019, once the pertinent regulatory approvals were obtained, Telefónica transferred to Grupo Catalana Occidente 100% of Antares' share capital for a total amount of 161 million euros. On the closing of the sale, Telefónica and Grupo Catalana Occidente executed an agreement pursuant to which Grupo Catalana Occidente will continue to manage the insurance policies of the Telefónica Group on an exclusive basis for the next 10 years.

On February 18, 2019, Telefónica, S.A. made an early repayment for 500 million euros of its bilateral loan of 1,000 million euros signed on June 26, 2014 and originally scheduled to mature on June 26, 2019.

2018 Consolidated Financial Statements

On February 20, 2019, the Board of Directors of Telefónica, S.A. has approved the sale of the Telefónica Group businesses in Panama, Nicaragua and Costa Rica. The closing of the agreement is expected in the short term.

The detail of the assets and liabilities of these companies as of 31 December 2018 is as follows:

Millions of euros	Telefónica Móviles Panamá, S.A.	Telefonía Celular de Nicaragua, S.A.	Telefónica de Costa Rica TC, S.A.
Non-current assets	332	146	177
Current assets	34	38	51
Total assets	366	184	228
Non-current liabilities	69	21	32
Current liabilities	71	49	53
Total liabilities	140	70	85

Note 30. Additional note for English translation

These consolidated financial statements were originally prepared in Spanish. In the event of a discrepancy, the Spanish-language version prevails.

Telefónica, S.A. 138

2018 Consolidated Financial Statements

Appendix I: Scope of consolidation

The main Companies of the Telefónica Group

The table below lists the main companies comprising the Telefónica Group at December 31, 2018 and the main investments consolidated using the equity method.

Included for each company are the company name, corporate purpose, country, functional currency, share capital (in millions of functional currency units), the Telefónica Group's effective shareholding and the company or companies through which the Group holds a stake.

Parent Company

Telefónica, S.A.

Name and corporate purpose	Country	Currency	Capital	%Telefónica Group	Holding Company
Telefónica Spain					
Telefónica de España, S.A.U. Telecommunications service provider	Spain	EUR	1,024	100	% Telefónica, S.A.
Telefónica Móviles España, S.A.U. Wireless communications services provider	Spain	EUR	209	100	% Telefónica, S.A.
Acens Technologies, S.L. Holding housing and telecommunications solutions Service provider	Spain	EUR	23	100	% Telefónica de España, S.A.U.
Teleinformática y Comunicaciones, S.A.U. (Telyco)					
Promotion, marketing and distribution of telephone and telematic equipment and services	Spain	EUR	8	100	% Telefónica de España, S.A.U.
Telefónica Soluciones de Informática y Com. de España S.A.U. Telecommunications systems, networks and infrastructure engineering	Spain	EUR	2	100	% Telefónica de España, S.A.U.
Telefónica Soluciones de Outsourcing, S.A. Promotion and networks management	Spain	EUR	1	100	Telefónica Soluciones de % Informática y Com. de España S.A.U.
Telefónica Servicios Integrales de Distribución S.A.U. Logistic service provider	Spain	EUR	2	100	% Telefónica de España, S.A.U.
DTS Distribuidora de Televisión Digital, S.A. Broadcasting satellite TV signal transmission and linkage services	Spain	EUR	80	100	% Telefónica de España, S.A.U.
Telefónica Servicios Audiovisuales, S.A.U. Provision of all type of audiovisual telecommunications services	Spain	EUR	6	100	% Telefónica de Contenidos, S.A.U.
Telefónica Broadcast Services, S.L.U. DSNG-based transmission and operation services	Spain	EUR	—	100	% Telefónica Servicios Audiovisuales, S.A.U.
Telefónica Audiovisual Digital, S.L.U. Provision of all type of audiovisual telecommunications services	Spain	EUR	46	100	% Telefónica de Contenidos, S.A.U.

