

TELEFONICA S A  
Form 20-F  
February 26, 2016

**As filed with the Securities and Exchange Commission on February 26, 2016**

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 20-F**

**(Mark One)**

REGISTRATION STATEMENT PURSUANT TO SECTION 12(b)  
OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2015

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934

OR

SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934

**Commission file number: 001-09531**

**TELEFÓNICA, S.A.**

(Exact name of Registrant as specified in its charter)

**KINGDOM OF SPAIN**

(Jurisdiction of incorporation or organization)

**Distrito Telefónica, Ronda de la Comunicación, s/n  
28050 Madrid, Spain**

(Address of principal executive offices)

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(Name, Telephone, E-Mail and/or Facsimile number and Address of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
<b>Ordinary Shares, nominal value 1.00 euro per share*</b>	<b>New York Stock Exchange</b>
<b>American Depositary Shares, each representing one Ordinary Share</b>	<b>New York Stock Exchange</b>

**Guarantees\*\* by Telefónica, S.A. of the \$1,250,000,000 Fixed Rate Guaranteed Senior Notes Due 2016; \$700,000,000 Fixed Rate Guaranteed Senior Notes Due 2017; \$500,000,000 Floating Rate Guaranteed Senior Notes Due 2017; \$1,250,000,000 Fixed Rate Guaranteed Senior Notes Due 2018; \$1,000,000,000 Fixed Rate Notes Due 2019; \$1,400,000,000 Fixed Rate Guaranteed Senior Notes Due 2020; \$1,500,000,000 Fixed Rate Guaranteed Senior Notes Due 2021; \$750,000,000 Fixed Rate Guaranteed Senior Notes Due 2023; \$2,000,000,000 Fixed Rate Guaranteed Senior Notes Due 2036; each of Telefónica Emisiones, S.A.U.; and of the \$1,250,000,000 Fixed Rate Guaranteed Senior Notes Due 2030 of Telefónica Europe, B.V.**

**New York  
Stock  
Exchange**

\* Not for trading, but only in connection with the listing of American Depositary Shares, pursuant to the requirements of the New York Stock Exchange.

Not for trading, but only in connection with the listing of the \$1,250,000,000 Fixed Rate Guaranteed Senior Notes Due 2016; \$700,000,000 Fixed Rate Guaranteed Senior Notes Due 2017; \$500,000,000 Floating Rate Guaranteed Senior Notes Due 2017; \$1,250,000,000 Fixed Rate Guaranteed Senior Notes Due 2018; \$1,000,000,000 Fixed Rate Notes Due 2019; \$1,400,000,000 Fixed Rate Guaranteed Senior Notes Due 2020; \$1,500,000,000 Fixed Rate Guaranteed Senior Notes Due 2021; \$750,000,000 Fixed Rate Guaranteed Senior Notes Due 2023; and \$2,000,000,000 Fixed Rate Guaranteed Senior Notes Due 2036; each of Telefónica Emisiones, S.A.U., and the \$1,250,000,000 Fixed Rate Guaranteed Senior Notes Due 2030 of Telefónica Europe, B.V. (each a wholly-owned subsidiary of Telefónica, S.A.)

Securities registered or to be registered pursuant to Section 12(g) of the Act: None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: None

The number of outstanding shares of each class of capital stock of Telefónica, S.A. at December 31, 2015 was:

**Ordinary Shares, nominal value 1.00 euro per share: 4,975,199,197**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

**Yes No**

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

**Yes No**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

**Yes No**

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

**Yes No**

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of “accelerated filer” and “large accelerated filer” in Rule 12b-2 of the Securities Exchange Act.

**Large accelerated filer      Accelerated filer      Non-accelerated filer**

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

**U.S. GAAP   International Financial Reporting Standards as Issued by the International Accounting Standards Board   Other**

If “Other” has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.

**Item 17**      **Item 18**

If this is an annual report indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act).

**Yes**    **No**

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report contains statements that constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), Section 21E of the Securities Exchange Act of 1934 (the “Exchange Act”), as amended, and the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The forward-looking statements in this Annual Report can be identified, in some instances, by the use of words such as “will,” “shall,” “target,” “expect,” “aim,” “hope,” “anticipate,” “should,” “may,” “might,” “assume,” “estimate,” “plan,” and similar language or other formulations of a similar meaning or, in each case, the negative formulations thereof. Other forward-looking statements can be identified in the context in which the statements are made or by the forward-looking nature of discussions of strategy, plans or intentions. These statements appear in a number of places in this Annual Report including, without limitation, certain statements made in “Item 3. Key Information—Risk Factors,” “Item 4. Information on the Company,” “Item 5. Operating and Financial Review and Prospects” and “Item 11. Quantitative and Qualitative Disclosures About Market Risk” and include statements regarding our intent, belief or current expectations with respect to, among other things:

- the effect on our results of operations of competition in telecommunications markets;
- trends affecting our business financial condition, results of operations or cash flows;
- ongoing or future acquisitions, investments or divestments (including the sale of Telefónica Europe plc);
  - our capital expenditures plan;
  - our estimated availability of funds;
  - our ability to repay debt with estimated future cash flows;
  - our shareholder remuneration policies;
- supervision and regulation of the telecommunications sectors where we have significant operations;
  - our strategic partnerships;
- the potential for growth and competition in current and anticipated areas of our business; and

· the outcome of pending or future litigation or other legal proceedings.

Such forward-looking statements are not guarantees of future performance and involve numerous risks and uncertainties, and actual results may differ materially from those anticipated in the forward-looking statements as a result of various factors. The risks and uncertainties involved in our businesses that could affect the matters referred to in such forward-looking statements include but are not limited to:

· changes in general economic, business or political conditions in the domestic or international markets in which we operate or have material investments that may affect demand for our services;

· exposure to currency exchange rates, interest rates or credit risk related to our treasury investments or in some of our financial transactions;

· existing or worsening conditions in the international financial markets;

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the impact of current, pending or future legislation and regulation in countries where we operate, as well as any failure to renew or obtain the necessary licenses, authorizations and concessions to carry out our operations and the impact of limitations in spectrum capacity;

- compliance with anti-corruption laws and regulations and economic sanctions programs;

- customers' perceptions of services offered by us;

the actions of existing and potential competitors in each of our markets as well as the potential effects of technological changes;

- failure of suppliers to provide necessary equipment and services on a timely basis;

- the impact of unanticipated network interruptions including due to cyber-security actions;

- the effect of reports suggesting that electromagnetic fields may cause health problems;

the impact of impairment charges on our goodwill and assets as a result of changes in the regulatory, business or political environment;

potential liability resulting from our internet access and hosting services arising from illegal or illicit use of the internet, including the inappropriate dissemination or modification of consumer data; and

- the outcome of pending or future litigation or other legal proceedings.

Readers are cautioned not to place undue reliance on those forward-looking statements, which speak only as of the date of this Annual Report. We do not undertake any obligation to update any forward-looking statements that may be made to reflect events or circumstances after the date of this Annual Report including, without limitation, changes in our business or acquisition strategy or planned capital expenditures, or to reflect the occurrence of unanticipated events.

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CERTAIN TERMS AND CONVENTIONS

Our ordinary shares, nominal value 1.00 euro per share, are currently listed on each of the Madrid, Barcelona, Bilbao and Valencia stock exchanges (collectively, the “**Spanish Stock Exchanges**”) and are quoted through the Automated Quotation System under the symbol “TEF.” They are also listed on the London and Buenos Aires stock exchanges. American Depositary Shares (“**ADSs**”), each representing the right to receive one ordinary share, are listed on the New York Stock Exchange and on the Lima Stock Exchange. ADSs are evidenced by American Depositary Receipts (“**ADRs**”) issued under a Deposit Agreement with Citibank, N.A., as Depositary.

As used herein, “**Telefónica**,” “**Telefónica Group**,” “**Group**”, the “**Company**” and terms such as “**we**,” “**us**” and “**our**” mean Telefónica, S.A. and its consolidated subsidiaries, unless the context requires otherwise.

As used herein, “**Atento**” means Atento Holding, Inversiones y Teleservicios, S.A. and its consolidated subsidiaries, unless the context requires otherwise.

Below are definitions of certain technical terms used in this Annual Report:

“**Access**” refers to a connection to any of the telecommunications services offered by Telefónica. Telefónica presents its customer base using accesses as a data point because the integration of telecommunications services in bundled service packages has changed the way residential and corporate customers contract for Telefónica’s services. A single fixed customer may contract for multiple services, and Telefónica believes that it is more useful to count the number of accesses a customer has contracted for, than to merely count the number of Telefónica’s customers. For example, a customer that has fixed line telephony service and broadband service is counted as two accesses rather than as one customer. For mobile customers, Telefónica counts each active SIM as an access regardless of the number of services contracted through the SIM, e.g. voice and data.

“**ARPU**” is the average revenues per user per month. ARPU is calculated by dividing total gross service revenues (excluding inbound roaming revenues) from sales to customers for the preceding 12 months by the weighted average number of accesses for the same period, and then dividing by 12.

“**Bundles**” refer to combination products that combine fixed services (wirelines, broad band and television) and mobile services.

“**Churn**” is the percentage of disconnections over the average customer base in a given period.

“**Cloud computing**” is the delivery of computing as a service rather than a product, whereby shared resources, software and information are provided to computers and other devices as a utility over a network (typically the Internet).

“**Commercial activity**” includes the addition of new lines, replacement of handsets and migrations.

“**Data ARPU**” is the average data revenues per user per month. Data ARPU is calculated by dividing total data revenues from sources such as Short Message Service (SMS), Multimedia Messaging Services (MMS), other mobile data services such as mobile connectivity and mobile Internet, premium messaging, downloading ringtones and logos, mobile mail and wireless application protocol (WAP) connectivity from sales to customers for the preceding 12 months by the weighted average number of accesses for the same period, and then dividing by 12.

“**Data revenues**” include revenues from SMS, MMS, other mobile data services such as mobile connectivity and mobile Internet, premium messaging, downloading ringtones and logos, mobile mail and WAP connectivity from sales to customers.

“**Data traffic**” includes all traffic from Internet access, messaging (SMS, MMS) and connectivity services that is transported by the networks owned by Telefónica.

“**FaaST**” is a cybersecurity technology that scans an organization’s system 24 hours a day, seven days a week, in order to prevent cybernetic attacks.

“**Final client accesses**” means accesses provided directly to residential and corporate clients.

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**“Fixed telephony accesses”** includes public switched telephone network, or PSTN, lines (including public use telephony), and integrated services digital network, or ISDN, lines and circuits. For purposes of calculating Telefónica’s number of fixed line accesses, Telefónica multiplies its lines in service as follows: PSTN (x1); basic ISDN (x1); primary ISDN (x30, x20 or x10); 2/6 digital accesses (x30).

**“Fixed termination rates”** is an established fixed network tariff that applies when a customer makes a call to someone in a network operated by another operator.

**“FTTx”** is a generic term for any broadband network architecture that uses optical fiber to replace all or part of the metal local loop.

**“Gross adds”** means the gross increase in the customer base measured in terms of accesses in a period.

**“HDTV”** or “high definition TV” has at least twice the resolution of standard definition television (SDTV), allowing it to show much more detail than an analog television or digital versatile disc (DVD).

**“Incoming revenues”** refers to the interconnection revenues derived from the completion of calls made from outside mobile or fixed carriers into Telefónica’s network.

**“Interconnection revenues”** means revenues received from other operators which use Telefónica’s networks to connect or to finish their calls and SMS or connect to their customers.

**“Internet and data accesses”** include broadband accesses (including retail asymmetrical digital subscriber line “ADSL,” very high bit-rate digital subscriber line “VDSL”, satellite, fiber optic and circuits over 2 Mbps), narrowband accesses (Internet service through the PSTN lines) and the remaining non-broadband final customer circuits. Internet and data accesses also include “Naked ADSL”, which allows customers to subscribe for a broadband connection without a monthly fixed line fee.

**“IPTV” (Internet Protocol Television)** refers to distribution systems for television subscription signals or video using broadband connections over the IP protocol.

**“ISP”** means Internet service provider.

**“IT”**, or information technology, is the acquisition, processing, storage and dissemination of vocal, pictorial, textual and numerical information by a microelectronics-based combination of computing and telecommunications.

**“Latch”** is a cybernetic application, protecting accounts and on-line services.

**“Local loop”** means the physical circuit connecting the network termination point at the subscriber’s premises to the main distribution frame or equivalent facility in the fixed public telephone network.

**“LTE”** means Long Term Evolution, a 4G mobile access technology.

**“M2M”**, or machine to machine, refers to technologies that allow both mobile and wired systems to communicate with other devices of the same ability.

**“Market share”** is the percentage ratio of the number of final accesses or operator revenues over the existing total market in an operating area.

**“Metashield”** is a cybernetic product for protecting metadata (information on data) in digital documents and archives.

**“Mobile accesses”** includes accesses to the mobile network for voice and/or data services (including connectivity). Mobile accesses are categorized into contract and pre-pay accesses.

**“Mobile broadband”** includes Mobile Internet (Internet access from devices also used to make voice calls such as smartphones), and Mobile Connectivity (Internet access from devices that complement fixed broadband, such as PC Cards/dongles, which enable large amounts of data to be downloaded on the move).

**“MTR”** means mobile termination rate, which is the charge per minute or SMS paid by a telecommunications network operator when a customer makes a call to another network operator.





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“**MVNO**” means mobile virtual network operator, which is a mobile operator that is not entitled to use spectrum for the provision of mobile services. Consequently, an MVNO must subscribe to an access agreement with a mobile network operator in order to provide mobile access to their customers. An MVNO pays a determined tariff to such a mobile network operator for using the infrastructure to facilitate coverage to their customers.

“**Net adds**” means the number of new accesses in a certain period.

“**Non SMS data revenues**” means data revenues excluding SMS revenues.

“**OTT services**” or “**over the top services**” means services provided through the Internet (such as television).

“**Outgoing revenues**” refers to mobile voice or data revenues (SMS, MMS) derived from our consumers’ consumed service.

“**P2P SMS**” means person to person short messaging service (usually sent by mobile customers).

“**Pay TV**” includes cable TV, direct to home satellite TV, or DTH, and Internet Protocol TV, or IPTV.

“**Revenues**” means net sales and revenues from rendering of services.

“**Service revenues**” means revenues less revenues from handset sales. Service revenues are mainly related to telecommunications services, especially voice revenues and data revenues (SMS and data traffic download and upload revenues) consumed by Telefónica’s customers.

“**SIM**” means subscriber identity module, a removable intelligent card used in mobile handsets, USB modems, etc. to identify the user in the network.

**“Tacyt”** is a cybersecurity tool that supervises, stores, analyzes, correlates and classifies mobile applications.

**“Unbundled local loop” or “ULL”** includes accesses to both ends of the copper local loop leased to other operators to provide voice and DSL services (fully unbundled loop, fully ULL) or only DSL service (shared unbundled loop, “shared ULL”).

**“VoiceTraffic”** means voice minutes used by Telefónica’s customers over a given period, both outbound and inbound.

**“VoIP”** means voice over Internet protocol.

**“Wholesale accesses”** means accesses Telefónica provides to its competitors, who then sell services over such accesses to their residential and corporate clients.

**“Wholesale ADSL”** means accesses of broadband or fiber that we provide to our competitors, who then sell services over such accesses to their residential and corporate clients.

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PRESENTATION OF CERTAIN FINANCIAL INFORMATION

In this Annual Report, references to “U.S. dollars,” “dollars” or “\$,” are to United States dollars, references to “pounds sterling,” “sterling” or “£” are to British pounds sterling, references to “reais” refer to Brazilian reais and references to “euro”, “euros” or “€” are to the single currency of the participating member states in the Third Stage of the European Economic and Monetary Union pursuant to the treaty establishing the European Community, as amended from time to time.

Our consolidated financial statements as of December 31, 2014 and 2015, and for the years ended December 31, 2013, 2014 and 2015 included elsewhere in this Annual Report including the notes thereto (the “Consolidated Financial Statements”), are prepared in conformity with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”).

**Retrospective revisions**

The consolidated income statement and cash flow data for the years ended December 2013 and 2014 (and also for the years ended December 2011 and 2012 in “Item 3. Key Information Selected Financial Data”) included in this Annual Report has been retrospectively revised to show the reclassification of the results attributable to our operations in the United Kingdom as discontinued operations. This reclassification resulted from the signing of an agreement on March 24, 2015 between us and Hutchison 3G UK Investments Limited and Hutchison 3G UK Holdings (CI) Limited (together, “Hutchison”), for the sale and purchase of the entire issued share capital of Telefónica Europe plc. A breakdown of the results and cash flows for discontinued operations is included in Note 23 to our Consolidated Financial Statements. This reclassification has had no impact on our previously reported consolidated statement of financial position as of the end of prior periods. Completion of the sale of Telefónica Europe plc is subject, among other conditions, to the approval of the applicable regulatory authorities and the obtainment of waivers to certain contractual provisions affected by the sale, including those related to network alliances as well as change of control provisions under certain contractual arrangements with third parties. The sale purchase agreement entered into with Hutchison establishes that the conditions must be satisfied by no later than June 30, 2016; however, this date may be extended to September 30, 2016 in specified circumstances.

In addition, our 2014 and 2013 financial information by operating segment has been revised to reflect our current reporting structure: Telefónica Spain, Telefónica Brazil, Telefónica Germany and Telefónica Hispanoamérica (formed by the Group’s operators in Argentina, Chile, Peru, Colombia, Mexico, Venezuela and Central America, Ecuador and Uruguay). Our prior organizational structure, which was approved by the Board of Directors of Telefónica, S.A. on February 26, 2014, was made up of one additional segment: Telefónica UK, which consisted of our operations in the United Kingdom.

Moreover, our consolidated statement of financial position as of December 31, 2014 has been adjusted to reflect the finalization of the purchase price allocation for the acquisition of E-Plus Mobilfunk GmbH Co KG (“**E-Plus**”). The impact of such finalization on our 2014 net income was immaterial and adjusted against retained profits as of December 31, 2014. As a result, we have not restated the consolidated income statement for the year ended December 31, 2014 in connection with this finalization.

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PART I

Item 1. Identity of Directors, Senior Management and Advisors

A. Directors and Senior Management

Not applicable.

B. Advisors

Not applicable.

C. Auditors

Not applicable.

Item 2. Offer Statistics and Expected Timetable

Not applicable.

Item 3. Key Information

A. Selected Financial Data

The following table presents certain selected consolidated financial data. It is to be read in conjunction with “Item 5. Operating and Financial Review and Prospects”, “Item 4. Information on the Company—Business Overview” and the Consolidated Financial Statements. The consolidated income statement and cash flow data for the years ended December 31, 2013, 2014 and 2015 and the consolidated statement of financial position data as of December 31, 2014 and 2015 set forth below are derived from, and are qualified in their entirety by reference to the Consolidated Financial Statements. The consolidated income statement and cash flow data for the years ended December 31, 2011, 2012, 2013 and 2014 set forth below have been retrospectively revised to show the reclassification of the results attributable to our operations in the United Kingdom as discontinued operations and are not derived from Telefónica, S.A.’s consolidated financial statements for such years, which are not included herein. See “Presentation of Certain Financial Information Retrospective revisions”. The consolidated statement of financial position data as of December 31, 2014 set forth below has been retrospectively revised to show the finalization of the purchase price allocation for the acquisition of E-Plus and is not derived from Telefónica, S.A.’s consolidated financial statements for such year, which are not included herein. See “Presentation of Certain Financial Information Retrospective revisions”. The consolidated statement of financial position data as of December 31, 2011, 2012 and 2013 set forth below are derived from Telefónica, S.A.’s consolidated financial statements for such years, which are not included herein.

Our Consolidated Financial Statements have been prepared in accordance with IFRS as issued by the IASB.

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The basis of presentation is described in detail in Note 2 to our Consolidated Financial Statements.

Millions of euros	2011	2012	2013	2014	2015
Revenues	55,977	55,337	50,547	43,458	47,219
Other income	2,037	2,164	1,491	1,521	1,841
Supplies	(14,712)	(14,461)	(13,758)	(11,750)	(12,910)
Personnel expenses	(10,534)	(8,097)	(6,659)	(6,621)	(9,800)
Other expenses	(14,303)	(15,367)	(14,144)	(12,827)	(14,936)
Depreciation and amortization	(9,084)	(9,440)	(8,616)	(7,431)	(8,517)
OPERATING INCOME	9,381	10,136	8,861	6,350	2,897
<b>Share of profit (loss) of investments accounted for by the equity method</b>	<b>(635)</b>	<b>(1,275)</b>	<b>(291)</b>	<b>(498)</b>	<b>(5)</b>
Net finance expense	(2,742)	(3,047)	(2,675)	(2,479)	(2,310)
Net exchange differences	(158)	(596)	(167)	(300)	(271)
<b>Net financial expense</b>	<b>(2,900)</b>	<b>(3,643)</b>	<b>(2,842)</b>	<b>(2,779)</b>	<b>(2,581)</b>
PROFIT BEFORE TAX	5,846	5,218	5,728	3,073	311
Corporate income tax	(166)	(1,443)	(1,201)	(260)	(13)
PROFIT AFTER TAX FROM CONTINUING OPERATIONS	5,680	3,775	4,527	2,813	298
<b>Profit after tax from discontinued operations</b>	<b>504</b>	<b>628</b>	<b>442</b>	<b>439</b>	<b>2,582</b>
PROFIT FOR THE YEAR	6,184	4,403	4,969	3,252	2,880
Non-controlling interests	(781)	(475)	(376)	(251)	(135)
PROFIT FOR THE YEAR ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT	5,403	3,928	4,593	3,001	2,745
Weighted average number of shares-Basic (thousands)(1)	4,803,739	4,711,457	4,736,401	4,714,374	4,928,478
Basic and diluted earnings (loss) per share from continuing operations attributable to equity holders of the parent (euro)(1)	1.02	0.70	0.87	0.50	(0.02)
Basic and diluted earnings per share from discontinued operations attributable to equity holders of the parent (euro)(1)	0.10	0.13	0.09	0.09	0.52
Basic and diluted earnings per share attributable to equity holders of the parent (euro)(1)	1.12	0.83	0.96	0.60	0.51
Basic and diluted earnings (loss) per ADS (euro)(1)(2)	1.12	0.83	0.87	0.50	(0.02)
Weighted average number of ADS-Basic (thousands)(1)(2)	4,803,739	4,711,457	4,736,401	4,714,374	4,928,478
Dividends per ordinary share (cash and scrip) (euro)	1.52	0.83	0.35	0.75	0.75
Dividends per ordinary share (cash and scrip) (\$)(3)	2.14	1.06	0.47	0.98	0.83
Consolidated Statement of Financial Position Data					
Cash and cash equivalents	4,135	9,847	9,977	6,529	2,599
Property, plant and equipment	35,469	35,021	31,040	33,156	30,549
Total assets	129,623	129,773	118,862	122,348	122,974



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Non-current liabilities	69,662	70,601	62,236	62,318	60,549
Equity net	27,383	27,661	27,482	30,321	27,556
Capital stock	4,564	4,551	4,551	4,657	4,975
Consolidated Cash Flow Data					
Net cash provided by operating activities	17,483	15,213	14,344	12,193	13,615
Net cash provided by operating activities from continuing operations	16,107	13,588	12,907	10,879	11,831
Net cash provided by operating activities from discontinued operations	1,376	1,625	1,437	1,314	1,784
Net cash used in investing activities	(12,497)	(7,877)	(9,900)	(9,968)	(12,917)
Net cash used in investing activities from continuing operations	(11,773)	(6,880)	(8,604)	(9,076)	(11,751)
Net cash used in investing activities from discontinued operations	(724)	(997)	(1,296)	(892)	(1,166)
Net cash used in financing activities	(4,912)	(1,243)	(2,685)	(4,041)	(3,612)
Net cash used in financing activities from continuing operations	(4,910)	(1,243)	(2,704)	(4,041)	(3,612)
Net cash (used)/provided by financing activities from discontinued operations	(2)	-	18	-	-

The per share and per ADS computations for all periods presented have been presented using the weighted average number of shares and ADSs, respectively, outstanding for each period, and have been adjusted to reflect the stock dividends which occurred during the periods presented, as if these had occurred at the beginning of the earliest period presented and have also been adjusted for mandatorily convertible notes issued in 2014. In accordance with (1) IAS 33 (“Earnings per share”), the weighted average number of ordinary shares and ADSs outstanding for each of the periods covered has been restated to reflect the issuance of shares pursuant to Telefónica’s scrip dividend in June 2012, December 2014 and December 2015. As a consequence, basic and diluted earnings per share have also been restated from 2011 to 2014.

Until January 20, 2011, each ADS represented the right to receive three ordinary shares. Since January 21, 2011, (2) each ADS represents the right to receive one ordinary share. The above figures have been restated accordingly. Figures do not include any charges of the ADS Depositary.

(3) Quantities in U.S. dollars are calculated in accordance with the conversion rate published by the Depositary (Citibank, N.A.) in connection with each dividend payment.

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## Exchange Rate Information

As used in this Annual Report, the term “Noon Buying Rate” refers to the rate of exchange for euro, expressed in U.S. dollars per euro, in the City of New York for cable transfers payable in foreign currencies as certified by the Federal Reserve Bank of New York for customs purposes. The Noon Buying Rate certified by the New York Federal Reserve Bank for the euro on February 19, 2016 was \$1.1127 = 1.00 euro. The following tables describe, for the periods and dates indicated, information concerning the Noon Buying Rate for the euro. Amounts are expressed in U.S. dollars per 1.00 euro.

## Noon Buying Rate

Year ended December 31,	Period end	Average (1)	High	Low
2011	1.2973	1.4002	1.4875	1.2926
2012	1.3186	1.2909	1.3463	1.2062
2013	1.3779	1.3303	1.3816	1.2774
2014	1.2101	1.3155	1.3816	1.2447
2015	1.0859	1.1032	1.2015	1.0524
2016 (through February 19, 2016)	1.1127	1.0980	1.1362	1.0743

Source: Federal Reserve Bank of New York.

(1) The average of the Noon Buying Rates for the euro on the last day reported of each month during the relevant period.

## Noon Buying Rate

Month ended	High	Low
August 31, 2015	1.1580	1.0868
September 30, 2015	1.1358	1.1104
October 31, 2015	1.1437	1.0963
November 30, 2015	1.1026	1.0562
December 31, 2015	1.1025	1.0573
January 31, 2015	1.0964	1.0743
February 26, 2015 (through February 19, 2016)	1.1362	1.0888

Source: Federal Reserve Bank of New York.

Monetary policy within the member states of the euro zone is set by the European Central Bank.

Our ordinary shares are quoted on the Spanish Stock Exchanges in euro. Currency fluctuations may affect the dollar equivalent of the euro price of our shares listed on the Spanish Stock Exchanges and, as a result, the market price of our ADSs, which are listed on the New York Stock Exchange. Currency fluctuations may also affect the dollar

amounts received by holders of ADSs on conversion by the depositary of any cash dividends paid in euro on the underlying shares.

Our consolidated results are affected by fluctuations between the euro and the currencies in which the revenues and expenses of some of our consolidated subsidiaries are denominated and recorded (principally the Brazilian real, the pound sterling, the Argentine peso, the Peruvian nuevo sol, the Chilean peso, the Colombian peso, the Mexican peso and the Venezuelan bolívar fuerte). See Note 3 (b) to our Consolidated Financial Statements for information on the exchange rate translation methodology we used in preparing our consolidated financial information.

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B. Capitalization and Indebtedness

Not applicable.

C. Reasons for the Offer and Use of Proceeds

Not applicable.

D. Risk Factors

The Telefónica Group's business is conditioned 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 the Company which could affect its business, financial position, reputation, corporate image and brand and its results of operations, must be considered jointly with the information in the Consolidated Financial Statements, and are as follows:

Group-Related Risks

***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 various legislations, as well as to the political and economic environments of the countries in which it operates. Any adverse developments or even uncertainties in these countries, including exchange-rate or sovereign-risk fluctuations, may adversely affect the business, financial position, cash flows 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.

Growth in Europe may be affected by political uncertainty in some European countries (including Spain), a possible revival of the crisis in Greece, restructuring of the banking sector, the impact of steps taken towards a EU banking union and a capital markets union and the referendum to be held in the near future in the United Kingdom, among others. In 2015, the Telefónica Group obtained 26.3% of its revenues in Spain and 16.7% in Germany.

In Latin America, higher exchange rate risks stand out after the large depreciation undergone by most currencies in this region, affected by the fall in commodity prices, the uncertainties about growth in China, and the interest rate evolution in the United States, among other macroeconomic factors. Abrupt exchange rate movements could especially be triggered by scenarios characterized by high inflation and fiscal and external deficits. In this regard, it should be noted that the Venezuelan bolivar exchange rate quoted in SIMADI has remained stable for a year despite the high increase in prices accumulated over this period, increasing the risk of readjustment. In addition, the Argentine peso (which already experienced a sharp depreciation in December 2015) is experiencing some depth constraints in its trading market, and the Brazilian real (which also experienced a depreciation in 2015) has remained volatile at the beginning of 2016. Cash flows from countries in this region could decrease, and financial conditions could become more unfavorable if any of these elements were to worsen in the future.

Some of the most significant macroeconomic risk factors in the region affect Brazil, where there is a combination of high inflation, negative economic growth rates and significant internal and external financing needs. All these elements have led to new downgrades to the country's credit rating.

Moreover, the recent fall in oil prices and other commodity prices is having a negative impact on the external and fiscal accounts in Chile, Peru, Colombia, Mexico, and Ecuador (which has a dollarized economy, and is currently experiencing a lower supply of U.S. dollars).

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In Argentina, the new government is focused on resolving Argentina's macroeconomic and financial imbalances and on recovering international confidence. Although reforms taking place may have positive effects in the medium term, short term risks persist.

In Venezuela after the parliamentary elections in which the Democratic Unity Roundtable (an opposition coalition to the ruling United Social Party of Venezuela) claimed the majority of seats in the National Assembly, a new economic emergency decree was announced which could increase state control on private businesses. In addition, there continues to be very limited access to U.S. dollars.

For the year ended December 31, 2015, Telefónica Hispanoamérica and Telefónica Brazil represented 30.5% and 23.4% of the Telefónica Group's revenues, respectively. Moreover, approximately 35.6% of the Group's revenues in the telephony business were generated in countries that do not have investment grade status (in order of importance Brazil, Argentina, Ecuador, Venezuela, Nicaragua, Guatemala, El Salvador and Costa Rica), and other countries are only one notch away from losing this threshold. At December 31, 2015 the percentage of Telefónica's net financial debt in Latin American currencies stood at 13%.

"Country risk" factors include the following, among others:

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;
- expropriation or nationalization of assets, adverse tax decisions, or other forms of state intervention;
- economic-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 will be 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 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, interest rates or financial investment risks.*

At December 31, 2015, 49.1% of the Group's net debt was pegged to fixed interest rates for a period greater than one year, while 28% was denominated in a currency other than the euro.

To illustrate the sensitivity of financial expenses to a change in short-term interest rates at December 31, 2015: (i) a 100 basis points increase in interest rates in all currencies in which Telefónica has a financial position at that date would lead to an increase in financial expenses of 245 million euros, (ii) whereas a 100 basis points decrease in interest rates in all currencies except the euro, the U.S. dollar and the pound sterling (these to zero rates in order to avoid negative rates), would lead to a reduction in financial expenses of 75 million euros. These calculations were made assuming a constant currency and a balance position equivalent to the position at that date and bearing in mind the derivative financial instruments arranged.

According to the Group's calculations, the impact on net financial expense by changes in the value of 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 33 million euros, primarily due to the weakening of the Venezuelan bolívar fuerte and the Argentine peso. These calculations were made assuming a constant currency position with an impact on profit or loss at December 31, 2015, including derivative instruments in place. At December 31, 2015, 31.3% of the Telefónica Group's operating income before depreciation and amortization (OIBDA) was concentrated in Telefónica Brazil and 38.2% in Telefónica Hispanoamérica.

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The Telefónica Group uses a variety of strategies to manage these risks, mainly through the use of financial derivatives, which themselves also expose us to risk, including counterparty risk. Furthermore, 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 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 performance, expansion and improvement of the Telefónica Group's networks, the development and distribution of the Telefónica Group's services and products, the development and 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 the Company, 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 or cash flows.

Funding could be more difficult and costly in the event of a significant deterioration of conditions in the international or local financial markets (especially considering the recent volatility resulting from uncertainties regarding China, the decline in commodity prices and the hikes in interest rates approved by the Federal Reserve, all of which impact Latin America), or if there is an eventual deterioration in the solvency or operating performance of the Company, or if Telefónica's divestment of its operations in the United Kingdom were to not be completed, or as a consequence of a credit rating downgrade of Spanish sovereign risk by rating agencies.

At December 31, 2015, gross financial debt scheduled to mature in 2016 amounted to 11,275 million euros (which includes the net position of derivative financial instruments and certain current payables), and gross financial debt scheduled to mature in 2017 amounted to 8,461 million euros.

In accordance with its liquidity policy, the Company has fully covered its gross debt maturities until the end of 2016 with cash and credit lines available at December 31, 2015, including a syndicated credit facility signed in November 2015 with several national and foreign institutions amounting to 3,000 million euros with a maturity of up to 27 months. Our liquidity could be affected if Telefónica's divestment of its operations in the United Kingdom is finally not consummated, or if market conditions make it difficult to renew existing undrawn credit lines, 8.7% of which, at December 31, 2015, were scheduled to mature prior to December 31, 2016.



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; which could have, as well, a negative effect on the Group's business, financial condition, results of operations or cash flows.

*Telefónica's divestment of its operations in the United Kingdom may not materialize.*

On March 24, 2015, Telefónica and Hutchison signed an agreement for the acquisition by the latter of Telefónica's operations in the UK (O2 UK) for a price (firm value) of 10,250 million pounds sterling in cash (approximately 14,000 million euros at the exchange rate as of the date of the agreement), composed of (i) an initial amount of 9,250 million pounds sterling (approximately 12,640 million euros as of the date of the agreement) which would be paid at closing and (ii) an additional deferred payment of 1,000 million pounds sterling (approximately 1,360 million euros) to be paid once the cumulative cash flow of the combined company in the United Kingdom has reached an agreed threshold.

Completion of the transaction is subject to, among other conditions, the approval of the European Commission and the obtainment of waivers to some contractual provisions affected by the sale, including those related to network alliances, as well as change of control provisions under certain contractual arrangements with third parties. As of the date of this Annual Report, such conditions had not been met. The European Commission authorization process is ongoing.

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As completion of the share purchase agreement is conditional on the satisfaction (or, if applicable, waiver) of certain conditions, the acquisition may or may not proceed. If the abovementioned divestment is ultimately not consummated, or it is consummated under conditions other than those initially reported, this could have a material adverse effect on the trading price of Telefónica's ordinary shares, bonds and financial instruments, and its leverage.

Risks Relating to the Group's Industry

***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 regulations in different countries, and 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 spectrum availability. Among the main risks of this nature 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.

Thus, 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 provisions of services in a specific market.

In this regard, the Telefónica Group pursues its license renewals in the terms referred in their respective contractual conditions, though it cannot guarantee that it will always complete this process successfully or under the most beneficial terms for the Group. In many cases complying with certain obligations is required, including, among others, minimum specified quality, service and coverage standards and capital investment. Failure to comply with these obligations could result in the imposition of fines, revision of the contractual terms, or even the revocation of the license, authorization or concession. Additionally, the Telefónica Group could be affected by regulatory actions carried out by the antitrust authorities. These authorities could prohibit certain actions, such as new acquisitions or specific practices, create obligations or lead to heavy fines. Any such measures implemented by the competition 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.

Moreover, the fact that the Group's business is highly regulated both affects its revenues and imposes costs on its operations. For example, regulations fix the rates that Telefónica charges for calls received from other companies' networks, and regulators have progressively lowered these rates in recent years. In addition, and particularly in Spain,

regulators have promoted competition in recent years by, for example, adopting policies which allow alternative operators access to Telefónica's networks. This intense competition has exerted downward pressure on Telefónica's tariff structure, adversely affecting revenues, and led to increased commercial expenses, adversely affecting margins.

*Regulation of spectrum and government licenses*

Further to the European Commission's new "Digital Single Market" (DSM) Strategy, Europe is expected to undergo an important review of its regulatory framework. The new European DSM Strategy comprises a series of policy initiatives to promote the development of the single market of digital services and networks. As a result, the European Commission will initiate legislative processes, which could have significant implications on access to network, spectrum use, auction conditions, duration and renewal of licenses, audiovisual services and platforms, among other various matters.

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On May 8, 2015, the European Commission approved a Decision on the harmonization of the 1452 - 1492 MHz frequency band (1500 MHz band), which encourages Member States to designate and to make available this band frequency from November 2015, on a non-exclusive basis. As a result, new spectrum award processes are expected in the short and mid-term all across the EU. Germany and the United Kingdom have already auctioned the band frequency and therefore the Decision will not have a material impact on Telefónica's cash flow in those markets. In Spain, the Government launched a consultation which ended on June 21, 2015 to evaluate demand for spectrum in the 1500 MHz band. The tender of the 1500 MHz band in Spain may take place during 2016.

Additionally, the main terms of the allocation and use of the 700 MHz band in Europe is expected to be decided in the coming months. This could require new cash outflows from Telefónica between 2018 and 2021 (the period over which it is expected that the spectrum will be available), except in Germany which was the first country in Europe to award spectrum in the 700 MHz band, together with the 1800 MHz, 900 MHz and 1500 MHz bands.

Further, in Germany, on July 4, 2014 and September 25, 2015, the German Federal Network Agency (BnetzA) adopted decisions concerning the impact of Telefónica Deutschland Holding AG merger with E-Plus Mobilfunk GmbH & Co. KG (E-Plus) on the spectrum held by Telefónica Deutschland (the surviving entity after the merger). BnetzA has required Telefónica Deutschland to terminate by June 30, 2016 (rather than December 31, 2016) some rights of use with respect to spectrum in the 1800 MHz band that was not reacquired by Telefónica Deutschland at the abovementioned auction proceeding. The remaining 1800 MHz spectrum band that was not reacquired in such auction was returned at the end of 2015. The German regulator also announced that it will perform a frequency distribution analysis, and determine whether any additional action is needed, particularly in the area of the 2 GHz spectrum band granted to Telefónica Deutschland.

United Internet and the regional cable operator Airdata have filed complaints against the EU General Court decision allowing the merger between Telefónica Deutschland Holding AG and E-Plus Mobilfunk GmbH & Co. Telefónica Deutschland has been accepted as an interested party in these proceedings.

In the United Kingdom, licenses were amended in January 2015 to introduce a 90% geographic coverage obligation for voice and text services. Separately, on September 24, 2015, the telecommunication regulator (Ofcom) issued a decision to increase the annual fees which mobile operators must pay for the use of 900 MHz and 1800 MHz spectrum. Accordingly, from October 31, 2015, the annual charge that Telefónica UK must pay is 32.2 million pounds sterling (increased from 15.6 million pounds sterling), rising to 48.7 million pounds sterling plus CPI from October 31, 2016. Finally, following consultation, on December 3, 2015 Ofcom published an update stating that it has decided to initiate an auction procedure to award 2.3 GHz and 3.4 GHz spectrum once decisions have been made by the relevant competition authorities, in relation to the proposed merger between Telefónica UK Limited and Hutchison 3G UK Limited.

In Latin America, spectrum auctions are expected to take place implying potential cash outflows to obtain additional spectrum or to meet the coverage requirements associated with these licenses. Specifically, the procedures expected to take place in 2016 are:

Peru: In August 2015, the government published the conditions for granting licenses in the 700 MHz spectrum band (three blocks of 2x15 MHz have been defined). On November 4, 2015 Telefónica was declared as a prequalified bidder.

Costa Rica: In December 2015, the Government communicated its intention to auction 40 MHz in the 1800 MHz band and 30 MHz in the 1900/2100 MHz band during 2016.

Mexico: The Federal Telecommunications Institute (IFT) has proposed to auction spectrum in the 2500 MHz band in 2016. In addition, and in light of the constitutional reform resulting from the "Pact for Mexico" political initiative, a wholesale network offering services in the 700 MHz band will be created under a Public-Private Partnership (PPP). On January 29, 2016, the SCT (*Secretaría de Comunicaciones y Transportes*) published the rules for the International Competitive Tender. The rules state that the contract will be awarded in August 2016 and commercial operations must begin no later than March 31, 2018.

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Panama: On December 4, 2015, the process of reallocation of the AWS band (140 MHz, 1710-1780 / 2110-2180 MHz) was announced. It is expected to start by the end of 2016.

Uruguay: The Government approved a resolution allowing for a spectrum auction for mobile services. The auction will contain 15 + 15 MHz in the "AWS Ext" spectrum band and 45 + 45 MHz in the 700 MHz spectrum band (20 + 20 MHz of the 45 + 45 MHz in 700 MHz were previously reserved for the National Telecommunications Administration, ANTEL). As of the date of this report, this process has been delayed and the bidding rules for spectrum have not yet been published.

Colombia: The regulator has published a consultation document for comment which analyzes alternatives and other considerations regarding the structuring of the allocation process for radio spectrum in the 700 MHz bands (which is part of the "Digital dividend", which is the set of frequencies that have been available to mobile communications services in the frequency bands traditionally used for television broadcast (700 MHz and 800 MHz) due to the migration from analogue TV to digital TV), 900 MHz, 1,900 MHz and 2,500 MHz for mobile services. The first auction is expected to take place in 2016. Colombia has established spectrum caps for lower bands, which are currently set at 30 MHz, and Telefónica has 25 MHz in lower bands.

Venezuela: The regulator has indicated the possibility of awarding spectrum in the 2600 MHz band (20 + 20 MHz) for 4G services, in the 1900 MHz band (5 + 5 MHz) for 3G services and in the 900 MHz band during 2016.

In December 2015, the Brazilian regulatory authority (Agencia Nacional de Telecomunicações or ANATEL) auctioned the spectrum lots remaining in the 1800 MHz, 1900 MHz, 2500 MHz and 3500 MHz bands, where Telefónica acquired seven lots of 2.5 GHz frequency band. These lots are associated to six different States, five of them in the capital cities of the States of São Paulo, Rio de Janeiro, Porto Alegre, Florianópolis, and Palmas and one in an interior city of the State of Mato Grosso do Sul. Such frequencies will be used for provision of mobile broadband service on 4G.

Further to the above, certain administrations may not have announced their intention to release new spectrum and may do so during the year. The above does not include processes announced via general statements by administrations, which involve bands not key to Telefónica's needs. Telefónica may also seek to acquire spectrum on the secondary market where opportunities might arise.

*Risks relating to concessions and licenses previously granted*

In the state of São Paulo, Telefónica Brazil provides local and national long-distance Commuted Fixed Telephony Service ("CFTS") under the public regime, through a concession agreement, which will be in force until 2025. In accordance with current regulations, Telefónica Brazil informed ANATEL that the net value as of December 31, 2015

of assets assigned to the provision of the CFTS (which include, among others, switching and transmission equipment and public use terminals, external network equipment, energy equipment and system and operation support equipment) were estimated to total 7,856 million Brazilian reais. In principle, the assets assigned to the provision of the CFTS are considered reversible assets; the scope of such reversibility is subject to a complex debate at different instances.

On June 27, 2014, as established in the concession agreement, ANATEL issued a public consultation for the revision of the concession agreement. Although definitive conditions (which might deal, among others, with the reversibility of assets, universalization goals and, in general, the obligational regime of the concessionaire) were to be published in 2015, such publication was postponed until April 2016. In addition, current reversibility regulations will be reviewed by ANATEL, which is expected to issue a public consultation in the near future. Definitive regulations might be issued in the second half of 2016. We cannot assure that changes made to the concession terms or to the reversibility regulations will not be detrimental to Telefónica's interests.

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In Colombia, the ICT Ministry issued Resolution 597 on March 27, 2014, to renew 850 MHz/1900 MHz licenses for 10 additional years. The reversion of assets (other than radio frequencies, which is clear that must be returned) and its scope, has been discussed in the context of the liquidation of the concession contract, taking into consideration the terms of the contract, and the Constitutional Court's review of Law 422 of 1998, and Law 1341 of 2009. Discussions on the matter concluded on February 16, 2016. The ITC Ministry has announced that it is going to convene the Arbitral Tribunal, in accordance with what was agreed upon in the concession contract. To date, the content of the claim is unknown.

In Peru, the concessions for the provision of the fixed-line service will remain in force until November 2027. However, the Company filed a partial renewal request for five more years in December 2013. As of the date of this Annual Report, the decision of the Ministry of Transport and Communications (Ministerio de Transportes y Comunicaciones) is still pending.

Telefónica Móviles Chile, S.A. was awarded spectrum on the 700 MHz (2x10 MHz) band in March 2014. The claim brought by a consumer organization against 700 MHz assignments was rejected by the Court of Defense of Free Competition in a judgment of July 24, 2015 and the appeal before the Hon. Supreme Court submitted by the consumer organization is still awaiting resolution.

In El Salvador, the process of renewal of the Group's licenses, which expires in 2018, has been postponed.

In Ecuador, once the Group's concession for mobile services expires in 2023, the renewal of such concession or the granting of a new concession will be subject to negotiation with the Government. If the Group fails to renew such concession or obtain a new concession, assets assigned to the provision of mobile services will revert to the State in exchange for a fee.

The Group's consolidated investment in spectrum acquisitions and renewals in 2015 amounted to 1,585 million euros.

The Group's failure to obtain sufficient or appropriate spectrum capacity in the jurisdictions discussed above 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 Telefónica's ability to maintain the quality of existing services, which may adversely affect the Group's business, financial condition, results of operations and cash flows.

*Regulation of wholesale and retail charges*



The European Regulation 2015/2120 on Net Neutrality and Roaming was adopted on November 25, 2015. Under this regulation, from April 30, 2016, when its implementation becomes effective, until June 15, 2017 operators may charge users roaming within the EU an additional fee on their domestic prices for roaming calls, SMS and data services, subject to certain regulated limits. In particular, the surcharges allowed during this period are 0.05 euro/minute for calls, 0.02 euro per SMS sent and 0.05 euro per megabits data (excluding VAT). During this period, the sum of the domestic retail price and any such surcharge shall not exceed 0.19 euro/minute for calls, 0.06 euro per SMS sent and 0.20 euro per megabits data. However, surcharges will not be permitted from June 15, 2017 onwards. The impact of this measure is very difficult to quantify because it will depend on the elasticity of traffic to decreases in the rates charged.

The decreases in wholesale mobile network termination rates (MTR) in Europe are also noteworthy. In the United Kingdom, wholesale MTRs have been reduced to 0.680 ppm (pence/minute) from May 1, 2015 (representing a 19.5% reduction compared to the previous rates). Further cuts of 26.3% and 3.1% (in real terms) will come into effect in April 1, 2016, and April 1, 2017, respectively. However, the impact of these decreases in the Group's results will be diminished if the proposed sale of our operations in the United Kingdom to Hutchison is completed on a timely basis.

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In Germany, on April 24, 2015, BNetzA adopted its final decisions to reduce MTRs. The new prices will gradually decrease from 0.0172 euro/minute to 0.0166 euro/minute from December 1, 2015 until the end of November 2016. The European Commission had beforehand requested that the German regulator withdraw or amend the proposal of such decision. Because BNetzA did not apply the "Pure LRIC (Long Run Incremental Cost Model)" approach recommended by the European Commission, there is a risk that the Commission will initiate infringement proceedings against Germany, and rates may be further reduced.

In Spain, the Spanish National Markets and Competition Commission (Comisión Nacional de los Mercados y la Competencia or CNMC) has initiated the process of reviewing the prices of mobile termination, with a final decision expected to be adopted in the second half of 2016. Additionally, in May 2015, the CNMC launched a public consultation on the analysis of the market for access and call origination on fixed networks. The CNMC proposes to maintain the obligation of Telefónica to provide a wholesale interconnection offer (RIO) and a wholesale offer of access to the fixed telephone line (WLR), both with cost-oriented prices. The final decision is expected to be issued during the first half of 2016.

In Latin America, it is likely that MTRs are also reduced in the short to medium term. For example, in Mexico, on October 1, 2015, the IFT adopted the MTR for 2016. The MTR was set at 0.1869 Mexican pesos per minute in consistency with the Pure LRIC model. The previous MTR was set at 0.2505 pesos per minute.

Telefónica has appealed this decision as well as other decisions concerning the MTR applicable from 2011 to 2015.

In Brazil, ANATEL has been issuing ex-ante regulations to ensure competition in the wholesale market which includes reductions of the MTR. In this regard, the "Plano Geral de Metas de Competição (PGMC), as amended by Resolution 649/2015, established that mobile termination fees are subject to successive yearly reductions from 2016 until 2019, when the definitive cost-oriented-model fees shall be in force (such Resolution has been challenged in courts without a definitive outcome).

In Argentina, the new legal framework "Argentina Digital" provides the new regulator the possibility to regulate the tariffs and prices of essential public services, wholesale services and those the regulator determines based on reasons of public interest, on which the law does not set parameters. As a result, there may be a negative impact, depending on how the new regulator exercises its powers. In addition, until the Secretary of Communications determines that there is effective competition for telecommunications services, the "dominant" providers in the relevant areas (which include Telefónica de Argentina) must respect the maximum tariffs established in the general tariff structure.

*Regulation of Universal Services*

In September 2015, as a part of the DSM Strategy, the European Commission issued a public consultation on the review of the regulatory framework for electronic communications, including certain aspects of the Universal Service obligations. Depending on the outcome of this public consultation, the European Commission could initiate a legislative process including both the potential inclusion of certain broadband speeds in its scope and a possible reduction of some of the current Universal Service obligations that are becoming obsolete. Depending on the terms that will be set forth in the new regulation, implementation at a local level could lead to higher costs for both the Universal Service provider and the operators forced to finance the Universal Service.