Edgar Filing: TELEFONICA S A - Form 6-K

Compañía Independiente de Televisión, S.L. Provision of all type of audiovisual telecommunications services Telefónica United Kingdom	Spain	EUR	1	100	% Telefónica Audiovisual Digital, S.L.U.
Telefónica Europe plc Holding company	UK	GBP	9	100	Telefónica, S.A. (99.99%) % Telefónica Capital S.A. (0.01%)

Telefónica, S.A. 139

Edgar Filing: TELEFONICA S A - Form 6-K

2018 Consolidated Financial Statements

Name and corporate purpose	Country	Currency	Capital	%Telefónica Group	Holding Company
Telefónica United Kingdom (cont.)					
MmO2 plc Holding company	UK	GBP	20	100	% O2 Secretaries Ltd. (0.01%) Telefónica Europe plc (99.99%)
O2 Holdings Ltd Holding company	UK	GBP	12	100	% Telefónica Europe plc
Telefónica United Kingdom Ltd. Wireless communications	UK	GBP	10	100	% O2 Holdings Ltd.
Giffgaff Ltd Wireless communications services provider	UK	GBP	—	100	% Telefónica United Kingdom Ltd.
O2 Networks Ltd. Holding company	UK	GBP	—	100	% O2 Holdings Ltd.
Cornerstone Telecommunications Network sharing	UK	GBP	—	50	% O2 Networks Ltd. (40%) O2 Cedar Ltd (10%)
Telefónica Germany					
Telefónica Deutschland Holding A.G Holding company	Germany	EUR	2,975	69.22	% Telefónica Germany Holdings Limited
Telefónica Germany GmbH & Co. OHG Wireless communications services operator	Germany	EUR	51	69.22	% Telefónica Deutschland Holding A.G (69.21%) T. Germany Management, GmbH (0.01%)
E-Plus Services GmbH Wireless communications services operator	Germany	EUR	—	69.22	% Telefónica Germany GmbH & Co. OHG
Telefónica Germany Next GmbH Technological and consulting services in Big Data provider	Germany	EUR	—	69.22	% Telefónica Germany GmbH & Co. OHG
Minodes GmbH Technological and consulting services in Big Data provider	Germany	EUR	—	69.22	% Telefónica Germany Next GmbH
Telefónica Brazil					
Telefônica Brasil, S.A. Wireline telephony operator	Brazil	BRL	63,571	73.68	% Telefónica Latinoamérica Holding, S.L. (24.18%) Telefónica, S.A. (29.77%) Sao Paulo Telecomunicações Participações, Ltda. (19.67%) Telefónica Chile, S.A. (0.06%)
Terra Networks Brasil, S.A. ISP and portal	Brazil	BRL	—	73.68	% Telefônica Brasil, S.A.
Telefónica Hispam Norte Telefónica Venezolana, C.A. Wireless communications operator	Venezuela	VES	498,953	100	% Latin America Cellular Holdings, S.L. (97.04%) Comtel Comunicaciones Telefónicas, S.A. (2.87%)

Edgar Filing: TELEFONICA S A - Form 6-K

Colombia Telecomunicaciones, S.A. ESP Communications services operator	Colombia COP	3,410	67.5	Telefónica, S.A. (0.09%) Telefónica Latinoamérica Holding, S.L. (51.52%) % Latin American Cellular Holdings, S.L. (8.08%) Telefónica, S.A. (7.90%)
--	--------------	-------	------	---

Telefónica, S.A. 140

Edgar Filing: TELEFONICA S A - Form 6-K

2018 Consolidated Financial Statements

Name and corporate purpose	Country	Currency	Capital	%Telefónica Group	Holding Company
Telefónica Hispam Norte (cont.)					
Empresa de Telecomunicaciones de Bucaramanga S.A. E.S.P Communications services operator	Colombia	COP	83,191	63.77	Colombia Telecomunicaciones, S.A. ESP (35.71%) % Metropolitana de Telecomunicaciones S.A E.S.P (28.06%)
Metropolitana de Telecomunicaciones S.A E.S.P Communications services operator	Colombia	COP	50,212	59.03	Colombia Telecomunicaciones, S.A. ESP (30.89%) % Empresa de Telecomunicaciones de Bucaramanga S.A. E.S.P (28.14%)
Operaciones Tecnológicas y Comerciales S.A.S Communications services operator	Colombia	COP	2,330	60.93	Empresa de Telecomunicaciones de Bucaramanga S.A. E.S.P (24.37%) % Metropolitana de Telecomunicaciones S.A E.S.P (36.56%)
Telefónica Móviles México, S.A. de C.V. Holding Company	Mexico	MXN	99,384	100	% Telefónica, S.A.
Telefónica Móviles Panamá, S.A. Wireless telephony services	Panama	USD	45	60	% Telefónica Centroamérica Inversiones, S.L.
Telefonía Celular de Nicaragua, S.A. Wireless telephony services	Nicaragua	NIO	247	60	Telefónica Centroamérica Inversiones S.L. (59.99%) % Guatemala Cellular Holdings, B.V. (0.01%)
Otecel, S.A. Wireless communications services provider	Ecuador	USD	183	100	% Telefónica Latinoamérica Holding, S.L.
Telefónica de Costa Rica TC, S.A. Wireless communications	Costa Rica	CRC	199,892	100	% Telefónica, S.A.
Telefónica Hispam Sur					Telefónica Móviles Argentina, S.A. (81.05%)
Telefónica de Argentina, S.A. Telecommunications service provider	Argentina	ARS	22,403	100	Telefónica Latinoamérica Holding, % S.L. (16.73%) Telefónica, S.A. (1.46%) Telefónica International Holding, B.V. (0.76%) Telefónica, S.A. (73.20%)
Telefónica Móviles Argentina, S.A. Telecommunications service provider	Argentina	ARS	4,432	100	Telefónica Latinoamérica Holding, % S.L. (25.28%) Telefónica International Holding, B.V. (1.52%)
Telefónica Móviles Chile, S.A. Wireless communications services	Chile	CLP	1,294,872	100	% Inversiones Telefónica Móviles Holding Limitada (98.90%)

Edgar Filing: TELEFONICA S A - Form 6-K

operator
Telefónica Chile, S.A.
Local and international long
distance telephony services
provider

Telefónica, S.A. (1.1%)

Chile CLP 569,773 99.14

%Telefónica Móviles Chile, S.A.

Telefónica, S.A. 141

Edgar Filing: TELEFONICA S A - Form 6-K

2018 Consolidated Financial Statements

Name and corporate purpose	Country	Currency	Capital	%Telefónica Group	Holding Company
Telefónica Hispam Sur (cont.)					
Telefónica del Perú, S.A.A. Local, domestic and international long distance telephone service provider	Peru	PEN	2,954	98.57	% Telefónica Latinoamérica Holding, S.L. (50.22%) Latin American Cellular Holdings, S.L. (48.35%)
Telefónica Móviles del Uruguay, S.A. Wireless communications and services operator	Uruguay	UYU	1,107	100	% Telefónica Latinoamérica Holding, S.L.
Other Companies					
O2 International Holdings Ltd. Holding company	UK	GBP	—	100	% O2 (Europe) Ltd.
Telefónica Germany Holdings Ltd. Holding company	UK	EUR	—	100	% O2 (Europe) Ltd.
O2 (Europe) Ltd. Holding company	UK	EUR	1,239	100	% Telefónica, S.A.
Telefónica International Holding, B.V. Holding company	Netherlands	EUR	—	100	% Telefónica Latinoamérica Holding, S.L.
Telefónica Latinoamérica Holding, S.L. Holding company	Spain	EUR	237	100	% Telefónica, S.A.
Pontel Participaciones, S.L. Holding company	Spain	EUR	—	83.35	% Telefónica, S.A.
Telxius Telecom, S.A. Telecommunications service provider	Spain	EUR	250	50.01	% Pontel Participaciones, S.L.
Telxius Cable América, S.A. Provision of high bandwidth communications services	Uruguay	USD	429	50.01	% Telxius Telecom, S.A.
Telxius Cable España, S.L.U. Establishment and operation of any kind of communications infrastructure and/or network	Spain	EUR	5	50.01	% Telxius Telecom, S.A.
Telxius Cable República Dominicana, S.A.S. Operation and deployment of telecommunications infrastructure	Republica Dominicana	USD	3	50.01	% Telxius Cable América, S.A. (49.51%) Telxius Cable España, S.L.U. (0.50%)
Telxius Cable Argentina, S.A. Operation and deployment of telecommunications infrastructure	Argentina	USD	78	50.01	% Telxius Cable América, S.A. (49.98%) Telxius Cable España, S.L.U. (0.03%)
Telxius Cable Panamá, S.A. Installation and operation of telecommunications networks for wholesalers	Panama	USD	—	50.01	% Telxius Cable América, S.A.
Telxius Cable Puerto Rico, Inc. High capacity optical fiber network communications services	Puerto Rico	USD	24	50.01	% Telxius Cable América, S.A.