In Spain, the licenses of Telefónica de España and Telefónica Telecomunicaciones Públicas (which owns public terminals) for the provision of Universal Services will expire on December 31, 2016. As from this date, there will be a new tender for the award of the provision of the Universal Services.

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*Regulation of fiber networks*

On November 18, 2015 the Spanish CNMC adopted a Draft Resolution on the wholesale broadband market regulation, which foresees a geographical segmentation in competitive and non-competitive areas. This draft Resolution was approved by the European Commission on December 18, 2015. The new resulting regulation, which will apply to NGA (Next Generation Access Networks), could be approved in the first quarter of 2016 and will presumably last for at least three years. Its implementation is expected to result in an increase, of the current regulatory obligations of Telefónica in Spain, in terms of its granting of access to other operators to its fiber network and with respect to certain aspects relating specifically to the business segment.

*Regulations on privacy*

In Europe, a political agreement between the Council and the European Parliament was reached on December 15, 2015, on the new General Data Protection Regulation (GDPR) and the Data Protection Directive. Formal adoption of such regulation by both the Council and the Parliament is expected to take place in spring 2016. The GDPR would become effective two years thereafter, by spring 2018. Some of the critical provisions of this new Regulation will make tougher the launch of new services focused on the processing of personal data. In addition, the GDPR will introduce administrative fines of up to 4% of an undertaking's annual global turnover for breaching the new data protection rules.

In October 2015, the Court of Justice of the European Union declared invalid the Decision of the European Commission of July 26, 2002, known as the "Safe Harbor Agreement", relating to the transfer of personal data from the EU to the United States. Since November 2015, EU and US Authorities have been negotiating a new agreement that ensures a level of protection similar to that provided by the EU. Failure to reach this agreement would create difficulties in the provision of services which involve the flow of EU citizens' personal data to the US.

In Brazil, it is expected, in the near future, that the Personal Data Protection Act will be adopted. This could lead to further obligations and restrictions for operators in relation to the collection of personal data and its treatment. In Peru, on May 8, 2015, the new Personal Data Protection Law came into force. The adoption of secondary legislation is still pending. In Ecuador, the Telecommunications Act (Ley Orgánica de Telecomunicaciones), adopted in February 2015, devotes a whole chapter to regulate the use of personal data.

*Regulation of functional separation*

The principles established in Europe's common regulatory framework, adopted in 2009 and transposed in the national legislation of each Member State in which Telefónica operates could result in greater regulatory pressure on the local competitive environment. Specifically, this framework supports the possibility of national regulators (in specific cases and under exceptional conditions) forcing operators with significant market power and vertically-integrated operators to separate their wholesale and retail businesses at a functional level. They would therefore be required to offer equal wholesale terms to third-party operators that acquire these products.

*Regulation of network neutrality*

As mentioned above, the European Regulation 2015/2120 on Net Neutrality and Roaming was adopted on November 25, 2015. The regulation will enter into force on April 30, 2016. The application of the Regulation could directly affect possible future business models of Telefónica and may affect the network management or differentiation of characteristics and quality of Internet access service.

Telefónica operates in Latin American countries where net neutrality has already been ruled, such as Chile, Colombia, Brazil, Argentina, Mexico and Peru, where Osiptel published on September 8, 2015 the Draft Regulation on Net Neutrality. In Brazil, the Secretariat of Legislative Matters of the Ministry of Justice is concluding a proposal on Net Neutrality Regulation.

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If changes to regulation such as those described above, or otherwise, occur in the various jurisdictions where the Telefónica Group operates, it could have a material adverse effect on its business, financial condition, results of operations and cash flows.

***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 U.S. Foreign Corrupt Practices Act of 1977 and the United Kingdom Bribery Act of 2010, and economic sanction programs, including those administered by the United Nations, the European Union and the United States, including the U.S. 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 our reputation and other consequences that could have a material adverse effect on the Group's business, results of operations and financial condition.

As at the date of this report, Telefónica is currently conducting an internal investigation regarding possible violations of applicable anti-corruption laws. Telefónica has been in contact with governmental authorities about this matter and intends to cooperate with those authorities as the investigation continues. It is not possible at this time to predict the scope or duration of this matter or its likely outcome.

***Customers' perceptions of services offered by the Company may put it at a disadvantage compared to competitors' offerings.***

Customers' perceptions of the assistance and services offered are critical to operating in highly-competitive markets. The ability to predict and respond to the changing needs and demands of customers affects the Company's competitive position relative to other technology sector companies, and its ability to extract the value generated during this process of transformation. Failure to do so adequately could have an adverse impact on the Group's business, financial condition, results of operations and cash flows.

*The Company may not be able to adequately foresee and respond to technological changes and sector trends.*

In a sector characterized by rapid technological change, it is essential to be able to offer the products and services demanded by the market and consider the impacts of changes in the life cycle of technical assets, secure margins and select the right investments to make.

The Telefónica Group operates in markets that are highly competitive and subject to constant technological development. Therefore, as a consequence of both of these characteristics, it is subject to the effects of actions by competitors in these markets and to its ability to anticipate and adapt, in a timely manner, to constant technological changes, changes in customer preferences that are taking place in the industry, as well as economic, political and social circumstances.

Failure to do so adequately could have an adverse impact on the Group's business, financial condition, results of operations and cash flows.

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New products and technologies arise constantly, and their development can render obsolete the products and services the Telefónica Group offers and the technology it uses. This means that Telefónica must invest in the development of new products, technology and services so it can continue to compete effectively with current or future competitors, which may result in the decrease of the Group's profits and revenue margins. In this respect, margins from traditional voice and data business are shrinking, while new sources of revenues are deriving from mobile Internet and connectivity services that are being launched. Research and development costs amounted to 1,012 million euros in 2015, representing a decrease of 0.9% from 1,021 million euros in 2014 (959 million euros in 2013). These expenses represented 2.1%, 2.3% and 1.9% of the Group's consolidated revenues in 2015, 2014 and 2013, respectively. These figures have been calculated using the guidelines established in the Organization for Economic Cooperation and Development (OECD) manual. One technology that telecommunications operators, including Telefónica (in Spain and Latin America), are focused on is the new FTTx-type network, which offers broadband access using optical fiber with superior services, such as Internet speed of up to 100MB or HD television services. However, substantial investment is required to deploy these networks, which entails fully or partially substituting copper loop access with optic fiber. While an increasing demand for the capabilities offered by these new networks to end users exists, the high level of the investments requires a continuous analysis of the return on investment.

The explosion of the digital market and entry of new players in the communications market, such as MVNOs, Internet companies or device manufacturers, may cause the loss of value of certain assets, and affect the Group's ability to generate income. Therefore, it is necessary to update the business model, encouraging the pursuit of incomes and additional efficiencies to those followed traditionally. Failure to do so adequately could have an adverse impact on the Group's business, financial condition, results of operations and cash flows.

In addition, the ability of the Telefónica Group's IT systems (operational and backup) to respond the Company's operating requirements is a key factor to be taken into account with respect to the commercial development, customer satisfaction and business efficiency.

***The Company 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 the Company's operations, and may cause legal contingencies or damages to the Company's image in the event that inappropriate practices are produced by a participant in the supply chain.

As of December 31, 2015, the Telefónica Group depended on five handset suppliers and 13 network infrastructure suppliers, which together accounted for 80% of the awarded contracts for the year then ended. These suppliers may, among other things, extend delivery times, raise prices and limit supply due to their own stock shortfalls and business requirements.



If these suppliers fail to deliver products and services to the Telefónica Group on a timely basis, it could jeopardize network deployment and expansion plans, which in some cases could adversely affect the Telefónica Group's ability to satisfy its license terms and requirements, or otherwise have an adverse impact on the Group's business, financial condition, results of operations and cash flows.

*Unanticipated network interruptions can lead to quality loss or the interruption of the service.*

Unanticipated network interruptions as a result of system failures, including those due to network, hardware or software, stealing of infrastructure elements or cyber-attacks, which affect the quality of or cause an interruption in the Telefónica Group's service, could lead to customer dissatisfaction, reduced revenues and traffic, costly repairs, penalties or other measures imposed by regulatory authorities and could harm the Telefónica Group's image and reputation.

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Telecommunications companies worldwide face increasing cybersecurity threats as businesses become increasingly dependent on telecommunications and computer networks and adopt cloud computing technologies. Cybersecurity threats include gaining unauthorized access to our systems or inserting computer viruses or malicious software in our systems to misappropriate consumer data and other sensitive information, corrupt our data or disrupt our operations. Unauthorized access may also be gained through traditional means such as the theft of laptop computers, portable data devices and mobile phones and intelligence gathering on employees with access.

Telefónica attempts to mitigate these risks through a number of measures, including backup systems and protective systems such as firewalls, virus scanners and other physical and logical security. However, these measures are not always effective. Although the Telefónica Group has insurance policies to cover these types of incidents, and the claims and loss in revenue caused by service interruptions to date have been covered by these policies, these policies may not be sufficient to cover all possible monetary losses.

***The telecommunications industry may be affected by the possible effects that electromagnetic fields, emitted by mobile devices and base stations, may have on human health.***

In some countries, there is a concern regarding potential effects of electromagnetic fields, emitted by mobile devices and base stations, on human health. This public concern has caused certain governments and administrations to take measures that have hindered the deployment of the infrastructures necessary to ensure quality of service, and affected the deployment criteria of new networks and digital services such as smart meters development.

There is a consensus between certain expert groups and public health agencies, including the World Health Organization (WHO), that states that currently there are no established risks associated with exposure to low frequency signals in mobile communications. However, the scientific community is still investigating this issue especially with respect to mobile devices. Exposure limits for radio frequency suggested in the guidelines of the Protection of Non-Ionizing Radiation Protection Committee (ICNIRP) have been internationally recognized. The mobile industry has adopted these exposure limits and works to request authorities worldwide to adopt these standards.

Worries about radio frequency emissions may discourage the use of mobile devices and new digital services, which could cause the public authorities to implement measures restricting where transmitters and cell sites can be located, how they operate, the use of mobile telephones and the massive deployment of smart meters and other products using mobile technology. This could lead to the Company being unable to expand or improve its mobile network.

The adoption of new measures by governments or administrations or other regulatory interventions in this respect, and any future assessment on the adverse impact of electromagnetic fields on health, may negatively affect the business, financial conditions, results of operations and cash flows of the Telefónica Group.

***Possible regulatory, business, economic or political changes 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 impairment in goodwill, intangible assets or fixed assets. Although the recognition of impairments of property, plant and equipment, intangible assets and financial 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. For example, with respect to the investment in Telco, S.p.A. (Telco), value adjustments were made in 2014 with a negative impact of 464 million euros.

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***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.

Any of the foregoing could have an adverse impact on the business, financial position, results of operations and cash flows of the Group.

***Telefónica and Telefónica Group companies are party to lawsuits, tax claims and other legal proceedings.***

Telefónica and Telefónica Group companies are party to lawsuits, tax claims 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 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 proceedings in Brazil, primarily relating to the CIMS (a Brazilian tax on telecommunication services). Further details on these matters are provided in Notes 17 and 21 of the Consolidated Financial Statements.

Item 4. Information on the Company

A. History and Development of the Company

Overview

Telefónica, S.A., is a corporation duly organized and existing under the laws of the Kingdom of Spain, incorporated on April 19, 1924. We are:

a diversified telecommunications group which provides a comprehensive range of services through one of the world's largest and most modern telecommunications networks;

- focused on providing telecommunications services; and

- present principally in Europe and Latin America.

The following significant events occurred in 2015:

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On March 24, 2015, Telefónica signed an agreement with Hutchison for the acquisition by the latter of Telefónica's operations in the UK (O2 UK) for a price (firm value) of 10,250 million pounds sterling in cash (approximately 14,000 million euros at the exchange rate as of the date of the agreement), composed of (i) an initial amount of 9,250 million pounds sterling (approximately 12,640 million euros as of the date of the agreement) which would be paid at closing and (ii) an additional deferred payment of 1,000 million pounds sterling (approximately 1,360 million euros as of the date of the agreement) to be paid once the cumulative cash flow of the combined company in the United Kingdom has reached an agreed threshold. According to the sale agreement, the price will be adjusted by the debt, the working capital and other defined circumstances that may ultimately arise upon closing of the O2 UK divestiture.

Completion of the transaction is subject to, among other conditions, the approval of the European Commission and the obtainment of waivers to some contractual provisions affected by the sale, including those related to network alliances, as well as change of control provisions under certain contractual arrangements with third parties. As of the date of this Annual Report, such conditions had not been met. The European Commission authorization process is ongoing.

These conditions must be satisfied by no later than June 30, 2016 however, this date may be extended until September 30, 2016 in specified circumstances.

On March 25, 2015, pursuant to the authorization granted by the General Shareholders' Meeting held on May 18, 2011, it was agreed to increase the share capital of Telefónica by a nominal amount of 281,213,184 euros, by means of issuing and circulating 281,213,184 new ordinary shares, with a nominal value of one (1) euro each, of the same class and series as those already existing, duly represented by book entries (the “**New Shares**” and the “**Share Capital Increase**”, respectively).

The subscription price of the New Shares was 10.84 euros per share, 1 euro corresponding to the nominal value and 9.84 euros to the issue premium, with the Share Capital Increase amounting to 3,048,350,914.56 euros.

The shareholders of Telefónica held pre-emptive subscription rights over the New Shares.

On April 17, 2015, Telefónica declared that the share capital increase had been fully subscribed and granted the public deed evidencing the Share Capital Increase, which was registered with the Commercial Registry of Madrid on April 20, 2015.

On March 25, 2015, the Brazilian antitrust authority, Conselho Administrativo de Defesa Economica (“**CADE**”), approved both the GVT Acquisition (as defined below) and the demerger of Telco, S.p.A. (described below), subject

to restrictions similar to those imposed by ANATEL. These restrictions required, among other things, that Telefônica Brasil, S.A. (“**Telefônica Brasil**”) commits to provide certain service coverage in certain geographical areas and cities in Brazil, to maintain certain products, contract requirements and services and to maintain a minimum quality with respect to certain other services. Moreover, as part of this authorization, Telefónica undertook, among other obligations, to not exercise its voting rights and ultimately to divest its entire stock participation in Telecom Italia, S.p.A. In addition, Telefónica and Telefônica Brasil have undertaken to comply with certain other restrictions agreed between CADE and the Vivendi, S.A. group.

On April 30, 2015, after obtaining the relevant regulatory authorization, the acquisition by Telefónica de Contenidos, S.A.U. of 56% of the capital stock of Distribuidora de Televisión Digital, S.A. (“**DTS**”) owned by Promotora de Informaciones, S.A. (PRISA) was completed.

On May 12, 2015, Telefónica paid a dividend of 0.40 euros per share in cash corresponding to the second tranche of the 2014 dividend.

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On May 28, 2015 after obtaining the relevant regulatory authorizations, the Extraordinary General Shareholders' Meeting of Telefônica Brasil held on that date approved the acquisition of Global Village Telecom, S.A. and its holding company, GVT Participações, S.A. (collectively "**GVT**") from Vivendi, S.A. (the "**GVT Acquisition**") and the issuance of shares of Telefônica Brasil to Vivendi, S.A. as partial payment of the purchase price of the shares of GVT. Consequently, the closing of such acquisition (for an amount of 4,663 million euros and the delivery of 12% of the share capital of the new Telefônica Brasil resulting from the integration) was completed.

On June 12, 2015, Telefónica's Annual General Shareholders' Meeting took place on second call with the attendance of holders, present or represented, of 58.40% of the share capital. In this meeting, all the resolutions submitted by the Board of Directors for deliberation and approval were approved by the majority of votes.

On June 17, 2015, having obtained all the required anti-trust and telecommunications approvals (including in Brazil and Argentina), Telco, S.p.A. carried out its demerger, which became effective on June 18, 2015. As a consequence of the demerger, the Telecom Italia, S.p.A. ("**Telecom Italia**") ordinary shares held by Telco, S.p.A. – which represented 22.3% of the company's ordinary share capital - were allocated as follows: 14.72% of Telecom Italia's share capital was allocated to Telco TE, S.p.A., a newly created company owned by Telefónica, S.A.; 4.31% to a newly created company owned by the Generali group; and 1.64% to each of the newly created companies owned by Intesa Sanpaolo and Mediobanca respectively.

Moreover, the shareholders' agreement in force between the shareholders in Telco, S.p.A. ceased to have effect on June 18, 2015.

On June 24, 2015, in compliance with the undertakings assumed in the agreement entered into on September 19, 2014 for the GVT Acquisition, Telefónica, through its 100%-subsidiary Telco TE S.p.A., delivered 1,110 million ordinary shares of Telecom Italia (representing 8.2% of its ordinary shares) to Vivendi, S.A. and received from Vivendi, S.A. all the ordinary shares and part of the preferred shares of Telefônica Brasil that Vivendi S.A. had received as consideration for the sale of GVT, which together represented 4.5% of the total share capital of Telefônica Brasil.

Moreover, Telefónica (through its 100% subsidiary Telco TE S.p.A.), entered into a purchase agreement with a financing institution for the sale of 872 million ordinary shares of Telecom Italia, representing 6.5% of the ordinary shares of this company, for an amount of approximately 1,025 million euros. Consequently, Telefónica completed the divestment of its entire stake in Telecom Italia, in accordance with the regulatory and competition commitments assumed.

Likewise, Telefónica has arranged several hedging instruments which will allow Telefónica to repurchase the shares of Telecom Italia that are necessary to meet its exchange obligations under the mandatory exchangeable bonds for shares of Telecom Italia, issued by Telefónica, S.A. in July 2014.



On July 10, 2015, DTS reached an agreement, for an amount of 600 million euros, with the Spanish Professional Soccer League (“LFP”) for the exploitation of audiovisual content rights of pay per view soccer events in the domestic market, for the 2015/2016 season.

On July 27, 2015, the Company announced that, pursuant to the resolution adopted by the Annual General Shareholders’ Meeting of Telefónica held on June 12, 2015 which approved a share capital reduction, through the cancellation of own shares, and following the execution agreement adopted by the Board of Directors of the Company, the public deed of this share capital reduction was registered in the Madrid Mercantile Registry (*Registro Mercantil*).

As a result, 74,076,263 shares of Telefónica were cancelled, reducing the company’s share capital in the same amount. The Company’s share capital after the reduction, at such date, stood at 4,864,341,251 euros made up of an equal number of ordinary shares, all of a single series and with a nominal value of one (1) euro per share.

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On July 29, 2015, Telefónica entered into an agreement with Vivendi, S.A. pursuant to which Telefónica committed to deliver 46.0 million of its treasury shares, representing 0.95% of its share capital, to Vivendi, S.A. in exchange for 58.4 million preferred shares of Telefônica Brasil (which had been received by Vivendi, S.A. as partial consideration for GVT in the GVT Acquisition), representing 3.5% of the share capital of Telefônica Brasil, from Vivendi, S.A.

The execution of this agreement was approved by the CADE.

On August 4, 2015, in relation to the long-term incentive plan consisting in the granting of shares of Telefónica –known as the Performance & Investment Plan (“PIP”)–, the Company announced the number of shares to be delivered under such Plan’s Second Phase (2012-2015) to each of the beneficiaries of the Plan in their positions as Executive Directors or Executives of the Company, and which amounts to 77% of the shares they were assigned originally.

On September 30, 2015, the Executive Commission of Telefónica’s Board of Directors agreed that the corporate resolutions required to carry out the free-of-charge capital increase related to the scrip dividend shareholder compensation scheme (“Telefónica’s Flexible Dividend”) approved by the Annual General Shareholder’s Meeting held on June 12, 2015, should be adopted on the Executive Commission meeting scheduled for November 13, 2015. On November 13, 2014, the Executive Commission agreed the implementation of the aforementioned capital increase.

On October 28, 2015, following a report of the Nominating, Compensation and Corporate Governance Committee, the Board of Directors of Telefónica approved, with regard to the second cycle (2015-2018) of the long-term incentive plan (which consists in the granting of shares of Telefónica to Telefónica Group Executives (including Executive Directors of Telefónica)) as approved by the Annual General Shareholders’ Meeting held on May 30, 2014, the amount of theoretical shares to be assigned to the other Executives, and the maximum possible number of shares to be received by them, in the event of fulfilment of the co-investment requirement set forth in the plan, and of the maximum achievement of the Total Shareholder Return (TSR) established in such plan.

On December 11, 2015, Telefónica announced that, on December 2, 2015, the free-of-charge allotment rights trading period for the free-of-charge capital increase related to Telefónica’s Flexible Dividend had ended. The holders of 20.01% of the free-of-charge allotment rights accepted the purchase commitment assumed by Telefónica. The gross amount paid by Telefónica for these rights amounted to 335,775,673.59 euros. The Company waived the rights thus acquired, which were amortized.

The holders of 79.99% of the free-of-charge allotment rights were entitled, therefore, to receive new shares of Telefónica. Nevertheless, Telefónica waived the free-of-charge allotment rights that corresponded to its treasury shares at the record date (November 17, 2015). Therefore, the final number of ordinary shares with a nominal value of one (1) euro issued in the capital increase was 110,857,946 (2.3% of Telefónica’s share capital as of that date), totaling 110,857,946 euros. As a result, the share capital of Telefónica after the capital increase, as registered on December 11, 2015 with the Commercial Registry of Madrid, was 4,975,199,197 euros (4,975,199,197 shares).

The new shares were admitted to listing on the Madrid, Barcelona, Bilbao and Valencia stock exchanges (the “**Spanish Stock Exchanges**”) on December 15, 2015 and the ordinary trading of the new shares in Spain begun on December 16, 2015. The admission to listing on the stock exchanges of London, Buenos Aires, New York and Lima was also requested.

#### Business areas

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

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Following our signing of an agreement on March 24, 2015 with Hutchison for the sale and purchase of the entire issued share capital of Telefónica Europe plc, and the reclassification of the results attributable to our operations in the United Kingdom as discontinued operations, our segments were revised as follows: Telefónica Spain, Telefónica Brazil, Telefónica Germany and Telefónica Hispanoamérica (comprised of our consolidated subsidiaries in Argentina, Chile, Peru, Colombia, Mexico, Venezuela and Central America, Ecuador and Uruguay). The companies that are not specifically included in these new segments are part of “Other companies and eliminations”.

As a result, 2014 and 2013 financial information by operating segment presented in this report has been revised to reflect the elimination of the Telefónica United Kingdom segment.

Our segments include the information relating to wireline, wireless, cable, data, internet and television businesses and other digital services in accordance with each location. “Other companies and eliminations” includes the companies belonging to cross-segment areas as well as other Group companies and eliminations in the consolidation process.

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

The Group manages borrowing activities and taxes centrally. Therefore, it does not disclose the related assets, liabilities, revenue and expenses by reportable segments. In addition, revenue and expenses arising from intra-group invoicing for the use of the trademark and management services have been eliminated from the operating results of each Group segment. These adjustments have no impact on the Group’s consolidated results.

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The following chart shows the organizational structure of the principal subsidiaries of the Telefónica Group at December 31, 2015, including their jurisdictions of incorporation and our ownership interest. For further detail, see Exhibit 8.1 to this Annual Report.

(1) Ownership in Telefónica Móviles España, S.A.U. is held directly by Telefónica, S.A.

(2) 94.85% in terms of voting rights.

(3) Ownership in Telefónica International Wholesale Services, S.L. is held by Telefónica, S.A. (92.51%) and by Telefónica Datacorp, S.A.U. (7.49%).

(4) Companies held indirectly.

(5) Ownership in this companies is held directly by Telefónica, S.A.

(6) In process of divestment. The completion of the sale is subject to various conditions.

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Telefónica, S.A., the parent company of the Telefónica Group, also operates as a holding company with the following objectives:

- coordinate the Group's activities;
- allocate resources efficiently among the Group;
- provide managerial guidelines for the Group;
- manage the Group's portfolio of businesses;
- foster cohesion within the Group; and
- foster synergies among the Group's subsidiaries.

Our principal executive offices are located at Distrito Telefónica, Ronda de la Comunicación, s/n, 28050 Madrid, Spain, and our registered offices are located at Gran Vía, 28, 28013 Madrid, Spain. Our telephone number is +34 900 111 004.

Capital Expenditures and Divestitures

Our principal capital expenditures during the three years ended December 31, 2015, consisted of additions to property, plant and equipment and additions to intangible assets, including spectrum. In 2015, 2014 and 2013, we made capital expenditures of 9,578 million euros, 8,681 million euros and 8,005 million euros, respectively.

**Year ended December 31, 2015**

Capital expenditures in 2015 increased 10.3% compared to 2014. Capital expenditures in 2015 included the cost of spectrum mainly in Germany, Argentina, Ecuador and Spain, amounting to 1,585 million euros.

Investment by Telefónica Spain in 2015 amounted to 1,827 million euros and was primarily focused on fiber networks, 3G, 4G and fiber as well as improvement of the quality of broad-band services and Pay TV. Investment by Telefónica Germany in 2015 amounted to 2,230 million euros, focusing on its LTE roll-out strategy. Investment by Telefónica Brazil in 2015 amounted to 2,105 million euros, and related mainly to the continuation of the 3G and LTE roll-outs and the expansion of the roll-out of fiber optic. Investment by Telefónica Hispanoamérica in 2015 amounted to 3,060 million euros and was mainly focused on LTE roll-outs, densification of the 3G network, the continuation of ultra-broad band (UBB) roll-out for fixed broadband by speed upgrades and network digitalization as well as improving the Pay TV network.

#### **Year ended December 31, 2014**

Capital expenditures in 2014 increased 8.4% compared to 2013. Capital expenditures in 2014 included the cost of spectrum mainly in Brazil, Argentina, Venezuela, Colombia and Panama, amounting to 1,294 million euros.

Investment by Telefónica Spain in 2014 amounted to 1,732 million euros. Fiber optic was rolled out rapidly, and by year-end 2014 Telefónica Spain had created more than 10 million “fiber-to-the-house” (“**FTTH**”) facilities in Spain, increasing its investments in LTE networks. Investment by Telefónica Germany in 2014 amounted to 849 million euros, focusing on its LTE roll-out strategy, securing 61% coverage in 2014. Investment by Telefónica Brazil in 2014 amounted to 2,933 million euros, mainly due to the fact that the mobile segment featured a continuation of LTE roll-outs in 2014, improving network capacity, systems and applications. Investment in the fixed-line network was used to expand roll-out of fiber optic, larger volumes of IPTV customers and corporate projects. Investment by Telefónica Hispanoamérica in 2014 amounted to 2,842 million euros mainly focused on LTE roll-outs in practically all operations in the region. Investment was also allocated to the densification of the 3G network, optimization of fixed-mobile convergence systems, the continuation of ultra-broad band (UBB) roll-out for fixed broadband by speed upgrades and network digitalization, television and digital initiatives.

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**Year ended December 31, 2013**

Capital expenditures in 2013 declined 8.1% compared to 2012. Capital expenditures in 2013 included the cost of spectrum mainly in Brazil, Peru, Colombia and Spain, amounting to 505 million euros.

Investment by Telefónica Spain in 2013 amounted to 1,529 million euros, reflecting a high level of investment efficiency, as a result of the improvements in quality indexes, the reduction of complaints and enhanced efficiency in IT. At the end of the year, there was an acceleration in the rollout of fiber optic, and a boost of LTE deployment. Investment by Telefónica Germany amounted to 666 million euros, focusing its efforts on network quality while accelerating investment in LTE network deployment. Investment by Telefónica Brazil amounted to 2,127 million euros mainly due to the expansion and improvement of the mobile networks, both 3G and 4G, as well as the rollout of its fiber network. Investment by Telefónica Hispanoamérica in 2013 amounted to 3,118 million euros, mainly in the mobile business and centered primarily on overlay projects and expansion of the coverage, quality and density of 3G networks, as well as the minimum roll-out of LTE (Colombia and Chile), the development of platforms to underpin new VASs, and the optimization of infrastructure and systems developments focusing on self-management. In the fixed line business, funds continued to be earmarked for rolling out UBB through speed upgrades in ADSL, fiber (FTTx) and VDSL in Argentina and Chile, as well as the installation of fixed-mobile convergence systems (Colombia, Chile and Peru).



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### Financial Investments and Divestitures

Our principal financial investment in 2015 was the acquisition of GVT, which was completed on May 28, 2015, through our subsidiary Telefônica Brasil for a total purchase price of 4,663 million euros (through payment in cash and debt assumption) as well as the delivery of shares representing 12% of the share capital of Telefônica Brasil (following its integration with GVT) and the acquisition on April 30, 2015 of 56% of DTS for an initial consideration of 707 million euros, subject to the finalization of the working capital and net debt adjustments. Our principal divestiture in 2015 was the sale of our stake in Telecom Italia (we disposed of 1,110 million ordinary shares in Telecom Italia in exchange for 4.5% of the share capital in Telefônica Brasil and 872 million ordinary shares in Telecom Italia in exchange for approximately 1,025 million euros). In addition, on March 24, 2015, Telefónica and Hutchison signed an agreement for the acquisition by the latter of Telefónica's operations in the UK. Completion of the transaction is subject to, among other conditions, the approval of the European Commission and the obtainment of waivers to some contractual provisions affected by the sale, including those related to network alliances, as well as change of control provisions under certain contractual arrangements with third parties.

Our principal financial investment in 2014 was the acquisition of E-Plus, which was completed on October 1, 2014, through our subsidiary Telefónica Deutschland for a total purchase price of 7,463 million euros. Our principal divestitures in 2014 were the completion of the sales of Telefónica Czech Republic, a.s. on January 28, 2014, Telefónica Ireland, Ltd on July 2, 2014, and the sale of shares representing approximately 2.5% of the share capital of China Unicom (Hong Kong) Limited ("**China Unicom**") for approximately 687 million euros.

There were no significant financial investments in 2013. Our principal divestitures in 2013 were the sale of 40.00% of our investment, through Telefónica Centroamérica de Inversiones, S.L., in Guatemala, Salvador, Nicaragua and Panama for 500 million U.S. dollars (equivalent to 377 million euros on the date of execution of the sale) with no impact in the results of the Group given our continued control over the company after the transaction; the agreement to sell 65.9% of our investment in Telefónica Czech Republic, a.s. for 306 Czech crown per share (approximately 2,467 million euros at the date of the agreement), resulting in a capital loss of 176 million euros and the agreement to sell our stake in Telefónica Ireland, Ltd for 850 million euros.

### Public Takeover Offers

Not applicable

### Recent Developments

The principal events that have occurred since December 31, 2015, are set forth below:

In January 2016, Distribuidora de Television Digital, S.A.U. (DTS) and Mediaproducción, S.L.U. (Mediapro) have reached an agreement for the broadcasting of the thematic pay TV channel called “beIN Sports LaLiga” with contents of the Spanish National League Championship First Division and the Copa del S.M. el Rey, corresponding to the three seasons 2016/17, 2017/18 and 2018/19.

Also, DTS and Mediapro reached an agreement for the broadcasting of the thematic pay TV channel called “beIN Sports” containing, among others, matches of the “UEFA Champions League” and “UEFA Europa League” competitions corresponding to the three seasons 2015/16 (from January 12, 2016), 2016/17 and 2017/18.

The total value of the agreements relating to those channels amounts to a maximum of 2,400 million euros.

With this agreement, mOVISTAR+ fulfills its commitment to provide to its entire customer base a comprehensive offer with all the best sports contents.

On February 10, 2016, Telefónica announced the creation of Telxius, a company which will bring together certain infrastructure assets of the Group, which will enable the management of the Telefónica Group’s infrastructure on a global scale with a more specialized and focused approach, with the aim of increasing the services provided to other operators, improving the return on capital

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invested and allowing Telxius to participate more actively in the growth opportunities that exist in the industry, including the possibility of incorporating third party assets.

For information related to our significant financing transactions completed in 2015 and through the date of this Annual Report, see “Item 5. Operating and Financial Review and Prospects—Liquidity and Capital Resources—Anticipated Sources of Liquidity”.

B. Business Overview

Telefónica is one of the world’s leading communications services providers, offering mobile and fixed communication services with a strategy focused on the possibilities that the new digital world offers and becoming one of its principal leaders.

Telefónica’s aim is to reinforce its position as an active player in the digital world by seizing all the opportunities afforded by its global scale and its industrial and strategic alliances.

Telefónica’s current organizational structure is composed of the following segments: Telefónica Spain, Telefónica Brazil, Telefónica Germany and Telefónica Hispanoamérica (comprised of our consolidated subsidiaries in Argentina, Chile, Peru, Colombia, Mexico, Venezuela and Central America, Ecuador and Uruguay). These segments include the information related to wireline, wireless, DSL, TV, and other digital services provided in each country or countries. Any services not specifically included in these new segments are part of “Other companies and eliminations”.

On March 24, 2015, Telefónica signed an agreement with Hutchison on the sale of Telefónica’s operations in the United Kingdom. Therefore, Telefónica’s operations in the United Kingdom are reported as discontinued operations, and its assets and liabilities are classified as “held for sale” in compliance with IFRS. 2014 and 2013 results have been retrospectively revised and are reported following these same criteria.

The Telefónica Group’s strategy aims to:

Enhance value through:

- Offering excellent connectivity
- Providing a bundled offer with video and digital services
- Providing increased customer value and customer experience

With the following enablers:

– End-to-end Digitalization: reducing our legacy investments to increase virtualization, reduce physical servers, data centers and applications

- Big Data and Innovation to add value to our customers
- Continued focus on capital allocation in our legacy investments and simplification processes

In addition, Telefónica maintains an industrial alliance with China Unicom. Furthermore, in order to potentially unlock the value of Telefónica’s scale, the “Partners” program was created in 2011, and now includes five operators (Bouygues, Etisalat, Sunrise, Megafon and O2 Czech Republic). The Telefónica Partners Program is an initiative that makes available to selected operators and under commercial terms a host of services that allows partners to leverage on Telefónica’s scale and to cooperate on key business topics (digital services, roaming, services to multinationals, procurement that allows us to deliver our financial commitments, devices, etc.).

Moreover, Telefónica has increased its presence in key markets. In 2014 Telefónica acquired E-Plus (through Telefónica Germany) and in 2015 Telefónica acquired DTS (through Telefónica Spain) and GVT (through Telefónica Brazil).

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On February 10, 2016, Telefónica announced the creation of “Telxius,” a company which will bring together certain infrastructure assets of the Group in several countries, which will enable the management of the Telefónica Group’s infrastructure on a global scale with a more specialized and focused approach, with the aim of increasing the services provided to other operators, improving the return on capital invested and allowing Telxius to participate more actively in the growth opportunities that exist in the industry, including the possibility of incorporating third party assets.

**Financial Results**

2015 highlights

In 2015 Telefónica has taken further steps aimed at achieving profitable and sustainable long-term growth and has also improved its competitive position in key markets. Commercial activity in fiber, smartphones, LTE and Pay-TV has intensified, leading to revenue growth acceleration (+8.7% year-on-year in reported terms).

In 2015, **revenues** totaled 47,219 million euros, 8.7% higher than 2014.

**OIBDA** totaled 11,414 million euros in 2015, down 17.2% in reported terms, and was adversely affected by a restructuring costs provision of 3,212 million euros in 2015. In organic terms (which term and calculation is explained further below), OIBDA was up 3.6%, due mainly to the positive evolution of Telefónica Germany (+20.9% year-on-year), reflecting increased synergies, as well as the positive results from Telefónica Hispanoamérica (+7.2% year-on-year).

The evolution of foreign exchange rates impacted negatively in the 2015 consolidated financial results, in particular the depreciation of several Latin American currencies against the euro, such as the Brazilian real and to a lesser extent the implicit depreciation of the Venezuelan bolívar.

In the 2015 consolidated financial statements, the Company used the exchange rate of the Venezuelan bolívar set at the denominated SIMADI, which at December 31, 2015 was set at 199 Venezuelan bolívar fuerte per U.S. dollar, for the purpose of translating the transactions, cash flows and balances related to the investments in Venezuela. In the 2014 consolidated financial statements, Telefónica used the exchange rate of the Venezuelan bolívar set at the denominated SICAD II (set at 49.988 Venezuelan bolívar fuerte per U.S. dollar).

Telefónica's **total accesses** totaled 322.3 million as of December 31, 2015. Telefónica United Kingdom customers have been excluded from our 2014 and 2015 customer base, since we have classified Telefónica United Kingdom as a disposal group held for sale and its operations have been classified as discontinued operations. Group accesses increased 1.9% year-on-year, as a result mainly of the additional accesses gained following the purchase of GVT by Telefónica Brazil and DTS in Spain and the growth in accesses in Telefónica Hispanoamérica and Telefónica Germany. If we consider the accesses from GVT and DTS as of December 31, 2014 to make both years comparable, accesses would have decreased by 1.1% affected, in part, by prepaid disconnections in Telefónica Brazil (which resulted in the disconnection of 11.5 million accesses in 2015 and 1.6 million accesses in 2014). In 2015, commercial activity increased based on high value customers, resulting in a sustained growth of the contract mobile segment (smartphones and LTE), fiber and Pay TV. Accesses in Telefónica Hispanoamérica (41.8% of the Group's total as of December 31, 2015) increased by 2.3% year-on-year, while accesses in Telefónica Germany (15.0% of the Group's total) increased by 1.5% year-on-year.

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The below table shows the evolution of accesses over the past two years:

## ACCESSES

Thousands of accesses	2014	2015	%Reported YoY	%Organic YoY(1)
Fixed telephony accesses (2)	36,602.0	39,487.7	7.9%	(3.1%)
Internet and data accesses	18,132.5	21,344.3	17.7%	1.3%
Broadband (3)	17,649.3	20,950.3	18.7%	1.7%
Fiber (4)	1,755.0	6,100.3	n.m.	29.9%
Mobile accesses	249,978.9	247,085.1	(1.2%)	(1.2%)
Prepay	164,959.2	157,283.7	(4.7%)	(4.7%)
Contract	85,019.6	89,801.4	5.6%	5.6%
M2M	7,595.5	9,142.4	20.4%	20.4%
Pay TV (5)	5,087.2	8,271.6	62.6%	12.0%
Unbundled loops	4,087.3	3,647.3	(10.8%)	(10.8%)
Shared ULL	94.1	77.9	(17.2%)	(17.2%)
Full ULL	3,993.3	3,569.4	(10.6%)	(10.6%)
Wholesale ADSL	750.1	868.2	15.7%	15.7%
Other	1,684.1	1,547.3	(8.1%)	(8.1%)
Final Clients Accesses	309,800.5	316,188.7	2.1%	(0.9%)
Wholesale Accesses	6,521.6	6,062.8	(7.0%)	(7.0%)
Total Accesses	316,322.1	322,251.5	1.9%	(1.1%)

## Notes:

- T. Ireland customers are excluded since third quarter 2014. Accesses include E-Plus customers since fourth quarter 2014 and GVT and DTS customers since May 1, 2015.

- O2 UK customers are excluded from accesses since first quarter 2014 due to the discontinuation of operations in the UK.

(1) In order to calculate organic changes, we have added the accesses of DTS and GVT as of December 31, 2014 to our accesses as of such date.

(2) Includes “fixed wireless” and Voice over IP accesses.

(3) Includes DSL, satellite, optic fiber, cable modem and broadband circuits.

(4) Includes 3.25 million GVT fiber (FTTx) customers since May 1, 2015.

(5) Includes 1.1 million DTS customers since May 1, 2015.

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The below table shows the contribution of each item for which we have adjusted to our reported growth. With respect to each line item, the contribution to reported growth of such line item, expressed in percentage points, is the result of dividing the impact of each item for which we have adjusted by the amount of such line item, on a reported basis, for the prior year.

TELEFÓNICA 2015	%Reported YoY	%Organic YoY (1)	DTS	GVT
Fixed telephony accesses	7.9%	(3.1%)	0.0 p.p.	11.3 p.p.
Internet and data accesses	17.7%	1.3%	0.0 p.p.	16.2 p.p.
Broadband	18.7%	1.7%	0.0 p.p.	16.7 p.p.
Fiber	n.m.	29.9%	0.0 p.p.	167.6 p.p.
Pay TV	62.6%	12.0%	28.3 p.p.	16.9 p.p.
Final Clients Accesses	2.1%	(0.9%)	0.5 p.p.	2.6 p.p.
Total Accesses	1.9%	(1.1%)	0.5 p.p.	2.5 p.p.

(1) In order to calculate organic changes, we have added the accesses of DTS and GVT as of December 31, 2014 to our accesses as of such date.

The table below shows the evolution of accesses by segment:

Accesses 2015	YoY variation	% Over Total Accesses		
			%Reported YoY	%Organic YoY (1)
Spain	1.9%	13.0%	13.0%	
Germany	1.5%	15.1%	15.0%	
Brazil	1.4%	30.2%	30.1%	
Hispanoamérica	2.3%	41.6%	41.8%	
Others	16.6%	0.1%	0.1%	

(1) In order to calculate organic changes, we have added the accesses of DTS and GVT as of December 31, 2014 to our accesses as of such date.

The Group's strategy is based on capturing growth in its markets, especially on attracting high-value customers.

**Mobile accesses** totaled 247.1 million at December 31, 2015, down 1.2% compared to December 31, 2014, affected mainly by the decrease in prepay accesses due to the disconnection of prepay accesses in Brazil (11.5 million accesses



in 2015 and 1.6 million accesses in 2014). Contract accesses, however, were up 5.6% year-on-year, continuing to increase their weight over total mobile accesses up to 36.3% (+2.3 p.p. year-on-year).

**Smartphone accesses** maintained a strong growth rate (up 42.9% year-on-year), totaling 112.9 million accesses and reaching a penetration rate over total accesses of 48.5% (+14.8 p.p. year-on-year), reflecting the Company's strategic focus on the growth of its data services.

**Fixed broadband accesses** stood at 21.0 million at December 31, 2015, up 18.7% year-on-year (of which 16.7 p.p. was due to the inclusion of accesses from GVT in the 2015). Fiber accesses stood at 6.1 million at December 31, 2015.

**TV accesses** totaled 8.3 million at December 31, 2015, up 63% year-on-year (of which 28 p.p. was due to the inclusion of accesses from DTS and 17 p.p. was due to the inclusion of accesses from GVT in the 2015 access base).

Telefónica's customer base includes the consumer and business segments, and therefore is not affected by customer concentration risk.

The table below shows the evolution of our estimated access market share for mobile and DSL for the past two years.

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## Competitive Position Evolution

	Mobile Market Share (1)	
Telefónica	2014	2015
Spain	31.2%	30.8%
Germany	36.9%	38.1%
Brazil	28.4%	28.4%
Argentina	31.3%	32.3%
Chile	39.4%	36.7%
Peru	55.2%	49.7%
Colombia	23.5%	22.4%
Venezuela	33.7%	34.2%
Mexico	20.8%	22.7%
Central America	31.5%	33.2%
Ecuador	27.9%	29.7%
Uruguay	34.4%	34.9%
(1) Internal estimation in both years		

## Competitive Position Evolution

	DSL Market Share (1)	
Telefónica	2014	2015
Spain	45.1%	43.5%
Brazil (2)	16.4%	28.1%
Argentina	30.3%	29.4%
Chile	39.8%	39.4%
Colombia	18.8%	18.1%
(1) Internal estimation in both years		
(2) Includes GVT in 2015		

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## 2015/2014 Consolidated results

In this section, we discuss changes in the Group's consolidated income statements for 2015 and 2014. Changes in the Group's consolidated income statements for 2014 and 2013 are discussed in a separate section further below. The consolidated income statement data for the years ended December 31, 2014 and 2013 set forth in both sections has been retrospectively revised to show the reclassification of the results attributable to our operations in the United Kingdom as discontinued operations and are not derived from Telefónica, S.A.'s consolidated financial statements originally published for such years, which are not included herein.

Millions of euros	Year ended December 31				Percent change	
	2014		2015		2015 vs 2014	
	Total	% of revenues	Total	% of revenues	Total	%
Revenues	43,458	100.0%	47,219	100.0%	3,761	8.7 %
Other income	1,521	3.5 %	1,841	3.9 %	320	21.1 %
Supplies	(11,750)	(27.0 %)	(12,910)	(27.3 %)	(1,160)	9.9 %
Personnel expenses	(6,621 )	(15.2 %)	(9,800 )	(20.8 %)	(3,179)	48.0 %
Other expenses	(12,827)	(29.5 %)	(14,936)	(31.6 %)	(2,109)	16.4 %
Operating income before depreciation and amortization (OIBDA)	13,781	31.7 %	11,414	24.2 %	(2,367)	(17.2 %)
Depreciation and amortization	(7,431 )	(17.1 %)	(8,517 )	(18.0 %)	(1,086)	14.6 %
Operating income	6,350	14.6 %	2,897	6.1 %	(3,453)	(54.4 %)
Share of loss of investments accounted for by the equity method	(498 )	(1.1 %)	(5 )	(0.0 %)	493	(99.0 %)
Net financial expense	(2,779 )	(6.4 %)	(2,581 )	(5.5 %)	198	(7.1 %)
Profit before tax	3,073	7.1 %	311	0.7 %	(2,762)	(89.9 %)
Corporate income tax	(260 )	(0.6 %)	(13 )	(0.0 %)	247	(95.0 %)
Profit after tax from continuing operations	2,813	6.5 %	298	0.6 %	(2,515)	(89.4 %)
Profit after tax from discontinued operations	439	1.0 %	2,582	5.5 %	2,143	n.m.
Profit for the year	3,252	7.5 %	2,880	6.1 %	(372 )	(11.4 %)
Non-controlling interests	(251 )	(0.6 %)	(135 )	(0.3 %)	116	(46.2 %)
Profit for the year attributable to equity holders of the parent	3,001	6.9 %	2,745	5.8 %	(256 )	(8.5 %)

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*Adjustments made to calculate organic variations*

Year-on-year changes referred to in this document as “organic” or presented in “organic terms” intend to present year-on-year variations on a comparable basis, by considering a constant perimeter of consolidation and constant exchange rates and by making certain other adjustments which are described herein. See “Item 5. Operating and Financial Review and Prospects—Operating Results—Presentation of Financial Information—Non-GAAP financial information—Organic variations.” We believe that “organic” variations, while not a substitute for reported variations, provide useful information for investors and other interested parties because:

they give additional information on the underlying performance of the operating business, removing the impact of certain items we believe are less relevant when considering the performance of Telefónica’s underlying business;

Telefónica uses this data internally to assess its profitability; and

we believe this data facilitates the comparison between Telefónica’s performance with that of other operators, although “organic” is not a term defined in IFRS, and “organic” measures included herein may not be comparable to similar measures presented by other companies.

For purposes of this report, “organic” variation is defined as the reported variation as adjusted to exclude the impact of certain items which we believe are less relevant when considering the performance of Telefónica’s underlying business.

The adjustments made to calculate 2015/2014 organic variations are the following:

**Foreign exchange effects and the impact of hyperinflationary adjustments in Venezuela:**

We have excluded the impact of changes in exchange rates by assuming constant average foreign exchange rates in 2015 and 2014. In particular, we have used the average foreign exchange rates of 2014 for both years.

Foreign exchange rates had a negative impact on our reported 2015 results, mainly due to the depreciation of various Latin American currencies versus the euro, in particular the Brazilian real and, to a lesser extent, the Venezuelan bolívar.

We have also excluded the impact of hyperinflationary adjustments in Venezuela by reversing such adjustments.

**Changes in the scope of consolidation:**

We have excluded the impact of changes in our consolidation perimeter in 2015 and 2014. The main changes in our consolidation perimeter in such years related to the consolidation of GVT in Telefónica Brazil since May 2015, the consolidation of DTS in Telefónica Spain since May 2015, the consolidation of E-Plus in Telefónica Germany since October 2014 and the sale of Telefónica Ireland in July 2014.

In order to exclude the impact of these changes in our perimeter, we have:

- consolidated GVT's results from May 1 to December 31, 2014 in our 2014 results;
- consolidated DTS's results from May 1 to December 31, 2014 in our 2014 results;
- consolidated E-Plus's results from January 1 to September 30, 2014 in our 2014 results; and
- excluded Telefónica Ireland's results from January 1 to June 30, 2014 from our 2014 results.

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**Restructuring costs:**

We have excluded the impact of certain restructuring costs, mainly those related to the 1st Collective Agreement of Related Companies in Spain, restructuring processes relating to Germany and Brazil and the Group's simplification program.

In 2015 these restructuring costs totaled 3,212 million euros and were aimed at increasing future efficiency, representing a further step towards the transformation and simplification initiatives carried out by Telefónica. These costs were distributed by segment as follows (impacts on OIBDA): Telefónica Spain (2,896 million euros), Telefónica Germany (74 million euros), Telefónica Hispanoamérica (38 million euros), Telefónica Brazil (7 million euros) and other companies (197 million euros).

In 2014 these restructuring costs totaled 658 million euros and were attributable to the simplification initiatives that the Group has implemented to meet its targets. These costs were mainly distributed by segment as follows (impacts on OIBDA): Telefónica Germany (414 million euros), Telefónica Brazil (68 million euros), Telefónica Hispanoamérica (99 million euros, mainly in Peru) and other companies (77 million euros).

**Results of tower sales:**

The results attributable to the sale of towers in 2015 and 2014 have been excluded in both years.

In 2015 the results from the sale of towers totaled 65 million euros, distributed as follows: Telefónica Spain (38 million euros), Telefónica Brazil (10 million euros) and Telefónica Hispanoamérica (18 million euros, mainly in Chile). In 2014 the results from the sale of towers totaled 196 million euros in OIBDA, mainly in Telefónica Spain (191 million euros).