Edgar Filing: TELEFONICA S A - Form 6-K

Telxius Cable USA, Inc. High bandwidth communications services	US	USD	58	50.01	% Telxius Cable América, S.A.
---	----	-----	----	-------	----------------------------------

Telefónica, S.A. 142

Edgar Filing: TELEFONICA S A - Form 6-K

2018 Consolidated Financial Statements

Name and corporate purpose	Country	Currency	Capital	%Telefónica Group	Holding Company
Other Companies (cont.)					
Telxius Cable Ecuador, S.A. Sale of usage of data transmission capacity via an underwater optical fiber network	Ecuador	USD	5	50.01	Telxius Cable América, S.A. (50%) % Telxius Cable Perú, S.A.C. (0.01%)
Telxius Cable Chile, S.A. Involvement in businesses related to public or private telecommunications services	Chile	USD	37	50.01	% Telxius Cable América, S.A.
Telxius Cable Guatemala, S.A. Installation and operation of telecommunications networks for wholesalers	Guatemala	USD	24	50.01	% Telxius Cable América, S.A.
Telxius Cable Perú, S.A.C. Involvement in the operation and deployment of international telecommunications services via underwater cables and others means	Peru	USD	20	50.01	% Telxius Cable América, S.A.
Telxius Cable Colombia, S.A. Supply of data transmission capacity via underwater cable system	Colombia	USD	4	50.01	Telxius Cable América, S.A. (47.50%) Telxius Cable Chile, S.A. (0.83%) % Telxius Cable Perú, S.A.C. (0.84%) Telxius Cable Guatemala, S.A. (0.83%) Telxius Cable Argentina, S.A. (0.01%)
Telxius Cable Brasil Participações, Ltda. Holding company	Brazil	USD	62	50.01	% Telxius Cable América, S.A.
Telxius Cable Brasil, Ltda. Operation and deployment of telecommunications infrastructure	Brazil	USD	74	50.01	% Telxius Cable Brasil Participações, Ltda.
Telxius Cable Bolivia, S.A. Establishment and operation of any kind of communications infrastructure and/or network	Bolivia	USD	5	50.01	Telxius Cable América, S.A. (49.01%) % Telxius Cable España, S.L.U. (0.5%) Telxius Cable Argentina, S.A. (0.5%)
Telxius Torres Latam, S.L.U. Establishment and operation of any kind of communications infrastructure and/or network	Spain	EUR	8	50.01	% Telxius Telecom, S.A.
	Spain	EUR	10	50.01	%

Edgar Filing: TELEFONICA S A - Form 6-K

Telxius Torres España, S.L.U. Establishment and operation of any kind of communications infrastructure and/or network						Telxius Telecom, S.A.
Telxius Towers Germany, Gmbh. Establishment and operation of any kind of communications infrastructure and/or network	Germany	EUR	—	50.01	%	Telxius Telecom, S.A.
Telxius Torres Perú S.A.C. Establishment and operation of any kind of communications infrastructure and/or network	Peru	PEN	104	50.01	%	Telxius Torres Latam, S.L.U.
Telxius Torres Chile Holding, S.A. Holding company	Chile	EUR	8	50.01	%	Telxius Torres Latam, S.L.U. (50%) Telxius Torres España, S.L.U. (0.01%)
Telxius Torres Chile, S.A. Operation and deployment of telecommunications infrastructure	Chile	CLP	8,891	50.01	%	Telxius Torres Chile Holding, S.A.
Telxius Torres Brasil, Ltda. Establishment and operation of any kind of communications infrastructure and/or network	Brazil	BRL	764	50.01	%	Telxius Torres Latam, S.L.U.