**Irrevocable commitment with Fundación Telefónica:**

In 2015 we have excluded the expense (325 million euros) resulting from Telefónica, S.A.'s irrevocable commitment to make a donation to Fundación Telefónica in order to provide this entity with the financing required so that it can carry out its existing or new social programs and non-profit activities in the short and medium term.

**Adjustments to the final purchase price of E-Plus:**

In 2015 we have excluded the result from the difference between the preliminary purchase price of E-Plus (as estimated at the end of the valuation period) and the final purchase price agreed with KPN, totaling 104 million euros (which had a 102 million euros positive impact on OIBDA, net of costs related to the acquisition).

**Spectrum acquisition:**

We have excluded the impact of spectrum acquisitions in 2015 and 2014.

In 2015, these acquisitions totaled 1,585 million euros, 1,198 million euros corresponding to Telefónica Germany, 49 million euros corresponding to Telefónica Spain and 338 million euros corresponding to Telefónica Hispanoamérica (mainly Argentina and Ecuador).

In 2014 these acquisitions totaled 1,294 million euros, 889 million euros corresponding to Telefónica Brazil and 405 million euros corresponding to Telefónica Hispanoamérica with the following distribution by country or region:

- Telefónica Argentina (168 million euros);
- Telefónica Colombia (111 million euros); and
- Telefónica Venezuela and Central America (126 million euros).

Table of Contents**Real Estate Efficiency Plan:**

In 2014 we have excluded the impact of certain urban assets qualification changes in Telefónica Spain and also the investment in Telefónica's Barcelona head office, which had an impact on capital expenditures (Capex) of 78 million euros.

**Other adjustments:**

We have excluded the impact of the impairment resulting from the deterioration in certain minority participations, totaling 23 million euros in 2015. We have also excluded the impact of the 30 million euros provision recorded in 2015 in Telefónica Spain to optimize the distribution network.

The table below shows 2015/2014 variations in reported and organic terms (the latter, calculated in accordance with the adjustments referred to above) of certain income statement and other measures:

TELEFÓNICA 2015	YoY variation	
	% Reported YoY	% Organic YoY
Revenues	8.7%	4.0%
Other income	21.1%	19.5%
Supplies	9.9%	1.6%
Personnel expenses	48.0%	4.1%
Other expenses	16.4%	8.1%
<b>OIBDA</b>	<b>(17.2%)</b>	<b>3.6%</b>
<b>Operating income (OI)</b>	<b>(54.4%)</b>	<b>3.7%</b>
CapEx	10.3%	5.0%
<b>OpCF (OIBDA-CapEx)</b>	<b>(64.0%)</b>	<b>1.9%</b>

The below table shows the contribution of each item for which we have adjusted to our reported growth. With respect to each line item, the contribution to reported growth of such line item, expressed in percentage points, is the result of dividing the impact of each item for which we have adjusted by the amount of such line item, on a reported basis, for the prior year.

**Contribution to reported growth (percentage points)**



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TELEFÓNICA 2015	Exchange rate effect and hyperinflation	Perimeter change	Restructuring costs	Towers sales	Commitment with Fundación	Adjustment to the final purchase price of E-Plus	Spectrum acquisition	Real Estate Efficiency Plan	Other adjustments
Revenues	(4.4)	8.8	-	-	-	-	-	-	-
Other income	(4.2)	8.4	-	(8.7)	-	6.9	-	-	-
Supplies	(3.2)	11.3	-	-	-	-	-	-	-
Personnel expenses	(2.5)	7.6	38.8	-	-	-	-	-	-
Other expenses	(6.2)	11.0	(0.1)	-	2.5	-	-	-	0.4
<b>OIBDA</b>	<b>(5.0)</b>	<b>5.4</b>	<b>(18.5)</b>	<b>(0.9)</b>	<b>(2.4)</b>	<b>0.7</b>	-	-	<b>(0.4)</b>
<b>Operating income (OI)</b>	<b>(6.9)</b>	<b>(4.6)</b>	<b>(40.2)</b>	<b>(2.0)</b>	<b>(5.1)</b>	<b>1.6</b>	-	-	<b>(0.8)</b>
CapEx	(5.1)	8.6	-	-	-	-	3.0	(0.9)	-
<b>OpCF (OIBDA-CapEx)</b>	<b>(4.9)</b>	<b>(0.0)</b>	<b>(50.1)</b>	<b>(2.5)</b>	<b>(6.4)</b>	<b>2.0</b>	<b>(5.2)</b>	<b>1.5</b>	<b>(1.0)</b>

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**Revenues** totaled 47,219 million euros in 2015, increasing 8.7% compared to 2014 in reported terms. This increase was mainly attributable to the consolidation of E-Plus, GVT and DTS (which accounted for 8.8 p.p. of the year-on-year increase), which was partially offset by the impact of changes in foreign exchange rates and hyperinflation in Venezuela (-4.4 p.p.). In organic terms, revenues increased 4.0% due to higher connectivity revenues, mainly in the mobile business as a consequence of the strong data revenue growth. The growing focus on our key markets was reflected in the revenue mix with Telefónica Spain, Telefónica Brazil and Telefónica Germany accounting for 66.0% of the revenues, increasing local scale and keeping at the same time the Group's differential diversification and global scale.

The structure of revenues reflects Telefónica's business diversification. Despite the adverse impact of exchange rates and hyperinflation in Venezuela, the segment with the largest contribution to our revenues in 2015 was Telefónica Hispanoamérica, representing 30.5% (+0.2 p.p. compared to 2014), followed by Telefónica Spain, representing 26.3% (-1.4 p.p. compared to 2014), Telefónica Brazil, representing 23.4% (-2.4 p.p. compared to 2014) and Telefónica Germany, which increased its contribution with respect to 2014 to 16.7% (+4 p.p. year-on-year).

**Mobile business revenues** totaled 27,936 million euros in 2015 (of which 24,510 million euros corresponded to service revenues and 3,505 million euros corresponded to handset revenues) up 7.7% year-on-year in reported terms. This increase was mainly attributable to the consolidation of E-Plus (which accounted for 7.8 p.p. of the year-on-year increase), which was partially offset by the impact of changes in foreign exchange rates and hyperinflation in Venezuela (-5.0 p.p.). Excluding these impacts, year-on-year growth was 4.6% due to higher mobile revenues in Telefónica Hispanoamérica and Telefónica Brazil as a result mainly of the increase in the customer base and data adoption.

**Mobile service revenues** totaled 24,510 million euros in 2015, up 6.5% year-on-year in reported terms. This increase was mainly attributable to the consolidation of E-Plus (which accounted for 7.4 p.p. of the year-on-year increase), which was partially offset by the impact of changes in foreign exchange rates and hyperinflation in Venezuela (-5.2 p.p.). Excluding these impacts, year-on-year growth was 4.0% due mainly to the higher customer base and higher data consumption.

**Mobile data revenues** totaled 10,501 million euros in 2015, up 22.5% in reported terms. This increase was mainly attributable to the consolidation of E-Plus (which accounted for 10.8 p.p. of the year-on-year increase) and the higher consumption of data of our customers, which was partially offset by the impact of changes in foreign exchange rates and hyperinflation in Venezuela (-6.9 p.p.). Excluding these impacts, mobile data revenues increased by 16.9% due mainly to the increased revenues of non-SMS data (up 25.3%) and higher use of data per customer. Mobile data revenues accounted for 42.5% of mobile service revenues in 2015, up 5.7 percentage points compared to 2014 in reported terms.

**Fixed revenues** totaled 17,634 million euros in 2015, up 9.3% year-on-year in reported terms. This increase was mainly attributable to the consolidation of GVT and DTS (which accounted for +11.1 p.p. of the year-on-year increase), which was partially offset by the impact of changes in foreign exchange rates and hyperinflation in Venezuela (-4.1 p.p.). Excluding these impacts, fixed revenues increased 2.2%. This increase was mainly due to higher broad band connection revenues and Pay-TV revenues as a result of the commercial actions carried out by the Company in order to increase our value proposition and the higher customer base in Pay-TV.

**Other income** in 2015 mainly included own work capitalized in our fixed assets, profit from the sale of other assets, and the sale of towers by Telefónica Spain, Telefónica Brazil and Telefónica Hispanoamérica.

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In 2015, other income totaled 1,841 million euros, up 21.1% year-on-year in reported terms. In 2015, other income was positively affected by the consolidation of E-Plus, GVT and DTS, the positive result from the E-Plus price adjustment (104 million euros), the positive impact from the expired payment obligation (98 million euros) in Telefónica Brazil, the spectrum swap with AT&T in Telefónica Mexico carried out in December 2015 (79 million euros), the sale of real estate in Telefónica Spain (78 million euros) and the results from the sale of towers amounting to 65 million euros.

In 2014, the sale of towers had a positive impact of 196 million euros. Other income also included an extraordinary sale of real estate in Telefónica Spain (63 million euros).

**Total expenses** (which include supply costs, personnel costs and other expenses (principally external services and taxes) but do not include amortization and depreciation expenses), were 37,646 million euros in 2015, up year-on-year 20.7% in reported terms. This increase was mainly attributable to the consolidation of E-Plus, GVT and DTS (which accounted for 10.2 p.p. of the year-on-year increase) and higher restructuring costs amounting to 3,212 million euros (which accounted for 8.2 p.p. of the year-on-year increase), which was partially offset by the impact of changes in foreign exchange rates and hyperinflation in Venezuela (-4.2 p.p.). The costs are explained in detail below:

**Supplies** amounted to 12,910 million euros in 2015, up 9.9% year-on-year in reported terms mainly as a result of the consolidation of E-Plus, GVT and DTS (which accounted for 11.3 p.p. of the year-on-year increase), and was partially offset by the impact of changes in foreign exchange rates and hyperinflation in Venezuela (-3.2 p.p.). In organic terms, supplies expenses grew by 1.6% year-on-year, due to increased commercial activity in high-end devices and higher TV content costs, which more than offset the decrease in mobile interconnection costs.

**Personnel expenses** amounted to 9,800 million euros in 2015, up 48.0% in reported terms year-on-year compared to 2014. This increase was mainly attributable to higher restructuring costs of 3,143 million euros (which accounted for +38.8 p.p. of the year-on-year increase), the consolidation of E-Plus, GVT and DTS (which accounted for 7.6 p.p. of the year-on-year increase), and was partially offset by the impact of changes in foreign exchange rates and hyperinflation in Venezuela (-2.5 p.p.). In organic terms, personnel costs increased 4.1% year-on-year mainly affected by inflationary pressures in some Latin American countries.

The average headcount was 125,892 employees in 2015, up 11.5% compared to 2014 (-2.3% excluding the impact of changes in the scope of consolidation). Including Telefónica United Kingdom, the average headcount 2015 was 133,569 employees, up 10.8% compared to 2014 (-2.1% excluding the impact of changes in the scope of consolidation).

**Other expenses** amounted to 14,936 million euros in 2015, up 16.4% in reported terms. This increase was mainly attributable to the consolidation of E-Plus, GVT and DTS (which accounted for 11.0 p.p. of the year-on-year

increase), the provision of 325 million euros related to the irrevocable agreement between Telefónica, S.A. and Fundación Telefónica for its short-and mid-term financing (+2.5 p.p.) and to a lesser extent, the impairment resulting from the deterioration in certain minority participations (+0.2 p.p.) and the increase in other expenses related to restructuring processes (+0.1 p.p.), which was partially offset by the impact of changes in foreign exchange rates and hyperinflation in Venezuela (-6.2 p.p.). In organic terms, other expenses increased by 8.1% compared to 2014, mainly as a result of increased network costs, higher IT costs and a higher commercial activity. Increased inflation in some Latin American countries offset in part the savings resulting from the simplification measures carried out by the Company.

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**OIBDA** was 11,414 million euros in 2015, down 17.2% in reported terms. This decrease was mainly attributable to the higher restructuring costs (which accounted for 18.5 p.p. of the year-on-year decrease and included a restructuring costs provision of 3,212 million euros), the impact of changes in foreign exchange rates and hyperinflation in Venezuela (-5.0 p.p.), the provision of 325 million euros related to the agreement between Telefónica, S.A. and Fundación Telefónica for its short and mid term financing (-2.4 p.p.) and, to a lesser extent, the decreased results from the sale of towers (-0.9 p.p.), the provision recorded in connection with the optimization of the distribution channel in Spain of 30 million euros (-0.2 p.p.) and the impairment resulting from the deterioration in certain minority participations (-0.2 p.p.), which was partially offset by the impact of the consolidation of E-Plus, GVT and DTS (+5.4 p.p.) and the adjustments made to the final acquisition price of E-Plus (+0.7 p.p.).

In organic terms, OIBDA grew 3.6% due to the positive evolution of Telefónica Germany (+20.9% year-on-year), reflecting increased synergies, the better performance of Telefónica Brazil (+2.9% year-on-year) and the results from Telefónica Hispanoamérica (+7.2% year-on-year).

**OIBDA margin** stood at 24.2% in 2015, down 7.5 percentage points compared to 2014 in reported terms due mainly to the restructuring costs provision of 3,212 million euros in 2015.

By segments, Telefónica Hispanoamérica was the main contributor to Group OIBDA with 38.2% (+8.6 p.p. compared to 2014), Telefónica Brazil contributed 31.3% (+5.6 p.p. compared to 2014) and Telefónica Germany contributed 16.3% (+11 p.p. compared to 2014). Telefónica Spain contributed 20.5% to Group OIBDA, down 20.7 percentage points compared to 2014, mainly as a result of the restructuring cost provision of 2,896 million euros in 2015.

**Depreciation and amortization** amounted to 8,517 million euros in 2015, up 14.6% year-on-year in reported terms, mainly due to the consolidation of E-Plus, GVT and DTS. The total depreciation and amortization charges arising from purchase price allocation processes amounted to 745 million euros in 2015, up 29.9% year-on-year.

**Operating income (OI)** in 2015 totaled 2,897 million euros, down 54.4% compared to 2014 for the reasons set forth above (see OIBDA explanation). In organic terms, operating income grew 3.7% year-on-year as a result of higher revenues and costs savings.

The **share of loss of investments accounted for by the equity method** for 2015 was a loss of 5 million euros (compared to a loss of 498 million euros in 2014). The loss recorded in 2014 was mainly due to the valuation adjustment of Telco, S.p.A. at Telecom Italia, S.p.A. amounting to 464 million euros.

**Net financial expense** amounted to 2,581 million euros in 2015, 7.1% lower than the previous year. Excluding exchange gains and losses, costs improved by 21.2% (528 million euros) to 1,961 million euros. Net exchange losses amounted to 620 million euros (excluding monetary correction), primarily due to adoption of the SIMADI exchange rate for the Venezuelan bolivar. The lower cost of debt in euros explains 146 million euros of this improvement, due to lower fixed rate debt and capture of the reduction in short-term rates. The divestment of the entire holding in Telecom Italia, S.p.A. generated a positive variation of 404 million euros. Other effects resulted in losses of 22 million euros. These included the monetary correction for inflation in Venezuela, net of higher expenses in Latin America currencies, costs for updating contingencies, and other gains and losses on equities. The effective cost of debt over the last twelve months, excluding exchange rate differences and the positive impact of the divestment of Telecom Italia, S.p.A., stood at 4.69%, down 57 basis points year-on-year.

**Corporate income tax** totaled 13 million euros in 2015 (compared to 260 million euros in 2014) mainly due to the temporary difference recorded related to the restructuring provision and a higher activation of tax credits in Spain. Considering a pre-tax income of 311 million euros, the effective tax rate was 4.2%, 4.3 percentage points lower year-on-year.

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**Profit after tax from discontinued operations** totaled 2,582 million euros (compared to 439 million euros in 2014), mainly due to deferred tax assets resulting from the estimated difference in Telefónica, S.A. between the tax value and the agreed sale value of Telefónica's operations in the United Kingdom, amounting to 1,789 million euros (which are expected to materialize in a foreseeable future when the sale is completed). This effect has been reduced by the amount corresponding to the tax amortization of goodwill generated in 2006 in connection with the acquisition of the companies to be sold under the sale agreement and deducted until December 31, 2015, amounting to 377 million euros. Additionally, the non-current assets ceased to be amortized and depreciated for accounting purposes once they were reclassified as assets held for sale.

The following table provides additional information on our discontinued operations:

Millions of euros	2015	2014	%
Revenues	7,697	6,919	11.2%
Other income	170	187	(9.1%)
Supplies	(3,636)	(3,431)	6.0%
Personnel expenses	(549)	(477)	15.1%
Other expenses	(1,857)	(1,463)	26.9%
OPERATING INCOME BEFORE DEPRECIATION AND AMORTIZATION (OIBDA)	1,825	1,735	5.2%
Depreciation and amortization	(300)	(1,118)	73.2%
OPERATING INCOME	1,525	617	n.m.
Share of loss of investments accounted for by the equity method	(5)	(12)	(58.3%)
Net financial expense	(28)	(43)	(34.9%)
PROFIT BEFORE TAX FROM DISCONTINUED OPERATIONS	1,492	562	n.m.
Corporate income tax	1,090	(123)	n.m.
PROFIT AFTER TAX FROM DISCONTINUED OPERATIONS	2,582	439	n.m.

**Profit attributable to non-controlling interest** reduced profit for the year attributable to equity holders of the parent by 135 million euros, 116 million euros less than in 2014, mainly due to the lower profit attributable to minority interests in Telefónica Brazil and Colombia Telecom.

As a result of the foregoing, **profit for the year attributable to equity holders of the parent** for 2015 was 2,745 million euros, down by 8.5% year on year.



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## Segment results

*TELEFÓNICA SPAIN*

The below table shows the evolution of accesses in Telefónica Spain over the past two years:

## ACCESSES

Thousands of accesses	2014	2015	%Reported YoY	%Organic YoY (1)
Fixed telephony accesses (2)	10,447.8	10,005.6	(4.2%)	(4.2%)
Internet and data accesses	5,928.7	6,000.0	1.2%	1.2%
Broadband (3)	5,885.9	5,962.0	1.3%	1.3%
Fiber	1,316.8	2,223.0	68.8%	68.8%
Mobile accesses	17,575.4	17,258.5	(1.8%)	(1.8%)
Prepay	3,328.1	2,777.1	(16.6%)	(16.6%)
Contract	14,247.3	14,481.4	1.6%	1.6%
M2M	1,612.4	1,778.8	10.3%	10.3%
Pay TV	1,884.7	3,671.5	94.8%	10.5%
Unbundled loops	4,087.3	3,647.3	(10.8%)	(9.1%)
Wholesale ADSL & Circuits	707.8	815.1	15.2%	15.2%
Final Clients Accesses	35,836.7	36,935.6	3.1%	(0.9%)
Wholesale Accesses	5,366.0	5,037.7	(6.1%)	(6.1%)
Total Accesses	41,202.7	41,973.3	1.9%	(1.6%)

## Notes:

(1) In order to calculate organic changes, we have added the accesses of DTS as of December 31, 2014 to our accesses as of such date.

(2) PSTN (including Public Use Telephony) x1; ISDN Basic access x1; ISDN Primary access; 2/6 Digital Access x30. Company's accesses for internal use included. Includes VoIP and Naked ADSL.

(3) Includes ADSL, satellite, optical fiber, cable modem and broadband circuits.

The below table shows the contribution of each item for which we have adjusted to our reported growth. With respect to each line item, the contribution to reported growth of such line item, expressed in percentage points, is the result of dividing the impact of each item for which we have adjusted by the amount of such line item, on a reported basis, for the prior year.

TELEFÓNICA SPAIN 2015	%Reported YoY	%Organic YoY (1)	DTS
Pay TV	94.8%	10.5%	76.3 p.p.
Final Clients Accesses	3.1%	(0.9%)	4.0 p.p.
Total Accesses	1.9%	(1.6%)	3.5 p.p.

(1) In order to calculate organic changes, we have added the accesses of DTS as of December 31, 2014 to our accesses as of such date.

In 2015 the commercial activity was leveraged on the differentiated assets of the Company and, in the second half of 2015 was strengthened by the convergent offer “Movistar Fusión+” launched in July 2015 as well as the promotion that included all “TV Premium Extra” content from 9.90 euros/month, launched in August 2015. This promotion was subscribed by almost 700 thousand customers, reflecting the attractiveness of the offer (new TV contents and ultra-speed fiber) in an economic environment where private consumption continues to improve.

Churn evolution has been positive in 2015, especially taking into account the elimination of “Fusión” long-term contracts on August 1, 2015. This fact, together with the good evolution in adds since the launching of “Movistar Fusión+” has resulted in a positive performance of commercial activity. In 2015, broadband net adds duplicated year-on-year, fiber net adds grew by 25.3%, mobile contract net adds resumed growth (+0.2 million customers) and in fixed telephony the net loss of accesses decreased by 31.1% year-on-year.

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The results of Telefónica Spain in 2015 showed a lower decrease in revenues compared to the year-on-year results of 2014-2013, as a result of the transformation strategy implemented in recent years which relies on a high value offer based on the differentiated assets of Telefónica Spain, a more rational market in competition terms and a more favorable macroeconomic context, with improvement in private consumption.

Telefónica Spain had 42.0 million accesses at the end of December 2015, up 1.9% year-on-year, after the consolidation of the DTS satellite TV accesses (0.9 million accesses at December 2015). The organic variation was down by 1.6%, explained by the decrease in mobile accesses and fixed telephony accesses, although it is important to highlight that retail accesses grew by 3.1% year-on-year.

“Movistar Fusión”, with a customer base of 4.2 million with 1.5 million additional wireless lines to the base offer as of December 31, 2015, maintained a solid year-on-year growth (+13% and +8% respectively compared to December 2014) and contributed 81% of the fixed retail broadband customer base and 63% of the wireless contract customer base. There was significant growth in the penetration of the high value services of “Movistar Fusión”, with 31.8% of the customer base already using 100 Mb or 300 Mb ultra-fast broadband (+10.9 p.p. year-on-year) and 62.4% of the customer base with Pay-TV as of December 31, 2015 (+17.7 p.p. year-on-year).

**Fixed accesses** decreased 4.2% year-on-year, with a net loss of 442 thousand accesses in the year 2015. This decrease was mainly due to a lower fixed access market growth.

**Retail broadband accesses** totaled 6.0 million and grew 1.3% year-on-year, with net adds of 76 thousand accesses, due to the good evolution of fiber adds (+37.1% year-on-year) and lower churn (1.4% in 2015, -0.1 p.p. year-on-year).

**Fiber accesses** posted a new record in terms of net adds (0.9 million new accesses in 2015), reaching 2.2 million customers (1.7 times compared to December 31, 2014), representing 37.3% of total broadband customers (+14.9 p.p. year-on-year). Two thirds of fiber accesses are benefiting from the new speeds (30 and 300 Mb) launched in May 2015.

Ultra speed fiber accesses, with 100 or 300 Mb (with additional ARPU of 12 euros, including VAT) reached 1.5 million accesses (68.6% of total fiber accesses), after the new record of 0.5 million accesses in 2015, triggered by the higher level of adds (+25.9% year-on-year) and contained churn (0.9%, +0.1 p.p. year-on-year).

At December 31, 2015 our fiber deployment reached 14.3 million premises, 4 million more than at December 31, 2014.

Total **mobile accesses** stood at 17.3 million, down 1.8% compared with year-end 2014 as a result of the decrease in prepay accesses. The contract access base accelerated its growth during 2015, growing by 1.6% year-on-year. The positive evolution of contract portability (-162 thousand customers at December 31, 2015, compared to -508 thousand customers at December 31, 2014), resulted in a positive contract net adds base (excluding M2M) (+68 thousand customers at December 31, 2015, compared to -113 thousand customers at December 31, 2014). Smartphone penetration stood at 66.3% of the mobile voice base (+5.7 p.p. compared to year-end 2014) and significantly boosted data traffic growth to 86.8% year-on-year in 2015 due to the higher number of customers with the renewed portfolio containing superior data packages.

LTE network rollout continued to progress well and coverage reached (based on our estimates) approximately 75% of the population at the end of 2015, up 17 percentage points compared to December 31, 2014, due to the deployment of the 800 MHz. As a result, the LTE customer base reached 3.3 million customers at December 31, 2015, doubling the customer base at December 31, 2014, while the penetration reached 21% (+10 p.p. year-on-year).

**Pay-TV accesses** reached 3.7 million, up by 94.8% in reported terms compared to December 31, 2014 as a result of the acquisition of DTS (+10.5% in organic terms), including 926 thousand satellite TV accesses from DTS.

#### *2015/2014 Results*

The table below shows the evolution of Telefónica Spain's results over the past two years:

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Millions of euros

TELEFÓNICA SPAIN	2014	2015	%Reported YoY	%Organic YoY (1)
Revenues	12,023	12,402	3.2%	(2.1%)
Mobile Business	4,556	4,337	(4.8%)	(4.8%)
Mobile service revenues	3,888	3,677	(5.4%)	(5.4%)
Fixed Business	8,543	9,359	9.6%	1.9%
Other income	635	516	(18.7%)	7.0%
Supplies	(2,592)	(2,996)	15.6%	(2.7%)
Personnel expenses	(2,139)	(5,173)	141.8%	4.0%
Other expenses	(2,256)	(2,413)	7.0%	(0.2%)
<b>OIBDA</b>	<b>5,671</b>	<b>2,336</b>	<b>(58.8%)</b>	<b>(4.3%)</b>
OIBDA Margin	47.2%	18.8%	(28.3 p.p.)	(1.0 p.p.)
Depreciation and amortization	(1,805)	(1,898)	5.2%	2.4%
<b>Operating income (OI)</b>	<b>3,866</b>	<b>438</b>	<b>(88.7%)</b>	<b>(7.8%)</b>
CapEx	1,732	1,827	5.5%	4.5%
OpCF (OIBDA-CapEx)	3,939	509	(87.1%)	(8.3%)

(1) See adjustments made to calculate organic variation below.

## Adjustments made to calculate organic variations

As explained above, year-on-year changes referred to in this document as “organic” or presented in “organic terms” intend to present year-on-year variations on a comparable basis.

With respect to Telefónica Spain, we have made the following adjustments in order to calculate 2015/2014 variations in organic terms:

**Changes in the scope of consolidation:**

We have excluded the impact of changes in our consolidation perimeter in 2015 and 2014. The only change to our Telefónica Spain consolidation perimeter in such years related to the consolidation of DTS in Telefónica Spain since May 1, 2015. In order to exclude the impact of such change in our perimeter, we have consolidated DTS’s results from May 1 to December 31, 2014 in our 2014 results.

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**Restructuring costs:**

We have excluded the impact of the 2,896 million euros of restructuring costs in 2015, mainly those related to the Voluntary Suspension Plan in Spain. The restructuring process is aimed at increasing future efficiency, representing a further step towards the transformation and simplification initiatives carried out by Telefónica.

No restructuring costs were excluded from our 2014 results to calculate organic variations.

**Results of tower sales:**

The results attributable to the sale of towers in 2015 and 2014 have been excluded in both years. In 2015, the results from the sale of towers totaled 38 million euros. In 2014, the results from the sale of towers totaled 191 million euros.

**Spectrum acquisition:**

We have excluded the impact of spectrum acquisitions in 2015, that totaled 49 million euros.

**Real Estate Efficiency Plan:**

We have excluded the impact of certain urban assets qualification changes in Telefónica Spain in 2014, totaling 49 million euros.

**Spain distribution channel:**

We have excluded the impact of the 30 million euros provision recorded in 2015 in Telefónica Spain to optimize the distribution network.

The table below shows 2015/2014 variations in reported and organic terms (the latter, calculated in accordance with the adjustments referred to above) of certain income statement and other measures, and the contribution of each item for which we have adjusted to our reported growth:

	YoY variation		Contribution to reported growth (percentage points)					
	%Reported YoY	%Organic YoY	Perimeter change (DTS)	Restructuring costs	Towers sales	Spectrum acquisition	Real Estate Efficiency Plan	Spain distribution channel
<b>TELEFÓNICA SPAIN 2015</b>								
Revenues	3.2%	(2.1%)	5.4	--	--	--	--	--
Other income	(18.7%)	7.0%	0.9	--	(24.5)	--	--	--
Supplies	15.6%	(2.7%)	18.7	--	--	--	--	--
Personnel expenses	141.8%	4.0%	2.4	135.4	--	--	--	--
Other expenses	7.0%	(0.2%)	5.9	--	(0.1)	--	--	1.3
<b>OIBDA</b>	<b>(58.8%)</b>	<b>(4.3%)</b>	<b>(0.4)</b>	<b>(51.1)</b>	<b>(2.7)</b>	--	--	<b>(0.5)</b>
CapEx	5.5%	4.5%	1.1	--	--	2.8	(2.8)	--
<b>OpCF (OIBDA-CapEx)</b>	<b>(87.1%)</b>	<b>(8.3%)</b>	<b>(1.0)</b>	<b>(73.5)</b>	<b>(3.9)</b>	<b>(1.2)</b>	<b>1.3</b>	<b>(0.8)</b>

### *Results Discussion*

**Revenues** in Telefónica Spain in 2015 were 12,402 million euros, up 3.2% year-on-year in reported terms mainly as a result of the consolidation of DTS since May 1, 2015 (which accounted for +5.4 p.p. of the year-on-year increase). In organic terms, revenues were down by 2.1% due to lower mobile service revenues in the mobile business and lower access and voice revenues in the fixed business.

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We consider revenue breakdown to be increasingly less relevant given the high penetration level of our convergent offer, by which we mean the offer of more than a single service for a single price. However, we continue to report revenue separately for information purposes. Fixed business revenues were up by 9.6% year-on-year in 2015, due to the consolidation of DTS, the repositioning of tariffs, higher retail broadband revenues and new services, mainly related to TV and IT services. Excluding the impact of DTS, fixed revenues increased by 1.9%. Mobile business revenues fell 4.8% year-on-year in 2015 due to the decline in mobile accesses and the 3.6% drop in ARPU.

**Mobile ARPU** was 15.3 euros in 2015, down by 3.6% year-on-year. Mobile ARPU is becoming less representative of the Group's business performance, owing to its high dependence on the allocation of revenue in convergent offers.

TELEFÓNICA SPAIN	2014	2015	%YoY
Voice Traffic (millions of minutes)		35,600	36,368 2.2%
ARPU (EUR)	15.9	15.3	(3.6%)
Prepay	6.2	5.7	(8.2%)
Contract (1)	20.6	19.5	(5.3%)
Data ARPU (EUR)	7.0	7.8	11.0%
% non-SMS over data revenues	95.0%	95.5%	0.5 p.p.

Notes:

(1) Excludes M2M.

**OIBDA** amounted to 2,336 million euros in 2015, down 58.8% year-on-year in reported terms, mainly due to provisions recorded in 2015 totaling 2,926 million euros (relating to restructuring costs accounted for 51.1 p.p. of the year-on-year decrease and 0.5 p.p. of the year-on-year decrease in distribution channel restructuring) and, to a lesser extent, the lower proceeds (38 million euros in 2015 compared to 191 million euros in 2014) from the sale of towers (-2.7 p.p.). This decrease was partially offset by the sale of real estate assets amounting to 73 million euros (net of costs).

In organic terms OIBDA decreased 4.3% year-on-year, mainly due to the lower revenues, higher personnel costs and higher content costs. The higher personnel costs, up by 4.0% year-on-year in organic terms, were primarily due to the resumption of the Company's contribution to its pension plan in July 2014, and to a lesser extent, the acquisition of DTS. Telefónica Spain had 32,171 employees at the end of December 2015, up 7.2% year-on-year, due mainly to the acquisition of DTS.

**OIBDA margin** was 18.8% in 2015, down 28.3 percentage points year-on-year.



Table of Contents*TELEFÓNICA GERMANY*

The below table shows the evolution of accesses in Telefónica Germany over the past two years:

ACCESSES			
Thousands of accesses	2014	2015	%YoY
Fixed telephony accesses (1)	2,036.4	1,997.8	(1.9%)
Internet and data accesses	2,387.0	2,330.6	(2.4%)
Broadband	2,143.8	2,098.0	(2.1%)
Mobile accesses	42,124.9	43,062.8	2.2%
Prepay	23,350.7	23,979.4	2.7%
Contract (2)	18,774.1	19,083.4	1.6%
M2M	414.0	632.0	52.7%
Final Clients Accesses	46,548.3	47,391.2	1.8%
Wholesale Accesses	1,113.3	972.0	(12.7%)
Total Accesses	47,661.5	48,363.2	1.5%

## Notes:

(1) Includes "fixed wireless" and Voice over IP accesses.

(2) In the fourth quarter of 2014, 428 thousand E-Plus accesses were excluded before integration, due to the criteria harmonization.

In 2015, Telefónica Germany maintained market momentum, increasing slightly its estimated mobile service revenue market share.

The **total access** base grew 1.5% year-on-year and stood at 48.4 million at December 31, 2015, mainly driven by a 2.2% increase in the mobile base (which reached 43.1 million).

The contract mobile customer base grew 1.6% year-on-year and reached 19.1 million accesses, with a broadly stable 44.3% share over the total mobile base. Net adds reached 309 thousand accesses due to the solid contribution of partners (second brands). Smartphone penetration reached 54.2% of the total mobile access base, up 5.5 percentage points year-on-year driven by the continued growth of LTE customers (+154.5% year-on-year reaching 7.9 million at December 31, 2015). LTE penetration reached 18.6% of the total mobile access base.

The prepay access base increased 2.7% year-on-year to 24.0 million. Prepay posted 629 thousand net additions in 2015, 32.5% more than in 2014 due to the strong contribution from wholesale agreements (second brands). The retail

broadband access loss trend continued to improve, with 46 thousand net loss in 2015, more than halving the number of 2014. VDSL was once again the main growth engine of fixed performance with 260 thousand net additions (+55% year-on-year) in 2015.

Table of Contents*2015/2014 Results*

The table below shows the evolution of Telefónica Germany's results over the past two years:

Millions of euros				
TELEFÓNICA GERMANY	2014	2015	%Reported YoY	%Organic YoY (1)
Revenues	5,522	7,888	42.9%	1.2%
Mobile Business	4,375	6,832	56.2%	2.8%
Mobile service revenues	3,580	5,532	54.5%	0.1%
Fixed Business	1,138	1,043	(8.3%)	(8.3%)
Other income	106	265	150.4%	14.7%
Supplies	(2,144)	(2,712)	26.5%	(3.4%)
Personnel expenses	(828)	(655)	(20.9%)	(10.1%)
Other expenses	(1,923)	(2,928)	52.2%	(1.1%)
<b>OIBDA</b>	<b>733</b>	<b>1,858</b>	<b>153.7%</b>	<b>20.9%</b>
OIBDA Margin	13.3%	23.6%	10.3 p.p.	3.8 p.p.
Depreciation and amortization	(1,426)	(2,128)	49.3%	(3.8%)
<b>Operating income (OI)</b>	<b>(693)</b>	<b>(270)</b>	<b>(61.0%)</b>	<b>(57.2%)</b>
CapEx	849	2,230	162.8%	(11.1%)
OpCF (OIBDA-CapEx)	(116)	(372)	n.m.	126.2%

(1) See adjustments made to calculate organic variation below.

*Adjustments made to calculate organic variations*

As explained above, year-on-year changes referred to in this document as “organic” or presented in “organic terms” intend to present year-on-year variations on a comparable basis.

With respect to Telefónica Germany, we have made the following adjustments in order to calculate 2015/2014 variations in organic terms:

**Changes in the scope of consolidation:**

We have excluded the impact of changes in our consolidation perimeter in 2015 and 2014. The only change to our Telefónica Germany consolidation perimeter in such years related to the consolidation of E-Plus in Telefónica Germany since October 1, 2014. In order to exclude the impact of this change in our perimeter, we have consolidated E-Plus's results from January 1 to September 30, 2014 in our 2014 results.

**Restructuring costs:**

We have excluded the impact of restructuring costs associated with certain simplification processes implemented in Germany. In 2015, restructuring costs had a 74 million euros impact on OIBDA. In 2014, restructuring costs had a 414 million euros impact on OIBDA.

**Spectrum acquisition:**

We have excluded the impact of spectrum acquisitions in 2015, amounting to 1,198 million euros. There were no spectrum acquisitions in 2014.

**Adjustments to the final purchase price of E-Plus:**

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In 2015 we have excluded the result from the difference between the preliminary purchase price of E-Plus (as estimated at the end of the valuation period) and the final purchase price agreed with KPN, totaling 104 million euros (which had a 102 million euros positive impact on OIBDA net of costs related to the acquisition).

The table below shows 2015/2014 variations in reported and organic terms (the latter, calculated in accordance with the adjustments referred to above) of certain income statement and other measures, and the contribution of each item for which we have adjusted to our reported growth:

TELEFÓNICA GERMANY 2015	YoY variation		Contribution to reported growth (percentage points)			
	%Reported YoY	%Organic YoY	Perimeter change	Restructuring costs	Spectrum acquisition	Adjustment to purchase price of E-Plus
Revenues	42.9%	1.2%	41.1	--	--	--
Other income	150.4%	14.7%	32.3	--	--	98.6
Supplies	26.5%	(3.4%)	30.9	--	--	--
Personnel expenses	(20.9%)	(10.1%)	26.9	(39.0)	--	--
Other expenses	52.2%	(1.1%)	54.7	(0.9)	--	0.1
<b>OIBDA</b>	<b>153.7%</b>	<b>20.9%</b>	<b>50.2</b>	<b>46.5</b>	<b>--</b>	<b>13.9</b>
CapEx	162.8%	(11.1%)	36.8	--	141.2	--
<b>OpCF (OIBDA-CapEx)</b>	<b>n.m.</b>	<b>126.2%</b>	<b>(47.1)</b>	<b>(293.2)</b>	<b>1031.3</b>	<b>(87.7)</b>

*Results Discussion*

Total **revenues** were 7,888 million euros in 2015, up 42.9% year-on-year in reported terms due mainly to the consolidation of E-Plus since October 1, 2014 (which accounted for 41.1 p.p. of the year-on-year increase). In organic terms, revenues increased by 1.2% due mainly to higher handset sales arising from Christmas campaigns.

**Mobile service revenues** totaled 5,532 million euros in 2015, up 54.5% year-on-year in reported terms, due mainly to the consolidation of E-Plus since October 1, 2014 and to a lesser extent, the increasing share of the partner segment (second brands) within the customer base. Telefónica Germany continued to focus on data revenues, which increased by 58.4% and accounted for 51.3% of mobile service revenues in 2015. Non-P2P SMS data revenues amounted to 2,034 million euros (increasing 4.9% year-on-year), accounting for 71.6% of the total data revenues (+0.4 p.p. year-on-year).

**Fixed revenues** were 1,043 million euros in 2015, down 8.3% year-on-year, due to continued decrease in accesses.

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**Mobile ARPU** was 10.7 euros in 2015, down 8.9% year-on-year, while contract ARPU stood at 17.2 euros down 6.5% year-on-year, as a result of the higher share of wholesale customers in the customer base. Data ARPU was 5.5 euros, down 6.8% year-on-year, mainly as a result of the continued decline of SMS volumes.

TELEFÓNICA GERMANY	2014	2015	%YoY
Voice Traffic (millions of minutes)	41,186	62,696	52.2%
ARPU (EUR)	11.8	10.7	(8.9%)
Prepay	5.4	5.4	5.88.2%
Contract (1)	18.4	17.2	(6.5%)
Data ARPU (EUR)	5.9	5.5	(6.8%)
% non-SMS over data revenues	71.2%	71.6%	0.4 p.p.

Notes:

(1) Excludes M2M.

**OIBDA** totaled 1,858 million euros in 2015, up 153.7% year-on-year in reported terms, as a result mainly of the consolidation of E-Plus (which accounted for 50.2 p.p. of the increase), the lower restructuring costs recorded in 2015 (+46.5 p.p.) and the positive result from the E-Plus preliminary acquisition price and the final acquisition price agreed on with KPN (+13.9 p.p.). In organic terms, OIBDA increased by 20.9% year-on-year, driven by the increased synergies, which mainly affected personnel expenses and supplies.

The **OIBDA margin** stood at 23.6% in reported terms for 2015, up 10.3 percentage points compared to 2014.

*TELEFÓNICA BRAZIL*

The below table shows the evolution of accesses in Telefónica Brazil over the past two years:

ACCESSES	2014	2015	%Reported YoY	%Organic YoY (1)
Thousands of accesses				
Fixed telephony accesses (2)	10,743.4	14,654.5	36.4%	(1.6%)
Internet and data accesses	4,082.6	7,195.5	76.2%	2.5%
Broadband	3,939.8	7,129.5	81.0%	3.6%
Fiber	374.6	3,779.9	n.m.	14.0%
Mobile accesses	79,932.1	73,261.3	(8.3%)	(8.3%)
Prepay	51,582.4	42,194.4	(18.2%)	(18.2%)
Contract	28,349.7	31,066.9	9.6%	9.6%

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M2M	3,506.9	4,234.7	20.8%	20.8%
Pay TV	770.6	1,787.9	132.0%	9.7%
Final Clients Accesses	95,528.6	96,899.3	1.4%	(6.4%)
Wholesale Accesses	25.9	22.3	(14.0%)	(14.0%)
Total Accesses	95,554.5	96,921.5	1.4%	(6.4%)

Notes:

(1) In order to calculate organic changes, we have added the accesses of GVT as of December 31, 2014 to our accesses as of such date.

(2) Includes "fixed wireless" and Voice over IP accesses.



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The below table shows the contribution of each item for which we have adjusted to our reported growth. With respect to each line item, the contribution to reported growth of such line item, expressed in percentage points, is the result of dividing the impact of each item for which we have adjusted by the amount of such line item, on a reported basis, for the prior year.

TELEFÓNICA BRAZIL 2015	%Reported YoY	%Organic YoY (1)	GVT
Fixed telephony accesses	36.4%	(1.6%)	38.6 p.p.
Internet and data accesses	76.2%	2.5%	72.0 p.p.
Broadband	81.0%	3.6%	74.6 p.p.
Fiber	n.m.	14.0%	785.0 p.p.
Pay TV	132.0%	9.7%	111.5 p.p.
Final Clients Accesses	1.4%	(6.4%)	8.3 p.p.
Total Accesses	1.4%	(6.4%)	8.3 p.p.

(1) In order to calculate organic changes, we have added the accesses of GVT as of December 31, 2014 to our accesses as of such date.

Telefónica Brazil closed the year 2015 improving its competitive position in the mobile as well as in the fixed market. In the mobile business, Telefónica Brazil kept its leadership in the higher value segments, which permitted the operator to capture mobile market revenue growth in 2015. In the fixed business, the transformation towards fiber and Pay-TV was strengthened by the GVT consolidation in May 2015, adding as of December 31, 2015, 8.5 million customers to the Group.

Revenues and OIBDA evolution was positively supported by the acceleration of mobile data and the good evolution of fixed broadband and Pay-TV. Additionally, Telefónica Brazil carried out costs control measures aimed at offsetting the adverse macroeconomic situation.

However, results in 2015 were adversely affected by the interconnection tariff reduction in the mobile business (-33.0%) and in the retail fixed-mobile tariff (-23.3%) since February 24, 2015.

Telefónica Brazil reached 96.9 million **accesses** at December 31, 2015, up 1.4% due mainly to the consolidation of GVT. Excluding the impact of such consolidation, accesses were down 6.4%, due to the disconnection of prepay accesses.

In the **mobile business**, the strategic focus remained on gaining and retaining high value customers, reaching a market share of 42.4% in the contract segment as of December 31, 2015 (Source: ANATEL). Telefónica Brazil maintained its market leadership in terms of total accesses with a market share of 29.5% as of December 2015 (source: ANATEL). The commercial offer in the contract segment included a higher data volume, more minutes of voice traffic and innovative products such as “Vivo Bis” (pursuant to which the data not consumed in a month is automatically added to data available for the following month). The contract growth was partially offset by the disconnection of 11.5 million prepaid accesses.

In the **fixed business**, Telefónica Brazil maintained its strategic focus on fiber deployment, with 16.6 million premises passed with FTTx at December 31, 2015 and 3.8 million homes connected, and also on increasing Pay-TV accesses (up 10% year-on-year). Fixed telephony accesses stood at 14.7 million in 2015, up 36.4% in reported terms due mainly to the consolidation of GVT. In organic terms, these accesses were down by 1.6% year-on-year. Retail broadband customers totaled 7.1 million customers as of December 31, 2015, up 81.0% year-on-year due mainly to the consolidation of GVT (up 3.6% year-on-year in organic terms due to the increase of fiber accesses). Of the 7.1 million customers at the end of 2015, 53.0% were connected with FTTC. Pay TV customers stood at 1.8 million as of December 31, 2015, up 132.0% in reported terms due mainly to the consolidation of GVT, increasing by 9.7% year-on-year in organic terms due to a higher penetration of high value and IPTV clients. IPTV accesses increased their relevance, representing 9.6% of total Pay-TV accesses.

Table of Contents*2015/2014 Results*

The table below shows the evolution of Telefónica Brazil's results over the past two years:

Millions of euros

TELEFÓNICA BRAZIL	2014	2015	%Reported YoY	%Organic YoY (1)
Revenues	11,231	11,060	(1.5%)	4.5%
<b>Mobile Business</b>	<b>7,618</b>	<b>6,906</b>	<b>(9.3%)</b>	<b>6.2%</b>
Mobile service revenues	7,228	6,495	(10.1%)	5.3%
<b>Fixed Business</b>	<b>3,613</b>	<b>4,154</b>	<b>15.0%</b>	<b>1.9%</b>
Other income	261	416	59.3%	35.4%
Supplies	(2,680)	(2,568)	(4.2%)	4.4%
Personnel expenses	(976)	(1,042)	6.8%	3.5%
Other expenses	(4,293)	(4,293)	(0.0%)	8.6%
<b>OIBDA</b>	<b>3,543</b>	<b>3,573</b>	<b>0.9%</b>	<b>2.9%</b>
OIBDA Margin	31.5%	32.3%	0.8 p.p.	(0.5 p.p.)
Depreciation and amortization	(1,762)	(1,916)	8.7%	12.9%
<b>Operating income (OI)</b>	<b>1,781</b>	<b>1,657</b>	<b>(6.9%)</b>	<b>(6.7%)</b>
CapEx	2,933	2,105	(28.2%)	(1.1%)
OpCF (OIBDA-CapEx)	610	1,468	140.8%	9.3%

Notes:

(1) See adjustments made to calculate organic variation below.

*Adjustments made to calculate organic variations*

As explained above, year-on-year changes referred to in this document as “organic” or presented in “organic terms” intend to present year-on-year variations on a comparable basis.

With respect to Telefónica Brazil, we have made the following adjustments in order to calculate 2015/2014 variations in organic terms:

**Foreign exchange effects:**

We have excluded the impact of changes in exchange rates by assuming constant average foreign exchange rates in 2015 and 2014. In particular, we have used the average foreign exchange rate of 2014 for both years. Foreign exchange rates had a negative impact on our reported 2015 Telefónica Brazil results as a result of the depreciation of the Brazilian real.

Table of Contents**Changes in the scope of consolidation:**

We have excluded the impact of changes in our consolidation perimeter in 2015 and 2014. The only change to our Telefónica Brazil consolidation perimeter in such years related to the consolidation of GVT since May 1, 2015. In order to exclude the impact of this change in our perimeter, we have consolidated GVT's results from May 1 to December 31, 2014 in our 2014 results.

**Restructuring costs:**

We have excluded the impact of certain restructuring costs associated with certain simplification processes implemented in Telefónica Brazil. In 2015, these restructuring costs totaled 7 million euros. In 2014, these restructuring costs totaled 68 million euros.

**Spectrum acquisition:**

We have excluded the impact of spectrum acquisitions in 2014 amounting to 889 million euros (related to a LTE block in the 700 MHz band) while there were no spectrum acquisitions in 2015.

**Results of tower sales:**

The results attributable to the sale of towers in 2015 and 2014 have been excluded in both years. The results from the sale of towers totaled 10 million euros and 1 million euros in 2015 and 2014, respectively.

The table below shows 2015/2014 variations in reported and organic terms (the latter, calculated in accordance with the adjustments referred to above) of certain income statement and other measures, and the contribution of each item for which we have adjusted to our reported growth:

	YoY variation		Contribution to reported growth (percentage points)				
	%Reported YoY	%Organic YoY	Exchange rate effect	Perimeter change (GVT)	Restructuring Costs	Spectrum acquisition	Towers sales
TELEFÓNICA BRAZIL 2015 Revenues	(1.5%)	4.5%	(16.6)	10.1	--	--	--

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Other income	59.3%	35.4%	(26.9)	34.5	--	--	4.1
Supplies	(4.2%)	4.4%	(16.2)	7.2	--	--	--
Personnel expenses	6.8%	3.5%	(18.1)	26.8	(6.2)	--	--
Other expenses	(0.0%)	8.6%	(16.9)	7.6	--	--	--
<b>OIBDA</b>	<b>0.9%</b>	<b>2.9%</b>	<b>(17.0)</b>	<b>12.5</b>	<b>1.7</b>	<b>--</b>	<b>0.3</b>
CapEx	(28.2%)	(1.1%)	(12.1)	15.1	--	(30.3)	--
<b>OpCF (OIBDA-CapEx)</b>	<b>140.8%</b>	<b>9.3%</b>	<b>40.7</b>	<b>0.2</b>	<b>9.9</b>	<b>145.8</b>	<b>1.7</b>

*Results Discussion*

**Revenues** totaled 11,060 million euros in 2015, down 1.5% in reported terms, mainly due to the depreciation of the Brazilian real (which accounted for -16.6 p.p. of the evolution) and partially offset by the impact of the consolidation of GVT (+10.1 p.p.). In organic terms, the year-on-year variation was 4.5%, principally due to the good evolution in the mobile business (+6.2% year-on-year) as well as the fixed business (+1.9% year-on-year), which was partially offset by the impact of the regulatory interconnection tariff reduction (-2.7 p.p. of the year-on-year variation).

**Revenues from the mobile business** totaled 6,906 million euros in 2015, down 9.3% in reported terms due mainly to the depreciation of the Brazilian real (which accounted for -15.3 p.p. of the evolution). Excluding this impact, revenues from the mobile business increased by 6.2% due to the positive evolution of service revenues (+5.3% year-on-year) as a result of the good performance of outbound revenues, which increased as a result of an increase in the contract customer base and the higher data penetration. This trend was partially offset by lower inbound revenues affected by lower interconnection tariffs. Handset revenues were up by 5.1% in reported terms, due to higher proportion of contract adds and higher smartphones and LTE handset sales.

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**Fixed telephony revenues** totaled 4,154 million euros, up by 15.0% in reported terms due mainly to the consolidation of GVT (+31.9 p.p.) and were partially offset by the impact of depreciation of the Brazilian real (which accounted for -19.4 p.p. of the evolution). Excluding these effects, revenues were up by 1.9%, mainly due to the increase in fixed broadband revenues, which were up by 9.3% supported by the increase of fiber and the growth of Pay TV accesses with higher ARPU, in spite of the lower retail fixed-mobile tariff (-2.5 p.p.).

The **mobile ARPU** decreased 13.2% year-on-year in reported terms due mainly to depreciation of the Brazilian real. In organic terms, it increased 1.6% year-on-year as a consequence of the higher data ARPU which more than offset the negative impact of the reduction in the mobile termination rates. We believe the high quality of the customer base is reflected in an increase in the outbound ARPU and the 31.5% growth in the data ARPU.

TELEFÓNICA BRAZIL	2014	2015	%YoY	%Local Currency YoY
Voice Traffic (millions of minutes)	127,412	131,029	2.8%	2.8%
ARPU (EUR)	7.3	6.3	(13.2%)	1.6%
Prepay	3.9	3.2	(18.5%)	(4.7%)
Contract (1)	15.7	13.3	(15.0%)	(0.7%)
Data ARPU (EUR)	2.6	2.9	12.5%	31.5%
% non-SMS over data revenues	77.4%	82.9%	5.5 p.p.	5.5 p.p.

Notes:

(1) Excludes M2M.

**OIBDA** stood at 3,573 million euros in 2015, up 0.9% in reported terms due mainly to the consolidation of GVT (which accounted for +12.5 p.p. of the evolution) and, to a lesser extent, the lower restructuring costs incurred in 2015 compared to 2014 (+1.7 p.p.), and the higher results from the sale of towers compared to 2014 (+0.3 p.p.), all of which was partially offset by the negative impact of the depreciation of the Brazilian real (-17.0 p.p.). In organic terms, the year-on-year increase was 2.9% due to revenue growth and cost efficiency offsetting a worse macro scenario with higher inflation, high devaluation and a higher rate of bad debt. Personnel expenses totaled 1,042 million euros in 2015, up 6.8% in reported terms as result mainly of the consolidation of GVT, which was partially offset by the depreciation of the Brazilian real. In organic terms, personnel expenses increased by 3.5% year-on-year due to higher social benefits and the internalization of the work of certain network contractors which more than offset the savings resulting from restructuring plans in 2014. In addition, network costs grew due to higher energy costs and the deployment and improvement of fixed- and mobile networks, legal contingencies and higher content costs. OIBDA was also positively impacted by the expiration of a payment obligation (98 million euros).

The **OIBDA margin** stood at 32.3% in reported terms for 2015, up 0.8 percentage points compared to 2014.

*TELEFÓNICA HISPANOAMÉRICA*

The below table shows the evolution of accesses in Telefónica Hispanoamérica over the past two years:

ACCESSES	2014	2015	%YoY
Thousands of accesses			
Fixed telephony accesses (1) (2)	13,374.4	12,829.8	(4.1%)
Internet and data accesses	5,433.8	5,667.8	4.3%
Broadband	5,379.4	5,610.4	4.3%
Mobile accesses	110,346.5	113,302.7	2.7%
Prepay (3)	86,698.0	88,332.8	1.9%
Contract	23,648.5	24,969.8	5.6%
M2M	2,062.2	2,296.9	11.4%
Pay TV	2,431.9	2,812.2	15.6%
Final Clients Accesses	131,586.6	134,612.4	2.3%
Wholesale Accesses	16.4	30.9	87.8%
Total Accesses T. Hispanoamérica	131,603.0	134,643.3	2.3%

Notes:

(1) Includes "fixed wireless" and Voice over IP accesses.

(2) Includes 50 thousand "fixed wireless" additional customers in Peru, in the second quarter of 2014.

(3) In the fourth quarter of 2014, 1.8 millions of inactive customers were disconnected in Central America.



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Total accesses in Telefónica Hispanoamérica reached 134.6 million accesses at December 31, 2015 (+2.3% year-on-year).

**Mobile accesses** totaled 113.3 million (+2.7% year-on-year) due to positive net adds of 3.0 million accesses.

There was strong contract segment growth, which expanded by 5.6% year-on-year. Growth was particularly strong in Peru (+12.9% year-on-year), Mexico (+22.3% year-on-year) and Chile (+4.2% year-on-year). Annual net adds reached 1.3 million accesses, primarily due to Peru (+659 thousand net adds) which benefitted from a successful migration strategy (from prepay to contract). Mexico also showed positive net adds (+327 thousand accesses) due to higher commercial activity.

In the prepay segment (+1.9% year-on-year), with net adds of 1.6 million customers, growth was driven mainly by Mexico (+2.9 million customers) while Venezuela and Central America closed with 1.2 million net adds, partially compensating the net loss in Chile (-0.9 million customers) and Peru (-0.7 million customers) where we have faced a fierce competition and we have concentrated on high value customers migrating the best prepaid customers to contract and not following competition offers that would damage the quality of our networks due to intense traffic.

There was growth in smartphones (+43.7% year-on-year) to 40.2 million accesses as of December 31, 2015, with a penetration over mobile accesses of 36.7% (+10.4 p.p. year-on-year), related mainly to Mexico, Argentina, Peru and Colombia. 4G handsets also continued to grow, reaching 8.3 million accesses as of December 31, 2015 (corresponding to a penetration of 7.4%).

Traditional **fixed business accesses** stood at 12.8 million at December 31, 2015 (-4.1% year-on-year), with negative net adds of 545 thousand customers, affected by the erosion of traditional fixed business in the region, including Chile (-5.9% year-on-year), Peru (-4.4% year-on-year), Colombia (-2.1% year-on-year) and Argentina (-1.9% year-on-year).

**Broadband accesses** totaled 5.6 million at December 31, 2015 (+4.3% year-on-year), after reaching net adds of 0.2 million accesses during 2015 due mainly to access growth in Peru (+8.0%), Chile (+5.8%) and Colombia (+4.0%). The penetration of fixed broadband accesses over traditional fixed business accesses was 43.7% at December 31, 2015 (+3.5 p.p. year-on-year). There was progressive migration towards data plans with higher speeds, with 53.4% of broadband accesses having a speed over 4Mb at December 31, 2015 (+4 p.p. year-on-year).

Pay TV accesses totaled 2.8 million (+15.6% year-on-year), with net adds of 0.4 million accesses as a result of an improvement in all countries in the region that offer the service. Growth was particularly positive in Peru (+26.7% year-on-year), Colombia (+17.5%) and Chile (+7.2%).



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The table below shows the evolution of Telefónica Hispanoamérica's results over the past two years:

Millions of euros				
TELEFÓNICA HISPANOAMÉRICA	2014	2015	%Reported YoY	%Organic YoY (1)
Revenues	13,155	14,387	9.4%	10.1%
Mobile Business	9,578	10,347	8.0%	10.2%
Mobile service revenues	8,454	9,160	8.4%	10.6%
Fixed Business	3,604	4,070	12.9%	10.0%
Other income	254	347	36.5%	29.6%
Supplies	(3,841)	(4,176)	8.7%	7.2%
Personnel expenses	(1,525)	(1,686)	10.6%	16.0%
Other expenses	(3,975)	(4,516)	13.6%	15.1%
<b>OIBDA</b>	<b>4,068</b>	<b>4,356</b>	<b>7.1%</b>	<b>7.2%</b>
OIBDA Margin	30.9%	30.3%	(0.6 p.p.)	(0.8 p.p.)
Depreciation and amortization	(2,034)	(2,241)	10.2%	7.8%
<b>Operating income (OI)</b>	<b>2,034</b>	<b>2,115</b>	<b>4.0%</b>	<b>6.7%</b>
CapEx	2,842	3,060	7.7%	17.2%
OpCF (OIBDA-CapEx)	1,226	1,296	5.7%	(7.0%)

(1) See adjustments made to calculate organic variation below.

*Adjustments made to calculate organic variations*

As explained above, year-on-year changes referred to in this document as “organic” or presented in “organic terms” intend to present year-on-year variations on a comparable basis.

With respect to Telefónica Hispanoamérica, we have made the following adjustments in order to calculate 2015/2014 variations in organic terms:

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**Foreign exchange effects and the impact of hyperinflationary adjustments in Venezuela:**

We have excluded the impact of changes in exchange rates by assuming constant average foreign exchange rates in 2015 and 2014. In particular, we have used the average foreign exchange rates in 2015 and 2014. In particular, we have used the average foreign exchange rates for 2014 in both years. We have also excluded the impact of hyperinflationary adjustments in Venezuela.

**Restructuring costs:**

We have excluded the impact of certain restructuring costs associated with certain simplification processes implemented in Telefónica Hispanoamérica. In 2015, restructuring costs totaled 38 million euros. In 2014, restructuring costs totaled 99 million euros.

**Results of tower sales:**

The results attributable to the sale of towers in 2015 and 2014 have been excluded, which totaled 18 million euros (mainly in Chile) in 2015 and 4 million euros in 2014.

**Spectrum acquisition:**

We have excluded the impact of spectrum acquisitions in 2015 and 2014.

In 2015, these acquisitions totaled 338 million euros and related to Telefónica Argentina (196 million euros), Telefónica Ecuador (127 million euros), Telefónica Chile (6 million euros) and Telefónica México (8 million euros). In 2014, these acquisitions totaled 405 million euros and related to Telefónica Argentina (168 million euros), Telefónica Colombia (111 million euros) and Telefónica Venezuela and Central America (126 million euros).

The table below shows 2015/2014 variations in reported and organic terms (the latter, calculated in accordance with the adjustments referred to above) of certain income statement and other measures, and the contribution of each item for which we have adjusted to our reported growth:

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YoY variation                      Contribution to reported growth (percentage points)

TELEFÓNICA HISPANOAMÉRICA 2015	%Reported YoY	%Organic YoY	Exchange rate effect and Hyperinflation	Towers sales	Restructuring Costs	Spectrum acquisition
Revenues	9.4%	10.1%	(0.6)	--	--	--
Other income	36.5%	29.6%	2.1	5.1	--	--
Supplies	8.7%	7.2%	1.5	--	--	--
Personnel expenses	10.6%	16.0%	--	--	(4.1)	--
Other expenses	13.6%	15.1%	(1.4)	--	--	--
<b>OIBDA</b>	<b>7.1%</b>	<b>7.2%</b>	<b>(2.0)</b>	<b>0.3</b>	<b>1.5</b>	<b>--</b>
CapEx	7.7%	17.2%	(3.6)	--	--	(3.3)
<b>OpCF (OIBDA-CapEx)</b>	<b>5.7%</b>	<b>(7.0%)</b>	<b>1.5</b>	<b>1.0</b>	<b>5.1</b>	<b>7.7</b>

*Results Discussion*

**Revenues** amounted to 14,387 million euros in 2015, increasing 9.4% year-on-year in reported terms mainly due to the good results of data revenues (fixed as well as mobile) and voice revenues, in both cases due to a higher customer base, increased consumption and higher data penetration. This increase was partially offset by foreign exchange effects and hyperinflation in Venezuela and the decrease in mobile termination rates. In organic terms, revenues increased 10.1% year-on-year.

Mobile service revenues reached 9,160 million euros in 2015, up 8.4% in reported terms mainly due to increased revenues in Argentina, Peru, Mexico and Chile, as explained in greater a detail below, which was partially offset by the foreign exchange effects and the hyperinflation in Venezuela (which accounted for -2.2 p.p. of the year-on-year variation). Mobile service revenues performance by country was as follows:

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In Argentina, mobile service revenues reached 2,194 million euros in 2015 and grew by 29.2% year-on-year in reported terms mainly due to the good performance of consumption and data penetration and, to a lesser extent, the growth of the voice business and the foreign exchange effect (which increased growth by 6.4 p.p.). In local currency, these revenues grew by 22.9%.

In Mexico, mobile service revenues reached 1,539 million euros in 2015, increasing by 8.9% in reported terms mainly due to a higher customer base and the positive performance of the data business. In local currency these revenues grew by 8.4%, accounting the foreign exchange effect for 0.5 percentage points of the year-on-year reported increase.

In Chile, mobile service revenues reached 1,177 million euros in 2015, up 5.8% in reported terms year-on-year mainly due to the foreign exchange effect (which accounted for 4.6 p.p. of the increase) and the increase in data revenues that more than compensated the fall in the traditional voice business and the lower mobile termination rates. In local currency these revenues grew by 1.2%.

In Peru, mobile service revenues reached 1,390 million euros in 2015, up 11.2% in reported terms mainly due to the foreign exchange effect (which accounted for 7.0 p.p. of the increase) and the higher contract customer base, the data boom and higher inbound revenues.

In Venezuela and Central America, mobile service revenues reached 1,261 million euros in 2015, down 3.5% in reported terms mainly due to the foreign exchange effect and hyperinflation in Venezuela (which decreased growth in 35.1 p.p.). Excluding these effects, these revenues increased by 31.7% mainly due to the higher tariffs in all services in order to try to compensate the high inflation in Venezuela and the higher non-SMS data revenues (+83% in 2015), which represented 83.4% of total data revenues (+11.4 p.p. year-on-year).

Data revenues in the segment were up by 19.5% in reported terms in 2015, reaching 3,198 million euros mainly due to the increase in penetration of data which increased from 31.7% to 34.9% in 2015 and higher data usage. This increase was partially offset by foreign exchange effects and hyperinflation in Venezuela (which decreased growth by 4.2 p.p.). Excluding these effects, these revenues grew by 23.6% as a result of the aforementioned increase in penetration of data.

Fixed business revenues reached 4,070 million euros in 2015, up 12.9% in reported terms mainly due to the increase in broadband and new services revenues (+20.5%). Revenues from broadband and new services, accounted for 64.7% of fixed revenues (+4.9 p.p. year-on-year). The growth was mainly related to Argentina which experienced a substantial increase in voice and broadband revenues, as well as Chile and Peru, which had increased broad band revenues. Excluding the foreign exchange effect and hyperinflation in Venezuela (which decreased growth by 2.9 p.p.) these revenues grew by 10.0%.

**ARPU** was up by 6.1% in 2015, due to the data ARPU increase (+19.9% year-on-year) due to the increase of smartphone penetration and higher average consumption, which offset voice ARPU decrease. The lower ARPU was mainly due to lower interconnection costs and the devaluation of certain Latin American currencies against the U.S. dollar, which more than offset the increase in outgoing voice ARPU (up 7.0% year-on-year).

**OIBDA** reached 4,356 million euros in 2015, up 7.1% in reported terms (+7.2% in organic terms), being Telefónica Argentina, Telefónica Peru and Telefónica Chile the main contributors to this growth, as higher revenues offset higher costs. OIBDA was positively affected by a spectrum swap in Mexico with AT&T in December 2015 (which contributed 79 million euros). The higher costs were mainly attributable to:

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higher commercial costs, due to higher handset costs as a result of higher high-end handset sales (which more than offset lower interconnection costs resulting from the mobile termination rates reductions in Chile, Colombia, Peru and Mexico);

· higher personnel costs driven by increases in inflation in some countries of the region;

· higher costs related to commercial campaigns, higher network costs due to higher voice and data traffic; and

· higher costs resulting from the devaluation of certain Latin American currencies against the U.S. dollar.

Additional information by country is provided below:

Argentina: **OIBDA** reached 1,006 million euros, up by 25.4% in reported terms mainly due to the exchange rate effect and higher service revenues, more than offsetting the higher costs resulting from the overall prices increase, although Telefónica continued to carry out cost containment plans in order to offset the inflation effect. In local currency, the year-on-year variation was 19.2%.

Chile: **OIBDA** reached 760 million euros, up 7.4% in reported terms mainly due to the exchange rate effect and higher service revenues, lower supply costs due to regulatory changes (lower interconnection costs resulting from the mobile termination rates reduction) and efficiency measures that helped to offset the commercial effort made to gain higher value customers. In local currency, the year-on-year variation was 2.7%.

Peru: **OIBDA** reached 943 million euros, up by 11.8% in reported terms mainly due to the exchange rate effect and higher service revenues, which more than offset higher commercial costs resulting from higher competitive pressure in the Peruvian market. In local currency **OIBDA** decreased by 4.7%.

Venezuela and Central America: **OIBDA** reached 342 million euros, down by 26.1% in reported terms mainly due to the exchange rate effect and hyperinflation in Venezuela. Excluding these impacts, **OIBDA** grew 15.8% mainly driven by higher service revenues, which compensated the overall rise in prices, and higher purchases in dollars for services and equipment purchases, which were affected by the currency devaluation in Venezuela.

**OIBDA margin** reached 30.3% in 2015, with a year-on-year decrease of 0.6 percentage points in reported terms. This margin decrease was driven by lower margins in all countries in the segment except Mexico (which benefitted from higher commercial efforts focused on higher value segments), especially in Argentina and Colombia.





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## 2014/2013 Consolidated results

In this section, we discuss changes in the Group's consolidated income statements for 2014 and 2013. The consolidated income statement data for the years ended December 31, 2014 and 2013 set forth below has been retrospectively revised to show the reclassification of the results attributable to our operations in the United Kingdom as discontinued operations and are not derived from Telefónica, S.A.'s consolidated financial statements originally published for such years, which are not included herein.

The Group's total accesses rose 5.7% during 2014 to 316 million at December 31, 2014, including the additional accesses it gained following the purchase of the E-Plus Group in Telefónica Germany. Excluding the E-Plus Group accesses from 2014 results and accesses from Telefónica Czech Republic and Telefónica Ireland from 2013 results, the increase would have been 1.9%. There was high commercial activity focus on high value customers which resulted in the growth of the contract mobile segment (smartphones and LTE), fiber and Pay TV. The volume of fiber accesses also grew, reaching 1.8 million at December 31, 2014. Notably, accesses in Telefónica Hispanoamérica (42% of the Group's total) increased by 2.5%, and accesses in Telefónica Brazil (30% of the Group's total) increased by 3.0% in 2014.

The below table shows the evolution of accesses in 2013 and 2014:

ACCESSES			%Reported	%Organic
Thousand of accesses	2013	2014	YoY	YoY(*)
Fixed telephony accesses (1) (2)	39,130.3	36,602.0	(6.5%)	(3.0%)
Internet and data accesses	19,087.1	18,132.5	(5.0%)	0.4%
Narrowband	510.8	373.1	(27.0%)	(14.4%)
Broadband	18,432.9	17,649.3	(4.3%)	0.8%
Others	143.4	110.1	(23.3%)	(5.4%)
Mobile accesses	231,068.3	249,978.9	8.2%	2.1%
Prepay (3) (4)	154,792.2	164,959.2	6.6%	(0.7%)
Contract	76,276.0	85,019.6	11.5%	7.8%
Pay TV (5)	3,602.2	5,087.2	41.2%	47.6%
Unbundled loops	3,833.4	4,087.3	6.6%	7.9%
Shared ULL	130.6	94.1	(27.9%)	(27.9%)
Full ULL	3,702.9	3,993.3	7.8%	9.2%
Wholesale ADSL	835.3	750.1	(10.2%)	4.4%
Other	1,658.2	1,684.1	1.6%	2.0%
Final Clients Accesses	292,887.9	309,800.5	5.8%	1.8%
Wholesale Accesses	6,327.0	6,521.6	3.1%	5.9%
Total Accesses	299,214.9	316,322.1	5.7%	1.9%

Notes:

Telefónica Spain mobile accesses includes since 2013 the accesses of Tuenti.

(\*) Excludes the E-Plus Group accesses from 2014 accesses and accesses from Telefónica Czech Republic and Telefónica Ireland from 2013 accesses.

(1) In the first quarter of 2014, 45 thousands inactive “fixed wireless” accesses were disconnected in Mexico.

(2) In the second quarter of 2014, fixed clients includes 50 thousands additional fixed wireless clients in Peru.

(3) In the first quarter of 2014, 1.9 million inactive accesses were disconnected in Mexico.

(4) In the fourth quarter 2014, 1.8 million inactive accesses were disconnected in Central America

(5) In the second quarter of 2014, Pay TV accesses includes 131 thousand “TV Mini” clients in Spain

In 2014, the Group’s strategy was based on capturing growth in its markets, especially on attracting high-value customers.

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**Mobile accesses** totaled 250.0 million as of December 31, 2014, increasing 8.2% compared to 2013 (a 2.1% increase excluding accesses from the E-Plus Group in 2014 and from Telefónica Czech Republic and in Telefónica Ireland in 2013), driven by the E-Plus Group acquisition and strong growth in the contract segment (+11.5%), which represented 34% of total mobile accesses as of December 31, 2014 (+1 p.p. year-on-year). Notably, Telefónica Spain increased its contract segment in 2014 in 77 thousand new accesses (excluding the impact of the disconnection of 569 thousand inactive M2M accesses), a positive number for the first time since 2011.

**Smartphone** accesses maintained a strong growth rate (up 45.4% at December 31, 2014 compared to December 31, 2013), totaling 79.0 million accesses and reaching a penetration rate over total accesses of 34% (+9 p.p. year-on-year), reflecting the Company's strategic focus on the growth of its data services.

**Fixed broadband accesses** stood at 17.6 million at December 31, 2014, a decrease of 4.3% year-on-year (+0.8% excluding accesses from Telefónica Czech Republic in 2013). Fiber accesses stood at 1.8 million at December 31, 2014 (a 111.8% increase compared to December 31, 2013).

**TV accesses** totaled 5.1 million at December 31, 2014, up 41.2% year-on-year in reported terms (47.6% excluding accesses from Telefónica Czech Republic in 2013). Net adds, excluding accesses from Telefónica Czech Republic, reached 1.6 million in the year.

Millions of euros	Year ended December 31				Percent change	
	2013		2014		2014 vs 2013	
	Total	% of revenues	Total	% of revenues	Var.	% Var.
Revenues	50,547	100.0%	43,458	100.0%	(7,089)	(14.0%)
Other income	1,491	2.9%	1,521	3.5%	30	2.0%
Supplies	(13,758)	(27.2%)	(11,750)	(27.0%)	2,008	(14.6%)
Personnel expenses	(6,659)	(13.2%)	(6,621)	(15.2%)	38	(0.6%)
Other expenses	(14,144)	(28.0%)	(12,827)	(29.5%)	1,317	(9.3%)
Operating income before depreciation and amortization (OIBDA)	17,477	34.6%	13,781	31.7%	(3,696)	(21.1%)
Depreciation and amortization	(8,616)	(17.0%)	(7,431)	(17.1%)	1,185	(13.8%)
Operating income	8,861	17.5%	6,350	14.6%	(2,511)	(28.3%)
Share of loss of investments accounted for by the equity method	(291)	(0.6%)	(498)	(1.1%)	(207)	70.9%
Net financial expense	(2,842)	(5.6%)	(2,779)	(6.4%)	63	(2.2%)
Profit before tax	5,728	11.3%	3,073	7.1%	(2,655)	(46.3%)
Corporate income tax	(1,201)	(2.4%)	(260)	(0.6%)	941	(78.3%)
Profit after tax from continuing operations	4,527	9.0%	2,813	6.5%	(1,714)	(37.9%)
<b>Profit after tax from discontinued operations</b>	<b>442</b>	<b>0.9%</b>	<b>439</b>	<b>1.0%</b>	<b>(3)</b>	<b>(0.7%)</b>

<b>Profit for the year</b>	<b>4,969</b>	<b>9.8%</b>	<b>3,252</b>	<b>7.5%</b>	<b>(1,717)</b>	<b>(34.6%)</b>
Non-controlling interests	(376)	(0.7%)	(251)	(0.6%)	125	(33.2%)
Profit for the year attributable to equity holders of the parent	4,593	9.1%	3,001	6.9%	(1,592)	(34.7%)

*Adjustments made to calculate 2014/2013 organic variations*

As stated above, year-on-year changes referred to in this document as “organic” or presented in “organic terms” intend to present year-on-year variations on a comparable basis. See “—2015/2014 consolidated results—Adjustments made to calculate organic variations”.

We have made the following adjustments in order to calculate 2014/2013 variations in organic terms:

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**Foreign exchange effects and the impact of hyperinflationary adjustments in Venezuela:**

We have excluded the impact of changes in exchange rates by assuming constant average foreign exchange rates in 2014 and 2013. In particular, we have used the average foreign exchange rates of 2013 for both years.

Foreign exchange rates had a negative impact on our reported 2014 results, mainly due to the depreciation of various Latin American currencies versus the euro, in particular the Argentine peso, the Brazilian real and the Venezuelan bolívar.

We have also excluded the impact of hyperinflationary adjustments in Venezuela by reversing such adjustments.

**Changes in the scope of consolidation:**

We have excluded the impact of changes in our consolidation perimeter in 2014 and 2013. The main changes in our consolidation perimeter in such years related to the consolidation of E-Plus in Telefónica Germany since October 2014, the sale of Telefónica Ireland in July 2014 and the sale of Telefónica Czech Republic in January 2014.

In order to exclude the impact of these changes in our perimeter, we have:

- excluded E-Plus's results from October 1 to December 31, 2014 from our 2014 results;
- excluded Telefónica Ireland's results from July 1 to December 31, 2013 from our 2013 results; and
- excluded Telefónica Czech Republic's results from January 1 to December 31, 2013 from our 2013 results.

**Restructuring costs:**

We have excluded the impact of certain restructuring costs in 2014, mainly those related to the simplification initiatives carried out by the Group in order to reach its targets, mainly in Telefónica Germany, Telefónica Hispanoamérica and Telefónica Brazil. In 2014 these costs totaled 409 million euros in Telefónica Germany, 99 million euros in Telefónica Hispanoamérica and 68 million euros in Telefónica Brazil (all impact on OIBDA).

No restructuring costs were excluded from our 2013 results to calculate organic variations.

**Impact of sale of companies:**

We have excluded the impact of the sale of certain companies in 2013. In particular we have excluded the results deriving from the sale of Telefónica Ireland (16 million euros loss), Telefónica Czech Republic (176 million euros loss) and Hispasat (21 million euros gain).

**Results of tower sales:**

The results attributable to the sale of towers in 2014 and 2013 have been excluded in both years.

In 2014 the results from the sale of towers totaled 196 million euros, mainly in Telefónica Spain (191 million euros). In 2013 the results from the sale of towers totaled 111 million euros, mainly in Telefónica Spain (70 million euros), Telefónica Brazil (29 million euros) and Telefónica Hispanoamérica (11 million euros in Mexico, Chile and Colombia).

**Spectrum acquisition:**

We have excluded the impact of spectrum acquisitions in 2014 and 2013.

In 2014, these acquisitions totaled 1,294 million euros, 889 million euros corresponding to Telefónica Brazil and 405 million euros corresponding to Telefónica Hispanoamérica, with the following distribution by country or region:

– Telefónica Argentina (168 million euros);

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- Telefónica Colombia (111 million euros); and
- Telefónica Venezuela and Central America (126 million euros).

In 2013 these acquisitions totaled 505 million euros and related mainly to Telefónica Brazil (185 million euros), Telefónica Hispanoamérica (251 million euros, mainly in Peru and Colombia) and Telefónica Spain (69 million euros).

**Real Estate Efficiency Plan:**

In 2014 we have excluded the impact of certain urban assets qualification changes in Telefónica Spain and the investment in Telefónica's Barcelona head office, which had an impact on capital expenditures (Capex) of 78 million euros.

The table below shows 2014/2013 variations in reported and organic terms (the latter, calculated in accordance with the adjustments referred to above) of certain income statement and other measures:

TELEFÓNICA 2014	YoY variation	
	% Reported YoY	% Organic YoY
Revenues	(14.0%)	2.9%
Other income	2.0%	7.0%
Supplies	(14.6%)	(0.4%)
Personnel expenses	(0.6%)	7.1%
Other expenses	(9.3%)	8.1%
<b>OIBDA</b>	<b>(21.1%)</b>	<b>(0.1%)</b>
<b>Operating income (OI)</b>	<b>(28.3%)</b>	<b>2.1%</b>
CapEx	8.4%	17.7%
<b>OpCF (OIBDA-CapEx)</b>	<b>(46.2%)</b>	<b>(13.9%)</b>

The below table shows the contribution of each item for which we have adjusted to our reported growth. With respect to each line item, the contribution to reported growth of such line item, expressed in percentage points, is the result of dividing the impact of each item for which we have adjusted by the amount of such line item, on a reported basis, for the prior year.



**Contribution to reported growth (percentage points)**

TELEFÓNICA 2014	Exchange rate effect and hyperinflation	Perimeter change Czech Rep., Ireland & E-Plus Others	Restruc- turing costs	Result on sale of companies	Towers sales	Spectrum acquisition	Real estate efficiency plan
Revenues	(14.4)	1.5	(3.9)	-	-	-	-
Other income	(0.1)	-	(0.1)	-	0.2	-	-
Supplies	(11.9)	1.9	(4.3)	-	-	-	-
Personnel expenses	(13.5)	1.0	(3.6)	8.7	-	-	-
Other expenses	(15.7)	2.4	(3.0)	0.6	(1.4)	-	-
<b>OIBDA</b>	<b>(14.8)</b>	<b>0.7</b>	<b>(4.6)</b>	<b>(3.8)</b>	<b>0.9</b>	<b>0.5</b>	<b>-</b>
<b>Operating income (OI)</b>	<b>(20.4)</b>	<b>(1.4)</b>	<b>(3.8)</b>	<b>(7.6)</b>	<b>1.8</b>	<b>1.0</b>	<b>-</b>
CapEx	(23.2)	2.3	(3.1)	0.5	-	15.0	1.0
<b>OpCF (OIBDA-CapEx)</b>	<b>(7.6)</b>	<b>(0.7)</b>	<b>(5.8)</b>	<b>(7.5)</b>	<b>1.7</b>	<b>(12.7)</b>	<b>(0.8)</b>

*Results Discussion*

**Revenues** totaled 43,458 million euros in 2014, down 14.0% compared to 2013 in reported terms due mainly to the adverse impact of changes in exchange rates and hyperinflation in Venezuela (which accounted for -14.4 p.p. of the decrease) and the sales of Telefónica Czech Republic and Telefónica Ireland (-3.9 p.p.), partially offset by the impact of the acquisition of E-Plus (+1.5 p.p.). In organic terms, revenues increased 2.9% due mainly to the good performance of Telefónica Hispanoamérica, where revenues from mobile data and digital services increased.

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The structure of revenues reflected Telefónica's business diversification. Despite the impact of changes in exchange rates, Telefónica Hispanoamérica was the larger contributor to our revenues in 2014, representing 30.3% (-3.1 p.p. compared to 2013), followed by Telefónica Spain, representing 27.7% (+2.0 p.p. compared to 2013), Telefónica Brazil, representing 25.8% (+1.7 p.p. compared to 2013) and Telefónica Germany, representing 12.7% (+3.0 p.p. compared to 2013).

**Mobile data revenues** totaled 8,568 million euros in 2014 and decreased by 8.9% in reported terms affected mainly by exchange rate differences and hyperinflation in Venezuela and changes in the consolidation perimeter. Excluding these impacts, these revenues grew by 12.7%, due to the expansion of smartphones and data plans, mainly in Telefónica Hispanoamérica and Telefónica Brazil. These revenues accounted for 37% of mobile service revenues in 2014, up 2.4 percentage points compared to 2013 in reported terms. Revenues from non-SMS data were up 2.8% in reported terms (+25.4% excluding the impact of exchange rate differences, the effect of hyperinflation in Venezuela and changes in the consolidation perimeter), representing 78% of total data revenues in reported terms (+8.9 p.p. year-on-year).

**Other income** in 2014 mainly included own work capitalized in our fixed assets, profit from the sale of other assets, and the sale of towers of Telefónica Spain, Telefónica Brazil and Telefónica Hispanoamérica, and totaled 1,521 million euros, up 2.0% year-on-year, mainly due to increased sales of towers (which had an impact on OIBDA of 196 million euros, primarily in Telefónica Spain with 191 million euros), and an extraordinary sale of real estate in Telefónica Spain (41 million euros).

Other income in 2013 totaled 1,491 million euros and was attributable in part to the sale of towers of Telefónica Brazil, Telefónica Hispanoamérica and Telefónica Spain (which had an impact of 113 million euros in other income and 111 million euros in OIBDA) and capital gains on the assets sale of Telefónica Germany (76 million euros) and the sale of Hispasat (21 million euros).

**Total expenses** (which include supply costs, personnel costs and other expenses, (principally external services and taxes, but do not include amortization and depreciation expenses), amounted to 31,198 million euros in 2014, down by 9.7% in reported terms year-on-year as a result mainly of the impact of changes in exchange rates and hyperinflation in Venezuela and the sales of Telefónica Czech Republic and Telefónica Ireland. In organic terms, expenses grew by 4.5% year-on-year, mainly due to higher commercial expenditures and outlays on networks and systems. The breakdown of our expenses was as follows:

**Supplies** amounted to 11,750 million euros in 2014, down 14.6% year-on-year in reported terms, as a result mainly of the impact of changes in exchange rates and hyperinflation in Venezuela and the sales of Telefónica Czech Republic and Telefónica Ireland. In organic terms, supplies fell by 0.4% due to lower mobile interconnection costs, which more than offset the higher equipment costs of handsets and TV content.

**Personnel expenses** totaled 6,621 million euros in 2014, down 0.6% year-on-year in reported terms, as a result mainly of the impact of changes in exchange rates and hyperinflation in Venezuela and the sales of Telefónica Czech Republic and Telefónica Ireland, which was partially offset by the increased expenditures on the Company's global restructuring program (including the integration costs in Telefónica Germany and costs resulting from the simplification initiatives that the Group is implementing to meet its targets) and, to a lesser extent, the impact of the acquisition of E-Plus. In organic terms, personnel costs rose by 7.1% in 2014 compared to 2013 due to higher prices in some countries.

The average headcount in 2014 was 112,921 employees, down 6.1% compared to 2013 due mainly to the changes in the scope of consolidation (-2.1% excluding changes to the scope of consolidation). Including Telefónica United Kingdom, the average headcount in 2014 would have been 120,497 employees, down 7.2% compared to 2013 due mainly to the changes in the scope of consolidation.

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**Other expenses** amounted to 12,827 million euros in 2014, down 9.3% year-on-year in reported terms mainly due to exchange rate differences and the effect of hyperinflation in Venezuela, the impact of value adjustments in the sales of Telefónica Ireland and Telefónica Czech Republic, changes to the scope of consolidation and the recognition of integration costs in Telefónica Germany. In organic terms, other expenses increased by 8.1% due to higher commercial costs, higher network costs produced by larger volumes of data traffic and greater outlays on modernization of the network.

**OIBDA** reached 13,781 million euros, down 21.1% in reported terms, mainly due to exchange rate differences and the effect of hyperinflation in Venezuela, the sales of Telefónica Czech Republic and Telefónica Ireland and the impact of value adjustments relating to such sales and the increased expenditures on the Company's global restructuring program (including the integration costs in Telefónica Germany and costs resulting from the simplification initiatives that the Group is implementing to meet its targets). In organic terms, OIBDA was practically stable (-0.1% year-on-year).

**OIBDA margin** was 31.7% in 2014, down 2.9 percentage points year-on-year in reported terms.

By segment, Telefónica Spain contributed most to the Group's consolidated OIBDA, accounting for 41.2% of the total (+4.9 p.p. compared to 2013), Telefónica Hispanoamérica accounted for 29.5% (-2.1 p.p. compared to 2013), Telefónica Brazil accounted for 25.7% (+3.2 p.p. compared to 2013), and Telefónica Germany accounted for 5.3% (-2.2 p.p. compared to 2013).

**Depreciation and amortization** amounted to 7,431 million euros in 2014, a decline of 13.8% year-on-year in reported terms, due to lower depreciation of fixed assets, mainly in Telefónica Brazil. The total depreciation and amortization charges arising from purchase price allocation processes amounted to 574 million euros in 2014 (-21.2% year-on-year).

**Operating income (OI)** in 2014 totaled 6,350 million euros, down 28.3% compared to 2013, mainly affected by exchange rate differences and the effect of hyperinflation in Venezuela (-20.4 p.p.), recognition in 2014 of expenditure on integrations costs in Telefónica Germany and the global restructuring program, in accordance with the simplification initiatives the Group is implementing to meet its targets (-7.6 p.p.), changes to the scope of consolidation (-5.2 p.p.), due to the sale of Telefónica Czech Republic and Telefónica Ireland and the acquisition of the E-Plus Group, and additionally affected by higher tower sales in 2014 as compared to 2013 (+1.0 p.p.). In organic terms, operating income would have increased by 2.1% year-on-year.

The **share of loss of investments accounted for by the equity method** was a loss of 498 million euros (compared to a loss of 291 million euros in 2013), mainly due to valuation adjustments of Telco, S.p.A. at Telecom Italia, S.p.A. This, along with the contribution to the year's results, had a negative impact of 464 million euros in 2014 (compared to

a loss of 267 million euros in 2013).

**Net financial expense** amounted to 2,779 million euros in 2014 (-2.2% year-on-year in reported terms), and included 290 million euros due to net negative foreign exchange differences primarily as a result of the Company's decision to adopt the SICAD II exchange rate of the Venezuelan bolivar. Excluding this effect, net financial expenses fell 9.0% year-on-year, mainly due to a 9.1% reduction in the average debt, placing the effective cost of debt in 2014 at 5.31%, one basis point higher than in 2013. The greater weight of debt in Latin America currencies and repayment and maturity of cheap debt in euros increased the average cost by 47 basis points, while the lower rates in Latin America and Europe reduced it by 41 basis points.

**Corporate income tax** totaled 260 million euros in 2014 on a pre-tax income of 3,073 million euros, implying an effective tax rate of 8.5%, 12.5 percentage points lower year-on-year. This was mainly due to the effect of a review of deferred taxes in Brazil following a change to legislation during the second quarter of 2014, and to a larger recognition of tax credits in Colombia.

**Profit after tax from discontinued operations** totaled 439 million euros, a decrease of 0.7% compared to 2013 and related exclusively to our operations in the United Kingdom.

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The following table provides additional information on our discontinued operations:

Millions of euros	January- December 2014	January- December 2013	% YoY 14/13
Revenues	6,919	6,514	6.2%
Other income	187	202	(7.4%)
Supplies	(3,431)	(3,283)	4.5%
Personnel expenses	(477)	(549)	(13.1%)
Other expenses	(1,463)	(1,284)	13.9%
<b>OPERATING INCOME BEFORE DEPRECIATION AND AMORTIZATION (OIBDA)</b>	<b>1,735</b>	<b>1,600</b>	<b>8.4%</b>
Depreciation and amortization	(1,118)	(1,011)	10.6%
<b>OPERATING INCOME</b>	<b>617</b>	<b>589</b>	<b>4.8%</b>
Share of loss of investments accounted for by the equity method	(12)	(13)	(7.7%)
Net financial expense	(43)	(24)	79.2%
<b>PROFIT BEFORE TAX FROM DISCONTINUED OPERATIONS</b>	<b>562</b>	<b>552</b>	<b>1.8%</b>
Corporate income tax	(123)	(110)	11.8%
<b>PROFIT AFTER TAX FROM DISCONTINUED OPERATIONS</b>	<b>439</b>	<b>442</b>	<b>(0.7%)</b>

**Profit attributable to non-controlling interests** reduced net profit by 251 million euros in 2014, 33.2% less than in 2013, mainly due to the losses attributed to minority shareholders of Telefónica Germany impacted by the recording of the restructuring expenses mentioned above, partially offset by the effect of the review of deferred taxes in Brazil following a change to legislation in 2014, and to a larger recognition of tax credits.

As a result of the foregoing, **profit for the year attributable to equity holders of the parent** for 2014 was 3,001 million euros (down 34.7% year-on-year).

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## Segment results

*TELEFÓNICA SPAIN*

The below table shows the evolution of accesses in Telefónica Spain in 2013 and 2014:

ACCESSES	2013	2014	%YoY
Thousands of accesses			
Fixed telephony accesses (1)	11,089.8	10,447.8	(5.8%)
Naked ADSL	22.8	21.3	(6.6%)
Internet and data accesses	5,899.0	5,928.7	0.5%
Narrowband	38.5	30.9	(19.6%)
Broadband (2)	5,846.8	5,885.9	0.7%
Other	13.7	11.9	(13.7%)
Mobile accesses	19,002.1	17,575.4	(7.5%)
Prepay	4,262.7	3,328.1	(21.9%)
Contract (3)	14,739.3	14,247.3	(3.3%)
Pay TV (4)	672.7	1,884.7	180.2%
WLR	525.8	570.6	8.5%
Unbundled loops	3,787.1	4,087.3	7.9%
Shared ULL	130.6	94.1	(27.9%)
Full ULL	3,656.5	3,993.3	9.2%
Wholesale ADSL	676.8	707.8	4.6%
Other	0.4	0.3	(28.5%)
Final Clients Accesses	36,663.6	35,836.7	(2.3%)
Wholesale Accesses	4,990.1	5,366.0	7.5%
Total Accesses	41,653.6	41,202.7	(1.1%)

## Notes:

(1) PSTN (including Public Use Telephony) x1; ISDN Basic access x1; ISDN Primary access; 2/6 Digital Access x30. Company's accesses for internal use included. Includes VoIP and Naked ADSL.

(2) Includes ADSL, satellite, optical fiber, cable modem and broadband circuits.

(3) In the first quarter of 2014, 569 thousand M2M inactive accesses were disconnected.

(4) Since the second quarter of 2014, Pay TV accesses include 131 thousand "TV Mini" customers.

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The table below shows the evolution of Telefónica Spain's results in 2013 and 2014:

Millions of euros

TELEFÓNICA SPAIN	2013	2014	%Reported YoY	%Organic YoY (1)
Revenues	12,959	12,023	(7.2%)	(7.2%)
Mobile Business	5,121	4,556	(11.0%)	(11.0%)
Mobile service revenues	4,580	3,888	(15.1%)	(15.1%)
Fixed Business	8,861	8,543	(3.6%)	(3.6%)
Other income	445	635	42.6%	17.7%
Supplies	(2,486)	(2,592)	4.2%	4.2%
Personnel expenses	(2,113)	(2,139)	1.2%	1.2%
Other expenses	(2,465)	(2,256)	(8.5%)	(8.6%)
<b>OIBDA</b>	<b>6,340</b>	<b>5,671</b>	<b>(10.6%)</b>	<b>(12.6%)</b>
OIBDA Margin	48.9%	47.2%	(1.8 p.p.)	(2.8 p.p.)
Depreciation and amortization	(1,903)	(1,805)	(5.1%)	(5.1%)
<b>Operating income (OI)</b>	<b>4,437</b>	<b>3,866</b>	<b>(12.9%)</b>	<b>(15.8%)</b>
CapEx	1,529	1,732	13.3%	15.2%
OpCF (OIBDA-CapEx)	4,811	3,939	(18.1%)	(21.0%)

(1) See adjustments made to calculate organic variation below.

*Adjustments made to calculate organic variations*

As explained above, year-on-year changes referred to in this document as “organic” or presented in “organic terms” intend to present year-on-year variations on a comparable basis.

With respect to Telefónica Spain, we have made the following adjustments in order to calculate 2014/2013 variations in organic terms:

**Results of tower sales:**

The results attributable to the sale of towers in 2014 and 2013 have been excluded in both years. In 2014, the results from the sale of towers totaled 191 million euros. In 2013, the results from the sale of towers totaled 70 million euros.



**Spectrum acquisition:**

We have excluded the impact of spectrum acquisitions in 2013 which totaled 69 million euros. There was no spectrum acquisition in 2014.

**Real Estate Efficiency Plan:**

In 2014, we have excluded the impact of certain urban assets qualification changes in Telefónica Spain, totaling 49 million euros.

The table below shows 2014/2013 variations in reported and organic terms (the latter, calculated in accordance with the adjustments referred to above) of certain income statement and other measures, and the contribution of each item for which we have adjusted to our reported growth.

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TELEFÓNICA SPAIN 2014	YoY variation		Contribution to reported growth (percentage points)			
	%Reported YoY	%Organic YoY	Towers sale	Spectrum acquisition	Real Estate	Efficiency Plan
Revenues	(7.2%)	(7.2%)	--	--	--	
Other income	42.6%	17.7%	27.7	--	--	
Supplies	4.2%	4.2%	--	--	--	
Personnel expenses	1.2%	1.2%	--	--	--	
Other expenses	(8.5%)	(8.6%)	0.1	--	--	
<b>OIBDA</b>	<b>(10.6%)</b>	<b>(12.6%)</b>	<b>1.9</b>	--	--	
CapEx	13.3%	15.2%	--	(4.5)	3.2	
<b>OpCF (OIBDA-CapEx)</b>	<b>(18.1%)</b>	<b>(21.0%)</b>	<b>2.5</b>	<b>1.4</b>	<b>(1.0)</b>	

*Results Discussion*

**Revenues** totaled 12,023 million euros in 2014 (-7.2% year-on-year) showing a softer decline than in previous years, due in part to a more favorable macroeconomic and competitive environment.

We consider revenue breakdown to be increasingly less relevant given the high penetration level of our convergent offer, by which we mean the offer of more than a single service for a single price. However, we continue to report revenue breakdown for information purposes. Fixed business revenues fell 3.6% year-on-year in 2014, due to lower access and voice revenues, partially offset by higher broadband and new services revenues, mainly TV and IT. Mobile business revenues fell 11.0% year-on-year in 2014 due to the decline in mobile accesses and the 10.1% drop in ARPU, impacted by lower prices in the new tariff portfolio.

**Mobile ARPU** is becoming less representative of the Group's business performance, owing to its significant dependence on the allocation of revenue in convergent offers. In 2014 mobile ARPU declined by 10.1% year-on-year, impacted by lower prices in the new tariff portfolio.

TELEFÓNICA SPAIN	2013	2014	%YoY
Voice Traffic (millions of minutes)	34,428	35,600	3.4%
ARPU (EUR) (1)	17.7	15.9	(10.1%)
Prepay	7.3	6.2	(14.5%)
Contract (2)	24.0	20.6	(14.2%)
Data ARPU (EUR) (1)	6.8	7.0	3.6%
% non-SMS over data revenues	92.1%	95.0%	2.8 p.p.
Notes:			

- (1) Impacted by the disconnection of 569 thousand inactive M2M accesses in the first quarter of 2014.
- (2) Excludes M2M.

**OIBDA** amounted to 5,671 million euros in 2014, down 10.6% year-on-year in reported terms, due mainly to lower revenues and higher supplies expense. In organic terms, OIBDA fell 12.6% year-on-year in 2014, affected by the drop in revenues despite the higher commercial effort by Telefónica Spain to capture the growth and value opportunities in the market and the decrease in total expenses. Total expenses decreased 1.1% year-on-year, reflecting the control of costs and the transformation efficiency initiatives implemented in recent years. However, personnel expenses increased 1.2% year-on-year, primarily due to the end of the redundancy program in 2013 and the Company's contribution to its pension plan in July 2014, following its temporary freeze from April 2013 to July 2014. This decrease was partially offset by the sale of real estate assets (63 million euros).

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**OIBDA margin** stood at 47.2% in 2014, down 1.8 percentage points year-on-year.

*TELEFÓNICA GERMANY*

The below table shows the evolution of accesses in Telefónica Germany in 2013 and 2014:

## ACCESSES

Thousands of accesses	2013	2014	%Reported YoY	%Organic YoY (1)
Fixed telephony accesses (2)	2,124.9	2,036.4	(4.2%)	(4.2%)
Internet and data accesses	2,516.1	2,387.0	(5.1%)	(5.1%)
Narrowband	271.7	243.2	(10.5%)	(10.5%)
Broadband	2,244.3	2,143.8	(4.5%)	(4.5%)
Mobile accesses	19,401.0	42,124.9	117.1%	1.4%
Prepay	9,114.9	23,350.7	156.2%	(2.8%)
Contract	10,286.1	18,774.1	82.5%	5.1%
Final Clients Accesses	24,042.0	46,548.3	93.6%	0.2%
Wholesale Accesses	1,125.0	1,113.3	(1.0%)	(1.0%)
Total Accesses	25,166.9	47,661.5	89.4%	0.2%

## Notes:

(1) In order to calculate organic changes, we have excluded the accesses of E-Plus as of December 31, 2014 to our accesses as of such date.

(2) PSTN (including Public Use Telephony) x1; ISDN Basic access x1; ISDN Primary access; 2/6 Digital Access x30. Company's accesses for internal use included. Includes VoIP and Naked ADSL.

The below table shows the contribution of each item for which we have adjusted to our reported growth. With respect to each line item, the contribution to reported growth of such line item, expressed in percentage points, is the result of dividing the impact of each item for which we have adjusted by the amount of such line item, on a reported basis, for the prior year.