Telefónica, S.A. 143

Edgar Filing: TELEFONICA S A - Form 6-K

2018 Consolidated Financial Statements

Name and corporate purpose	Country	Currency	Capital	%Telefónica Group	Holding Company
Other Companies (cont.)					
Telxius Torres Argentina, S.A. Establishment and operation of any kind of communications infrastructure and/or network	Argentina	ARS	1,005	50.01	% Telxius Torres Latam, S.L.U. (47.51%) % Telxius Telecom, S.A. (2.50%)
Latin American Cellular Holdings, S.L. Holding company	Spain	EUR	—	100	% Telefónica Latinoamérica Holding, S.L.
Telefónica International Wholesale Services II, S.L. International services provider	Spain	EUR	1	100	% Telefónica, S.A.
Telefónica International Wholesale Services México, S.A. Telecommunications research activities and projects	Mexico	MXN	31	100	% Telefónica International Wholesale Services II, S.L.
Telefónica Digital España, S.L. Developer Telco Services Holding Company	Spain	EUR	24	100	% Telefónica, S.A.
Wayra Investigación y Desarrollo S.L. Talent identification and development in ICT.	Spain	EUR	2	100	% Telefónica Digital España, S.L.
Wayra Chile Tecnología e Innovación Limitada Technological innovation based business project development	Chile	CLP	29,644	100	% Wayra Investigacion y Desarrollo, S.L.
Wayra Brasil Aceleradora de Projetos Ltda. Technological innovation based business project development	Brazil	BRL	43	100	% Wayra Investigación y Desarrollo S.L.
WY Telecom, S.A. de C.V. Talent identification and development in ICT	Mexico	MXN	153	100	% Wayra Investigacion y Desarrollo, S.L.
Wayra Argentina, S.A. Talent identification and development in ICT	Argentina	ARS	144	100	% Wayra Investigacion y Desarrollo, S.L. (95%) % Telefónica Latinoamérica Holding, S.L. (5%)
Wayra Colombia, S.A.S. Technological innovation based business project development	Colombia	COP	2,400	100	% Wayra Investigacion y Desarrollo, S.L.
Proyecto Wayra, C.A. Commercial, industrial and mercantile activities	Venezuela	VES	3,051	100	% Telefónica Venezolana, C.A.
Wayra Perú Aceleradora de Proyectos, S.A.C. Technological innovation based business project development	Peru	PEN	20	100	% Wayra Investigacion y Desarrollo, S.L.
	UK	GBP	—	100	%

Edgar Filing: TELEFONICA S A - Form 6-K

Wayra UK Ltd. Technological innovation based business project development					Wayra Investigación y Desarrollo, S.L.
Terra Networks Perú, S.A. ISP and portal	Peru	PEN	10	100	% Telefónica Latinoamérica Holding, S.L.
Terra Networks Argentina, S.A. ISP and portal	Argentina	ARS	58	100	% Telefónica Latinoamérica Holding, S.L. (99.99%) Telefónica International Holding, B.V. (0.01%)
Terra Networks México, S.A. de C.V. ISP, portal and real-time financial information services	Mexico	MXN	305	100	% Terra Networks Mexico Holding, S.A. de C.V.
Telfisa Global, B.V. Integrated cash management, consulting and financial support for Group companies	Netherlands	EUR	—	100	% Telefónica, S.A.
Telefónica Global Activities Holding, B.V. Holding Company	Netherlands	EUR	—	100	% Telfisa Global, B.V.
Telefónica Global Services, GmbH Purchasing services	Germany	EUR	—	100	% Group 3G UMTS Holding, GmbH