TELEFÓNICA GERMANY 2014	%Reported YoY	%Organic YoY <sup>(1)</sup>	E-Plus
Mobile accesses	117.1%	1.4%	115.7 p.p.
Prepay	156.2%	(2.8%)	159.0 p.p.
Contract	82.5%	5.1%	77.4 p.p.
Final Clients Accesses	93.6%	0.2%	93.4 p.p.
Total Accesses	89.4%	0.2%	89.2 p.p.

(1) In order to calculate organic changes, we have excluded the accesses of E-Plus as of December 31, 2014 to our accesses as of such date.

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The table below shows the evolution of Telefónica Germany's results in 2013 and 2014:

Millions of euros

TELEFÓNICA GERMANY	2013	2014	%Reported YoY	%Organic YoY (1)
Revenues	4,914	5,522	12.4%	(3.5%)
Mobile Business	3,673	4,375	19.1%	(2.2%)
Mobile service revenues	2,989	3,580	19.8%	(2.3%)
Fixed Business	1,235	1,138	(7.8%)	(7.8%)
Other income	169	106	(37.4%)	(44.8%)
Supplies	(1,958)	(2,144)	9.5%	(3.9%)
Personnel expenses	(419)	(828)	97.7%	5.6%
Other expenses	(1,398)	(1,923)	37.5%	6.6%
<b>OIBDA</b>	<b>1,308</b>	<b>733</b>	<b>(44.0%)</b>	<b>(22.1%)</b>
OIBDA Margin	26.6%	13.3%	(13.4 p.p.)	(5.1 p.p.)
Depreciation and amortization	(1,231)	(1,426)	15.7%	(4.9%)
<b>Operating income (OI)</b>	<b>77</b>	<b>(693)</b>	<b>n.m.</b>	<b>n.m.</b>
CapEx	666	849	27.5%	(6.4%)
OpCF (OIBDA-CapEx)	642	(116)	n.m.	(38.3%)

(1) See adjustments made to calculate organic variation below.

*Adjustments made to calculate organic variations*

As explained above, year-on-year changes referred to in this document as “organic” or presented in “organic terms” intend to present year-on-year variations on a comparable basis.

With respect to Telefónica Germany, we have made the following adjustments in order to calculate 2014/2013 variations in organic terms:

**Changes in the scope of consolidation:**

We have excluded the impact of changes in our consolidation perimeter in 2014 and 2013. The main change to our Telefónica Germany consolidation perimeter in such years related to the consolidation of E-Plus in Telefónica Germany since October 2014. In order to exclude the impact of this change in our perimeter, we have excluded E-Plus's results from October 1 to December 31, 2014 from our 2014 results.

**Restructuring costs:**

We have excluded the impact of certain restructuring costs associated with certain simplification processes implemented in Telefónica Germany. In 2014, these restructuring costs totaled 409 million euros. In 2013 there were no restructuring costs.

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The table below shows 2014/2013 variations in reported and organic terms (the latter, calculated in accordance with the adjustments referred to above) of certain income statement and other measures, and the contribution of each item for which we have adjusted to our reported growth:

TELEFÓNICA GERMANY 2014	YoY variation		Contribution to reported growth (percentage points)	
	%Reported YoY	%Organic YoY	E-Plus	Restructuring Costs
Revenues	12.4%	(3.5%)	15.9	--
Other income	(37.4%)	(44.8%)	7.5	--
Supplies	9.5%	(3.9%)	13.4	--
Personnel expenses	97.7%	5.6%	15.3	76.8
Other expenses	37.5%	6.6%	24.7	6.2
<b>OIBDA</b>	<b>(44.0%)</b>	<b>(22.1%)</b>	<b>9.3</b>	<b>(31.2)</b>
CapEx	27.5%	(6.4%)	27.9	6.0
<b>OpCF (OIBDA-CapEx)</b>	<b>n.m.</b>	<b>(38.3%)</b>	<b>(9.9)</b>	<b>(69.9)</b>

*Results Discussion*

Total **revenues** amounted to 5,522 million euros in 2014, up by 12.4% due mainly to the consolidation of the E-Plus Group since October 1, 2014, and offset in part by the lower service revenues during the rest of the year.

Mobile service revenues totaled 3,580 million euros in 2014, up by 19.8% year-on-year in reported terms, due mainly to the consolidation of the E-Plus Group since October 1, 2014 and offset in part by the lower voice and SMS revenues during the rest of the year. Telefónica Germany continued to focus on data revenues, which increased 24.3% and accounted for 50.1% of mobile service revenues. Non P2P SMS data revenues accounted for 71.2% of the total data revenues (+4.7 p.p. year-on-year), increasing 32.8% year-on-year.

Fixed telephony revenues fell by 7.8% year-on-year in 2014 to stand at 1,138 million euros. The main reason for this was a decline in fixed broadband customers (partially mitigated by VDSL growth) and transit business revenues, impacting slightly on the margin.

**ARPU** was negatively affected by the consolidation of the E-Plus Group and decreased by 7.1% year-on-year in 2014, reducing its year-on-year decline compared to 2013, due to the smaller proportional impact of migration to new tariffs, and the various actions undertaken with respect to the Telefónica Germany's customer base in order to boost income and data leverage.



TELEFÓNICA GERMANY	2013	2014	%YoY
Voice Traffic (millions of minutes)	30,152	41,186	36.6%
ARPU (EUR)	12.7	11.8	(7.1%)
Prepay	5.1	5.4	4.5%
Contract (1)	19.6	18.4	(5.9%)
Data ARPU (EUR)	6.2	5.9	(3.9%)
% non-SMS over data revenues	66.5%	71.2%	4.7 p.p.
Notes:			
(1) Excludes M2M.			

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**OIBDA** was 733 million euros in 2014, falling by 44.0% year-on-year in reported terms, mainly due to the 409 million euros provision relating to the restructuring process resulting from integration of the E-Plus Group, which impact was partially offset by the consolidation of E-Plus. In organic terms, OIBDA decreased 22.1% year-on-year, as a result of higher handset costs of sale, partially offset by lower interconnection costs resulting from less SMS and lower interconnection tariffs.

**OIBDA margin** stood at 13.3% in 2014, down 13.4 percentage points year-on-year in reported terms, mainly due to the provision relating to the restructuring process resulting from the integration of the E-Plus Group, which impact was partially offset by the consolidation of E-Plus.

*TELEFÓNICA BRAZIL*

The below table shows the evolution of accesses in Telefónica Brazil in 2013 and 2014:

ACCESSES	2013	2014	%YoY
Thousands of accesses			
Fixed telephony accesses (1)	10,747.8	10,743.4	(0.0%)
Internet and data accesses	4,102.0	4,082.6	(0.5%)
Narrowband	92.1	73.7	(19.9%)
Broadband (2)	3,936.7	3,939.8	0.1%
Other	73.2	69.0	(5.8%)
Mobile accesses	77,240.2	79,932.1	3.5%
Prepay	53,551.9	51,582.4	(3.7%)
Contract	23,688.3	28,349.7	19.7%
Pay TV	640.1	770.6	20.4%
Final Clients Accesses	92,730.0	95,528.6	3.0%
Wholesale Accesses	18.8	25.9	37.5%
Total Accesses	92,748.9	95,554.5	3.0%

## Notes:

(1) PSTN (including Public Use Telephony) x1; ISDN Basic access x1; ISDN Primary access; 2/6 Digital Access x30. Company's accesses for internal use included. Voice fixed wireless accesses included.

(2) Includes ADSL, optical fiber, cable modem and broadband circuits.

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The table below shows the evolution of Telefónica Brazil's results in 2013 and 2014:

Millions of euros

TELEFÓNICA BRAZIL	2013	2014	%Reported YoY	%Organic YoY (1)
Revenues	12,217	11,231	(8.1%)	0.5%
Mobile Business	8,092	7,618	(5.9%)	2.9%
Mobile service revenues	7,608	7,228	(5.0%)	3.8%
Fixed Business	4,125	3,613	(12.4%)	(4.2%)
Other income	299	261	(12.6%)	5.5%
Supplies	(3,128)	(2,680)	(14.3%)	(6.3%)
Personnel expenses	(1,036)	(976)	(5.8%)	(4.2%)
Other expenses	(4,412)	(4,293)	(2.7%)	6.4%
<b>OIBDA</b>	<b>3,940</b>	<b>3,543</b>	<b>(10.1%)</b>	<b>0.9%</b>
OIBDA Margin	32.3%	31.5%	(0.7 p.p.)	0.1 p.p.
Depreciation and amortization	(2,109)	(1,762)	(16.5%)	(8.7%)
<b>Operating income (OI)</b>	<b>1,831</b>	<b>1,781</b>	<b>(2.7%)</b>	<b>12.1%</b>
CapEx	2,127	2,933	37.9%	15.0%
OpCF (OIBDA-CapEx)	1,813	610	(66.4%)	(13.0%)

(1) See adjustments made to calculate organic variation below.

*Adjustments made to calculate organic variations*

As explained above, year-on-year changes referred to in this document as “organic” or presented in “organic terms” intend to present year-on-year variations on a comparable basis.

With respect to Telefónica Brazil, we have made the following adjustments in order to calculate 2014/2013 variations in organic terms:

**Foreign exchange effects:**

We have excluded the impact of changes in exchange rates by assuming constant average foreign exchange rates in 2014 and 2013. In particular, we have used the average foreign exchange rate of 2013 for both years. Foreign exchange rates had a negative impact on our reported 2014 Telefónica Brazil results as a result of the depreciation of the Brazilian real.

**Restructuring costs:**

We have excluded the impact of certain restructuring costs associated with certain simplification processes implemented in Brazil. In 2014, these restructuring costs totaled 68 million euros. No restructuring costs were excluded from our 2013 results to calculate organic variations.

**Results of tower sales:**

The results attributable to the sale of towers in 2014 and 2013 have been excluded in both years. The results from the sale of towers totaled 1 million euros and 29 million euros in 2014 and 2013, respectively.

**Spectrum acquisition:**

We have excluded the impact of spectrum acquisitions in 2014 and 2013. In 2014, these acquisitions totaled 889 million euros (and related to a LTE block in the 700 MHz band). In 2013 these acquisitions amounted to 185 million euros.

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The table below shows 2014/2013 variations in reported and organic terms (the latter, calculated in accordance with the adjustments referred to above) of certain income statement and other measures, and the contribution of each item for which we have adjusted to our reported growth:

	YoY variation		Contribution to reported growth (percentage points)			
	%Reported YoY	%Organic YoY	Exchange rate effect	Restructuring Costs	Towers sale	Spectrum acquisition
TELEFÓNICA BRAZIL 2014						
Revenues	(8.1%)	0.5%	(8.6)	--	--	--
Other income	(12.6%)	5.5%	(8.1)	--	(9.5)	--
Supplies	(14.3%)	(6.3%)	(8.0)	--	--	--
Personnel expenses	(5.8%)	(4.2%)	(8.8)	7.2	--	--
Other expenses	(2.7%)	6.4%	(9.1)	--	--	--
<b>OIBDA</b>	<b>(10.1%)</b>	<b>0.9%</b>	<b>(8.4)</b>	<b>(1.9)</b>	<b>(0.7)</b>	<b>--</b>
CapEx	37.9%	15.0%	(12.8)	--	--	37.0
<b>OpCF (OIBDA-CapEx)</b>	<b>(66.4%)</b>	<b>(13.0%)</b>	<b>(3.1)</b>	<b>(4.1)</b>	<b>(1.6)</b>	<b>(43.4)</b>

*Results Discussion*

**Revenues** totaled 11,231 million euros in 2014, down 8.1% in reported terms as a result mainly of the depreciation of the Brazilian real. In local currency, revenues increased by 0.5%, principally due to the good evolution in the mobile business (+2.9% year-on-year in local currency).

Revenues from the mobile business totaled 7,618 million euros in 2014, falling by 5.9% in reported terms as a result mainly of the depreciation of the Brazilian real. In local currency, revenues from the mobile business increased by 2.9% due to the positive evolution of service revenues (up 3.8% year-on-year in local currency) as a result of the good performance of outbound revenues, which in turn increased as a result of an increase in the customer base and the increased proportion of data revenues. This evolution was partially offset by the decrease in handset revenues (down 11.9% year-on-year in local currency), and the lower inbound revenues affected by lower interconnection tariffs.

Fixed telephony revenues totaled 3,613 million euros, down by 12.4% in reported terms, as a result mainly of the depreciation of the Brazilian real. In local currency, revenues were down by 4.2%. This decrease was attributable in part to the lower retail fixed-mobile tariff, which reduced fixed revenues despite the stable client base and higher minute bundling plans. This was partially offset by the increase of the broadband and new services revenues (up by 4.0% in local currency) helped by the increase of accesses connected with fiber, with a higher ARPU, and the growth of the Pay TV accesses.

The **mobile ARPU** accounted to 7.3 euros in 2014, down 9.1% in reported terms and 0.6% year-on-year in organic terms, mainly as a consequence of the reduction of the mobile termination rates. We believe that the better quality of the clients' base is reflected in an increase of the outbound ARPU and a 16.0% growth of the data ARPU.

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TELEFÓNICA BRAZIL	2013	2014	%YoY	%Local Currency YoY
Voice Traffic (millions of minutes)	115,698	127,412	10.1%	10.1%
ARPU (EUR)	8.0	7.3	(9.1%)	(0.6%)
Prepay	4.5	3.9	(12.4%)	(4.3%)
Contract (1)	18.8	15.7	(16.5%)	(8.7%)
Data ARPU (EUR)	2.5	2.6	6.1%	16.0%
% non-SMS over data revenues	67.0%	77.4%	10.4 p.p.	10.4 p.p.

Notes:

(1) Excludes M2M.

**OIBDA** was 3,543 million euros in 2014, a fall of 10.1% in reported terms as a result mainly of the depreciation of the Brazilian real and, to a lesser extent, restructuring costs incurred in 2014 and lower proceeds from the sale of towers. In organic terms, OIBDA grew by 0.9%. This growth was attributable in part to the decrease in personnel expenses (-4.2% year-on-year in organic terms) as a result of the various restructuring plans and voluntary redundancy programs carried out in 2013 and the decrease in supplies (-6.3% year-on-year in organic terms). In addition, in 2014 there were lower interconnection costs due to regulatory changes and lower handset consumption.

**The OIBDA margin** stood at 31.5% in 2014 in reported terms, down 0.7 percentage points compared to 2013.

*TELEFÓNICA HISPANOAMÉRICA*

The below table shows the evolution of accesses in Telefónica Hispanoamérica in 2013 and 2014.

ACCESSES	2013	2014	%YoY
Thousands of accesses			
Fixed telephony accesses (1) (2)	13,778.5	13,374.4	(2.9%)
Internet and data accesses	5,137.7	5,433.8	5.8%
Narrowband	33.4	25.2	(24.5%)
Broadband	5,074.9	5,379.4	6.0%
Other	29.4	29.2	(0.6%)
Mobile accesses	107,266.9	110,346.5	2.9%
Prepay (3) (4)	84,524.1	86,698.0	2.6%
Contract	22,742.7	23,648.5	4.0%
Pay TV	2,133.5	2,431.9	14.0%
Final Clients Accesses	128,316.6	131,586.6	2.5%
Wholesale Accesses	22.7	16.4	(27.6%)
Total Accesses T. Hispanoamérica	128,339.3	131,603.0	2.5%

Notes:

- (1) In the first quarter of 2014, 45 thousand fixed wireless inactive accesses were disconnected in Mexico.
- (2) In 2014, fixed telephony accesses include 50 thousand “fixed wireless” additional customers in Peru.
- (3) In the first quarter of 2014, 1.9 million inactive accesses were disconnected in Mexico.
- (4) In the fourth quarter of 2014, 1.8 million inactive accesses were disconnected in Central America



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The table below shows the evolution of Telefónica Hispanoamérica's results in 2013 and 2014:

Millions of euros

TELEFÓNICA HISPANOAMÉRICA	2013	2014	%Reported YoY	%Organic YoY (1)
Revenues	16,855	13,155	(22.0%)	14.6%
Mobile Business	13,020	9,578	(25.7%)	16.5%
Mobile service revenues	11,510	8,454	(25.7%)	17.5%
Fixed Business	4,272	3,604	(10.1%)	8.4%
Other income	238	254	6.8%	32.6%
Supplies	(4,983)	(3,841)	(22.9%)	4.9%
Personnel expenses	(1,746)	(1,525)	(12.7%)	21.1%
Other expenses	(4,833)	(3,975)	(17.7%)	21.1%
<b>OIBDA</b>	<b>5,531</b>	<b>4,068</b>	<b>(26.5%)</b>	<b>16.4%</b>
OIBDA Margin	32.8%	30.9%	(1.9 p.p.)	0.5 p.p.
Depreciation and amortization	(2,524)	(2,034)	(19.4%)	5.3%
<b>Operating income (OI)</b>	<b>3,007</b>	<b>2,034</b>	<b>(32.4%)</b>	<b>24.8%</b>
CapEx	3,118	2,842	(8.8%)	29.1%
OpCF (OIBDA-CapEx)	2,413	1,226	(49.2%)	2.2%

(1) See adjustments made to calculate organic variation below.

*Adjustments made to calculate organic variations*

As explained above, year-on-year changes referred to in this document as “organic” or presented in “organic terms” intend to present year-on-year variations on a comparable basis.

With respect to Telefónica Hispanoamérica, we have made the following adjustments in order to calculate 2014/2013 variations in organic terms:

**Foreign exchange effects and the impact of hyperinflationary adjustments in Venezuela:**

We have excluded the impact of changes in exchange rates by assuming constant average foreign exchange rates in 2014 and 2013. In particular, we have used the average foreign exchange rates of 2013 for both years.

Foreign exchange rates had a negative impact on our reported 2014 Telefónica Hispanoamérica results, mainly due to the depreciation of various Latin American currencies versus the euro, in particular the Argentine peso and the Venezuelan bolívar.

We have also excluded the impact of hyperinflationary adjustments in Venezuela by reversing such adjustments.

**Restructuring costs:**

We have excluded the impact of certain restructuring costs associated with certain simplification processes implemented in Telefónica Hispanoamérica. In 2014, restructuring costs totaled 99 million euros. No restructuring costs were excluded from our 2013 results to calculate organic variations.

**Results of tower sales:**

The results attributable to the sale of towers in 2014 and 2013 have been excluded, which totaled 4 million euros in 2014 and 11 million euros in 2013.

Table of Contents**Spectrum acquisition:**

We have excluded the impact of spectrum acquisitions in 2014 and 2013. In 2014, these acquisitions totaled 405 million euros and related to Telefónica Argentina (168 million euros), Telefónica Colombia (111 million euros) and Telefónica Venezuela and Central America (126 million euros). In 2013 these acquisitions amounted to 251 million euros.

The table below shows 2014/2013 variations in reported and organic terms (the latter, calculated in accordance with the adjustments referred to above) of certain income statement and other measures, and the contribution of each item for which we have adjusted to our reported growth:

	YoY variation		Contribution to reported growth (percentage points)			
TELEFÓNICA HISPANOAMÉRICA 2014	%Reported YoY	%Organic YoY	Exchange rate effect and Hyperinflation	Restructuring Costs	Towers sale	Spectrum acquisition
Revenues	(22.0%)	14.6%	(36.1)	--	--	--
Other income	6.8%	32.6%	(18.9)	--	(4.5)	--
Supplies	(22.9%)	4.9%	(27.6)	--	--	--
Personnel expenses	(12.7%)	21.1%	(39.5)	6.3	--	--
Other expenses	(17.7%)	21.1%	(38.2)	--	(0.1)	--
<b>OIBDA</b>	<b>(26.5%)</b>	<b>16.4%</b>	<b>(40.1)</b>	<b>(2.0)</b>	<b>(0.1)</b>	<b>0.0</b>
CapEx	(8.8%)	29.1%	(50.6)	--	--	15.5
<b>OpCF (OIBDA-CapEx)</b>	<b>(49.2%)</b>	<b>2.2%</b>	<b>(26.6)</b>	<b>(4.6)</b>	<b>(0.3)</b>	<b>(20.0)</b>

*Results Discussion*

**Revenues** were 13,155 million euros in 2014, down 22.0% year-on-year in reported terms due mainly to the impact of changes in exchange rates and hyperinflation in Venezuela (which accounted for -36.1 p.p. of the evolution). In organic terms, revenues increased 14.6% year-on-year, due to the good evolution of mobile and fixed data revenues and mobile voice revenues, in both cases mainly due to customer base growth and higher data consumption along with higher data penetration, which offset the negative impact of the lower interconnection rates (which reduced growth by -1.6 p.p. year-on-year).

**Mobile service revenues** totaled 8,454 million euros in 2014, down 25.7% in reported terms mainly due to the impact of changes in exchange rates and hyperinflation in Venezuela. Excluding these impacts, mobile service revenues increased 17.5% year-on-year. Additional information on the evolution of mobile service revenues, on a by

country basis, is provided below:

Argentina: mobile services revenues totaled 1,697 million euros, down 19.8% in reported terms due to the foreign exchange effect (which decreased growth by 39.1 p.p.). In local currency, these revenues increased by 19.3% due to the good evolution of voice and data revenues, despite the negative impact of certain changes implemented in our billing (which implies billing on a per second basis once a call's first 30 seconds have elapsed), and higher network usage by customer and data penetration.

Peru: mobile service revenues totaled 1,250 million euros, up 7.8% in reported terms mainly due to the higher customer base and data massification (non-SMS data revenues were up 42.7% in 2014) and the launch of LTE which contributed to an increase in average revenues per client, which more than offset the impact of changes in exchange rates (which decreased growth by 5.6 p.p.). In local currency, revenues increased 13.4%.

Mexico: service revenues totaled 1,413 million euros, up 5.4% in reported terms due to the favorable regulatory interconnection terms which allowed the company to launch new competitive offers which boosted the customer consumption level in both voice and data. This increase was partially offset by the foreign exchange effect (which decreased growth by 4.6 p.p.). In local currency, revenues grew 10.0%.

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Venezuela and Central America: mobile service revenues totaled 1,305 million euros, down 65.1% in reported terms mainly due to the foreign exchange effects and hyperinflation in Venezuela. Excluding the foreign exchange effects and hyperinflation in Venezuela, mobile service revenues were up by 36.8% year-on-year mainly due to a tariffs –increase of up to 25% in Venezuela, since July 2014, in all services and a mobile data services expansion driven by non-SMS revenues growth (+43.4% year-on-year excluding the foreign exchange effects and hyperinflation in Venezuela), which represented 74.0% of data revenues (+10.5 p.p. year-on-year excluding the foreign exchange effects and hyperinflation in Venezuela).

**Data revenues** in the region totaled 2,676 million euros in 2014, down 24.4% in reported terms as a result mainly of the adverse impact of changes in exchange rates and hyperinflation in Venezuela. Excluding the foreign exchange effects and hyperinflation in Venezuela, data revenues were up 23%, mainly driven by non-SMS data revenues (+43.4% excluding the foreign exchange effects and hyperinflation in Venezuela) which represented 74.0% of data revenues (+11 p.p. year-on-year excluding the foreign exchange effects and hyperinflation in Venezuela).

**Fixed business revenues** totaled 3,604 million euros in 2014, down 10.1% in reported terms as a result mainly of the adverse impact of changes in exchange rates and hyperinflation in Venezuela. Excluding the foreign exchange effects and hyperinflation in Venezuela, these revenues increased 8.4% driven by broadband and new services revenues (+16.2% excluding the foreign exchange effects and hyperinflation in Venezuela). Broadband and new services revenues represented 60.0% of fixed revenues (+5 p.p. year-on-year excluding the foreign exchange effects and hyperinflation in Venezuela). Argentina in particular, experienced an acceleration of the fixed business with strong growth in access and voice revenues (which led to an ARPU increase).

**ARPU** was up by 10.6% in 2014 excluding the foreign exchange effects and hyperinflation in Venezuela, due to the data ARPU increase (+16.0% year-on-year) resulting from higher volume of minutes per client (+5.4%). Data traffic also increased (+65.3%). This growth was mainly driven by higher smartphones penetration and higher average consumption per access.

**OIBDA** totaled 4,068 million euros in 2014, down 26.5% in reported terms as a result mainly of the adverse impact of changes in exchange rates and hyperinflation in Venezuela. In organic terms, OIBDA increased by 16.4% as higher revenues registered in 2014 more than offset higher expenses, which were mainly attributable to:

higher commercial costs, due to higher handset costs as a result of higher high-end handset sales (which more than offset lower interconnection costs resulting from the mobile termination rates reductions in Chile, Colombia, Peru and Mexico);

higher personnel costs driven by increases in inflation in some countries of the region; and

·higher costs related to commercial campaigns and higher network costs due to the increased voice and data traffic.

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Set forth below is additional information on OIBDA on a country basis:

Argentina: **OIBDA** reached 802 million euros, down by 17.9% in reported terms mainly due to the exchange rate effect. In local currency, OIBDA increased by 22.1% as higher revenues more than offset the higher costs. Higher costs were attributable to the overall prices increase, although Telefónica continued to carry out cost containment plans in order to offset the inflation effect.

Peru: **OIBDA** reached 844 million euros, down by 3.5% in reported terms mainly due to higher costs, which impact was partially offset by the exchange rate effect. In local currency, OIBDA increased by 1.4% mainly due to the higher services revenues that offset the higher commercial costs resulting from higher competitive pressure in the Peruvian market.

Venezuela and Central America: **OIBDA** reached 463 million euros, down by 73.4% in reported terms mainly due to the exchange rate effect and the hyperinflation in Venezuela. Excluding these impacts OIBDA grew 21.1% mainly due to higher service revenues that offset the overall rise of prices and the higher purchases in U.S. dollars for services and equipment purchases, both affected by the negative impact of currency devaluation in Venezuela.

**OIBDA margin** was 30.9% in 2014, decreasing 1.9 percentage points year-on-year in reported terms as a result mainly of the impact of changes in exchange rates and hyperinflation in Venezuela.

## **Our services and products**

### **Mobile business**

Telefónica offers a wide variety of mobile and related services and products to personal and business customers. Although they vary from country to country, Telefónica's principal services and products are as follows:

- **Mobile voice services:** Telefónica's principal service in all of its markets is mobile voice telephony.

**Value added services:** Customers in most of the markets have access to a range of enhanced mobile calling features, including voice mail, call hold, call waiting, call forwarding and three-way calling.

**Mobile data and Internet services:** Current data services offered include Short Messaging Services, or SMS, and Multimedia Messaging Services, or MMS, which allow customers to send messages with images, photographs, sound recordings and video recordings. Customers may also receive selected information, such as news, sports scores and stock quotes. Telefónica also provides mobile broadband connectivity and Internet access. Through mobile Internet access, customers are able to send and receive e-mail, browse the Internet, download games, purchase goods and services in m-commerce transactions and use Telefónica's other data and software services.

**Wholesale services:** Telefónica has signed network usage agreements with several MVNOs in different countries.

**Corporate services:** Telefónica provides business solutions, including mobile infrastructure in offices, private networking and portals for corporate customers that provide flexible online billing.

**Roaming:** Roaming agreements allow Telefónica customers to use their mobile handsets when they are outside their service territories, including on an international basis.

**Fixed wireless:** Telefónica provides fixed voice telephony services through mobile networks in Brazil, Venezuela, Argentina, Peru, Mexico, Ecuador, El Salvador, Guatemala and Nicaragua.

**Trunking and paging:** Telefónica provides digital mobile services for closed user groups of clients and paging services in Spain and most of its operations in Latin America.

Fixed-line telephony business

The principal services Telefónica offers in its fixed businesses in Europe and Latin America are:



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**Traditional fixed telecommunication services:** Telefónica's principal traditional fixed telecommunication services include PSTN lines; ISDN accesses; public telephone services; local, domestic and international long-distance and fixed-to-mobile communications services; corporate communications services; supplementary value added services (including call waiting, call forwarding, voice and text messaging, advanced voicemail services and conference-call facilities); video telephony; business oriented value-added services; intelligent network services; leasing and sale of handset equipment; and telephony information services.

**Internet and broadband multimedia services:** The principal Internet and broadband multimedia services include Internet service provider service; portal and network services; retail and wholesale broadband access through ADSL, naked ADSL (broadband connection without the monthly fixed line fee); narrowband switched access to Internet for Universal Service, and other technologies. Telefónica also offers high-speed Internet services through fiber to the home (FTTH) in certain markets (primarily Spain, Brazil and Chile) and VDSL-based services (primarily Spain and Germany). Telefónica also offers VoIP services in some markets.

**Data and business-solutions services:** the data and business-solutions services principally include leased lines; virtual private network, or VPN, services; fiber optics services; the provision of hosting and application, or ASP, service, including web hosting, managed hosting, content delivery and application, and security services; outsourcing and consultancy services, including network management, or CGP; and desktop services and system integration and professional services.

**Wholesale services for telecommunication operators:** the wholesale services for telecommunication operators principally include domestic interconnection services; international wholesale services; leased lines for other operators; network deployment; and local loop leasing under the unbundled local loop regulation framework). It also includes bit stream services, bit stream naked, wholesale line rental accesses and leased ducts for other operators' fiber deployment.

Digital services

The main highlights in services developed by Telefónica Digital are:

**Video/TV services:** IPTV services (Internet protocol), over-the-top network television services, and cable and satellite TV. In certain markets, advanced pay TV services are offered, such as high-definition TV (HDTV), Multiroom (allowing clients to watch different TV channels in different rooms) and Digital Video Recording (DVR).

**M2M:** The Telefónica M2M Portfolio includes both Horizontal Services where the managed connectivity platforms "Smart M2M" and "Jasper" are the key pillars and end-to-end solutions (including Transport, Connected Car, Utilities, Energy Efficiency, Industry Telemetry, Retail and Smart Cities among others) where Telefónica delivers full solutions "device + connectivity + application".

**e-Health services or telecare:** Set of services that help to support usual healthcare practice through electronic and communication processes, that lead to healthcare sector costs and time optimization for all agents involved, workers and patients. They include remote chronic patient management, telecare services allowing tele-assistance through connectivity services, emergencies and medical appointments management and Digital Imaging.

**Financial services and other payment services:** These services allow merchants and financial institutions to make and receive payments.

**Security services:** A broad set of facilities and services (Managed Security, Cloud and Comms Security, Cybersecurity (threats, vulnerabilities and antifraud platforms)) which aim to protect information stored in different end customers' devices and networks from unauthorized access, use, disclosure, disruption or destruction, and including 11Paths developed services such as Latch, FaasT, Metashield or Tacyt.

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**Cloud computing services:** Telefónica offers a broad set of products and services to large enterprises which are focused on “Managed Services” and aim to build fully managed infrastructure environments and manage the complex tools and applications that run on top of the IT infrastructure, and small and medium-sized businesses including different SaaS bundles services with communications services that aim to expand customer digital presence (“Smarter Selling + Serving”) and increase the employees’ productivity and collaboration (“Smarter Working”).

**Advertising:** Portfolio of marketing channels that third party brands can use to acquire and engage with customers. Traditional channels such as messaging may be utilized alongside new channels like programmatic display and sponsored connectivity. These are powered by our in-house technologies; SMS, bulk SMS, mobile portals- and fuelled by our customer data.

**Big Data:** Includes the product “Smart Steps” which helps retailers, municipalities and public security bodies to understand the influx of people. Anonymous mobile data network and aggregates are used to calculate the influx of people in an area. Telefónica also offers B2B opt-in services to the financial sector (Risk Management) for improving fraud prevention and credit scoring in Brazil, United Kingdom and Chile. Recently a Smart Steps joint venture has been launched with China Unicom based out of Beijing to sell data insights in China.

**Future Communications:** Includes “TU Go”, Movistar’s exclusive application that lets clients have the same number on all their devices and communicate among such devices via Wi-Fi.

## Sales and Marketing

Our sales and marketing strategy is aimed toward reinforcing our market position, generating brand awareness, promoting customer growth and achieving customer satisfaction. We use a variety of marketing initiatives and programs, including those that focus on customer value, with in-depth market segmentation; programs to promote customer loyalty; pricing initiatives aimed toward stimulating usage, including segmented packages and innovative tariff options; and initiatives that are responsive to the latest market trends, including those aimed toward boosting demand for our mobile Internet and mobile broadband offerings. In connection with these and our other sales and marketing initiatives, we market our products through a broad range of channels, including television, radio, billboards, telemarketing, direct mail and Internet advertising. We also sponsor a variety of local cultural and sporting events in order to enhance our brand recognition.

## Competition

The telecommunications industry is competitive and consumers generally have a choice of mobile and fixed line operators from which to select services. We are a global telecommunications services provider and face significant competition in most of the markets in which we operate. In Europe, our largest competitor is Vodafone and in Latin

America, our largest competitor is América Móvil. Newer competitors, including handset manufacturers, MVNOs, internet companies and software providers, are also entering the market and offering integrated communications services.

We compete in our markets on the basis of the price of our services; the quality and range of features; the added value we offer with our service; additional services associated with those main services; the reliability of our network infrastructure and its technological attributes; and the desirability of our offerings, including bundled offerings of one type of service with another and, in the case of the mobile industry, in most of the markets offerings that include subsidized handsets.

To compete effectively with our competitors, we need to successfully market our products and services and to anticipate and respond to various competitive factors affecting the relevant markets, such as the introduction of new products and services, different pricing strategies and changes in consumer preferences. See “Risk Factors – Risks Relating to the Group’s Industry – The Company may not be able to adequately foresee and respond to technological changes and sector trends.”

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Strategic Partnerships

**China Unicom**

Since 2005, we have had a stake in China Unicom and its predecessor company. On September 6, 2009 we entered into a strategic alliance agreement with China Unicom, which provides, among other areas for cooperation, joint procurement of infrastructure and client equipment, common development of mobile service platforms, joint provisions of service to multinational customers, roaming, research and development, sharing of best practices and technical, operational and management know-how, joint development of strategic initiatives in the area of network evolution, joint participation in international alliances and exchanges of senior management. In furtherance of this strategic alliance we entered into a subscription agreement with China Unicom, pursuant to which we increased our voting interest in the share capital of China Unicom to 8.06% and China Unicom obtained 0.87% voting interest in our share capital in October 2009.

Pursuant to the strategic alliance agreement mentioned above, China Unicom has agreed to use its best endeavors to maintain a listing of all the issued ordinary shares of China Unicom on the Hong Kong Stock Exchange. For so long as the strategic alliance agreement with us is in effect, China Unicom shall not (i) offer, issue or sell any significant number of its ordinary shares (including treasury shares), or any securities convertible into or other rights to subscribe for or purchase a significant number of China Unicom's ordinary shares (including treasury shares), to any current major competitor of Telefónica or (ii) make any significant investment, directly or indirectly, in any current major competitor of Telefónica. We made similar undertakings.

The initial term of the strategic alliance agreement between us and China Unicom terminated on September 6, 2012 and it is subject to automatic annual renewals, subject to either party's right to terminate on six months' notice. Also, the strategic alliance agreement may be terminated by China Unicom if our shareholding in China Unicom drops below 5% of its issued share capital or if China Unicom's shareholding in us drops below 0.5% of our issued share capital. In addition, the strategic alliance agreement is subject to termination in the event either party is in default and automatically terminates on a change in control of China Unicom.

On January 28, 2011, China Unicom completed its acquisition of 21,827,499 Telefónica shares.

On June 10, 2012, Telefónica, S.A. through its 100% subsidiary, Telefónica Internacional, S.A.U., and China United Network Communications Group Company Limited ("Unicom Parent") through a 100% owned subsidiary, signed an agreement for the acquisition by this last company of 1,073,777,121 shares of China Unicom-Hong Kong-Limited, owned by Telefónica, equivalent to 4.56% of the issued share capital of China Unicom.

On July 21, 2012 the aforementioned agreement was complemented by a Supplemental Agreement which determined the acquisition of the shares at a price of HK\$10.02 per share, for a total amount of HK\$10,759,246,752.42 (approximately 1,142 million euros). The transaction was completed on July 30, 2012.

On November 10, 2014, Telefónica, through its 100% subsidiary, Telefónica Internacional, S.A.U., sold 597,844,100 shares of China Unicom, representing 2.5% of the share capital of the company, by means of a block trade, at a price of HK\$11.14 per share, for a total amount of HK\$6,660 million, approximately 687 million euros at the exchange rate as at the date of the sale.

Further to the sale, Telefónica maintains its commitment to the strategic alliance with China Unicom.

Recently a Smart Steps joint venture has been launched with China Unicom based out of Beijing to sell data insights in China.

As of the date of this Annual Report, Telefónica's shareholding in China Unicom amounts 2.51% of its capital stock. Furthermore, Mr. César Alierta, chairman of Telefónica, S.A. is a member of the Board of Directors of China Unicom while Mr. Wang Xiaochu, chairman of China Unicom, is a member of the Board of Directors of Telefónica.

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**Telecom Italia**

Through a series of transactions from 2007 to 2009, Telefónica acquired an indirect holding of 10.49% in the voting shares of Telecom Italia (7.21% of the dividend rights) through its holdings in Telco, S.p.A. (“Telco”).

On June 16, 2014, the Italian shareholders of Telco (Assicurazioni Generali S.p.A., Intesa Sanpaolo, S.p.A. Mediobanca, S.p.A.) requested the initiation of the process of demerger of such company, as provided in the shareholders’ agreement.

The implementation of such demerger process, which was approved by the General Shareholders’ Meeting of Telco held on July 9, 2014, was subject to obtaining all the required anti-trust and telecommunications approvals (including in Brazil and Argentina). Once the aforementioned approvals were obtained, the demerger deed was executed on June 17, 2015, becoming effective on June 18, 2015 after its registration in the Madrid Mercantile Registry. As a consequence of the demerger, the Telecom Italia ordinary shares held by Telco – which represented 22.3% of the company’s ordinary share capital – were allocated as follows: 14.72% to Telco TE, S.p.A., a newly created company owned by Telefónica; 4.31% to a newly created company owned by the Generali group; and 1.64% to each of the newly created companies owned by Intesa Sanpaolo and Mediobanca respectively.

Moreover, the shareholders’ agreement in force between the shareholders of Telco ceased to have effect on June 18, 2015.

In accordance with the regulatory and competition commitments it had assumed, Telefónica completed the divestment of its entire stake in Telecom Italia during this period.

The Telecom Italia group is principally engaged in the communications sector and, particularly, in telephone and data services on fixed lines for final and wholesale customers, in the development of fiber optic networks for wholesale customers in the provision of broadband services and Internet services, in domestic and international mobile telecommunications (especially in Brazil), in the television sector using both analog and digital terrestrial technology and in the office products sector. Telecom Italia operates primarily in Europe, the Mediterranean basin and in South America.

For more information, please see “Item 5. Operating and Financial Review and Prospects —Operating Results—Significant Factors Affecting the Comparability of our Results of Operations in the Period Under Review” and “Item 10. Additional

Information—Material Contracts.”

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Regulation

Please see Appendix VII to our Consolidated Financial Statements.

Licenses and Concessions

Please see Appendix VII to our Consolidated Financial Statements.

Seasonality

Our main business is not significantly affected by seasonal trends.

Patents

Our business is not materially dependent upon the ownership of patents, commercial or financial contracts or new manufacturing processes.

Disclosure Pursuant to Section 219 of the Iran Threat Reduction and Syria Human Rights Act

Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012 added Section 13(r) to the Exchange Act. Section 13(r) requires an issuer to disclose in its annual or quarterly reports filed with the SEC whether the issuer or any of its affiliates has knowingly engaged in certain activities, transactions or dealings with the Government of Iran, relating to Iran or with designated natural persons or entities involved in terrorism or the proliferation of weapons of mass destruction during the period covered by the annual or quarterly report. Disclosure is required even when the activities were conducted outside the United States by non-U.S. entities and even when such activities were conducted in compliance with applicable law.

The following information is disclosed pursuant to Section 13(r). None of these activities involved U.S. affiliates of Telefónica.

### Roaming Agreements

Various of our subsidiaries have entered into roaming agreements with Iranian telecommunication companies, certain of which are or may be owned or controlled by the government of Iran. Pursuant to such roaming agreements our subsidiaries' customers are able to roam in the particular Iranian network (outbound roaming) and customers of such Iranian operators are able to roam in our relevant subsidiary's network (inbound roaming). For outbound roaming, our subsidiaries pay the relevant Iranian operator roaming fees for use of its network by our customers, and for inbound roaming the Iranian operator pays the relevant subsidiary roaming fees for use of its network by its customers.

Our subsidiaries were party to the following roaming agreements with Iranian telecommunication companies in 2015:

Telefónica Móviles España, S.A. ("TME"), our Spanish directly wholly-owned subsidiary, has respective roaming agreements with (i) Mobile Telecommunication Company of Iran ("MTCI"), (ii) MTN Irancell ("Irancell"), (iii) Taliya (1)("Taliya"), and (iv) Telecommunication Kish Co ("TKC"). During 2015 TME recorded the following revenues related to these roaming agreements: (i) 137,997.05 euros from MTCI, (ii) 5,346.42 euros from Irancell, (iii) none from Taliya and (iv) 6.94 euros from TKC.

TME also holds a Roaming Hub through its 55% directly-owned subsidiary, Link2One, a.e.i.e. ("L2O"). L2O provides a roaming hub service to Irancell enabling the latter to maintain a relationship with other members of the hub. Some members of the hub are also entities of the Telefónica Group. Under this roaming hub service, for 2015, L2O has billed Irancell 158,957.38 euros.

(2) *Telefónica Germany GmbH & Co. OHG* ("TG"), our German 63.22% indirectly-owned subsidiary, has a roaming agreement with MTCI. TG recorded 249,902.03 euros in roaming revenues under this agreement in 2015.

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(3) *Telefónica UK Ltd* (“TUK”), our English directly wholly-owned subsidiary, has a roaming agreement with Irancell. TUK recorded 3.65 euros in roaming revenues under this agreement in 2015.

(4) *Telefónica Argentina, S.A. and Telefónica Móviles Argentina, S.A.* (together “TA”), our Argentinean directly wholly-owned subsidiaries, have a roaming agreement with Irancell. TA recorded 61.37 euros in roaming revenues under this agreement in 2015.

(5) *E-Plus Mobilfunk GmbH* (“E-Plus”), our German 100% indirectly-owned subsidiary, has respective roaming agreements with MTCI, Irancell and Taliya. During 2015, E-Plus recorded 4,303.13 euros from Irancell.

(6) *Telefônica Brasil, S.A.* (“TB”), our Brazilian 73.68% indirectly owned subsidiary, has a roaming agreement with Irancell. TB recorded no revenues under this agreement in 2015.

(7) *Pegaso Comunicaciones y Sistemas, S.A. de C.V.* (“PCS”), our Mexican directly wholly-owned subsidiary, has a roaming agreement with Irancell. PCS recorded no revenues under this agreement in 2015.

(8) *Telefónica Celular de Nicaragua, S.A.* (“TCN”), our Nicaraguan 60% indirectly-owned subsidiary, has a roaming agreement with Irancell. TCN recorded no revenues under this agreement in 2015.

The net profit recorded by our subsidiaries pursuant to these agreements did not exceed the related revenues recorded thereunder.

The purpose of all of these agreements is to provide our customers with coverage in areas where we do not own networks. For that purpose, we intend to continue maintaining these agreements.

International Carrier Agreement with Iran

*Telefónica de España, S.A.U.* (“TES”) our Spanish directly wholly-owned subsidiary has an international carrier agreement with Telecom Infrastructure Company of Iran (“TICI”).

Pursuant to this agreement, both companies interconnect their networks to allow for international exchange of telephone traffic. TES recorded 4,569.00 euros in revenues under this agreement in 2015. The net profit recorded by TES pursuant to this agreement did not exceed such revenues.

The purpose of this agreement is to allow exchange of international telephone traffic. Consequently, we intend to continue maintaining this agreement.

### C. Organizational Structure

See “—History and Development of the Company” and “—Business Overview”.

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D. Property, Plant and Equipment

Our central headquarters for the Telefónica Group are located in “Distrito Telefónica,” in Madrid, Spain.

Fixed Networks

We own fixed networks in Spain, Latin America and Europe, having an incumbent role in Spain, Argentina (the greater Buenos Aires metropolitan area and the southern portion of the country), Brazil (São Paulo), Chile, Peru and Colombia.

Following market trends, competitive environments, evolution of technologies and new multimedia and broadband services demanded by our customers, we have upgraded our networks in recent years in the following manners:

· progressive introduction of broadband access technologies over copper: ADSL, ADSL2+, VDSL2, etc., increasing the bandwidth capacity provided to our broadband clients several times in the last ten years;

· introduction of fiber access technologies (xPON) across different deployment scenarios: fiber to the home (FTTH), fiber to the building (FTTB), fiber to the curb (FTTC), fiber to the node (FTTN), etc., increasing the access speed up to 300 Mbps;

· service support based on powerful Internet Protocol/ Multiprotocol Label Switching (IP/MPLS) backbones, providing full connectivity to the rest of the network layers, such as access and control, to support services for business and customer market segments (fixed and mobile);

· migration of the legacy time division multiplexing (TDM) switching networks (PSTN and ISDN) to new generation network (NGN) over all-IP packet networks;

· migration from legacy transport technologies, such as asynchronous transfer mode (ATM), frame relay (FR), low-rate leased lines, plesiochronous digital hierarchy (PDH) and synchronous digital hierarchy (SDH), to the new generation of optical transport ones, such as dense wavelength division multiplexing (DWDM), coarse wavelength division multiplexing (CWDM) and new generation-synchronous digital hierarchy (NG-SDH);

introduction of IMS (Internet Multimedia Subsystem) to simplify the control of the network and ease the deployment of new services over the all-IP converged network;

empowerment of the intelligence of the network to better manage its use, to avoid saturations and frauds and to identify new business opportunities;

convergence of fixed and mobile networks, services and support systems from both technological and operational points of view; and

deployment of new services such as Pay TV, to customers connected through broadband accesses in Spain, Chile and Brazil.

#### Mobile Networks

We operate mobile networks in Spain, the United Kingdom, Germany, Brazil, Argentina, Venezuela, Chile, Peru, Colombia, Mexico, Guatemala, Panama, El Salvador, Nicaragua, Costa Rica, Ecuador and Uruguay.

We use a number of mobile technologies in the countries in which we operate, namely: GSM, UMTS and LTE in Spain, the United Kingdom, Germany and Latin America. We continue the work of upgrading our mobile networks in line with market trends, the demand of new services from customers and the evolution of technologies. The main steps we are currently taking include:

- evolution of broadband into mobile access using technologies such as HSUPA/HSPA+ and LTE;

deployment of new services such as mobile television and distribution services for next generation music, video and games;

exploration of the adequacy of new technologies such as HSPA and LTE to provide mobile accesses with increased bandwidth, in particular:

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HSPA: we have extended our coverage up to the majority of the urban/suburban areas, and we have increased the capacity of the network by upgrading the network technology to the latest available releases of UMTS standards 3GPP REL 6, REL 7 and REL 8;

LTE: together with main vendors and sharing experience with other operators, we are exploiting the opportunities that LTE brings to create higher capacity at lower relative cost by user/traffic unit. We are now expanding the capacity of LTE networks in all operations, and we are planning the deployment of LTE-Advanced, the evolved version of LTE, in the coming years.

convergence of fixed and mobile networks, services and support systems from both technological and operational points of view.

Satellite communications

The services provided using satellite platforms include television contribution signal to feed cable and IPTV head ends, DTH television, VSAT mainly for telephony and Internet access in rural areas, emergency solutions, corporate communications and international communications.

Submarine cables

We are one of the world's largest submarine cable operators. We participate in approximately 25 international underwater cable systems (nine of which are moored in Spain) and own eleven domestic fiber optic cables.

There are submarine cable connections between Spain and Africa, America, Asia and Europe, respectively, which are jointly owned by us with other telecom operators. The SAM-1 cable, which we own, has a length of approximately 22,000 kilometers underwater and 3,000 kilometers terrestrial and links different countries such as the United States, Puerto Rico, Ecuador, Guatemala, Peru, Chile, Brazil, Argentina and Colombia.

The principal services using the capacity of submarine cables are voice circuits, Internet and dedicated circuits for international traffic and for corporations and business customers.

On February 10, 2016, Telefónica announced the creation of Telxius, a company which brings together certain infrastructure assets of the Group, which will enable the management of the Telefónica Group's infrastructure on a global scale with a more specialized and focused approach, with the aim of increasing the services provided to other operators, improving the return on capital invested and allowing Telxius to participate more actively in the growth opportunities that exist in the industry, including the possibility of incorporating third party assets.



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Item 4A. Unresolved Staff Comments

Not applicable.

Item 5. Operating and Financial Review and Prospects

A. Operating Results

Presentation of Financial Information

The information in this section should be read in conjunction with our Consolidated Financial Statements and the notes thereto, included elsewhere in this Annual Report. Our Consolidated Financial Statements have been prepared in accordance with IFRS as issued by the IASB. See also “Presentation of Certain Financial Information Retrospective revisions”.

Following our signing of an agreement on March 24, 2015 with Hutchison for the sale and purchase of the entire issued share capital of Telefónica Europe plc and the reclassification of the results attributable to our operations in the United Kingdom as discontinued operations, our segments were revised as follows: Telefónica Spain, Telefónica Brazil, Telefónica Germany and Telefónica Hispanoamérica (formed by the Group’s operators in Argentina, Chile, Peru, Colombia, Mexico, Venezuela and Central America, Ecuador and Uruguay). These segments include the information related to wireline, wireless, DSL, TV, and other digital services provided in each country or countries. Any services not specifically included in these new segments are part of “Other companies and eliminations”.