Telefónica, S.A. 144

Edgar Filing: TELEFONICA S A - Form 6-K

2018 Consolidated Financial Statements

Name and corporate purpose	Country	Currency	Capital	%Telefónica Group	Holding Company
Other Companies (cont.)					
Telefónica Global Roaming, GmbH Optimization of network traffic	Germany	EUR	—	100	% Telefónica Global Services, GmbH
Group 3G UMTS Holding GmbH Holding Company	Germany	EUR	250	100	% Telefónica Global Activities Holdings, B.V
Telefónica Compras Electrónicas, S.L. Development and provision of information Society services	Spain	EUR	—	100	% Telefónica Global Services, GmbH
Telefónica de Contenidos, S.A.U. Organization and operation of multimedia service-related business	Spain	EUR	226	100	% Telefónica, S.A.
Telefónica On The Spot Services, S.A.U. Provision of telemarketing services	Spain	EUR	1	100	% Telefónica de Contenidos, S.A.U.
Telefónica Educación Digital, S.L. Vertical e learning portal	Spain	EUR	1	100	% Telefónica Digital España, S.L.
Telfin Ireland Ltd. Intragroup financing	Ireland	EUR	—	100	% Telefónica, S.A.
Telefónica Ingeniería de Seguridad, S.A.U. Security services and systems	Spain	EUR	13	100	% Telefónica, S.A.
Telefónica Engenharia de Segurança do Brasil Ltda Security services and systems	Brazil	BRL	155	99.99	% Telefónica Ingeniería de Seguridad, S.A.U.
Telefónica Capital, S.A.U. Finance company	Spain	EUR	7	100	% Telefónica, S.A.
Lotca Servicios Integrales, S.L. Aircraft ownership and operation	Spain	EUR	17	100	% Telefónica, S.A.
Fonditel Pensiones, Entidad Gestora de Fondos de Pensiones, S.A Administration of pension funds	Spain	EUR	16	70	% Telefónica Capital, S.A.
Fonditel Gestión, Soc. Gestora de Instituciones de Inversión Colectiva, S.A. Administration and representation of collective investment schemes	Spain	EUR	2	100	% Telefónica Capital, S.A.
Telefónica Investigación y Desarrollo, S.A.U. Telecommunications research activities and projects	Spain	EUR	7	100	% Telefónica, S.A.
Media Networks Latin America, S.A.C Telecommunications research activities and projects	Peru	USD	91	100	% Telefónica Latinoamérica Holding, S.L.
Telefónica Luxembourg Holding, S.à.r.L. Holding company	Luxembourg	EUR	3	100	% Telefónica, S.A.
Casiopea Reaseguradora, S.A. Reinsurance	Luxembourg	EUR	4	100	% Telefónica Luxembourg Holding, S.à.r.L.

Edgar Filing: TELEFONICA S A - Form 6-K

Nova Casiopea RE S.A. Reinsurance	Luxembourg	EUR	15	100	% Telefónica Luxembourg Holding, S.à.r.L.
Telefónica Insurance, S.A. Direct insurance transactions	Luxembourg	EUR	23	100	% Telefónica Luxembourg Holding, S.à.r.L.
Telefónica Finanzas, S.A.U. Integrated cash management, consulting and financial support for Group companies	Spain	EUR	3	100	% Telefónica, S.A.
Pléyade Peninsular, Correduría de Seguros y Reaseguros del Grupo Telefónica, S.A. Distribution, promotion or preparation of insurance contracts	Spain	EUR	—	100	% Telefónica Finanzas, S.A.U. (TELFISA) (83.33%) Telefónica, S.A. (16.67%)