Our prior organizational structure, which was approved by the Board of Directors of Telefónica, S.A. on February 26, 2014, was made up of one additional segment: Telefónica UK, which consisted of our operations in the United Kingdom. The Group’s segment results presented in this report have been revised for 2014 and 2013 to reflect the elimination of such segment.

In 2013, Telefónica created the role of the Chief Commercial Digital Officer, who is responsible for fostering revenue growth. On the cost side, the Company has strengthened the role of the Chief Global Resources Officer. Both Officers report directly to the Chief Operating Officer (COO), as well as the local operators in Spain, Brazil, Germany and the

United Kingdom, in addition to the Hispanoamérica unit (which excludes Brazil).

***Non-GAAP financial information***

*Operating income before depreciation and amortization*

Operating income before depreciation and amortization, or OIBDA, is calculated by excluding depreciation and amortization expenses from our operating income in order to eliminate the impact of generally long-term capital investments that cannot be significantly influenced by our management in the short-term. Our management believes that OIBDA is meaningful for investors because it provides an analysis of our operating results and our segment profitability using the same measure used by our management. OIBDA also allows us to compare our results with those of other companies in the telecommunications sector without considering their asset structure. We use OIBDA to track our business evolution and establish operational and strategic targets. OIBDA is also a measure commonly reported and widely used by analysts, investors and other interested parties in the telecommunications industry. OIBDA is not an explicit measure of financial performance under IFRS and may not be comparable to other similarly titled measures for other companies. OIBDA should not be considered an alternative to operating income as an indicator of our operating performance, or an alternative to cash flows from operating activities as a measure of our leverage.

The following table provides a reconciliation of our OIBDA to operating income for the periods indicated.

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Year ended December 31,

Millions of euros	2013	2014	2015
Operating income before depreciation and amortization	17,477	13,781	11,414
Depreciation and amortization expense	(8,616)	(7,431)	(8,517)
Operating income	8,861	6,350	2,897

The following tables provide a reconciliation of OIBDA to operating income for us and each of our business areas for the periods indicated.

2015

Millions of euros	Telefónica Spain	Telefónica Germany	Telefónica Brazil	Telefónica Hispanoamérica	Other companies and eliminations	Total Group
Operating income before depreciation and amortization	2,336	1,858	3,573	4,356	(709)	11,414
Depreciation and amortization expense	(1,898)	(2,128)	(1,916)	(2,241)	(334)	(8,517)
Operating income	438	(270)	1,657	2,115	(1,043)	2,897

2014

Millions of euros	Telefónica Spain	Telefónica Germany	Telefónica Brazil	Telefónica Hispanoamérica	Other companies and eliminations	Total Group
Operating income before depreciation and amortization	5,671	733	3,543	4,068	(234)	13,781
Depreciation and amortization expense	(1,805)	(1,426)	(1,762)	(2,034)	(404)	(7,431)
Operating income	3,866	(693)	1,781	2,034	(638)	6,350

2013

Millions of euros	Telefónica Spain	Telefónica Germany	Telefónica Brazil	Telefónica Hispanoamérica	Other companies and eliminations	Total Group
Operating income before depreciation and amortization	6,340	1,308	3,940	5,531	358	17,477
Depreciation and amortization expense	(1,903)	(1,231)	(2,109)	(2,524)	(849)	(8,616)
Operating income	4,437	77	1,831	3,007	(491)	8,861



Table of Contents*Net financial debt and net debt*

We calculate net financial debt by deducting the positive mark-to-market value of derivatives with a maturity beyond one year from the relevant balance sheet date and other interest-bearing assets (each of which are components of non-current financial assets in our consolidated statement of financial position), current financial assets and cash and cash equivalents from the sum of (i) current and non-current interest-bearing debt (which includes the negative mark-to-market value of derivatives with a maturity beyond one year) and (ii) other payables (a component of non-current trade and other payables in our consolidated statement of financial position). We calculate net debt by adding to net financial debt those commitments related to employee benefits. We believe that net financial debt and net debt are meaningful for investors because they provide an analysis of our solvency using the same measures used by our management. We use net financial debt and net debt to calculate internally certain solvency and leverage ratios used by management. Neither net debt nor net financial debt as calculated by us should be considered an alternative to gross financial debt (the sum of current and non-current interest-bearing debt) as a measure of our leverage.

The following table provides a reconciliation of our net financial debt and net debt to gross financial debt at the dates indicated:

Millions of euros	12/31/2015	12/31/2014	12/31/2013
Non-current interest-bearing debt	47,117	50,688	51,172
Current interest-bearing debt	12,953	9,094	9,527
Gross financial debt	60,070	59,782	60,699
Non-current trade and other payables	1,073	1,276	1,145
Current trade and other payables	462	210	99
Non-current financial assets	(5,793)	(6,267)	(4,468)
Trade and other receivables	(321)	(453)	–
Current financial assets	(2,971)	(2,932)	(2,117)
Cash and cash equivalents	(2,599)	(6,529)	(9,977)
Net financial debt	49,921	45,087	45,381
Net commitments related to employee benefits	3,668	1,976	2,270
Net debt	53,589	47,063	47,651

Net financial debt as of December 31, 2015 is calculated from gross financial debt by including certain current and non-current trade and other payables totaling 1,535 million euros and subtracting 2,599 million euros of “Cash and cash equivalents”, 2,971 million euros of “Current financial assets”, 321 million euros of “Trade and other receivables” with a maturity of less than one year and 5,793 million euros of certain investments in financial assets with a maturity of over one year, included in the consolidated statement of financial position under “Non-current financial assets”. Net financial debt does not include non-current financial assets that cover net commitments related to employee benefits, even though they are included in the net commitments related to employee benefits (see Note 13.a to our Consolidated Financial Statements). After adjustment for these items, net financial debt at December 31, 2015 amounted to 49,921 million euros, with an increase of 10.7% from 2014 (45,087 million euros at December 31, 2014).

*Organic variations*

Year-on-year changes referred to in this document as “organic” or presented in “organic terms” intend to present year-on-year variations on a comparable basis, by considering a constant perimeter of consolidation and constant exchange rates and by making certain other adjustments which are described in “Item 4. Information on the Company — Business Overview — Financial Results.” “Organic” is not a term defined in IFRS and “organic” measures included herein may not be comparable to similar measures presented by other companies. In addition, “organic” variations are not a substitute for reported variations.

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Significant Factors Affecting the Comparability of our Results of Operations in the Periods Under Review

Please see “Comparative information and main changes in the consolidation scope” in Note 2 to our Consolidated Financial Statements.

Significant Changes in Accounting Policies

Please see Note 3(n) to our Consolidated Financial Statements.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the amounts reflected in the Consolidated Financial Statements and accompanying notes. We base our estimates on historical experience, where applicable, and other assumptions that we believe are reasonable under the circumstances. Actual results may differ from those estimates under different assumptions or conditions.

We consider an accounting estimate to be critical if:

it requires us to make assumptions because information was not available at the time or it included matters that were highly uncertain at the time we were making our estimate; and

changes in the estimate or different estimates that we could have selected may have had a material impact on our financial condition, results of operations or cash flows.

The various policies that are important to the portrayal of our financial condition, results of operations and cash flows include:

accounting for long-lived assets, including goodwill;

deferred taxes;

provisions;

revenue recognition; and

exchange rate used to remeasure Venezuelan bolívar fuerte (BsF)-denominated items.

***Accounting for long-lived assets, including goodwill***

Property, plant and equipment and intangible assets, other than goodwill, are recorded at acquisition cost. If such assets are acquired in a business combination, the acquisition cost is the estimated fair value of the acquired property, plant and equipment or intangible assets. Property, plant and equipment and intangible assets with definite useful lives are depreciated or amortized on a straight-line basis over their estimated useful lives.

Intangible assets with indefinite useful lives are not amortized, but are, instead, subject to an impairment test on a yearly basis and whenever there is an indication that such assets may be impaired.



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Accounting for long-lived assets and intangible assets involves the use of estimates for determining: (a) the fair value at the acquisition date in the case of such assets acquired in a business combination, and (b) the useful lives of the assets over which they are to be depreciated or amortized. We believe that the estimates we make to determine an asset's useful life are "critical accounting estimates" because they require our management to make estimates about technological evolution and competitive uses of assets.

When an impairment in the carrying amount of an asset occurs, non-scheduled write-downs are made. We perform impairment tests of identifiable intangible and long-lived assets whenever there is reason to believe that the carrying value may exceed the recoverable amount, which is the higher of the asset's fair value less costs to sell and its value in use. Furthermore, previously recognized impairment losses may be reversed when changes in the estimates used to determine the asset's recoverable amount indicate that an impairment loss recognized in prior periods no longer exists or may have decreased.

The determination of whether the impairment of long-lived and intangible assets is necessary involves the use of significant estimates and judgment that includes, but is not limited to, the analysis of the cause of potential impairment in value, the timing of such potential impairment and an estimate of the amount of the impairment, which requires the estimation of the future expected cash flows, discount rates and the fair value of the assets.

Specifically, management has to make certain assumptions in respect of uncertain matters, such as growth in revenues, changes in market prices, operating margins, and technology developments and obsolescence, discontinuance of services and other changes in circumstances that indicate the need to perform an impairment test. Management's estimates about technology and its future development require significant judgment because the timing and nature of technological advances are difficult to predict.

Goodwill arises when the cost of a business combination exceeds the acquirer's interest in the net fair value of the identifiable assets acquired and liabilities assumed at the acquisition date. Goodwill is not amortized, but is, instead, subject to an impairment test on a yearly basis and whenever there is an indication that the goodwill may be impaired.

Non-scheduled write-downs of goodwill are made when an impairment in the carrying amount of goodwill occurs. We review, on a regular basis, the performance of our cash-generating units. We compare the carrying amount of the cash-generating unit to which the goodwill has been allocated with its recoverable amount. The determination of the recoverable amount of the cash-generating unit involves extensive use of estimates and significant management judgment is involved. Methods commonly used by us for valuations include discounted cash flow methods.

A significant change in the facts and circumstances that we relied upon in making our estimates may have a material impact on our operating results and financial condition.

*Deferred taxes*

Management assesses the recoverability of deferred tax assets on the basis of estimates of our future taxable profit. The recoverability of deferred tax assets ultimately depends on our ability to generate sufficient taxable profit during the periods in which the deferred tax assets are utilized. In making this assessment, our management considers the scheduled reversal of deferred tax liabilities, projected taxable profit and tax planning strategies.

This assessment is carried out on the basis of internal projections, which are updated to reflect our most recent operating trends. In accordance with applicable accounting standards, a deferred tax asset must be recognized for all deductible temporary differences and for the carry-forward of unused tax credits and unused tax losses to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilized. Our current and deferred income taxes are impacted by events and transactions arising in the normal course of business as well as in connection with special and non-recurring items. Assessment of the appropriate amount and classification of income taxes is dependent on several factors, including estimates of the timing and realization of deferred tax assets and the timing of income tax payments. Actual collections and payments may materially differ from these estimates as a result of changes in tax laws as well as unanticipated future transactions impacting our income tax balances.

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***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.

If we are unable to reliably measure the obligation, no provision is recorded and information is then 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***

*Connection fees*

Revenues from connection fees originated when customers connect to our network are deferred over the average expected length of the customer relationship.

The expected customer relationship period is estimated based on recent historical experience of customer churn rates. Significant changes in our estimations may result in differences in the amount and timing of revenues recognized.

*Multiple-element arrangements*

Arrangements involving the delivery of bundled products or services are assessed to determine whether it is necessary to separate the arrangement into individual component deliverables, each with its own revenue recognition criteria.

Revenue relating to the bundled contracts is allocated to the different deliverables identified, based on their relative fair values (i.e., the fair value of each individual component deliverables in relation to the total fair value of the bundled deliverables), considering that amounts contingent upon delivery of undelivered items are not allocated to delivered items. Given that the handsets and airtime are price-sensitive and volatile in a competitive marketplace, the determination of fair values in the mobile phone business is quite complex.

Additionally, a significant change in the facts and circumstances upon which we based our fair value estimates may have an impact on the allocation of revenues among the different deliverables identified and, consequently, on future revenues.

***Exchange rate used to remeasure the financial statements of our Venezuelan subsidiaries***

As of December 31, 2015, there were multiple exchange mechanisms and three published exchange rates legally available in Venezuela. We review, on a regular basis, the economic conditions in Venezuela and the specific circumstances of our Venezuelan operations. Assessment of the exchange rate that better reflects the economics of Telefónica's business activities in Venezuela relies on several factors and is performed considering all the information available at the closing date, involving the use of estimates, where significant management judgment is required.

Because of the inherent uncertainties in the estimations required to determine the appropriate exchange rate for the conversion of BsF-denominated financial statements, actual cash flows denominated in such currency may differ from the amounts originally recognized on the basis of our estimations, as a result of changes in currency laws or changes in exchange mechanisms or published exchange rates that may have a material impact on the conversion rate to be used for our Venezuelan subsidiaries' financial statements, affecting the net monetary position of assets (liabilities) denominated in BsF.

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Operating Environment

Our results of operations are dependent, to a large extent, on the level of demand for our services in the countries in which we operate. Demand for services in those countries is affected by the performance of their respective economies, particularly household private consumption, but also gross domestic product, or GDP, inflation, or CPI, external accounts and unemployment rates.

During 2015, global activity slowed slightly compared to 2014 and recent developments suggest that growth in 2016 is going to be very similar to 2015. The European Union is showing signs of turning the corner from recession to recovery due to the improvement of internal demand, especially in Spain and in the United Kingdom. Despite the positive fundamentals in both economies, political uncertainty in Spain and in the United Kingdom due to the proposed EU membership referendum, could add risks to this outlook depending on their outcome.

In Latin America, economic growth in 2016 is expected to be higher than in 2015, although the growth rates are expected to be significantly lower than those achieved before the recession. Moreover, commodity prices, especially oil, are expected to pose downward risks to the external accounts balances and to activity growth in the region. Additionally, a faster monetary normalization in the United States could have an impact on inward external flows, making financing conditions in Latin American countries more stringent, which would affect household private consumption negatively.

***Operating environment by country***

*Spain*

In 2015, Spanish GDP expanded by 3.2% (according to Consensus Economics Forecast (“CFe”), an independent research firm), compared with a positive growth rate of 1.4% in 2014 and a contraction on average of 1.3% per year in 2009-2013.

This performance was explained by a positive evolution of internal demand, with household consumption increasing 3.2% in 2015 (CFe), compared to a 1.2% increase in 2014 and a contraction on average of -2.0% per year during 2009-13.

Investment also showed positive growth in 2015, for the second consecutive year in a row, at a rate of 6.1% (CFe) compared to 3.5% growth in 2014 and the 8.2% annual decline experienced on average in 2009-13. Inflation was -0.1% in 2015, compared with -1.1% and 0.3% in 2014 and 2013, respectively.

The current account surplus for 2015 was 1.2% of GDP (CFe), compared with 1.0% of GDP in 2014 and 1.5% in 2013.

The unemployment rate continued its downward trend in 2015 after the 26.9% peak reached in the first quarter of 2013. The unemployment rate was 20.9% at the end of 2015, less than the 23.7% reached in 2014.

#### *United Kingdom*

In 2015, the British economy, measured in terms of GDP, grew by an estimated 2.3% (CFe) compared with a growth rate of 2.9% in 2014 and 2.2% in 2013.

Fixed capital investment increased by an estimated 4.3% in 2015 (CFe), compared with an increase of 7.3% in 2014, and 2.6% in 2013. Private consumption grew by 2.9% (CFe), compared with a growth rate of 2.6% and 1.9% in 2014 and 2013, respectively.

The CPI increased by 0.2% in 2015, compared with 0.5% in 2014 and 2.0% in 2013, driven by downward pressures from energy prices and past exchange rate appreciation.

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The positive performance of economic growth has had a favorable impact on the unemployment rate, which reached 5.4% in 2015 (CFe) on average, compared with an average annual rate of 6.2% in 2013 and 7.3% in 2012.

*Germany*

In 2015, the German economy grew by 1.6%, after growing at the same rate in 2014 and at 0.4% in 2013.

The economic growth recovery in 2015 and 2014 was mainly due to a positive contribution of the internal demand, specially private consumption that showed the highest growth rate in the last decade (1.9% in 2015 (CFe)), which offset the negative contribution of the external sector to GDP growth.

In December 2015 the CPI rate reached 0.3% year-on-year (compared with 0.9% in 2014 and 1.5% in 2013), and the unemployment rate stood at 6.4%, compared with 6.7% in 2014 and 6.9% in 2013.

*Brazil*

Brazilian GDP decreased approximately 3.7% in 2015 (CFe), following increases of 0.1% in 2014 and 3.0% in 2013, according to the Brazilian Geography and Statistics Institute. Investments contracted by approximately 15.0% in 2015, after a decrease of 4.5% in 2014. Household consumption growth decreased by approximately 3.5% in 2015, from 1.3% growth in 2014.

Inflation, as measured by the IPCA, increased by 10.7% in 2015 (above the inflation target established by the Brazilian Central Bank of 4.5% and above its range of tolerance), compared to 6.4% in 2014 and 5.9% in 2013. Due to increasing inflation, the basic interest rate, the Special Clearance and Escrow System rate (Selic rate), was raised from 11.75% at the end of 2014 to 14.25% at the end of 2015.

The current account deficit reached 58.9 billion U.S. dollars in 2015, compared to 104.2 billion U.S. dollars in 2014 and 74.8 billion U.S. dollars in 2013. In 2015, this deficit was financed by capital inflows, such as foreign direct investments, of 75.1 billion U.S. dollars, and portfolio investments, of 18.5 billion U.S. dollars. International reserves decreased by 5.3 billion U.S. dollars in 2015, to a level of 368.7 billion U.S. dollars.

With the worsening of most domestic economic data, especially those regarding government accounts, the country risk increased. The J.P. Morgan Emerging Markets Bond Index Plus (EMBI + Brazil) reached 487 basis points at the end of 2015, up from 265 basis points at the end of 2014 and 238 basis points at the end of 2013.

The Brazilian real continued to depreciate in 2015. It depreciated against the U.S. dollar by 47.0%, reaching an exchange rate of 3.90 reais per one (1) U.S. dollar on December 31, 2015, compared to 2.66 reais per one (1) U.S. dollar on December 31, 2014 and to 2.34 reais per one (1) U.S. dollar on December 31, 2013.

### *Mexico*

Mexico's real GDP increased by an estimated 2.5% in 2015 (CFe), compared with a 2.3% and 1.4% growth in 2014 and 2013, respectively.

Inflation, as measured by the CPI, was 2.1% year-on-year in December 2015 compared with 4.1% in December 2014, below the Mexican Central Bank's target of 3% and also within its tolerance range of 2% to 4%.

During 2015, exports decreased by 1.3%, private consumption increased by almost 3.1% and investment increased by 4.3% compared with 2014.

The current account balance posted a deficit of 31 billion U.S. dollars in 2015 –according to CFe- compared with 24 billion U.S. dollars in 2014 (2.7% and 1.9% of GDP, respectively).



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On December 31, 2015, the exchange rate relative to the U.S. dollar was 17.18 Mexican pesos to the U.S. dollar (14.75 and 13.04 on December 31, 2014 and 2013, respectively).

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*Venezuela*

The expectations about the worsening of economic conditions in Venezuela were confirmed with the recent release of official data. GDP fell by -4.5% year-on-year in the first nine months of 2015, after a negative performance of -3.9% year-on-year in 2014. The oil sector experienced a slight contraction of -0.9% year-on-year while the non-oil sector fell by -4.6% year-on-year. Nonetheless there were some sectors that showed growth in this period. For instance, Communications (+2.7%) and Government Services (+1.1%). Disaggregated by institutional sector, the GDP generated by the private sector declined by -7.1% in the first nine months of 2015.

Private consumption fell -6.7% in the first nine months of 2015 compared to the same period in 2014 and public consumption contracted -2.5% in the same period. Additionally, investments declined by -14.4%.

Additionally, exports declined by -51% year-on-year in the first nine months of 2015 and imports contracted by -17%. As of September 30, 2015, there was an accumulated trade balance deficit of 4,139 million U.S. dollars.

The inflationary spiral in Venezuela continues to accelerate its pace. The latest data released show an increase of prices of 141% year-on-year as of September 2015, which implies an accumulated variation of 108%. If the last quarter of 2015 recorded a similar evolution, the annual inflation in Venezuela could reach 190.7% year-on-year.

The unemployment rate reached 6% in December of 2015, compared to 5.5% at the end of 2014.

*Chile*

Chilean GDP expanded moderately at an estimated rate of 2.1% (CFe), marginally better than in 2014 (1.9%) but 3.2 percent points under the average annual growth rate for the 2010-2013 period (5.3%). Private consumption grew by an estimated 2.3% (Central Bank estimates) in 2015, marginally better than in 2014 (1.9%) but 5.6 percent points under the average annual growth rate for the 2010-2013 period. Investment growth remained almost flat in 2015 after contracting 6.1% in 2014. As most emerging economies, Chile faced headwinds from the international financial markets tightening, the decreasing commodity prices (especially copper prices) and the emerging/advanced capital flows reallocation. Domestically, a persistent slack of confidence and decreasing expectations also weighed negatively on expenditure decisions.

The labor market remained substantially resilient to the economic underperformance for a second year in a row. The unemployment rate reached 5.9% at the end of 2015, slightly lower than at the end of 2014 (6.0%) and among the lowest unemployment rates in the last decade. Nominal wages rose slightly higher than historical rates, in part, to compensate the loss in purchasing power due to the higher inflation.

Inflation, measured by CPI, reached 4.4% in 2015 compared with 4.6% in 2014 and 3.0% in 2013. Twelve-month inflation remained above the monetary policy target range (between 2% and 4%) during the whole year, capturing the impact of the Chilean Peso depreciation on local prices and of the indexation rules applied on prices of several services included in the CPI bundle. Core inflation (excluding food and energy) closed 2015 at 4.7%, 0.3 percentage points above total CPI growth.

The Chilean Central Bank raised its interest rate twice along the year from 3.0% to 3.5%. Given the higher inflation outcome, the Bank's Council decided to reduce the monetary stimulus with a view to reducing inflation expectations so that they do not exceed the Bank's long term target of 3%. The fiscal deficit is estimated to have risen up to 3.0% of GDP (CFe), climbing by 1.4 and 2.4 percentage points compared to deficits in 2014 and 2013 respectively. In an effort to stimulate domestic demand, government spending grew at its highest rate since the recession of 2009.

The trade balance surplus decreased from 7.7 billion U.S. dollars in 2014 to 4.1 billion U.S. dollars in 2015 mainly as a result of the copper prices downtrend and a reduced demand for Chilean no mining exports.

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At the end of 2015, the nominal exchange rate was 707 Chilean Pesos per U.S. dollar, reflecting a year-over-year Chilean Peso depreciation of 16.5%. The exchange rate performance in 2015 was mainly explained by the turbulences in the global financial markets which in general punished emerging currencies. The fall in copper prices also contributed to the Chilean Peso weakening.

*Argentina*

Argentina's GDP increased by an estimated 1.3% in 2015 (CFe), slightly above the 2014 growth rate (0.5%) but significantly below the average annual growth rate of approximately 8.5% achieved from 2003 through 2008, and 5.3% from 2009 to 2012.

The Argentine peso depreciated 53% relative to the U.S. dollar, closing at 12.94 Argentine pesos per U.S. dollar at the end of 2015 compared with 8.46 Argentine pesos per U.S. dollar at the end of 2014 and 6.52 Argentine pesos per U.S. dollar at the end of 2013.

The official CPI increased by an estimated 19.4% in 2015 (CFe) (compared with 23.9% in 2014 and 11.0% in 2013).

The expected current account deficit of 10.7 billion U.S. dollars in 2015 (CFe) is the highest deficit in the last decade. The trade balance contributed significantly to this result, with a decrease in both exports and imports during the year (-14.6% and -9.9% respectively).

Economic conditions affected the unemployment rate negatively, which increased to 7.4% in 2015 from 7.3% in 2014 and 7.1% in 2013.

*Colombia*

According to CFe, Colombian GDP is estimated to have grown by 3.0% in 2015, significantly below the 4.6% and 4.9% year-on-year growth recorded in 2014 and 2013 respectively. This deceleration was mainly attributable to the fall in oil prices, which had a negative impact on investment and a less dynamic household consumption growth.

Despite the lower economic growth, the unemployment rate continued to show a stable performance in 2015. According to CFe the unemployment rate is estimated to have ended 2015 at 9.2% compared with 9.1% and 9.7% in 2014 and 2013, respectively.

According to CFe, in 2015 the current account deficit is estimated to have reached 19 billion U.S. dollars, 6.4% of GDP, compared with 5.2% of GDP in 2014, and 3.2% of GDP in 2013.

The Colombian peso depreciated by 31.6% against the U.S. dollar during 2015 (3,149 Colombian pesos per U.S. dollar at close of 2015). This depreciation was mainly explained by the decrease in oil prices, which affected total exports. Furthermore, net foreign direct investment and net portfolio investment decreased during the period magnifying the Colombian peso depreciation.

The inflation rate was 6.8% year-on-year at the end of 2015, compared with 3.7% year-on-year and 1.9% year-on-year at the end of 2014 and 2013, respectively. The high variation in prices in 2015 were mainly attributable to pressures in food and tradable goods prices due to the ENSO (El Niño Southern Oscillation) and the depreciation of the Colombian peso.

In 2015 the Colombian Central Bank decided to increase the interest rate by 125 basic points from 4.5% to 5.75%, in line with the increased inflationary pressures.

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Peru

Peruvian GDP expanded well below its potential pace for the second straight year (2.7% expected for 2015 and 2.3% in 2014). The main drivers of the slowdown were a strong contraction of investment (both private and public) and its contagion to non-primary sectors through a weaker labor market. Private consumption posted stable growth through the year (3.6% expected for 2015), but well below 2014 and 2013 readings (4.1% and 5.3%, respectively). In addition, exports recovered (due to expanding local copper production), after contracting by 1% in 2014 and 1.3% in 2013.

Consumer prices, as measured by the CPI, increased by 4.4% in 2015, remaining over the Central Bank's target (between 1% and 3%) for the second consecutive year, compared with 3.2% in 2014 and 2.9% in 2013. Inflation gained momentum affected by El Niño-like weather anomalies and strong currency depreciation.

The Peruvian Central Bank raised its interest key rate by 50 basis points from 3.25% to 3.75%.

Lower metal prices took their toll on fiscal revenue, which contracted by 6.9% in 2015. Government budget is expected to post a moderate deficit (around 2.0% of GDP) in 2015 (CFE), compared with a slight fiscal deficit of 0.3% in 2014 and a fiscal surplus of 0.9% in 2013.

In the foreign exchange market, the Peruvian Nuevo Sol weakened 14.6% against the U.S. dollar in 2015, reaching 3.41 Peruvian Nuevo Sol per U.S. dollar at the end of the year, compared with a depreciation of 6.5% in 2014 and 9.6% in 2013. The large commercial deficit and slower financial capital inflows lead to a reduction of international net reserves, reaching 61.5 billion U.S. dollars in 2015 compared to 62.3 billion U.S. dollars in 2014 and 65.7 billion U.S. dollars in 2013.

Country risk, measured by the J.P. Morgan Emerging Markets Bond Index (EMBIG Peru), raised 144 basis points to 236 basis points, in 2015. Long-term sovereign debt is currently investment grade rated by Fitch, Standard and Poor's and Moody's rating agencies.

Exchange Rate Fluctuations

We publish our Consolidated Financial Statements in euros. Because a substantial portion of our assets, liabilities, revenues and expenses are denominated in currencies other than the euro, we are exposed to fluctuations in the values of these currencies against the euro. Currency fluctuations have had and may continue to have a material impact on

our financial condition, results of operations and cash flows.

We estimate that in 2015 variations in currencies and hyperinflation in Venezuela decreased our consolidated revenues by approximately 4.4%. Currency fluctuations can also have a significant impact on our statement of financial position, particularly equity attributable to equity holders of the parent, and on our statement of cash flows, when translating the financial statements of subsidiaries located outside the Eurozone into euro. In 2015 equity attributable to equity holders of the parent decreased by 4,623 million euros and cash and cash equivalents decreased by approximately 999 million euros due to the translation of the financial statements of our foreign subsidiaries, principally due to the depreciation of the Brazilian real, Argentine peso and the Venezuelan bolívar fuerte, partially offset, by the appreciation of the pound sterling relative to the euro.

We estimate that in 2014 variations in currencies and hyperinflation in Venezuela decreased our consolidated revenues by approximately 14.4%. In 2014 equity attributable to equity holders of the parent decreased by 2,857 million euros and cash and cash equivalents decreased by approximately 1,616 million euros due to the translation of the financial statements of our foreign subsidiaries, principally due to the depreciation of the Venezuelan bolívar fuerte and the Argentine peso, partially offset by the appreciation of the pound sterling relative to the euro.

We estimate that in 2013 variations in currencies and hyperinflation in Venezuela decreased our consolidated revenues by approximately 7.9%. In 2013 equity attributable to equity holders of the parent decreased by 5,646 million euros and cash and cash equivalents decreased by approximately 1,468 million euros due to the translation of the financial statements of our foreign subsidiaries, principally due to the depreciation of the Brazilian real, the Venezuelan bolívar fuerte and the Argentine peso, relative to the euro.

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Venezuela is considered as a hyperinflationary economy since 2009. The inflation rates used to prepare the financial information included herein are based on the National Consumer Price Index of Venezuela (Indice Nacional de Precios al Consumidor de Venezuela) published by the Central Bank of Venezuela, or where a definitive index is not available, the best estimation. On an annual basis, these rates are 190.8%, 64.1% and 56.2% for 2015, 2014 and 2013, respectively. The exchange rates used to convert items denominated in Venezuelan bolívar fuerte, once adjusted for inflation, in the Group's 2015-2013 financial statements are the closing rates as of December 31, 2015, 2014 and 2013, which were 199 bolivars per U.S. dollar (by reference to SIMADI), 49.988 bolivars per U.S. dollar (by reference to SICAD II) and 6.3 bolivars per U.S. dollar (by reference to SICAD I), respectively.



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The table below sets forth the average exchange rates against the euro of the U.S. dollar and the key currencies that impacted our consolidated results of operations for the periods indicated. Positive percentage changes represent a decline in the value of the applicable currency relative to the euro, and negative percentage changes represent increases in the value of the applicable currency relative to the euro.

	2013(1)	2014(1)	2015(1)	% change 2013 to 2014	% change 2014 to 2015
	Average	Average	Average	Average	Average
Pound Sterling	0.85	0.81	0.73	(4.71)%	(9.88)%
U.S. Dollar	1.33	1.33	1.11	–	(16.54)%
Brazilian Real	2.85	3.12	3.64	9.47%	16.67%
Argentine Peso	7.23	10.75	10.22	48.69%	(4.93)%
Peruvian Nuevo Sol	3.58	3.77	3.53	5.31%	(6.37)%
Chilean Peso	656.25	756.71	723.91	15.31%	(4.33)%
Mexican Peso	16.93	17.65	17.57	4.25%	(0.45)%
Venezuelan Bolívar Fuerte (2)	8.69	60.69	216.31	n.m.	n.m.
Czech Crown	25.99	27.53	27.28	5.93%	(0.91)%
Colombian Peso	2,478.69	2,650.03	3,016.49	6.91%	13.83%
Guatemalan Quetzal	10.43	10.25	8.49	(1.73)%	(17.17)%

Source: Central treasury bank of the respective countries.

(1) These exchange rates are used to convert the income statements of our subsidiaries from local currency to euro.

(2) As Venezuela is considered a hyperinflationary country, the income statement from operations in Venezuela is accounted pursuant to the closing exchange rate of bolívar fuerte to euro.

We describe certain risks relating to exchange rate fluctuations in “Item 3. Key Information—Risk Factors,” and we describe our policy with respect to limiting our exposure to short-term fluctuations in exchange rates under “Item 11. Quantitative and Qualitative Disclosures About Market Risk.”

## Group Results of Operations

Please see “Item 4 —Information on the Company — Business Overview — Financial Results.”

## B. Liquidity and Capital Resources

### Cash Flow Analysis

The table below sets forth consolidated cash flow information for the periods indicated. Positive figures refer to cash inflows and those in parenthesis refer to cash outflows.

(millions of euros)	2013	2014	2015
Net cash from operating activities	14,344	12,193	13,615
Net cash used in investing activities	(9,900)	(9,968)	(12,917)
Net cash used in financing activities	(2,685)	(4,041)	(3,612)

For a discussion of our cash flows for the years ended December 31, 2013, 2014 and 2015, please see Note 20 to our Consolidated Financial Statements.

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Anticipated Uses of Funds

Our principal liquidity and capital resource requirements consist of the following:

- costs and expenses relating to the operation of our business;
- debt service requirements relating to our existing and future debt;
- capital expenditures for existing and new operations;
- acquisitions of new licenses or other operators or companies engaged in complementary or related businesses; and
- dividend, other shareholder remuneration, and pre-retirement payments.

In 2016, we expect to continue transforming our networks, evolving them towards all-IP hyper-connected networks, by investing in FTTx in key markets, and by expanding our mobile networks with LTE in most of our operations, and also with 3G. We also expect to continue investing in IT as a critical factor in our transformation. We will continue to invest in TV and digital sources to take advantage of the opportunities in the digital markets. And we may also use funds to acquire new licenses engaged in complementary or related businesses in the digital world.

We also have liquidity requirements related to the costs and expenses relating to the operation of our business, financial investments, our payment of dividends, shareholder remuneration and pre-retirement payment commitments.

We also have liquidity requirements related to debt service requirements in connection with our existing and future debt. At December 31, 2015, we had gross financial debt of 60,070 million euros compared with 59,782 million euros at December 31, 2014. For the amortization schedule of our consolidated gross financial debt at December 31, 2015 and a further description of financing activity in 2015, see “—Anticipated Sources of Liquidity” below. Our net financial debt increased by 4,834 million euros to 49,921 million euros at December 31, 2015, compared with 45,087 million euros at December 31, 2014. The factors contributing to increased debt in 2015 include: (i) 6,934 million euros in net financial investments, including investments resulting in changes in the perimeter of consolidation (see Note 2 to our Consolidated Financial Statements); (ii) shareholder remuneration (including dividends, treasury stock and coupons on equity instruments) totaling 4,188 million euros; (iii) spectrum payments totaling 1,307 million euros; (iv) the payment of labor-related commitments (721 million euros), mainly related to early retirements; and (v) other factors affecting the liabilities amounting to 1,185 million euros (mainly due to the refinancing of commercial liabilities). The

increased debt resulting from these items was partially offset by the following: (i) our 2015 cash flow generation before spectrum payments of 4,821 million euros; (ii) the 3,003 million euros capital increase of Telefónica, S.A.; (iii) the contribution of minority shareholders in Telefônica Brasil's capital increase, totaling 1,258 million euros; and (iv) the issuance of capital instruments for a total of 419 million euros.

For a reconciliation of net financial debt to gross financial debt (the sum of current and non-current interest-bearing liabilities), see “—Presentation of Financial Information—Non-GAAP financial information—Net financial debt and net debt”

For a discussion of our liquidity risk management policy, see Note 16 to our Consolidated Financial Statements.

#### Anticipated Sources of Liquidity

Cash flows from operations are our primary source of cash funding for existing operations, capital expenditures, investments, licenses, interest obligations and principal payments. We also rely on external financing, including a variety of short- and medium-term financial instruments, principally bonds and debentures, undated deeply subordinated securities and borrowings from financial institutions. Cash and cash equivalents are mainly held in euros and euro-denominated instruments.

Recently, we raised funds by issuing equity instruments, principally undated deeply subordinated securities, mandatory convertible notes and new shares.

Table of Contents*Financing*

The following table shows the amortization schedule of our consolidated gross financial debt at December 31, 2015 as stated in euro. We may have exchange rate financial derivatives as instruments assigned to the underlying debt instruments. In 2015, the effective cost of debt, excluding exchange rate differences and the positive impact of the divestment of Telecom Italia, S.p.A., stood at 4.69%, down 57 basis points year-on-year (net financial payments represented 4.8% of the net average debt in 2015). The table below includes the fair value of those derivatives classified as financial liabilities (negative mark-to-market) under IFRS (328 million euros classified as a current financial liability and 3,007 million euros as a non-current financial liability). The table does not include the fair value of derivatives classified as financial assets (positive mark-to-market) under IFRS (2,140 million euros classified as current financial assets and 5,315 million euros as non-current financial assets). For description of the liquidity risk we face, see Note 16 to our Consolidated Financial Statements, and for a description of our financial liabilities, see Note 13 to our Consolidated Financial Statements.

Millions of euros

Maturity	Current						Non-current total	Total
	2016	2017	2018	2019	2020	Subsequent years		
Debentures and bonds	7,826	6,719	4,091	1,965	2,773	20,183	35,731	<b>43,557</b>
Promissory notes & commercial paper	1,515	–	–	–	112	188	300	<b>1,815</b>
Total Issues	9,341	6,719	4,091	1,965	2,885	20,371	36,031	45,372
Loans and other payables	3,284	1,070	2,121	1,520	1,214	2,154	8,079	<b>11,363</b>
Derivative instruments	328	672	331	256	799	949	3,007	<b>3,335</b>
Total	12,953	8,461	6,543	3,741	4,898	23,474	47,117	60,070

Notes:

- Estimated future interest payments as of December 31, 2015 on our interest-bearing debt (not included above) are as follows: 2,352 million euros in 2016, 2,045 million euros in 2017, 1,623 million euros in 2018, 1,381 million euros in 2019, 1,155 million euros in 2020 and 6,650 million euros in subsequent years. With respect to floating rate debt, we estimate future interest payments as the forward rates derived from yield curves quoted for the different currencies on December 31, 2015.

During 2015, we obtained financing totaling approximately 18,001 million euros, excluding the euro commercial paper program and short-term banking loans, 26% of which were obtained through equity (shares and hybrids) and the remaining amount as financial debt.

The financing activity in 2015 was mainly focused on financing the GVT Acquisition as well as on strengthening the liquidity position, refinancing maturing debt, and actively managing the cost of debt, through the extension of the maturity of credit lines and the reduction of credit margins. The capital increase of Telefónica, S.A., for a total of

3,048 million euros, and Telefônica Brasil, S.A. for a total of 16,107 million Brazilian reais, were completed during the second quarter of 2015, and related mainly to the acquisition of GVT. Approximately 25.2% of the capital increase of Telefônica Brasil, S.A. was subscribed by minority shareholders (approximately 1,179 million euros). In addition, on September 14, 2015 we issued six-year notes in an aggregate principal amount of 1,000 million euros.

For a description of our financing, see Note 13 to our Consolidated Financial Statements.

In 2016, through the date of this Annual Report, our debt issuances and principal financing arrangements consisted of:

on February 10, 2016, Telefónica del Perú, S.A.A. signed an amendment to its long-term credit facility arranged on October 12, 2015 modifying, mainly, the maximum outstanding amount from 1,050 million Peruvian Nuevos Soles (equivalent to 283 million euros) to 780 million Peruvian Nuevos Soles (equivalent to 210 million euros); and

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Telefónica, S.A. agreed on a 12-month extension on its 2,500 million euros syndicated credit facility dated February 19, 2015 (up to 2021) and its 3,000 million euros syndicated credit facility dated February 18, 2014 (up to 2020) with the relevant banks. These extensions became effective on February 19, 2016.

Our borrowing requirements are not significantly affected by seasonal trends.

*Availability of funds*

At December 31, 2015, we had funds available (including cash and cash equivalents and undrawn lines of credit) totaling 19,143 million euros. This amount included: undrawn lines of credit for an amount of 13,684 million euros (12,497 million euros maturing in more than 12 months); cash and cash equivalents and current financial assets.

On February 19, 2015, Telefónica, S.A. signed a 2,500 million euros syndicated credit facility maturing in 2020 with two 12-month extension options requiring the mutual agreement of the parties (which could extend the maturity to as late as 2022). On the same date, Telefónica, S.A. signed an amendment to its 3,000 million euros syndicated credit facility arranged on February 18, 2014 and maturing in 2019 in which the parties mutually agreed two 12-month extension options (which could extend the maturity to as late as 2021). Following the signing of such agreement, in February 2016 both syndicated credit facilities maturities have been extended up to 2021 and 2020, respectively. On November 17, 2015, Telefónica, S.A. signed a 3,000 million euros syndicated credit facility maturing in 2018. At December 31, 2015 there was no outstanding amount under this facility. Therefore, with the signing in November 2015 of the 3,000 million euros syndicated credit facility maturing in 2018, funds available were increased and our gross debt maturities were fully covered until the end of 2016 with cash and credit lines available at December 31, 2015. Other initiatives are expected to increase our liquidity.

We believe that, in addition to internal generation of funds, our working capital, our medium-term note program, our euro commercial paper program, our corporate domestic promissory note program and available lines of credit will allow us to meet our future capital requirements, including (according to our liquidity policy) gross debt maturing in 2016.

For a description of our liquidity and undrawn lines of credit available at December 31, 2015, see Notes 12 and 13 to our Consolidated Financial Statements, and for a discussion of our liquidity risk management and our capital management, see Note 16 to our Consolidated Financial Statements.

Telefónica, S.A. is the parent company of the Telefónica Group and receives funding from its subsidiaries in the form of dividends and loans. Consequently, restrictions on the ability of the Group's subsidiaries to transfer funds to Telefónica, S.A. in the form of cash dividends, loans or advances, capital repatriation and other forms would negatively affect our liquidity and thus our business.

Certain Latin American economies, such as Argentina and Venezuela, have experienced shortages in foreign currency reserves and their respective governments have adopted restrictions on the ability to transfer funds out of the country and convert local currencies into U.S. dollars. This may limit our ability to repatriate funds out of certain subsidiaries from such countries. However, regarding net repatriation of funds to Spain, in 2015 we have received 1,252 million euros from our Latin American subsidiaries, of which 846 million euros was from dividends and 406 million euros was from other items.

### *Credit Ratings*

Our ability to use external sources of financing will depend in large part on our credit ratings. We believe that we are well-positioned to raise capital in financial markets. However, negative conditions in the financial markets or a downgrade of any of the ratings of our debt or the Kingdom of Spain's debt by any of Fitch, Moody's and/or Standard & Poor's may increase the cost of our future borrowings or may make it more difficult to access the public debt markets. In connection with the credit rating agencies' review of our debt ratings, the rating agencies may give considerable weight to general macroeconomic and political conditions (including sovereign credit rating prospects), the performance of our businesses in countries where we operate, our financial and shareholder remuneration policy, our M&A policy, our ability to integrate acquired companies and our ability to refinance debt.



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In 2015, we have taken certain measures to protect our credit rating. These measures mainly include: our financing activity together with our liquidity policy, the implementation of part of the dividend as a scrip dividend (instead of a cash only dividend) in the fourth quarter of 2015, portfolio management through the announced disposal of O2 UK, the rights issue in connection with the financing of the GVT Acquisition or the issuance of undated deeply subordinated securities as a solvency protection measure to mitigate negative impacts on our consolidated financial statements.

Intragroup Loans

We lend funds to our operating subsidiaries, directly or through holding companies that head our different lines of business. At December 31, 2015, we had loans outstanding totaling 9,142 million euros (7,433 million euros at December 31, 2014) to companies in the Telefónica Group (including subsidiaries located in Latin American countries). These funds are derived from retained cash flows, loans, bonds, issuances of undated deeply subordinated securities and other sources (such as asset disposals).

C. Research and Development, Patents and Licenses, etc.

Telefónica remains firmly committed to technological innovation as an essential tool for achieving competitive advantages, anticipating market trends and differentiating its products. By introducing new technologies and developing new products and business processes, we seek to become a more effective, efficient and customer-oriented Group.

Telefónica has developed an open innovation model for the management of technological innovation to boost the application of technical research in the development of new commercial products and services. Telefónica focuses on certain applied research and development (R&D) priorities that are aligned with its strategy. Open innovation initiatives driving this model include the creation of a venture capital fund and involvement in business collaboration forums, among others. The model also promotes the use of knowledge developed at technology centers, universities and start-ups, among other sources, and encourages innovation in conjunction with other agents (e.g. customers, universities, public administrations, suppliers, content providers and other companies), making them “technological partners.” Within this open innovation strategy, during 2015 the Open Future initiative has been consolidated.

Telefónica believes that in order to differentiate its products from competitors and enhance its market position it cannot rely solely on acquired technology. It is also important to promote R&D in an effort to achieve this differentiation and reinforce Telefónica’s commitment to a sustainable business development. The policy of the Group’s R & D is aimed at:

- developing new products and services in order to win market share;
- - boosting customer loyalty;
  - increasing revenue;
  - enhancing innovation management;
  - improving business practices;
- increasing the quality of infrastructure services to improve customer service and reduce costs;
- - promoting global products;
  - supporting open innovation; and
  - creating value from the technology generated.

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In 2015, the technological innovation projects undertaken focused on sustainable innovation, process efficiency, creation of new revenue streams, customer satisfaction, consolidation of presence in new markets and technological leadership.

Technical innovation activities are a key element of Telefónica's strategy to create value through latest-generation network communications and services.

In 2015, projects were undertaken to promote the increase of access to information technology, new services focused on new internet business models, advanced user interfaces, TV distribution, multimedia content and other added-value services leveraging on the potential of the new infrastructures. These initiatives, among others, were undertaken based on our objective of rapidly identifying emerging technologies that could have a relevant impact on our businesses and pilot testing these technologies in relation to our new services, applications and platform prototypes.

Most of our R&D activities are carried out by Telefónica Investigación y Desarrollo, S.A.U. (Telefónica I+D), a wholly-owned subsidiary, which works mainly for the lines of business. In its operations, Telefónica I+D receives the assistance of other companies and universities. Telefónica I+D's mission is centered on enhancing the Company's competitive positioning by leveraging technological innovation and product development. Telefónica I+D undertakes experimental and applied research and new product development with the overriding goal of broadening the range of services offered and reducing operating costs.

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Telefónica I+D's technological innovation activities focus on two big areas:

Telefónica I+D's works on the development of new networks, primarily in collaboration with Telefónica's Global Resources team. These activities are related to new radio access technologies and fiber; network virtualization technologies, in line with the technology trend known as software defined networks (SDN); and network optimization and zero touch developments making networks more flexible and moldable and able to adapt dynamically to new digital consumer and service requirements.

2. R&D activities to develop new products and services, which are conducted as part of the digital services strategy. These activities are the following:

- Natural P2P communication of the future, using the Internet and smartphones.

- Video and multimedia services (combining text, audio, images and video) offering a user experience in all connected devices.

- Advanced solutions in emerging ITC businesses such as cloud computing, security, financial services or e-health.

- M2M (machine-to-machine) service management associated with energy efficiency and mobility and with the Internet of Things and their adoption in the urban and industrial scenario, and as a service creation enabler.

- Making use of user communication profiles to exploit opportunities to operate different products and business models (marketing campaigns, target marketing, contextual services, churn reduction, cross-selling, etc.).

With a view over the medium and long term, Telefónica I+D's also boasts scientific work groups that aim to look into opportunities relating to new networks and services and solutions to the technological challenges that arise.

In 2015, the new Telefónica I+D center in Chile -launched in 2014 in collaboration with the Chilean government- was reinforced with the launch of the first MVP (Minimum Viable Product), in the field of Smart Cities, Smart Industry and Smart Agro.

At December 31, 2015, Telefónica I+D had 654 employees (652 employees in 2014).

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The total I+D expense in the Group for 2015 amounted to 1,012 million euros, down 0.9% from the 1,021 million euros incurred in 2014 (959 million euros in 2013). This expense represents 2.1%, 2.3% and 1.9% of the Group's consolidated revenue for 2015, 2014 and 2013, respectively. These figures were calculated using guidelines of the Organization for Economic Co-operation and Development (OECD).

During 2015, Telefónica filed 21 new patent applications, two of them registered through the United State Patent and Trademark Office (USPTO) and 19 through the Spanish Patent and Trademark Office (OEPM), of which 9 are International applications (PCT). Additionally two utility models were filed, also through the OEPM.

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D. Trend Information

Telefónica is one of the world's leading mobile and fixed communications services providers, with a strategy focused on becoming a leader in digital communications to support future growth.

In 2015, Telefónica made progress towards long-term profitable and sustainable growth, improving its competitive position in key markets, increasing efficiencies and capturing synergies from the integrated approach of its business, processes and technologies. During recent years, the Company has taken several steps designed to transform its business, which have affected 2015 results:

First, Telefónica has developed new business models based on mobile data centric proposals, bundled services, including converged fixed and mobile services, and digital capacities as part of a group-wide digital transformation drive to address changing consumption habits. A key component of this effort has been the increased investments in fiber and Long Term Evolution technology, which Telefónica believes will allow it to further monetize data and digital services. In this regard, Telefónica has significantly increased its number of data-driven accesses, including 78.0 million new smartphone accesses, 4.9 million new Pay TV accesses and 5.7 million new fiber accesses during the 2013-2015 period, to more than offset declining revenues and thereby increased average revenue per access year-on-year by 1.9% over the period.

Second, changing consumption habits have resulted in reduced demand for fixed voice and mobile voice services and increased demand for mobile data services, such as watching videos and internet browsing on a smartphone, which finally in 2015 has been at a sufficient pace to offset in most of our markets the decline in fixed and mobile voice revenues (excluding declines due to changes in regulation) and start to show a positive trend.

Third, Telefónica has strengthened its competitive position through a strategy of active portfolio management and in-market consolidation in key markets like Germany (with the acquisition of the E-Plus Group), Brazil (with the acquisition of GVT) and Spain (with the acquisition of DTS). These strategic acquisitions in core markets, coupled with recent divestments in non-core markets, have already allowed Telefónica to capture significant synergies.

Finally, Telefónica has launched a simplification program designed to enable growth and transformation across its businesses; capture Group-wide synergies; simplify its commercial offerings (as it has done with the launch of "Movistar Fusión" bundle packages in Spain); modernize its information technology ("IT") network and global processes (through increased IT investment and commercial and customer care cost-reduction efforts); and improve its channels by increasing back-office efficiency. As part of this program, Telefónica has also sought to boost efficiency by increasing its outsourcing of support functions.

Telefónica has taken these steps against a backdrop of several broad trends and developments affecting Telefónica in recent years which have contributed to a downward trend in certain key performance indicators during the 2013-2015 period.

First, changes in foreign exchange rates, particularly during 2014 and 2015 with the depreciation of the Brazilian real against the euro and the effects of the depreciation of the Venezuelan bolivar, have affected Telefónica's revenue growth.

Second, inflation rates have increased Telefónica's expenses in many of our markets and we have not been able to increase our revenues at the same pace.

Third, after a period of significant expansion, Telefónica has generally reduced the scope of its activities and exited certain countries in recent years to reduce its level of indebtedness and strengthen Telefónica's capacity for future growth.

Fourth, Telefónica's business is highly regulated, which affects its revenues and imposes costs on its operations. For example, regulation sets the fixed rates that Telefónica charges for calls received from other companies' networks, and regulators have progressively lowered these rates in recent years.

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In addition, weak economic conditions in Europe generally, and in Spain in particular, have been a key driver of revenue trends in recent years, leading to a reduced demand for many of Telefónica's products and services, and the same trend is beginning to emerge in Latin America.

These trends and developments have contributed to a general downward trend in certain of Telefónica's key performance indicators during the 2013-2015 period, with revenues decreasing by 6.6% to 47,219 million euros for the year ended December 31, 2015 from 50,547 million euros for the year ended December 31, 2013 and operating income, profit for the year and net cash from operating activities decreasing during this period by 67.6%, 40.2% and 5.11%, respectively. 2015 results have been significantly affected by restructuring costs.

Nevertheless, we believe that Telefónica is positioned to benefit from the return to GDP growth in Europe, which began in 2014, as well as the potential implementation of the European Commission's recently announced Digital Single Market package of legislative measures, as we believe Telefónica is prepared to thrive in a policy environment that supports innovation and investment for the benefits of end users.

E. Off-Balance Sheet Arrangements

We have commitments that could require us to make material payments in the future. These commitments are not included in our consolidated statement of financial position at December 31, 2015 although they are described in the notes to our Consolidated Financial Statements. For summary of our off-balance sheet commitments, see Note 21(b) and Note 16 to our Consolidated Financial Statements.



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## F. Tabular Disclosure of Contractual Obligations

The following table describes our contractual obligations and commitments with definitive payment terms which may require significant cash outlays in the future. The amounts payable (including accrued interest payments) are as of December 31, 2015. For additional information, see our Consolidated Financial Statements.

Millions of euros	Payments Due by Period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Financial liabilities (1)(2)	<b>60,070</b>	12,953	15,004	8,639	23,474
Operating lease obligations (3)	<b>9,631</b>	1,570	2,497	1,961	3,603
Purchase and other contractual obligations(4)	<b>7,393</b>	3,872	1,943	382	1,196
Other liabilities (5)	<b>4,336</b>	964	3,372	–	–
<b>Total</b>	<b>81,430</b>	<b>19,359</b>	<b>22,816</b>	<b>10,982</b>	<b>28,273</b>

(1) Capital (finance) lease obligations are not calculated separately and are instead included as part of our long-term debt obligations.

(2) Estimated future interest payments as of December 31, 2015 on our interest-bearing debt (not included above) are as follows: 2,352 million euros in 2016, 2,045 million euros in 2017, 1,623 million euros in 2018, 1,381 million euros in 2019, 1,155 million euros in 2020 and 6,650 million euros in subsequent years. With respect to floating rate debt, we estimate future interest payments as the forward rates derived from yield curves quoted for the different currencies on December 31, 2015. This item includes the fair value of those derivatives classified as current financial liabilities (negative mark-to-market) under IFRS (328 million euros). It does not include the fair value of derivatives classified as financial assets (positive mark-to-market) under IFRS (2,140 million euros classified as current financial assets and 5,315 million euros as non-current financial assets). For a more detailed description of our financial derivative transactions, see Note 16 to our Consolidated Financial Statements. For details of the composition of this item, see “Liquidity and Capital Resources– Anticipated Sources of Liquidity”).

(3) This item includes definitive payments (non-cancellable 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. At December 31, 2015, the present value of future payments for operating leases was approximately 6,853 million euros (1,758 million euros in Telefónica Brazil, 1,701 million euros in Telefónica Hispanoamérica, 947 million euros in Telefónica Spain, 2,316 million euros in Telefónica Germany and 131 million euros in other companies). For a more detailed information about payments due under this item, see Note 18 to our Consolidated Financial Statements.

(4) This item includes definitive payments (non-cancellable without penalty cost) due for agreements to purchase goods (such as network equipment) and services.

(5) “Other liabilities” include: (a) long-term obligations that require us to make cash payments, excluding financial debt obligations included in the table under “Financial Liabilities” above and (b) other provisions. Because of the nature of the risks covered by “Other liabilities” such as other provisions, it is not possible to determine a reliable schedule of potential payments, if any. For details of the composition of other provisions, see Note 15 to our Consolidated

Financial Statements.

In addition, at December 31, 2015, we had short-term and long-term employee benefits provisions amounting to 1,007 million euros and 5,366 million euros, respectively (see Note 15 to our Consolidated Financial Statements).

For details of the composition of, and changes in, our debt, see “—Liquidity and Capital Resources—Anticipated Sources of Liquidity” and Note 13 to our Consolidated Financial Statements.

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## Item 6. Directors, Senior Management and Employees

## A. Directors and Senior Management

During 2015, our Board of Directors met 15 times. At February 26, 2016, our Board of Directors had met two times during 2016. At February 26, 2016, our directors, their respective positions on our Board and the year they were appointed to such positions were as follows:

Name	Age	First Appointed	Current Term Ends
<b>Chairman</b>			
Mr. César Alierta Izuel(1)	70	1997	2017
<b>Vice-chairmen</b>			
Mr. Isidro Fainé Casas(1)(2)	73	1994	2016
Mr. José María Abril Pérez (1)(3)(7)	63	2007	2018
Mr. Julio Linares López (5)(7)(8)	70	2005	2016
<b>Members (vocales)</b>			
Mr. José María Álvarez-Pallete López (1)	52	2006	2017
Mr. José Fernando de Almansa Moreno -Barreda(5)(6)(8)	67	2003	2018
Ms. Eva Castillo Sanz (6)(8)(10)	53	2008	2018
Mr. Carlos Colomer Casellas(1)(4)(7)(9)(10)	71	2001	2016
Mr. Peter Erskine(1)(7)(8)(9)	64	2006	2016
Mr. Santiago Fernández Valbuena	57	2012	2018
Mr. Alfonso Ferrari Herrero (1)(4)(5)(6)(8)(9)(10)	73	2001	2016
Mr. Luiz Fernando Furlán	69	2008	2018
Mr. Gonzalo Hinojosa Fernández de Angulo (1)(4)(5)(6)(8)(9)(10)	70	2002	2017
Mr. Pablo Isla Álvarez de Tejera(9)	52	2002	2017
Mr. Antonio Massanell Lavilla(2)(4)(5)(7)(10)	61	1995	2016
Mr. Ignacio Moreno Martínez (3)(4)(6)(10)	58	2011	2017
Mr. Francisco Javier de Paz Mancho (1)(5)(6)(10)	57	2007	2018
Mr. Wang Xiaochu (11)	57	2015	2016

(1) Member of the Executive Commission of the Board of Directors.

(2) Nominated by Fundació Bancaria Caixa d'Estalvis i Pensions de Barcelona ("la Caixa").

(3) Nominated by Banco Bilbao Vizcaya Argentaria, S.A. ("BBVA").

(4) Member of the Audit and Control Committee of the Board of Directors.

(5) Member of the Institutional Affairs Committee.

- (6) Member of the Regulation Committee.
- (7) Member of the Innovation Committee.
- (8) Member of the Strategy Committee.
- (9) Member of the Nominating, Compensation and Corporate Governance Committee.
- (10) Member of the Service Quality and Customer Service Committee.
- (11) Nominated by China Unicom (Hong Kong) Limited.

Board Committees

At February 26, 2016, the committees of our Board of Directors and members thereof are as follows:

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*Executive Commission*

Our Board of Directors has expressly delegated all of its authority and power to the Executive Commission except as prohibited by the Spanish Corporation Act, under our Articles of Association, or under our Board Regulations. This commission is made up of fewer directors and meets more frequently than our Board of Directors. The members of the Executive Commission are Mr. César Alierta Izuel, Mr. Isidro Fainé Casas, Mr. José María Abril Pérez, Mr. José María Álvarez-Pallete López, Mr. Carlos Colomer Casellas, Mr. Peter Erskine, Mr. Alfonso Ferrari Herrero, Mr. Gonzalo Hinojosa Fernández de Angulo, Mr. Francisco Javier de Paz Mancho and Mr. Ramiro Sánchez de Lerín García-Ovies, as secretary.

*Audit and Control Committee*

The Audit and Control Committee functions are regulated by our bylaws and our Board Regulations. The Audit and Control Committee has the primary objective of providing support to our Board of Directors in its supervisory and oversight functions, specifically having the following responsibilities:

To report to the shareholders at the General Shareholders' Meeting regarding matters raised therein for which it is responsible.

To submit to the Board of Directors proposals for the selection, appointment, re-election and replacement of the external auditor, as well as the terms and conditions of the contract therewith, and regularly obtain from such external auditor information regarding the audit plan and the implementation thereof, in addition to the preservation of its independence in the performance of its duties.

To supervise the effectiveness of the Company's internal control system, the internal audit and the systems for the management of risks, including tax risks, as well as to discuss with the auditor the significant weaknesses in the internal control system detected during the audit.

To supervise the process of preparation and submission of regulated financial information.

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 independence thereof, as well as any other matters relating to the audit procedure, 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 annually written confirmation from the auditor of its independence vis-à-vis the entity or entities directly or indirectly related thereto, as well as

information regarding additional services of any kind provided to such entities by the auditor, or by the persons or entities related thereto, pursuant to the legislation in force.

To issue on an annual basis, prior to the issuance of the audit report, a report stating an opinion regarding the independence of the auditor. This report must in all cases include an opinion on the provision of the additional services referred to in the preceding paragraph.

To report to the Board of Directors in advance on all matters contemplated by law, the By-Laws and the Regulations of the Board of Directors.

Any other powers granted to it under the Regulations of the Board of Directors.

The Audit and Control Committee meets at least once per quarter and as many times as considered necessary. During 2015, the Audit and Control Committee met thirteen times and, as of the date of this Annual Report, had met three times in 2016. The members of the Audit and Control Committee are Mr. Carlos Colomer Casellas (chairman), Mr. Gonzalo Hinojosa Fernández de Angulo, Mr. Antonio Massanell Lavilla, Mr. Alfonso Ferrari Herrero and Mr. Ignacio Moreno Martínez. Our Board of Directors has determined that Mr. Antonio Masanell Lavilla meets the requirements of an “audit committee financial expert” as such term is defined by the SEC.

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*Nominating, Compensation and Corporate Governance Committee*

The Nominating, Compensation and Corporate Governance Committee is responsible for, among other things, reporting to our Board of Directors with respect to proposals for the appointment, re-election and removal of directors, members of the Executive Commission and the other committees of our Board of Directors and top members of our management and management of our subsidiaries. In addition, the Nominating, Compensation and Corporate Governance Committee is responsible for proposing to the Board of Directors, within the framework established in the bylaws, the compensation for the directors and reviewing it periodically to ensure that it is in keeping with the tasks performed by them, as provided in Article 35 of the Board Regulations, 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, the executive directors and the senior executive officers of Telefónica, including the basic terms of their contracts, for purposes of contractual implementation thereof and to supervise compliance with the corporate governance rules in effect from time to time.

The members of the Nominating, Compensation and Corporate Governance Committee are Mr. Alfonso Ferrari Herrero (chairman), Mr. Carlos Colomer Casellas, Mr. Peter Erskine, Mr. Gonzalo Hinojosa Fernández de Angulo and Mr. Pablo Isla Álvarez de Tejera. During 2015, the Nominating, Compensation and Corporate Governance Committee met eleven times, and as of the date of this Annual Report, it had met two times in 2016.

*Regulation Committee*

The Regulation Committee's main objective is to monitor the main regulatory matters which affect us. Another responsibility of the Regulation Committee is to act as a communication and information channel between our management team and our Board of Directors concerning regulatory matters. The members of the Regulation Committee are Mr. Gonzalo Hinojosa Fernández de Angulo (chairman), Mr. José Fernando de Almansa Moreno-Barreda, Ms. Eva Castillo Sanz, Mr. Alfonso Ferrari Herrero, Mr. Ignacio Moreno Martínez and Mr. Francisco Javier de Paz Mancho. During 2015, the Regulation Committee met four times and as of the date of this Annual Report has not met in 2016.

*Service Quality and Customer Service Committee*

The Service Quality and Customer Service Committee is responsible for monitoring and reviewing the standards of quality of the main services we provide. The Service Quality and Customer Service Committee acts as an information channel between our senior management team and our Board of Directors. The members of the Service Quality and Customer Service Committee are Mr. Antonio Massanell Lavilla (chairman), Ms. Eva Castillo Sanz, Mr. Carlos

Colomer Casellas, Mr. Alfonso Ferrari Herrero, Mr. Gonzalo Hinojosa Fernández de Angulo, Mr. Ignacio Moreno Martínez and Mr. Javier de Paz Mancho. During 2015 the Service Quality and Customer Service Committee met four times and as of the date of this Annual Report has not met in 2016.

### *Institutional Affairs Committee*

The Institutional Affairs Committee is responsible for reviewing, reporting and proposing to the Board of Directors the principles that are to govern the Group's Sponsorship and Patronage Policy, to monitor such policy, and to individually approve sponsorships or patronages the amount or importance of which exceed the limit set by the Board and which require its approval. The Committee is responsible for promoting the development of the Telefónica Group's Corporate Reputation and Responsibility project and its institutional affairs. The members of the Institutional Affairs Committee are Mr. Julio Linares López (chairman), Mr. José Fernando de Almansa Moreno-Barreda, Mr. Alfonso Ferrari Herrero, Mr. Gonzalo Hinojosa Fernández de Angulo, Mr. Antonio Massanell Lavilla and Mr. Francisco Javier de Paz Mancho. During 2015, the International Affairs Committee met eleven times, and as of the date of this Annual Report it had met two times in 2016.



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***Innovation Committee***

The Innovation Committee is responsible for advising and assisting in all matters regarding innovation. Its main object is to examine, analyze and periodically monitor the Group's innovation projects, provide guidance and help ensure the implementation and development of innovation initiatives across the Group. The members of the Innovation Committee are Mr. Carlos Colomer Casellas (chairman), Mr. José María Abril Pérez, Mr. Antonio Massanell Lavilla, Mr. Julio Linares López and Mr. Peter Erskine. During 2015, the Innovation Committee met eleven times, and as of the date of this Annual Report, it had met two times in 2016.

***Strategy Committee***

Without prejudice to any other tasks that the Board of Directors may assign thereto, the primary duty of the Strategy Committee is to support the Board of Directors in the analysis and implementation of the global strategy policy of the Telefónica Group. The members of the Strategy Committee are Mr. Peter Erskine (chairman), Mr. José Fernando de Almansa Moreno-Barreda, Ms. Eva Castillo Sanz, Mr. Alfonso Ferrari Herrero, Mr. Julio Linares López and Mr. Gonzalo Hinojosa Fernández de Angulo. The Strategy Committee met eleven times during 2015, and as of the date of this Annual Report, had met two times in 2016.

***Biographies of Directors***

Mr. César Alierta Izuel serves as our Executive Chairman and Chairman of our Board of Directors. Mr. Alierta began his career in 1970 as general manager of the capital markets division at Banco Urquijo, S.A. in Madrid, where he worked until 1985. Subsequently, he founded and served as Chairman of Beta Capital Sociedad de Valores, S.A. which he combined as from 1991 with his post as Chairman of the Spanish Financial Analysts' Association (Instituto Español de Analistas Financieros). Between 1996 and 2000, he was Director and Chairman of Tabacalera, S.A. At that time Tabacalera, S.A. changed its name into Altadis, S.A. (following its merger with the French Group, Seita-Société Nationale D'Éxplotation Industrielle des Tabacs et Allumettes) and he became Director and Chairman of Altadis, S.A. He has also been a member of the Board of Directors of the Madrid Stock Exchange (Bolsa de Madrid), Plus Ultra Compañía de Seguros y Reaseguros, S.A., Telefónica Internacional and Iberia, S.A. In January 1997, Mr. Alierta was appointed as a Director of Telefónica and on July 26, 2000, he was appointed as our Executive Chairman. Mr. Alierta is Director of China Unicom (Hong Kong) Limited since October 15, 2008, and of International Consolidated Airlines Group (IAG) since September 2010. Also, he is Trustee of Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona ("la Caixa"). Mr. Alierta has been a Director of Telecom Italia from November 8, 2007, to December 13, 2013. Mr. Alierta holds a Law degree from the University of Zaragoza and an MBA from Columbia University (New York) and is currently a member of the Columbia Business School Board of Overseers, Chairman of the Business Competitiveness Council and Chairman of the Social Board of the UNED (National Long Distance Spanish University).

Mr. Isidro Fainé Casas serves as Vice-Chairman of our Board of Directors. For over 40 years, Mr. Fainé has worked in several financial institutions, including amongst others: Banco Atlántico, S.A., (1964), Banco de Asunción (Paraguay) (1969), Banca Riva y García, S.A. (1973), Banca Jover, S.A. (1974), and Banco Unión, S.A. (1978). Mr. Fainé is currently Chairman of CaixaBank, he is also Chairman of the Board of trustees of the Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona "la Caixa", of Criteria Caixa, S.A.U., and of the Spanish Confederation of Savings Banks (CECA). He is also First Vice-Chairman of Repsol YPF, S.A., of the European Savings Banks Group (ESGB) and Deputy Chairman of the World Savings Banks Institute (WSBI). Furthermore, he is a member of the Boards of Directors of Banco Português de Investimento, S.A. (BPI), of Gas Natural, S.A., of the Bank of East Asia and of Suez Environnement Company. He is currently the Chairman of the Spanish Confederation of Executives (CEDE), the Spanish Chapter of the Club of Rome and the Círculo Financiero. He is also a member of the Business Council for Competitiveness (CEC). Mr. Fainé holds a Doctorate degree in Economics, a Diploma in Senior Management from IESE Business School and an ISMP certificate in Business Administration from Harvard University. He is a member of the Royal Academy of Economics and Finance and of the Royal Academy of Doctorate Holders.

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Mr. José María Abril Pérez serves as Vice-Chairman of our Board of Directors. From 1975 to 1982 he served as Financial Manager of Sociedad Anónima de Alimentación (SAAL). Since then, and until he joined the Banco Bilbao Vizcaya Argentaria Group (BBVA), he was Financial Manager of Sancel-Scott Ibérica, S.A. In 1985 he joined Banco Bilbao, S.A. as Managing Director of Investment Corporate Banking. From January to April 1993, he was appointed Executive Coordinator of Banco Español de Crédito, S.A. In 1998, he became General Manager of the Industrial Group of BBV. In 1999, he was appointed member of the Executive Committee of the BBV Group. He has also been a member of the Board of Directors of Repsol, S.A., Iberia, S.A., Corporación IBV, and Vice-Chairman of Bolsas y Mercados Españoles, S.A. In 2002 he became Managing Director of the Wholesale and Investment Banking Division and a member of the Executive Committee of Banco Bilbao Vizcaya Argentaria, S.A., and he is now in retirement. He holds a degree in Economics from the University of Deusto (Bilbao, Spain) and he has been professor of such University for nine years.

Mr. Julio Linares López serves as Vice-Chairman of our Board of Directors since September 2012 and had been our Chief Operating Officer from December 2007 to September 2012. He is also a member of the Advisory Committee of Telefónica Hispanoamérica and Telefónica de España and he is also trustee of the Telefónica Foundation. In May 1970, he joined our Research and Development Center, where he held several positions until he was appointed head of our Technology Department in 1984. In April 1990, he was appointed General Manager of Telefónica Research and Development, S.A. In December 1994, he became Deputy General Manager of the Marketing and Services Development department in the commercial area and subsequently, Deputy General Manager for Corporate Marketing. In July 1997, he was appointed Chief Executive Officer of Telefónica Multimedia S.A. and Chairman of Telefónica Cable and Producciones Multitemáticas, S.A. in the Telefónica multimedia business. In May 1998 he was appointed General Manager of Strategy and Technology in Telefónica, S.A. In January 2000, he was appointed Executive Chairman of Telefónica de España, S.A., being also president of certain Telefónica subsidiaries such as TELYCO or Cable, positions which he held until December 2005, when he was appointed our Managing Director for Coordination, Business Development and Synergies in Telefónica, S.A., a member of its Board of Directors and Secretary of the Executive Committee. In June 2005, Mr. Linares was appointed Chairman of the Supervisory Board of Cesky Telecom. Mr. Linares was a Director of Telecom Italia until December 13, 2013. He is currently member of the GSM Association Board and Executive Committee, and is Chairman of the Strategic Committee. He is also member of GSMA Ltd. He is a Trustee of the Mobile World Capital Barcelona Foundation and of the CEDE-Confederación Española de Directivos and Ejecutivos Foundation. He is also a member of the Association Management Board for Managerial Progress and of the Social Council of the Complutense University in Madrid, member of the Executive Committee and the Board of the CEOE (Confederación Española de Organizaciones Empresariales). Furthermore, he is member of the Advisory Council AMETIC, member of COIT (Official College of Telecommunications Engineering), AEIT (Spanish Association of Telecommunications Engineers) and member of the Advisory council of the Higher Technical School of Engineers Telecommunications. Mr. Linares holds a degree in Telecommunications Engineering from the Polytechnic University of Madrid (Universidad Politécnica de Madrid).

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Mr. José María Álvarez-Pallete López serves as a Director of our Board of Directors and, since September 2012 as our Chief Operating Officer. From September 11, 2011, to September 2012, he served as Chairman of Telefónica Europe. He began his career at Arthur Young Auditors in 1987. In 1988, he joined Benito & Monjardín/Kidder, Peabody & Co., where he held various positions in the research and corporate finance departments. In 1991, he held the “Associate” training course in New York and participated in investment projects of the GE Group in Spain. In 1995, he joined Compañía Valenciana de Cementos Portland, S.A. (Cemex) as head of the Investor Relations and Analysis department. In 1996 he was promoted to Chief Financial Officer of Cemex Group in Spain, and in 1998, to Chief Administration and Financial Officer of Cemex in Indonesia, headquartered in Jakarta, and he was appointed member of the Board of Cemex Asia, Ltd. In February 1999 he joined the Telefónica Group as General Manager of Finance for Telefónica International, S.A. In September of the same year he was promoted to Chief Financial Officer of Telefónica. In July 2002, he was appointed Chairman and Chief Executive Officer of Telefónica Internacional, S.A., in July 2006 General Manager of Telefónica Latin America, and in March 2009, Chairman of Telefónica Latin America. He has also been Chairman of the Board of Directors of Telefónica Internacional S.A.U. and of the Supervisory Board of Brasilcel, N.V and Cesky Telecom and Vice-Chairman of the Board of Directors of Telesp, S.A. and Telefónica Móviles México, S.A. He was member of the Board of Directors of the following companies: Telecomunicações de Sao Paulo; Telefónica Datacorp, S.A.; Telefónica del Perú, S.A.A.; Colombia Telecomunicaciones, ESP; Telefónica Móviles México; Telefónica Larga Distancia de Puerto Rico, S.A.; Admira Media; Inmobiliaria Telefónica; TPI; Telefónica Móviles; Telefónica Holding Argentina; Telefónica de España; Telefónica O2 Europe; Portugal Telecom and China Netcom. He was Alternate Director of the following companies: Telefónica Chile, S.A.; Telefónica Móviles Colombia, S.A.; Telefónica de Argentina, S.A.; and Telefónica Móviles Chile. He has also been Chairman of Antares, Fonditel, Telfisa and Telefónica North América, and Vice-Chairman of Telefónica Perú. Mr. Álvarez-Pallete holds a degree in Economics from the Complutense University in Madrid. He also studied Economics at the Université Libre de Belgique and holds an International Management Program from the Pan-American Institute of Executive Business Administration (IPADE) and a Diplome of Advanced Studies (DEA) from the department of financial economics and accounting of the Complutense University of Madrid.

Mr. José Fernando de Almansa Moreno-Barreda serves as a Director of our Board of Directors. In December 1974 he joined the Spanish Diplomatic Corps (Cuerpo Diplomático) and served from 1976 to 1992 as Secretary of the Spanish Embassy in Brussels, Cultural Counsellor of the Spanish Delegation to Mexico, Chief Director of the General Coordination Branch of Eastern Europe, Director of Atlantic Affairs in the General Directorate of Foreign Policy for Europe and Atlantic Affairs, Political Counsellor to the Spanish Permanent Representation to NATO in Brussels, Minister-Counsellor of the Spanish Embassy in the Soviet Union, General Secretary of the National Commission for the 5th Centennial of the Discovery of the Americas and Deputy General Director for Eastern Europe in the General Directorate of Foreign Policy for Europe. From 1993 to 2002, Mr. Fernando de Almansa was appointed Chief of the Royal Household by His Majesty King Juan Carlos I. He is also a Director of Telefónica Brasil, S.A., and of Telefónica Móviles México, S.A. de C.V. and a Deputy Director of Grupo Financiero BBVA Bancomer, S.A. de C.V. and of BBVA Bancomer, S.A. Furthermore, he is currently member of the Board of Laboratorios Farmacéuticos Rovi, S.A. He holds a law degree from the University of Deusto (Bilbao, Spain).

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Ms. Eva Castillo Sanz serves as a Director of our Board of Directors. Ms. Castillo began her career at the Spanish broker Beta Capital Sociedad de Valores, S.A., where she worked for five years. After that, she worked for another five years for Goldman Sachs International in London in the International Equity Markets Department. In 1997, Ms. Castillo joined Merrill Lynch as head of Equity Markets for Spain and Portugal. In 1999, she was promoted to Country Manager for Spain and Portugal and in 2000 she became Chief Executive Officer of Merrill Lynch Capital Markets Spain. After that, Ms. Castillo was appointed Chief Operating Officer for EMEA Equity Markets. In October 2003, she was appointed head of Global Markets & Investment Banking in Spain and Portugal, as well as president of Merrill Lynch Spain. Until December 2009, she headed Global Wealth Management business operations in Europe, the Middle East and Africa, including Merrill Lynch Bank (Suisse) and the International Trust and Wealth Structuring business. She was a member of the Merrill Lynch EMEA Executive Committee, the Global Wealth Management Executive and Operating Committees. Ms. Castillo was Chairwoman of Telefónica Europe and a member of Telefónica's Executive Committee from September 2012 to February 2014. From February 2011 to February 2013, Ms. Castillo was member of the Board of Directors of Old Mutual, Plc. and since May 2010 until January 2014 she was Chairperson of the Board of Telefónica Czech Republic, a.s. Currently, Ms. Castillo is the Chairperson of the Supervisory Board of Telefónica Deutschland Holding AG, member of the Board of Directors of Bankia, S.A., of Visa Europea and of the Telefónica Foundation. She is also a member of the Board of the Comillas-ICAI Foundation and member of the Board of Entreculturas Foundation. Ms. Castillo holds degrees in Business and Law (ICADE – E3) from the Universidad Pontificia de Comillas of Madrid.

Mr. Carlos Colomer Casellas serves as a Director of our Board of Directors. Mr. Colomer began his career in 1970 as Marketing Vice-Chairman of Henry Colomer, S.A. In 1980, he was appointed Chairman and General Manager of Henry Colomer, S.A. and Haugron Cientifical, S.A. In 1986, he was also appointed President of Revlon for Europe. In 1989, he became Chairman of Revlon International and in 1990, he was appointed Executive Vice-President and Chief Operating Officer of Revlon Inc. in New York. In 2000, he was appointed Chairman and Chief Executive Officer of The Colomer Group. Currently, he is Chairman of Ahorro Bursátil, S.A. SICAV, Inversiones Mobiliarias Urquiola, S.A. SICAV, Haugron Holdings S.L. He is a member of MDF Family Partners and Abertis Infraestructuras, S.A. Mr. Colomer has a degree in Economics from the University of Barcelona and an MBA from IESE Business School.

Mr. Peter Erskine serves as a Director of our Board of Directors. He began his career in the field of marketing in Polycell and in Colgate Palmolive. He worked for several years at the Mars Group, serving as Vice-Chairman for Europe of Mars Electronics. In 1990 he was appointed Vice-Chairman of Marketing and Sales of Unitel. From 1993 to 1998, he held a number of senior positions, including Director of British Telecom (BT) Mobile and President and Chief Executive Officer of Concert. In 1998 he became Managing Director of BT Cellnet. Subsequently, in 2001 he became Chief Executive Officer and a Director of the Board of Directors of Telefónica Europe, Plc. In 2006 he became Executive Chairman of Telefónica Europe, Plc (until December 31, 2007, after which he became a Non-Executive Director) and from July 2006 until December 2007 he served as General Manager of the business unit Telefónica Europe. In January 2009 he joined the Board of Ladbrokes Plc. as a Non-Executive Director until December 2015, becoming Chairman in May 2009. Currently, he is Chairman of the Henley Business School Strategy Board, member of the Council of Reading University and also serves as a member of the University's Strategy and Finance Committee. In 1973, he received a degree in Psychology from Liverpool University.

Mr. Santiago Fernández Valbuena is Chief Officer. He is also a member of the Board of Telefónica, S.A. and Deputy Chairman of Telefônica do Brasil. He has been Chairman & CEO of Telefónica Latin America (2011-2014), Chief Finance and Strategy Officer (2010-2011) and Chief Financial and Corporate Development Officer (2002-2010). Throughout this period he was also responsible (not continuously) for Procurement, IT, HR, Internal Audit and Subsidiaries (Atento, Endemol). From 1997 to 2002 he was CEO of Fonditel, the pension fund manager for Telefónica. Since 2008 he serves as Independent Director at Ferrovial S.A. and member of its Audit Committee. Before joining Telefónica he was Managing Director at Société Générale de Valores and Head of Equities at Beta Capital in Madrid. He holds a degree in Economics from the Complutense University of Madrid, a PhD and a Master's degree in Economics from Northeastern University in Boston. He has been a Professor of Applied Economics at Complutense University in Madrid and the Universidad de Murcia and has lectured at Instituto de Empresa (IE Business School) in Madrid.

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Mr. Alfonso Ferrari Herrero serves as a Director of our Board of Directors. From 1968 to 1969 he was Assistant to the Financial Manager of Hidroeléctrica del Cantábrico, S.A. From 1969 to 1985, he worked in Banco Urquijo, S.A. holding several positions as Analyst, Manager of Industrial Investments and as a representative in several subsidiaries of Banco Urquijo, S.A. in his capacity as member of the Board of Directors. From 1985 to 1996 he was a member of the Board of Directors and Manager of the Corporate Finance of Beta Capital Sociedad de Valores, S.A., of which Mr. Ferrari was a co-founder. From 1996 until 2000 served as Chairman and Chief Operating Officer of Beta Capital, S.A. Currently, he is a Director of Telefónica del Perú, S.A.A., and a Deputy Director of Telefónica Chile, S.A. He has a doctorate in Industrial Engineering from the Industrial Engineers Technical School of the Polytechnic University of Madrid (Escuela Técnica Superior de Ingenieros Industriales de la Universidad Politécnica de Madrid) and holds an MBA from Harvard University.

Mr. Luiz Fernando Furlán serves as a Director of our Board of Directors. He is currently Chairman of the Board of Directors of Amazonas Sustainability Foundation and member of Global Ocean Commission. He is also a member of the Board of Directors of Telefônica Brasil, S.A., BRF-Brasil Foods, S.A. (Brazil) and AGCO Corporation (USA). Throughout his career he has been a member of the board of directors of several companies in Brazil and abroad such as Chairman of Sadia, S.A., Co-Chairman of BRF-Brasil Foods, S.A., member of the Board of Redecard, S.A., and member of the Advisory/ Consultive Board of Panasonic (Japan) and Wal-Mart (USA) and a member of the Advisory/Consultive Board of Abertis Infraestructuras, S.A. (Spain). From 2003 to 2007 he was Minister of Development, Industry and Foreign Trade of Brazil. He holds a degree in Chemical Engineering from the Industrial Engineering Faculty of São Paulo and in Business Administration from University of Santana (São Paulo), with specialization in financial administration from Fundação Getúlio Vargas (São Paulo).

Mr. Gonzalo Hinojosa Fernández de Angulo serves as a Director of our Board of Directors and of Telefónica del Perú, S.A.A. He began his career in 1966 in Cortefiel, S.A. and served in several management positions since then. From 1976 to 1985 Mr. Hinojosa was General Manager of Cortefiel, S.A. and from 1985 until 2005 he served as Chief Executive Officer of Cortefiel Group, a post which he combined with his appointment as Chairman from 1998 until 2006. From 1991 through 2002, he served as a Director of Banco Central Hispano Americano, S.A. and as a Director of Portland Valderribas, S.A. He has also served as a Director of Altadis, S.A. (1998-2007) and of Dinamia Capital Privado, S.A., SCR. Mr. Hinojosa has a degree in Industrial Engineering from the Industrial Engineers Technical School of the Polytechnic University of Madrid (Escuela Técnica Superior de Ingenieros Industriales de la Universidad Politécnica de Madrid).

Mr. Pablo Isla Álvarez de Tejera serves as a Director of our Board of Directors. Mr. Isla began his career in 1989 as a State's Attorney (abogado del estado), holding the first position of his class. He joined the Body of State's Attorneys that year and was assigned to the Spanish Ministry of Transportation, Tourism and Communications. In 1991 he moved to the General Management of the Legal Services of the Spanish Government (Dirección General del Servicio Jurídico del Estado). From 1992 to 1996, Mr. Isla served as General Manager of the Legal Services Department of Banco Popular, S.A. In 1996, he was appointed General Manager of the National Heritage Department of the Treasury Department of Spain (Ministerio de Economía y Hacienda). He also served as General Secretary of Banco Popular Español, S.A. from 1998 to 2000. In July 2000, Mr. Isla was appointed Chairman of the board of Grupo Altadis and Co-Chairman of such company. In June 2005, Mr. Isla was appointed the Deputy Chairman and Chief Executive

Officer of Inditex, S.A. Since 2011, Mr. Isla is the current Chairman and CEO of Inditex, S.A. Mr. Isla has a degree in Law from the Complutense University of Madrid.



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Mr. Antonio Massanell Lavilla serves as a Director of our Board of Directors. In 1971 he joined the Caja de Ahorros y Pensiones de Barcelona (“La Caixa”), where he held several posts and in 1990, he was appointed Assistant Manager and Secretary of the Steering Committee, and from 1999 to June 2011 he served as Executive General Assistant Manager. In the same year, he was appointed member of the board of Directors of Sociedad Española de Medios de Pago, S.A. From 1992 to 1994, Mr. Massanell served as Chairman of the Steering Committee of Sistema 6000 de la Confederación Española de Cajas de Ahorros, and Director of Visa Spain (1995-1998), Director of Autema (1991-2003), Director of Inmobiliaria Colonial (1992-2003), Director of Baqueira Beret (1998-2006), Director of Occidental Hotels Management, B.V. (2003-2007), Chairman of Port Aventura Entertainment, S.A. (2009-2012), Director of e-la Caixa, S.A., Director of Caixa Capital Risc, S.G.E.C.R, S.A. and Director of Serveis Informàtics “La Caixa”, S.A. Mr. Massanell has been Deputy Chairman of Caixa Bank since June 2014. He also served as Chairman of Barcelona Digital Centre Tecnològic (former Fundació Barcelona Digital) and as member of the Board of Directors of Boursorama, S.A. He is currently member of the Board of Directors of SAREB (Sociedad de Gestión de Activos Inmobiliarios procedentes de la Reestructuración Bancaria), Mediterránea Beach & Golf Community S.A, member of the Supervisory board of ERSTE Group Bank, as well as Telefónica and Caixabank and Non-Executive Chairman of Cecabank. He is Vice-Chairman of the Board of Trustees of COTEC, Chairman of the Barcelona Centre Financer Europeu association, member of the Plenary Body of the Chamber of Commerce of Barcelona and member of ERPB. Mr. Antonio Massanell Lavilla holds a degree in Economics from the University of Barcelona.

Mr. Ignacio Moreno Martínez serves as a Director on our Board of Directors. Previous posts include head of Corporate Banking and Private Equity at Banco de Vizcaya, Banco Santander de Negocios, and Mercapital. He also served as Deputy General Manager of Corporate and Institutional Banking at Corporación Bancaria de España, S.A. – Argentaria, Chief Executive Officer of Desarrollo Urbanístico Chamartín, S.A., and Chairman of Argentaria Bolsa, Sociedad de Valores. In addition, he also served as General Manager of the Chairman’s Office at Banco Bilbao Vizcaya Argentaria, S.A., Chairman Executive Officer of Vista Capital Expansión, S.A., SGECE – Private Equity and Chairman Executive Officer of N+1 Private Equity. Mr. Moreno is currently CEO of Metrovacesa, S.A., and Director of Secuoya Grupo de Comunicación, S.A. Mr. Moreno holds a degree in Economics and Business Studies from the University of Bilbao, and a Master’s degree in Marketing and Sales Management from the Instituto de Empresa and an MBA from INSEAD.

Mr. Francisco Javier De Paz Mancho serves as a Director of our Board of Directors. From 1990 to 1993, he was general secretary of the Spanish Consumers Association (Unión de Consumidores de España, UCE). From 1993 to 1996, he served as General Manager of Internal Trade of the Spanish Ministry of Tourism and Commerce. From 1991 to 1993, he was Director of Tabacalera, S.A. From 1994 to 1996 and from 1996 to 2000, he was Chairman of the Observatory of Trading of the Spanish Ministry of Tourism and Commerce (Observatorio de la Distribución Comercial del Ministerio de Comercio y Turismo); from 1996 to 2004, he was Corporate Strategy Manager of the Panrico Donuts Group. From 1998 to 2004, he served as Director of Mutua de Accidentes de Zaragoza (MAZ) and of the Panrico Group. From 2004 to 2006, he was Director of Tunel de Cadí, S.A.C. and from 2003 to 2004, he served as Chairman of the Patronal Pan y Bollería Marca (COE). From 2004 to 2007, he was Chairman of the National Company MERCASA. He has also been a member of the Board of Directors of Altadis, S.A., and of the Economic and Social Board and its permanent commission. From July 2006 to November 2014, he has been a member of the Executive Committee of the Chambers Board (Consejo Superior de Cámaras). Currently, he is Director of Telefónica de Argentina, S.A. and Telefônica Brasil, S.A. He is also Chairman of Telefónica Gestión de Servicios Compartidos, S.A.U. Mr. de Paz has a diploma in Publicity and Information and undertook studies in Law. He completed a

Programa de Alta Dirección de Empresas from the IESE Business School (Instituto de Estudios Superiores de la Empresa, University of Navarra).

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Mr. Wang Xiaochu serves as a Director of our Board of Directors. Prior to joining Telefónica, Mr. Wang served as Deputy Director General and Director General of the Hangzhou Telecommunications Bureau in Zhejiang province; Director General of the Tianjin Posts and Telecommunications Administration; Chairman and Chief Executive Officer of China Mobile (Hong Kong) Limited; Vice President of China Mobile Communications Corporation; an Executive Director, Chairman and Chief Executive Officer of China Telecom Corporation Limited; President and Chairman of China Telecommunications Corporation; and Chairman and Non-executive Director of China Communications Services Corporation Limited. Furthermore, Mr. Wang serves as the Chairman of China United Network Communications Group Company Limited, and as an Executive Director, Chairman and Chief Executive Officer of China Unicom (Hong Kong) Limited. He is a professor level senior engineer, graduated from Beijing Institute of Posts and Telecommunications in 1989 and received a doctorate degree in business administration from the Hong Kong Polytechnic University in 2005.

## Executive Officers/Management Team

At February 26, 2016, our executive management team consisted of the following individuals:

Name	Position	Appointed Age	
Mr. César Alierta Izuel	Chairman of the Board of Directors and Chief Executive Officer	2000	70
Mr. José María Álvarez -Pallete López	Chief Operating Officer	2012	52
Mr. Santiago Fernández Valbuena	Chief Officer	2011	57
Mr. Guillermo Ansaldo Lutz	Chief Global Resources Officer	2011	54
Mr. Ramiro Sánchez de Lerín Garcia-Ovies	General Legal Secretary and Secretary to the Board	2005	61
Mr. Angel Vilá Boix	Chief Financial and Strategy Officer	2011	51
Mr. Eduardo Navarro de Carvalho	Chief Commercial Digital Officer	2012	53
Mr. Ignacio Cuesta	General Manager of Internal Audit	2012	53

## Biographies of the Executive Officers and Senior Management

We present below the biographies of our executive officers and senior management who do not also serve on our Board of Directors.

Mr. Guillermo Ansaldo Lutz serves as Chief Global Resources Officer (CGRO) of Telefónica Global Resources operating unit since September 2011, he is also member of the Executive Committee of Telefónica. From 1989 to 2000 he worked for McKinsey & Company holding different positions in Spain and Argentina. In 1995, he was

appointed partner of McKinsey & Company in Argentina. From 2000 to 2004 he was the Chief Executive Officer of Telefónica de Argentina, S.A. and since April 2005, he held the position of Chief Executive Officer of Telefónica de España, S.A. From December 2007 to September 2011 he was Chairman and Chief Executive Officer of Telefónica de España, S.A. He holds a degree in Industrial Engineering from the Universidad de Buenos Aires and an MBA from The Amos Tuck School of Business Administration, Dartmouth College.

Mr. Ramiro Sánchez de Lerín García-Ovies serves as our General Secretary and Secretary to our Board of Directors. He is also a member of the Executive Committee. He began his career in Arthur Andersen, first working for its audit department and later for its tax department. In 1982, he became a State's Attorney (abogado del estado) and started working for the local tax authorities in Madrid (Delegación de Hacienda de Madrid). Afterwards he was assigned to the State Secretariat for the European Communities and later to the Foreign Affairs Ministry. He has been General Secretary and Secretary of the board of Elosúa, S.A., Tabacalera, S.A., Altadis, S.A. and Xfera Móviles, S.A. He has also held teaching positions in Instituto Católico de Administración y Dirección de Empresas (ICADE), Instituto de Empresa and Escuela de Hacienda Pública.

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Mr. Ángel Vilá is Chief Strategy and Finance Officer and member of the Executive Committee of Telefónica, S.A. Mr Vilá joined Telefónica in 1997 as Group Controller, and became in 1998 CFO of Telefónica Internacional. In 2000, he was appointed Group Head of Corporate Development and from 2010 onwards he also oversaw the affiliates group, comprising Atento, T-Gestiona and Telefónica Contenidos. In 2011 he was appointed Chief Financial and Corporate Development Officer, recently becoming the new Chief Strategy and Finance Officer, expanding his responsibilities by incorporating two additional areas: Fonditel and Corporate Strategy. From the different positions held in Telefónica Group, Ángel Vilá has executed landmark corporate transactions such as O2 plc, Brasilcel/Vivo, E-Plus, GVT, Telco/TI or Telefónica Germany IPO, among others. Prior to joining Telefónica, he held positions at Citigroup, McKinsey&Co, Ferrovial and Planeta. Ángel Vilá is currently a Board member of Telefónica Germany and a Trustee in the Telefónica Foundation. He previously served on the Boards of Telco SpA (Italy), BBVA, Digital Plus, Atento, Telefónica Contenidos, Telefónica Czech Republic, Endemol, CTC Chile, Indra SSI and Terra Lycos, and the Advisory panel of Macquarie MEIF funds. Mr. Vilá graduated in Industrial Engineering from Universitat Politècnica de Catalunya and holds an MBA from Columbia University (New York).

Mr. Eduardo Navarro de Carvalho is Chief Commercial Digital Officer at Telefónica S.A and member of the Executive Committee. He joined Telefónica in 1999, and since then he has been responsible for Strategy and Alliances for Telefónica Group from 2010 to February 2014, responsible for Strategy and Regulatory Affairs for Telefónica Latin America from 2005 to 2009, and for Telefônica Brasil from 1999 to 2004. Previously, he worked for five years as a Consultant in Mckinsey & Company, focused on Infrastructure and Telecommunications Projects in several countries and also worked as Steel Works Manager in the Group ARBED in Brazil. He is a graduate in Metallurgical Engineering from the Federal University of Minas Gerais, Brazil.

Mr. Ignacio Cuesta is the Chief Audit Executive of the Telefónica Group since January 2013. He joined the Telefónica International financial department in January 1995 as Manager. In 1999 he joined Telefónica, S.A., working in the corporate finance department for the next ten years. In 2001, he was appointed Deputy Chief Financial Officer of Telefónica's Corporation in charge of several areas as accounting, financial planning and taxes among others. In October 2009 he was appointed Telefónica Latin America Chief Financial Officer, working in that role for the next three years. Previously he had worked as a Financial Auditor for an audit firm and as internal auditor and as Chief Consolidation Accounting Officer for the multinational Pedro Domecq. From 2004 to 2009, he was nominated member of the Standard Advisory Committee of the Spanish Institute of Accounting and Auditing and member of the Accounting Experts Group of the CNMV. He holds a degree in Economics.

B. Compensation

Please see Note 21(f) and Appendix II to our Consolidated Financial Statements for information on the compensation paid to members of our Board of Directors and Executive Officers/Senior Management Team during the year 2015.

Incentive Plans

Please see Note 19 to our Consolidated Financial Statements.

C. Board Practices

Please see “—Directors and Senior Management” above.

D. Employees

Please see “Headcount” in Note 18 to our Consolidated Financial Statements.

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Telefónica de España has signed the 1<sup>st</sup> Collective Agreement of Related Companies, which is wholly backed by the largest trade unions. Telefónica Móviles España and Telefónica Soluciones are also parties to this agreement. The agreement contemplates, among other elements, an “Individual Employment Suspension Plan” for their respective employees, which implementation is entirely voluntary in the period 2016-2017. All employees who fulfil the following criteria are eligible to participate in the plan: (i) employees must have been employed as of January 1, 2015, (ii) as of the date of the agreement, they must have worked for the Group 15 years or more, and (iii) as of December 31, 2017, they must be at least 53 years old. In relation to the aforementioned Plan:

The Company has opened the registration period for employees to sign up to the Plan.

The current value of the expected expenses resulting from the Plan is estimated to be approximately 2,896 million euros.

## E. Share Ownership

At February 26, 2016, the following members of our Board of Directors beneficially owned directly or indirectly an aggregate of 8,639,634 shares, representing approximately 0.174% of our capital stock.

Name or corporate name of director	Number of direct voting rights		Number of indirect voting rights	% of total voting rights
Mr. César Alierta Izuel	5,293,586	-		0.106
Mr. Isidro Fainé Casas	572,483	-		0.012
Mr. José María Abril Pérez	134,886	152,124		0.006
Mr. Julio Linares López	462,393	2,115		0.009
Mr. José María Álvarez-Pallete López	553,240	-		0.011
Mr. Alfonso Ferrari Herrero	659,250	21,937		0.014
Mr. Antonio Massanell Lavilla	2,638	-		0.000
Mr. Carlos Colomer Casellas	49,377	68,260		0.002
Mr. Francisco Javier de Paz Mancho	62,368	-		0.001
Mr. Gonzalo Hinojosa Fernández de Angulo	49,128	198,862		0.005
Mr. Ignacio Moreno Martínez	17,606	-		0.000
Mr. José Fernando de Almansa Moreno-Barreda	20,397	-		0.000
Mr. Luiz Fernando Furlán	36,945	-		0.001
Ms. Eva Castillo Sanz	109,225	-		0.002
Mr. Pablo Isla Álvarez de Tejera	9,889	-		0.000
Mr. Peter Erskine	79,963	-		0.002
Mr. Santiago Fernández Valbuena	217,578	-		0.004
Mr. Wang Xiaochu	-	-		0.000

At February 26, 2016, members of our executive management team (excluding members of our Board of Directors listed above) beneficially owned an aggregate of 1,093,105 of our shares, representing approximately 0.022 % of our capital stock.

None of our directors or executive officers beneficially owned shares representing one percent or more of our share capital at February 26, 2016.



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None of our directors and executive officers held options in respect of shares representing one percent or more of our share capital at February 26, 2016.

Please see “Share-based payment plans” in Note 19 to our Consolidated Financial Statements.

## Item 7. Major Shareholders and Related Party Transactions

### A. Major Shareholders

#### General

At February 26, 2016, we had 4,975,199,197 shares outstanding, each having a nominal value of 1.00 euro per share. All outstanding shares have the same rights.