Telefónica, S.A. 145

2018 Consolidated Financial Statements

Name and corporate purpose	Country	Currency	Capital	%Telefónica Group	Holding Company
Other Companies (cont.)					
Fisatel Mexico, S.A. de C.V. Integrated cash management, consulting and financial support for Group companies	Mexico	MXN	3,505	100	% Telefónica, S.A.
Telefónica Europe, B.V. Fund raising in capital markets	Netherlands	EUR	—	100	% Telefónica, S.A.
Telefónica Participaciones, S.A.U. Financial debt instrument issuer	Spain	EUR	—	100	% Telefónica, S.A.
Telefónica Emisiones, S.A.U. Financial debt instrument issuer	Spain	EUR	—	100	% Telefónica, S.A.
Telefónica Global Technology, S.A.U. Global management and operation of IT systems	Spain	EUR	16	100	% Telefónica, S.A.
Aliança Atlântica Holding B.V. Holding company	Netherlands	EUR	150	100	Telefónica, S.A. (50%) % Telefônica Brasil, S.A. (50%)
Telefónica Serviços Empresariais do BRASIL, Ltda. Management and administrative services rendered	Brazil	BRL	45	99.99	% Telefónica Servicios Globales, S.L.U.
Telefónica Gestión Logística, S.A.C Logistic service provider	Peru	PEN	15	100	Telefónica Servicios Globales, S.L.U. (99.49%) % Telefónica del Perú, S.A.A. (0.51%)
Telefónica Gestión Integral de Edificios y Servicios S.L. Management and administrative services rendered	Spain	EUR	—	100	% Telefónica Servicios Globales, S.L.U.
Tempotel, Empresa de Trabajo Temporal, S.A. Temporary employment agency	Spain	EUR	—	100	% Telefónica Servicios Globales, S.L.U.
O2 Worldwide Limited Wireless telecommunications activities	UK	GBP	—	100	% Telefónica, S.A.
Telefónica Innovación Alpha, S.L. Electronic communications and audiovisual services provider	Spain	EUR	1	100	% Telefónica, S.A.
Telefónica Servicios Globales, S.L.U. Holding Company	Spain	EUR	1	100	% Telefónica, S.A.
Telefónica Holding Atticus, B.V. Holding company	Netherlands	EUR	—	100	% Telefónica Latinoamérica Holding, S.L.
Telefónica Chile Holdings, S.L. Holding Company	Chile	CLP	—	100	% Telefónica, S.A.
Other companies held for sale	Spain	EUR	51	100	% Telefónica, S.A.

Seguros de Vida y Pensiones Antares,
S.A.

Life insurance, pensions and health
insurance

Telefónica Móviles El Salvador, S.A. de
C.V.

Provision of wireless and international
long distance communications services

Telefónica Móviles Guatemala, S.A.

Wireless, wireline and radio paging
communications services provider

El Salvador USD 42 59.58

Guatemala GTQ 1,396 60

Telefónica Centroamérica
Inversiones S.L. (59.46%)
%
Telefónica Multiservicios
S.A. de C.V. (0.12%)
Telefónica Centroamérica
Inversiones S.L. (0.01%)
%
Guatemala Cellular
Holdings, B.V. (59.99%)

Telefónica, S.A. 146

Edgar Filing: TELEFONICA S A - Form 6-K

2018 Consolidated Financial Statements

Name and corporate purpose	Country	Currency	Capital	%Telefónica Group	Holding Company
Companies accounted for using the equity method					
Telefónica Factoring España, S.A. Factoring services provider	Spain	EUR	5	50	% Telefónica, S.A. Telefónica, S.A. (40.00%)
Telefónica Factoring Do Brasil, Ltd. Factoring services provider	Brazil	BRL	5	50	% Telefónica Factoring España, S.A. (10.00)% Telefónica, S.A. (40.50%)
Telefónica Factoring Mexico, S.A. de C.V. SOFOM ENR Factoring services provider	Mexico	MXN	34	50	% Telefónica Factoring España, S.A. (9.50)% Telefónica, S.A. (40.50%)
Telefónica Factoring Perú, S.A.C. Factoring services provider	Peru	PEN	6	50	% Telefónica Factoring España, S.A. (9.50)% Telefónica, S.A. (40.50%)
Telefónica Factoring Colombia, S.A. Factoring services provider	Colombia	COP	4,000	50	% Telefónica Factoring España, S.A. (9.50)% Telefónica Internacional Holding, B.V (26.28%)
Mobile Financial Services Holding SPRL Financial services	Belgica	USD	197	50	% Telefónica Holding Atticus, B.V (23.72%)