At February 26, 2016, according to information provided to us or to the Spanish National Securities Commission (Comisión Nacional de Mercado de Valores or the “CNMV”), beneficial owners of 3% or more of our voting stock were as follows:

Name of Beneficial Owner	Number of Shares		Percent
	Direct	Indirect	
Banco Bilbao Vizcaya Argentaria, S.A.(1)	302,205,736-		6.07%
Fundación Bancaria Caixa d’ Estalvis i Pensions de Barcelona (“la Caixa”)(2)		249,501,612	5.01%
Blackrock, Inc.(3)	-	253,632,799	5.09%

(1) Based on the information provided by Banco Bilbao Vizcaya Argentaria, S.A. as at December 31, 2015 for the 2015 Annual Report on Corporate Governance.

(2) Based on information provided by Fundación Bancaria Caixa d’ Estalvis i Pensions de Barcelona (“la Caixa”) as at December 31, 2015 for the 2015 Annual Report on Corporate Governance. The indirect shareholding is held by (2) Caixabank, S.A. which owns 249,482,489 shares and by Vidacaixa, S.A. de Seguros y Reaseguros which owns 19,123 shares.

(3) According to the form on Schedule 13G filed on February 9, 2016 with the SEC. Though the reported beneficial ownership is 5.09%, Blackrock, Inc. has sole voting power with respect to 233,260,845 shares (representing 4.68%

of Telefónica's share capital as of the date of this report).

To the extent that our shares are represented by account in the book-entry form, we do not keep a shareholder registry and our ownership structure cannot be known precisely. Based on the information available to us there is no individual or corporation that directly or indirectly through one or more intermediaries may exercise any type of control over us. Nevertheless, we have certain shareholders whose holdings are considered material.

#### Ownership Limitations

There are no limitations with respect to the ownership of our assets or share capital except those related to assets derived from the application of the reciprocity principle. Article 6 of the General Telecommunications Law, or the GTL, provides for the application of the reciprocity principle under existing international treaties or agreements signed and ratified by Spain. The Spanish government, upon request, may authorize exceptions to the reciprocity principle contained in the GTL.

#### B. Related Party Transactions

During 2015 and through the date of this Annual Report, the Directors and senior executives did not enter into any transaction with Telefónica, S.A. or any Telefónica Group company other than those in the Group's normal trading activity and business.

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Our Board of Directors' Regulations grant the Board of Directors the exclusive power to authorize any transactions with major shareholders or with our directors. Prior to authorizing any such transaction, our Board will receive an opinion from the Nominating, Compensation and Corporate Governance Committee addressing the fairness of the transaction to our shareholders and us. Any of our directors that may have an interest in the proposed transaction must abstain from voting on the proposed transaction.

Related Party Transactions with Significant Shareholders

Two of our major shareholders are financial institutions (see “—Major Shareholders—General” above). We have entered into related party transactions with both companies within our ordinary course of business, and always on arm's length terms. During 2015, the executed transactions were generally loans, capital markets or derivative transactions provided to us by these financial institutions and agreements for us to provide telecommunications and broadband services to such institutions.

In addition, please see Note 10 to our Consolidated Financial Statements.

Intra-Group Loans

We are the parent company of the Telefónica Group and operate through our subsidiaries and affiliated companies. We coordinate group policies, including financial policy and, in some cases, actual financial management is conducted by us. Most of the transactions we perform with other members of the Telefónica Group relate to financing transactions, including covering their needs for funds and providing interest rate and exchange rate hedges.

At December 31, 2015, as recorded in our parent company accounts, we loaned a total of 9,142 million euros (7,433 million euros at December 31, 2014) to companies of the Telefónica Group while companies of the Telefónica Group and their associates loaned us a total of 48,738 million euros (51,680 million euros at December 31, 2014), of which 8,560 million euros (8,437 million euros at December 31, 2014) was loaned to us by Telefónica Europe, B.V. and 36,937 million euros (37,157 million euros at December 31, 2014) was loaned to us by Telefónica Emisiones S.A.U., our financing subsidiaries devoted to raising funds in the capital markets, 500 million euros (1,912 million euros at December 31, 2014) was loaned to us by Telefónica Finanzas, S.A.U., our subsidiary in charge of financial support for Telefónica Group companies and 2,571 million euros (3,913 million euros at December 31, 2014) was loaned by us to Telfisa Global, B.V., our financing subsidiary charged with centralizing and managing the cash pooling of our subsidiaries in Latin America, Europe and the United States.

With respect to the balances with associated companies, the line item “Non-current financial assets” on the consolidated statement of financial position at December 31, 2015, includes “Loans to Associates” amounting to 21 million euros (16 million euros at December 31, 2014).

#### C. Interests of Experts and Counsel

Not applicable.

#### Item 8. Financial Information

##### Consolidated Financial Statements

Please see Item 18.

##### Legal Proceedings

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, we believe it is reasonable to assume that these legal proceedings will not materially affect our financial condition or solvency, regardless of the outcome.

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We highlight the following unresolved legal proceedings or those underway in 2015 (see Note 17 to our Consolidated Financial Statements for details of tax-related cases):

**Cancellation of the UMTS license granted to Quam GMBH in Germany**

In December 2004, the German Telecommunications Market Regulator revoked the UMTS license granted in 2000 to Quam GmbH (Quam), in which Telefónica has a stake. After obtaining a suspension of the revocation order, on January 16, 2006, Quam filed a suit against the order with the German courts. This claim sought two objectives: 1) to overturn the revocation order issued by the German Telecommunications Market Regulator, and 2) if this failed, to be reimbursed for the total or partial payment of the original amount paid for the license, 8,400 million euros.

This legal process ended on June 25, 2015, when the German Federal Constitutional Court dismissed the appeal lodged by Quam against the decision to reverse the UMTS license issued by the regulatory authority and endorsed by the courts in their different instances.

This judgment is not subject to appeal.

**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**

Vivo Group operators (currently Telefônica 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 Fund for Universal Access to Telecommunications Services (FUST) – a fund which pays for the obligations to provide Universal Service -with retroactive application from 2000. On March 13, 2006, the Brasilia Regional Federal Court 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. ANATEL filed an appeal to overturn this decision with Brasilia Regional Federal Court no. 1. This appeal is pending resolution.

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 and expense 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 Brasilia Federal Regional Court no. 1.

No further action has been taken since then. The amount of the claim is quantified at 1% of the interconnection revenues.

**Public civil procedure by the São Paulo government against Telefônica Brasil for alleged reiterated malfunctioning in services provided**

This proceeding was filed by the Public Ministry of the State of São Paulo for alleged reiterated malfunctioning in the services provided by Telefônica Brasil, seeking compensation for damages to the customers affected. A general claim was filed by the Public Ministry of the State of São Paulo, for 1 billion Brazilian reais (approximately 225 million euros), calculated on the company's revenue base over the last five years.

In April 2010, a ruling against the Telefónica Group was issued in first instance. The full impact of this proceeding will not be known until there is a final ruling, and the total amount of persons affected by and party to the proceeding is known. At that moment, the amount of the indemnity will be established, ranging between 1 billion and 60 million reais (approximately, between 225 and 13 million euros), depending on the number of parties. On May 5, 2010, Telefônica Brasil filed an appeal before the São Paulo Court of Justice, suspending the effect of the ruling.

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On April 13, 2015, the appeal was judged in favor of Telefónica, by unanimous vote, reversing the earlier decision in first instance. The Public Prosecutor filed an extraordinary petition for review at the High Court of Brasilia. This Court must take a decision on the admissibility of the appeal once it has assessed the allegations made by Telefónica.

The Public Prosecutor filed an extraordinary petition for review at the High Court of Brasilia. This Court must take a decision on the admissibility of the appeal once it has assessed the allegations made by Telefónica.

***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. 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.

On January 23, 2013, the EC passed a ruling on the formal proceedings. The ruling imposed a fine on Telefónica of 67 million euros, as the EC 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 referred to above.

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 EC, in which the EC 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 EC filed its appeal.

A hearing was held on May 19, 2015, at the European Union General Court and is pending resolution by the Court.

**Judicial appeals against the decisions by the Conselho Administrativo de Defesa Econômica (CADE) regarding the acquisition by Telefónica, S.A. of stakes in Portugal Telecom and Telco**

On December 4, 2013, the Brazilian Antitrust Regulator, CADE announced the two following decisions:

To approve, with the restrictions described further below, the acquisition by Telefónica of the entire participation 1. held by Portugal Telecom, SGPS, S.A. and PT Móveis-Serviços de Telecomunicações, SGPS, S.A. (the PT Companies) in Brasilcel, N.V., which controlled the Brazilian mobile company, Vivo Participações, S.A. (Vivo).

This transaction had already been approved by ANATEL and its closing (which did not require CADE's prior approval at the time), occurred immediately after ANATEL's approval was granted on September 27, 2010.

This decision was granted by CADE subject to the following conditions:

- (a) the entry of a new shareholder in Vivo, sharing the control of Vivo with Telefónica, S.A. in conditions identical to those that were applicable to the PT Companies when they had a participation in Brasilcel N.V., or
- (b) that Telefónica, S.A. ceases to have any direct or indirect financial interest in TIM Participações S.A.

Due to the fulfilment of the conditions set forth in the authorizations granted by ANATEL (on December 22, 2014 and March 12, 2015) and CADE (on March 25, 2015) for the acquisition by Telefónica Brazil S.A of Global Village Telecom S.A and his holding company GVT Participações S.A (collectively GVT), and for the demerger of Telco, the previously mentioned decision of CADE on December 4, 2013 was overridden due to Telefonica's divestment of its total shareholding in Telecom Italia.



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In this regard, Telefónica, S.A. delivered 1,110 million ordinary shares of Telecom Italia (representing 8.2% of its ordinary shares) to Vivendi, S.A. in exchange for 4.5% of the total share capital of Telefônica Brasil, S.A. and sold, by means of an agreement with a financing institution, 872 million ordinary shares of Telecom Italia, representing 6.5% of the ordinary shares of this company, for an amount of approximately 1,025 million euros.

Telefónica also arranged several hedging instruments to allow Telefónica to repurchase the shares of Telecom Italia that may be necessary to meet its exchange obligations under the mandatory exchangeable bonds for shares of Telecom Italia issued by Telefónica, S.A. in July 2014.

Thus, Telefónica has completed the divestment process of its entire stake in Telecom Italia, in accordance with the regulatory and anti-trust commitments assumed.

2. To impose a fine on Telefónica, S.A. of 15 million Brazilian reais, for having allegedly breached the spirit and the purpose of the agreement signed between Telefónica, S.A. and CADE (as a condition to the approval of Telefónica's original acquisition of an interest in Telecom Italia in 2007), due to the subscription of and payment for non-voting shares of Telco, S.p.A. in the capital increase carried out in accordance with the agreement dated September 24, 2013. This Decision also requires Telefónica, S.A. to divest such non-voting shares of Telco, S.p.A. As indicated above, the divestment by Telefónica of its entire stock participation in Telco, S.p.A. and, consequently, in Telecom Italia, S.p.A. has already been completed.

On July 9, 2014, Telefónica filed a judicial appeal against the CADE's decision to impose a fine on Telefónica.

## **Other Contingencies**

Telefónica is currently conducting an internal investigation regarding possible violations of applicable anti-corruption laws. Telefónica has been in contact with governmental authorities about this matter and intends to cooperate with those authorities as the investigation continues. It is not possible at this time to predict the scope or duration of this matter or its likely outcome.

## **Tax proceedings**

Tax inspections in the tax group in Spain

With regard to the tax inspection for the years 2001 to 2004, the Supreme Court issued a ruling in 2015, accepting the tax losses incurred by the Group in relation to the transfer of certain interests in TeleSudeste, Telefónica Móviles México and Lycos as tax deductible, rejecting the other contentions, and therefore the contingencies related to this process disappeared. This has resulted in recognition of a tax expense of 49 million euros in the 2015 financial statements. However, this did not require payment of any tax because the Company applied unused tax loss carryforwards to offset the effect of these adjustments, at the corresponding tax rate for each period.

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.

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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. 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.

At 2015 year end, it is not expected that there is any need to recognize additional liabilities for the outcome of this litigation.

### **Telefónica Brazil**

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. In 2015 the tax authorities embarked upon a new round of inspections in this regard.

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 and modem rental.

All related procedures are being contested in all instances (administrative and court proceedings). The aggregate amount of these assessments, updated to take into account interest, fines and other items, is approximately 11,900 million Brazilian reais (2,750 million euros). No provisions have been set aside for these matters, as the risk of them giving rise to liabilities is not probable. Telefónica Brasil has obtained independent expert reports supporting its position, i.e. that the aforesaid services are not subject to ICMS.

### **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. This dispute accounts for more than 75% of the total amount under litigation, with the objections relating to insolvency provisions, 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.

At the time of preparation of this Annual Report, the settlements carried out by SUNAT for 2000 and 2001 are in the final instance of the legal process (under review by the Supreme Court).

In general, the discussions over this litigation are taking place before the courts (not only through the current contentious-administrative appeals but also through constitutional protection suits, which are being heard in all instances in both cases). In connection with these proceedings in Peru, the Group and its legal advisors consider that the Group's position is based on robust legal arguments.

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.

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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 has been 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).

Given the sentences and rulings handed down in June and August 2015, the Group decided to recognize a provision in the accompanying Consolidated Financial Statements of 431 million euros (see Note 15 to the Consolidated Financial Statements).

**Years open for inspection**

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, following the tax audit completed in 2015, the taxes from 2012 onwards are open to inspection with respect to the main companies of the Spanish tax group.

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 twelve years in Germany.
- The last eight years in United Kingdom.
- The last seven years in Argentina.
- The last five years in Brazil, Mexico, Uruguay, Colombia and the Netherlands.
- The last four years in Venezuela, Peru, Guatemala, Nicaragua and Costa Rica.
- 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.

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Dividend information and shareholders' return

***Dividend background***

The table below sets forth the annual dividends declared per share and the year to which such dividends correspond. Generally, the dividend for a given year is paid in two tranches, one in the second-half of the relevant year and the other during the first half of the following year.

Year ended December 31,	Dividends per share (euro)
2015 <sup>(1)</sup>	0.75
2014 <sup>(2)</sup>	0.75
2013 <sup>(3)</sup>	0.75
2012 <sup>(4)</sup>	–
2011 <sup>(5)</sup>	1.60

Company's shareholder remuneration in 2015 consists of paying a dividend of 0.75 euros per share. A scrip dividend of up to 0.35 euros was paid in November 2015, consisting of the assignment of free allotment rights with (1) an irrevocable purchase commitment by the Company, and a subsequent capital increase by means of the issue of new shares to fulfill said allotments. The second tranche of the dividend of 0.40 euros per share will be paid in cash in the second quarter of 2016.

A scrip dividend of up to 0.35 euros was paid in November 2014, consisting of the assignment of free allotment (2) rights with an irrevocable purchase commitment by the Company, and a subsequent capital increase by means of the issue of new shares to fulfill said allotments.

A cash dividend of 0.40 euros per share from 2015 net income was paid on May 12, 2015.

(3) A cash dividend of 0.35 euros per share was paid on November 6, 2013, charged against unrestricted reserves. A cash dividend of 0.40 euros per share from 2014 net income was paid on May 7, 2014.

(4) As of July 25, 2012, the Board of Directors cancelled the dividend and share buyback program corresponding to 2012 (including November 2012 and May 2013 cash and scrip payments, respectively).

(5) A cash dividend of 0.77 euros per share was paid on November 7, 2011, charged against unrestricted reserves.

A cash dividend of 0.53 euros per share was paid on May 14, 2012, charged against unrestricted reserves. In addition, a scrip dividend of up to 0.30 euros was paid, consisting of the assignment of free allotment rights with an irrevocable purchase commitment by the Company, and a subsequent capital increase by means of the issue of new shares to fulfill said allotments.

Payments of any future dividends will be dependent on the Group's earnings, cash generation, solvency, liquidity, flexibility to make strategic investments, and shareholder and investor expectations at the time, all of which may be influenced by a variety of factors. See "Cautionary Statement Regarding Forward-Looking Statements."

***Treasury shares and share buyback program***

We have 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; and

other purposes in accordance with prevailing legislation. In the past, treasury shares purchased on the stock market were exchanged for other shares-or securities (as in the case of preferred capital securities), swapped for stakes in other companies (e.g. China Unicom, Telco, S.p.A., or Telefônica Brasil in 2015) or acquired to reduce the number of shares in circulation (by redeeming the shares acquired), thereby improving earnings per share.



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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.

For a description on treasury shares, see Note 12 g) to our Consolidated Financial Statements.

Item 9. The Offering and Listing

A. Offer and Listing Details

General

Our ordinary shares, nominal value 1.00 euro each, are currently listed on each of the Madrid, Barcelona, Bilbao and Valencia stock exchanges and are quoted through the Automated Quotation System under the symbol “TEF”. They are also listed on the London and Buenos Aires stock exchanges. Our ADSs are listed on the New York Stock Exchange and the Lima Stock Exchange.

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The table below sets forth, for the periods indicated, the reported high and low quoted closing prices, as adjusted for all stock splits, for our shares on the Madrid Stock Exchange, which is the principal Spanish market for our shares, and our ADSs on the New York Stock Exchange:

	Per Share		Per ADS	
	(in euro)		(in dollars)(1)	
	High	Low	High	Low
Year ended December 31, 2011	18.655	12.690	27.08	16.61
Year ended December 31, 2012	13.710	8.630	17.76	10.25
Year ended December 31, 2013	13.105	9.492	18.02	12.43
Year ended December 31, 2014	13.370	10.865	17.40	13.99
Year ended December 31, 2015	14.210	10.020	15.64	10.96
Quarter ended March 31, 2014	12.515	10.865	16.90	14.96
Quarter ended June 30, 2014	12.850	11.480	17.40	15.79
Quarter ended September 30, 2014	12.705	11.590	17.28	15.34
Quarter ended December 31, 2014	13.370	10.965	16.39	13.99
Quarter ended March 31, 2015	13.925	11.355	15.64	13.45
Quarter ended June 30, 2015	13.855	12.560	15.32	14.07
Quarter ended September 30, 2015	14.210	10.640	15.48	11.93
Quarter ended December 31, 2015	12.395	10.020	13.44	10.96
Month ended August 31, 2015	14.210	12.140	15.48	13.86
Month ended September 30, 2015	12.255	10.640	13.63	11.93
Month ended October 31, 2015	12.030	10.600	13.27	11.91
Month ended November 30, 2015	12.395	11.485	13.44	12.11
Month ended December 31, 2015	11.585	10.020	12.30	10.96
Month ended January 31, 2016	9.976	8.843	10.81	9.68
Month ended February 29, 2016 (through February 23, 2016)	9.569	8.484	10.56	9.65

Source: Madrid Stock Exchange Information and Bloomberg.

(1) Until January 21, 2011, each ADS represented the right to receive three ordinary shares. As of January 21, 2011, the ADS-to-ordinary share ratio was changed, so that each ADS now represents the right to receive one ordinary share. The closing prices prior to January 21, 2011 reflect the adjustment for the ratio change.

On February 23, 2016, the closing price of our shares on the Automated Quotation System of the Spanish Stock Exchanges was 9.322 euro per share, equal to 10.373 dollars at the Noon Buying Rate on February 19, 2016 for cable transfers in euro as certified for customs purposes by the Federal Reserve Bank of New York on that date.

Our ADSs are listed on the New York Stock Exchange under the symbol "TEF". Citibank, N.A. is the Depositary issuing ADSs in form of certificated ADSs (American Depositary Receipts, or ADRs) or uncertificated ADSs pursuant to the deposit agreement dated as of November 13, 1996, as amended as of December 3, 1999 and as further

amended as of June 23, 2000 and as of March 9, 2007 among Telefónica, the Depository and the holders from time to time of ADSs (the “Deposit Agreement”).

At December 31, 2015, 145,944,492 of our shares were held in the form of ADSs by 721 holders of record, including Cede & Co., the nominee of Depository Trust Company (“DTC”). The number of ADSs outstanding was 169,855,242 at December 31, 2014.

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Spanish Securities Market Legislation

The Spanish Securities Markets Act (Ley del Mercado de Valores, or the "LMV"), enacted in 1988 and further amended, regulates the primary and secondary securities markets in Spain by establishing principles for their organization and operation, rules governing the activities of persons and institutions operating in these markets and a system for their supervision. This legislation and the regulation implementing it (mainly, as far as private issuers are concerned, the Royal Legislative Decree 4/2015, of October 23, approving the restated text of the LMV, the Royal Decree 1310/2005, of November 4, in relation to the issuance of securities and its admission to listing in official secondary markets, and Royal Decree 1362/2007, of October 19, concerning the transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market):

- establishes an independent regulatory authority, the CNMV, to supervise the securities markets;

- establishes the rules for surveillance, supervision and sanction provided for the representation of transferable securities by book entries or by certificate;

- establishes a framework for the issuance of securities;

- establishes a framework for trading activities;

- establishes the disclosure obligations of issuers, particularly the obligation to file annual audited financial statements and to make public quarterly financial information;

- establishes the framework for tender offers;

- establishes the code of conduct for all market participants; and

- regulates market abuse infringements.

On March 11, 2005, Royal Decree Law 5/2005 was approved, modifying the LMV in order to implement the Directive 2003/71/EC of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading. The Directive: (i) harmonizes the requirements for the process of approval of the prospectuses in order to grant to the issuer a single passport for such document, valid throughout the European Union; (ii) incorporates the application of the country of origin principle by which the prospectus will be approved by the Member States of the European Union where the issuer has its registered office but

it also introduces the possibility that in certain circumstances, such as issues with high minimum denominations (1,000 euros or more), the issuer may designate the relevant European Union competent authority for prospectus approval.

Subsequently, Royal Decree 1310/2005 partially developed the LMV in relation to the admission to trading of securities in the official secondary markets, the sales or subscription public offers and the prospectus required to those effects.

Royal Decree 1333/2005 developed the LMV in relation to market abuse, implementing Directive 2003/6/EC of the European Parliament and of the Council, relating insider dealing and market manipulation practices (“market abuse”).

On April 12, 2007, Law 6/2007 was approved, modifying the LMV in order to implement the Directive 2004/25/EC of the European Parliament and of the Council relating to public tender offers and the Directive 2004/109/EC relating to the transparency of issuers. Law 6/2007 intends: (i) to encourage an efficient market for corporate control, while protecting the rights of minority shareholders of listed companies and (ii) to enforce transparency in financial markets.

In relation to public tender offers, Law 6/2007 (i) establishes the cases in which a company must launch a takeover bid over the whole share capital of the relevant company; (ii) establishes that takeover bids shall be launched once a specific stake on the share capital of the company has been reached; (iii) adds new obligations for the board of directors of the target companies of the takeover bid in terms of defensive measures against the takeover bid; and (iv) regulates the squeeze-out and sell-out procedure when a 90% of the share capital is held following a takeover bid. Royal Decree 1066/2007 completes the regulation currently in place for takeover bids in Spain.

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Regarding transparency of issuers whose shares are accepted to trading on an official market, Law 6/2007 (i) modifies the reporting requirements of the periodic financial information of listed companies and issuers of listed securities; (ii) establishes a new disclosure regime for significant shareholders; (iii) adds new information and disclosure requirements for issuers of listed securities; (iv) establishes a civil liability procedure of the issuer and board of directors in connection with the financial information disclosed by issuers of securities; and (v) confers new supervisory powers upon the CNMV with respect to the review of accounting information.

On December 19, 2007, Law 47/2007 was approved, modifying the LMV in order to implement the Directive 2004/39/EC of the European Parliament and of the Council, on Markets in Financial Instruments (MiFID); the Directive 2006/73/EC of the European Parliament and of the Council on organizational requirements and operating conditions regarding the Market in Financial Instruments Directive, and the Directive 2006/49/EC of the European Parliament and of the Council on the capital adequacy of investment firms and credit institutions. Its principal aim is to establish a general legal framework for financial markets in the European Union, in particular with regard to financial services, as well as to ensure appropriate transparency for investors through a regular flow of the relevant information concerning security issuers. Amongst other things, the new regime (i) establishes new multilateral trading facilities for listing shares apart from the stock markets; (ii) reinforces the measures for the protection of investors; (iii) establishes new organizational requirements for investment firms; (iv) implements new supervisory powers for CNMV, establishing cooperation mechanisms amongst national supervisory authorities.

On July 4, 2009, Law 3/2009, regarding structural modifications on Spanish corporations (Ley 3/2009, de 3 de abril, sobre modificaciones estructurales de las sociedades mercantiles) came into force, modifying the maximum threshold established in the Spanish Corporation Act as to the number of treasury shares held by listed companies and their subsidiaries from 5% up to 10% of their total capital outstanding.

On August 1, 2011, Law 25/2011, partially reforming the Spanish Corporation Act and transposing Directive 2007/36/EC of the European Parliament and of the Council of July 11 relating to the exercise of certain rights shareholders in listed companies (Ley 25/2011, de 1 de agosto, de reforma parcial de la Ley de Sociedades de Capital y de incorporación de la Directiva 2007/36/CE, del Parlamento Europeo y del Consejo, de 11 de Julio, sobre el ejercicio de determinados derechos de los accionistas de las sociedades cotizadas) was approved.

In December 2012, Royal Decree 1698/2012, amending regulations regarding prospectus and transparency requirements due on securities issues by the transposition of Directive 2010/73/EU of the European Parliament and of the Council of November 24, 2010, by amending Directive 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading and Directive 2004/109/EC on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, pursues essentially the reduction of administrative burdens related to the publication of a prospectus for the public offering of securities and admission to trading on markets within the European Union.

On March 20, 2013, ECC/461/2013 regulation was approved. This regulation establishes the content and structure of the annual report on corporate governance, the annual compensation report and other information mechanisms for public listed companies, the savings bank and other entities that issue securities admitted to trading on regulated securities markets. The aforementioned regulation was amended by Order ECC/2515/2013, of December 26, which develops article 86.2 of the LMV.

On June 12, 2013, Circular 5/2013 of the National Securities Market Commission (CNMV), was approved. This regulation establishes the templates of the annual report on corporate governance for public listed companies, savings banks and other entities that issue securities admitted to trading on regulated markets. This regulation is applicable to annual reports on corporate governance to be submitted from January 1, 2014 onwards.

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On June 12, 2013, Circular 4/2013 of the CNMV was approved. This regulation establishes the templates of the annual report on director's compensation for public listed companies and members of the board of directors and the supervisory board of savings banks that issue securities admitted to trading on regulated securities markets. This regulation is applicable to the compensation report for the year 2013 onwards and will be put to a vote by the next ordinary general shareholders' meeting on a consultative basis and as a separate item on the agenda.

On December 3, 2014, Law 31/2014, amending the Spanish Corporation Act was enacted. The new law introduces changes in matters related to general shareholders' meetings, and shareholders rights. It also, modifies the legal status of members of the Board of Directors, including their compensation, practices and composition, and sets forth new rules on the composition of Board Committees. Law 31/2014 entered into force on December 24, 2014, although certain specific provisions affecting listed companies will not be effective until after the first general shareholders' meeting held by such companies in 2015, in which companies will have to amend their bylaws to bring them in line with the new provisions of Law 31/2014.

On June 23, 2015, Circular 3/2015 of the CNMV established the information and technical and legal specifications that must be published on public listed companies, savings banks and other entities' website, in order to duly comply with the principle of transparency.

On October 2, 2015, Royal Decree 878/2015 was approved with the aim of reaching a greater level of efficiency and safety in the Spanish Automated Quotation System as well as contributing to the development towards an integrated European financial services market. This Royal Decree was enacted to fully implement the provisions of Directive 2013/50/UE of the European Parliament and of the Council, which amended Directive 2004/109/EC of the European Parliament and of the Council on harmonization of transparency requirements for issuers of listed securities, into Spanish legislation.

On October 23, 2015, Royal Legislative Decree 4/2015, was approved to consolidate and unify in a single text the legislative instruments that govern the activities of individuals and institutions in the Spanish securities markets.

On December 22, 2015, Circular 7/2015 of the CNMV amended those provisions of the Circular 5/2013 that relate to the templates of the annual report on corporate governance to be used by public listed companies, savings banks and other entities, and those provisions of Circular 4/2013 that relate to the templates of the annual report on director's compensation for public listed companies.

On December 22, 2015, Circular 8/2015 of the CNMV published new forms to be used as notification templates for directors, executives and close relatives to communicate their significant shareholdings and for issuers to



communicate transactions relating to own shares, with the aim to comply with the new obligations introduced by Royal Decree 1362/2007 and Royal Decree 878/2015. Individuals bound by such Circular must use the new forms from April 1, 2016.

### Securities Trading in Spain

The Spanish securities market for equity securities consists of four stock exchanges located in Madrid, Bilbao, Barcelona and Valencia and the Automated Quotation System, or Mercado Continuo. During 2009, the Automated Quotation System accounted for the majority of the total trading volume of equity securities on the Spanish Stock Exchanges.

#### *Automated Quotation System*

The Automated Quotation System links the Spanish Stock Exchanges, providing those securities listed on it with a uniform continuous market that eliminates certain of the differences among the local exchanges. The principal features of the system are the computerized matching of buy and sell orders at the time of entry of the order. Each order is executed as soon as a matching order is entered, but can be modified or canceled until executed. The activity of the market can be continuously monitored by investors and brokers. The Automated Quotation System is operated and regulated by Sociedad de Bolsas, S.A., a corporation owned by the companies that manage the local exchanges. All trades on the Automated Quotation System must be placed through a brokerage firm, an official stock broker or a dealer firm that is a member of a Spanish Stock Exchange. Beginning January 1, 2000, Spanish banks were allowed to become members of the Spanish Stock Exchanges and, therefore, can trade through the Automated Quotation System.

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In a pre-opening session held from 8:30 a.m. to 9:00 a.m. each trading day, an opening price is established for each security traded on the Automated Quotation System based on a real-time auction. The regime concerning opening prices was changed by an internal rule issued by the Sociedad de Bolsas. Pursuant to such rule, each stock in the continuous market is assigned a static and a dynamic range within which its price can fluctuate. The price of a stock may rise or fall within its static range (which is published once a month and is calculated according to the stock's average historic price volatility) above or below its opening price (which shall be the closing price of the previous session). When the stock trades outside of this range, the trading of the stock is suspended for 5 minutes, during which an auction takes place. After this auction, the price of the stock can once again rise or fall within its static range above or below its last auction price (which will be considered as the new static price before triggering another auction). Furthermore, the price of a stock cannot rise or fall by more than its dynamic price range (which is fixed and published once a month and is calculated according to the stock's average intra-day volatility), from the last price at which it has traded. If the price variation exceeds the stock's dynamic range, a five minute auction is triggered. Between 5:30 p.m. and 5:35 p.m. a closing price is established for each security through an auction system similar to the one held for the pre-opening early in the morning.

Trading hours for block trades are also from 9:00 a.m. to 5:30 p.m. Between 5:30 p.m. and 8:00 p.m., certain trades may occur outside the computerized matching system without prior authorization from Sociedad de Bolsas, S.A. at a price within the range of 5% above the higher of the average price and closing price for the day and 5% below the lower of the average price and closing price for the day if there are no outstanding bids or offers, respectively, on the system matching or bettering the terms of the proposed off-system transaction and, if, among other things, the trade involves more than 300,000 euros and more than 20% of the average daily trading volume of the stock during the preceding three months. These trades must also relate to individual orders from the same person or entity and be reported to the Sociedad de Bolsas, S.A. before 8:00 p.m. At any time trades may take place (with the prior authorization of the Sociedad de Bolsas, S.A.) at any price if:

· the trade involves more than 1.5 million euros and more than 40% of the average daily volume of the stock during the preceding three months;

· the transaction derives from a merger or spin-off process, or from the reorganization of a group of companies;

· the transaction is executed for the purposes of settling a litigation or completing a complex group of contracts; or

· Sociedad de Bolsas, S.A. finds other justifiable cause.

Information with respect to the computerized trades between 9:00 a.m. and 5:30 p.m. is made public immediately, and information with respect to trades outside the computerized matching system is reported to Sociedad de Bolsas, S.A. by the end of the trading day and published in the Boletín de Cotización and in the computer system by the beginning of the next trading day.

*Clearance and settlement system*

The Sociedad de Gestión de los Sistemas de Registro, Compensación y Liquidación de Valores S.A.U., formerly Iberclear, was created by the Ley 44/2002 de Medidas de Reforma del Sistema Financiero, enacted on November 22, 2002 to increase the efficiency of the Spanish financial markets. Such law introduced a new article, 44-bis to the LMV which established the framework for the constitution of Sociedad de Gestión de los Sistemas de Registro, Compensación y Liquidación de Valores S.A.U.

Iberclear is regulated by the Spanish Securities Act and where appropriate by Royal Decree 505/1987 of April 3, 1987, Royal Decree 166/1992 of February 14, 1992, and by any other related regulation. This company, which is a wholly owned subsidiary of Bolsas y Mercados Españoles, Sociedad Holding de Mercados y Sistemas Financieros, S.A. (Bolsas y Mercados Españoles), has the following functions:

· bookkeeping of securities represented by means of book entries admitted to trading in the stock markets or in the public debt book entry market;

· managing the clearance and settlement system for the brokerage transactions in the stock markets and at the public debt book entry market; and

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providing technical and operational services directly linked to the registry, clearance and settlement of securities, or any other service required by Iberclear to be integrated with any other registry, clearance, and settlement systems.

Iberclear will provide the CNMV, the Bank of Spain and the Ministry of Economy with the information that these entities may request regarding the registry clearance and settlement performed within the systems managed by Iberclear.

Transactions carried out on the Spanish Stock Exchanges are cleared and settled through Iberclear.

Only members of the system are entitled to use Iberclear, and membership is restricted to authorized broker members of the Spanish Stock Exchanges, the Bank of Spain (when an agreement, approved by the Spanish Ministry of Economy and Finance, is reached with Iberclear) and, with the approval of the CNMV, other brokers not members of the Spanish Stock Exchanges, banks, savings banks and foreign settlement and clearing systems. The clearance and settlement system and its members are responsible for maintaining records of purchases and sales under the book-entry system. Shares of listed Spanish companies are held in book-entry form. Iberclear, which manages the clearance and settlement system, maintains a registry reflecting the number of shares held by each of its member entities (each, an entidad participante) as well as the amount of such shares held on behalf of beneficial owners. Each member entity, in turn, maintains a registry of the owners of such shares. Spanish law considers the legal owner of the shares to be the member entity appearing in the records of Iberclear as holding the relevant shares in its own name or the investor appearing in the records of the member entity as holding the shares.

The settlement of any transactions must be made three business days following the date on which the transaction was carried out.

Obtaining legal title to shares of a company listed on a Spanish Stock Exchange requires the participation of a Spanish official stockbroker, broker-dealer or other entity authorized under Spanish law to record the transfer of shares. To evidence title to shares, at the owner's request, the relevant member entity must issue a certificate of ownership. In the event the owner is a member entity, Iberclear is in charge of the issuance of the certificate with respect to the shares held in the member entity's name.

Brokerage commissions are not regulated. Brokers' fees, to the extent charged, will apply upon transfer of title of shares from the Depository to a holder of ADRs in exchange for such ADSs, and upon any later sale of such shares by such holder. Transfers of ADSs do not require the participation of an official stockbroker. The Deposit Agreement provides that holders depositing shares with the Depository in exchange for ADSs or withdrawing shares in exchange for ADSs will pay the fees of the official stockbroker or other person or entity authorized under Spanish law applicable both to such holder and to the Depository.

B. Plan of Distribution

Not applicable.

C. Markets

Please see “—Offer and Listing Details” above.

D. Selling Shareholders

Not applicable.

E. Dilution

Not applicable.

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F. Expenses of the Issue

Not applicable.

Item 10. Additional Information

A. Share Capital

Not applicable.

B. Memorandum and Articles of Association

The following summary describes certain material considerations concerning our capital stock and briefly describes certain provisions of our bylaws and Spanish law.

Corporate Objectives

Article 5 of Title I of our bylaws sets forth our corporate purposes:

The provision and operation of all kinds of public or private telecommunications services and, for such purpose, the design, installation, maintenance, repair, improvement, acquisition, disposition, interconnection, management, administration of, and any other activity not included in the preceding enumeration with respect to, all kinds of telecommunications networks, lines, satellites, equipment, systems and technical infrastructure whether now existing or to be created in the future, including the premises in which any and all of the foregoing items are located;

the provision and operation of all kinds of services that are ancillary or supplemental to or result from telecommunications services;

the research and development, promotion and application of all kinds of component principles, equipment and systems directly or indirectly used for telecommunications;

manufacturing and production activities and, in general, all other forms of industrial activity in connection with telecommunications; and

acquisition, disposition and, in general, all other forms of commercial activity in connection with telecommunications.

#### Director Qualification

In order to be elected as a director, a person must have held a number of our shares representing a nominal value of no less than 3,000 euros for at least three years prior to his or her election. These shares may not be transferred so long as such person remains a director. This requirement does not apply to any person who, at the time of his or her appointment, has either a labor or professional relationship with the company or is expressly exempted from such requirement by a vote of at least 85% of the Board of Directors.

#### Interested Transactions

When a director or persons related to him or her has an interest in a transaction with us or with any of the companies of our Group, such transaction (if unrelated to the ordinary course of our business or if not performed on an arm's length basis involving consideration that is significant to the Company and otherwise) must be presented to the Nominating, Compensation and Corporate Governance Committee. Such committee shall assess the transaction 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 information of the Company upon the terms set forth in applicable laws and regulations. The performance of such transactions requires the authorization of our Board of Directors, after the favorable report of the committee. The interested director must refrain from participating in votes that affect such transaction.

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Significant Differences in Corporate Governance Practices

*Corporate governance guidelines*

For a description of our corporate governance practices see “Item 16G. Corporate Governance.”

Description of Our Capital Stock

*Description of share capital*

At February 26, 2016, our issued share capital consisted of 4,975,199,197 ordinary registered shares with a nominal value of 1.00 euro each.

Our shareholders have delegated to the Board of Directors the authority to issue up to 2,469,208,757 new shares (equal to half of Telefónica’s share capital on June 12, 2015, the date of the authorization). The Board of Directors is authorized to exclude preemptive rights, in whole or in part, pursuant to the applicable provisions of the Spanish Corporation Act. The Board’s authorization to issue new shares expires on June 12, 2020.

*Meetings and voting rights*

We hold our ordinary general shareholders’ meeting during the first six months of each fiscal year on a date fixed by the Board of Directors. Extraordinary general shareholders’ meetings may be called, from time to time, at the discretion of our Board of Directors or upon the request of shareholders representing at least 3% of our paid-in share capital. The minimum percentage required to exercise this right was lowered from 5% to 3% by Law 31/2014.

We publish notices of all ordinary and extraordinary general shareholders’ meetings in the Official Gazette of the Commercial Registry or in one of the more widely circulated newspapers in Spain, on the website of the Spanish Securities and Exchange Commission (Comisión Nacional del Mercado de Valores (the “CNMV”)), and on our web site in due time pursuant to the Spanish Corporation Act, being on a general basis at least one month before the relevant



meeting. Furthermore, the Board of Directors may publish notices in other media, if deemed appropriate to ensure the public and effective dissemination of the notice meeting.

Each share of Telefónica, S.A. entitles the holder to one vote. However, only registered holders of at least 300 shares are entitled to attend a general shareholders' meeting. Holders of a lesser number of shares may grant a proxy in respect thereof to a shareholder having the right to attend, as well as group together with other shareholders in the same situation until reaching the required number of shares, following which a proxy must be granted by the shareholders so grouped together to one of such shareholders. The grouping must be carried out specifically for each General Shareholders' Meeting and be recorded in writing.

However, under our bylaws, the maximum number of votes that a shareholder may cast is capped at 10% of our total outstanding voting capital. In determining the maximum number of votes that each shareholder may cast, only the shares held by such shareholder are counted, disregarding those that correspond to other shareholders who have appointed such shareholder as his or her proxy, in spite of applying the limit individually to each of the represented shareholders. This cap will 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 that individual or corporate shareholder. Moreover, in accordance with the Spanish Corporation Act, such cap would become ineffective where the bidder reaches, as a consequence of a tender offer, a percentage equal to or greater than 70% of the share capital carrying voting rights, unless the bidder (or those acting in concert with the bidder) is not subject to equivalent neutralization measures or has not adopted them.

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In addition, according to Article 34 of Spanish Royal Decree-Law 6/2000 of June 23 on urgent measures to improve competition in the goods and services markets, individuals and legal entities directly and indirectly holding more than 3% of the total share capital or voting rights of two or more principal operator companies in Spain in, among other markets, the fixed-line and mobile-line telephony markets, may not exercise their voting rights in excess of 3% of the total in more than one company, except with the prior authorization of the Spanish National Markets and Competition Commission (Comisión Nacional de los Mercados o la Competencia (the “CNMC”). Principal operators are defined as one of the five operators with the largest market share in the corresponding market (“Principal Operators”). In addition, no individual or legal entity is allowed to appoint, directly or indirectly, members of the management body of more than one Principal Operator in, among others, the fixed-line or mobile-line telephony markets, except with the prior authorization of the CNMC. Additionally, individuals or legal entities considered Principal Operators are not allowed to exercise more than 3% of the voting rights of another Principal Operator nor to appoint, directly or indirectly, members of the management body of any Principal Operator, except, in both cases, with the prior authorization of the CNMC. Telefónica is considered a Principal Operator for the purposes of Article 34 of Royal Decree-Law 6/2000 of June 23 in the Spanish fixed-line and mobile-line telephony markets.

Any share may be voted by proxy. The proxies may be granted in writing or electronically and are valid only for a single meeting, unless the proxy-holder is the granting shareholder’s spouse, ascendant or descendant, or holds a general power of attorney granted in a public instrument with powers to manage all of the assets held by the shareholder granting the proxy in Spain. Under the Deposit Agreement relating to our ADSs, the Depositary accepts voting instructions from holders of ADSs. The Depositary executes such instructions to the extent permitted by law and by the terms governing the shares and ADSs. The Depositary or its nominee, as the case may be, will be entitled to vote by proxy the shares underlying the relevant ADSs.

Only holders of record five days prior to the day on which a general meeting of shareholders is scheduled to be held may attend and vote at the meeting.

According to the Spanish Corporation Act, as amended by Law 31/2014, the general shareholders’ meeting will be quorate on first call if the shareholders present, in person or by proxy, hold at least 25% of the subscribed share capital carrying voting rights. On second call, the meeting will be quorate regardless of the capital in attendance.

However, if the agenda of the meeting includes resolutions on the amendment of the bylaws, including an increase or reduction of share capital, the transformation, merger, split-off, the en bloc assignment of assets and liabilities, the migration of the registered office abroad, the issuance of debentures or the exclusion or limitation of pre-emptive rights, the required quorum on first call must be met by the attendance of shareholders representing at least 50% of the subscribed share capital carrying voting rights (each a “Special Resolution”). On second call, the attendance of 25% of the subscribed share capital carrying voting rights will suffice.

As a general rule, resolutions at the general shareholder's meeting will be passed by a simple majority of votes cast at such meeting (i.e., provided that the votes for outnumber the votes against the relevant resolution).

In contrast, in order to approve any Special Resolution, if the capital present or represented at the general shareholders' meeting exceeds 50% of the subscribed share capital carrying voting rights, the favorable vote of the absolute majority (that is, if the votes in favor exceed 50% of the votes corresponding to capital present and represented at the shareholders' meeting) will be required. If, on second call, shareholders representing 25% or more of the subscribed share capital carrying voting rights are present or represented but fail to reach the 50% threshold, the favorable vote of at least two-thirds of the share capital present or represented at the meeting will be required.

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### *Preemptive Rights*

Pursuant to the Spanish Corporation Act, shareholders have preemptive rights to subscribe for any new shares in capital increases with issuances of new shares with a charge to monetary contributions and in issuances of debentures convertible into shares. Such rights may be excluded (partially or totally) under special circumstances by virtue of a resolution passed at a general shareholders' meeting in accordance with Articles 308, 504 and 506 of the Spanish Corporation Act, or by the Board of Directors, if previously authorized at a general shareholders' meeting in accordance with Article 506 of the Spanish Corporation Act (for capital increases) and Articles 417 and 511 (for issuances of debentures convertible into shares). Such preemptive rights will not be available in the event of an increase in capital to meet the requirements of a convertible bond issue or a merger or demerger of another entity into Telefónica or of all or part of the assets split from another company, in which shares are issued as consideration or, in general, when the increase is carried out as consideration in exchange for non-cash contributions. Such rights are transferable, may be traded on the Automated Quotation System and may be of value to existing shareholders because new shares may be offered for subscription at prices lower than prevailing market prices.

### *Form and Transfer*

Ordinary shares are in book-entry form and are indivisible. Joint holders must nominate one person to exercise their rights as shareholders, though joint holders are jointly and severally liable for all obligations arising from their status as shareholders. Sociedad de Gestión de los Sistemas de Registro, Compensación y Liquidación de Valores, S.A. Unipersonal (“**Iberclear**”), which manages the clearance and settlement system of the Spanish Stock Exchanges, maintains the central registry of ordinary shares reflecting the number of ordinary shares held by each of its participant entities (*entidades participantes*) as well as the number of such shares held by registered legal owners. Each participant entity in turn maintains a register of the owners of such shares.

Transfers of Telefónica's ordinary shares quoted on the Spanish Stock Exchanges must be made by book-entry registry or delivery of evidence of title to the buyer through, or with the participation of, a member of the Spanish Stock Exchanges that is an authorized broker or dealer. Transfers of Telefónica's ordinary shares may also be subject to certain fees and expenses.

### *Reporting Requirements*

According to Royal Decree 1362/2007 of October 19 on the disclosure of significant stakes in listed companies (“Royal Decree 1362/2007”), recently modified by Royal Decree 878/2015, of October 2, the acquisition or disposition of shares of Telefónica must be reported within four trading days of the acquisition or disposition to Telefónica and the

CNMV, where:

in the case of an acquisition, the acquisition results in that person or group holding a number of voting rights in Telefónica which reaches or surpasses 3% (or 5%, 10%, 15%, 20%, 25%, 30%, 35%, 40%, 45%, 50%, 60%, 70%, 75%, 80% or 90%) of Telefónica's total number of voting rights; or

in the case of a disposal, the disposition reduces the number of voting rights held by a person or group below a threshold of 3% (or 5%, 10%, 15%, 20%, 25%, 30%, 35%, 40%, 45%, 50%, 60%, 70%, 75%, 80% or 90%) of Telefónica's total number of voting rights.

Royal Decree 878/2015 has recently established a new approach for calculating whether these thresholds are reached, surpassed or fell short which requires adding the voting rights corresponding to shares and financial instruments. Royal Decree 878/2015 also expands the definition of financial instruments which should be reported, including financial instruments having a similar economic effect as the shares of a company, whether the instruments are cash or physically settled, including convertible securities, options, forwards, futures, swaps, CFDs or any other type of instrument which grants the holder the right to acquire shares or a right to receive an equivalent cash settlement amount. Additionally, Royal Decree 878/2015 amends the calculation rules of the voting rights attributable to a financial instrument which, among other changes, shall now be calculated on a daily basis.

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The reporting requirements referred to above apply not only to the acquisition or transfer of shares, but also when, without an acquisition or transfer of shares, the proportion of voting rights of an individual or legal entity reaches, exceeds or falls below the threshold that triggers the obligation to report as a consequence of a change in the total number of voting rights of Telefónica on the basis of the information reported to the CNMV and disclosed by it, in accordance with the Royal Decree.

Regardless of the actual ownership of the shares, any individual or legal entity with a right to acquire, transfer or exercise voting rights granted by the shares, and any individual or legal entity who owns, acquires or transfers, whether directly or indirectly, other securities or financial instruments which grant a right to acquire shares carrying voting rights (such as transferable securities, options, futures, swaps, forwards and other derivative contracts), will also have an obligation to notify the company and the CNMV of the holding of a significant stake in accordance with the above-mentioned regulations.

Stricter disclosure obligations apply if the person obligated to disclose has residency in a country considered a tax haven by the Spanish authorities, a zero-taxation country or territory or a country or territory that does not share information with the Spanish authorities, in which cases the initial threshold for disclosure is reduced to 1% (and successive multiples of 1%).

Our directors must report to us and the CNMV the percentage and number of voting rights in Telefónica held by them at the time of becoming or ceasing to be a member of the Board of Directors. Furthermore, all members of the Board must report any change in the percentage of voting rights they hold, regardless of the amount, as a result of any acquisition or disposition of our shares or voting rights, or financial instruments which carry a right to acquire or dispose of shares which have voting rights attached, including any stock-based compensation that they may receive pursuant to any of our compensation plans. Members of our senior management must also report any stock-based compensation that they may receive pursuant to any of our compensation plans or any subsequent amendment to such plans. Royal Decree 1362/2007 (as amended) refers to the definition given by Royal Decree 1333/2005 of November 11, which develops the Spanish Securities Market Act, regarding market abuse, which defines senior management (*directivos*) as those “high-level employees in positions of responsibility with regular access to insider information (*información privilegiada*) related, directly or indirectly, to the issuer and that, furthermore, are empowered to adopt management decisions affecting the future development and business perspectives of the issuer”.

In addition, pursuant to Royal Decree 1333/2005 of November 11 (implementing European Directive 2004/72/EC), any member of our Board and our senior management, or any parties closely related to any of them, as such terms are defined therein, must report to the CNMV any transactions carried out with respect to our shares or derivatives or other financial instruments relating to our shares within five business days of such transaction. The notification of the transaction must include particulars of, among others, the type of transaction, the date of the transaction and the market in which the transactions were carried out, the number of shares traded and the price paid.

These disclosure obligations are primarily regulated by Royal Decree 1362/2007 (as amended), which contains a more detailed set of rules on this legal framework (including, *inter alia*, rules determining the persons subject to disclosure obligations, the different types of situations triggering disclosure and corresponding exceptions, specific attribution and aggregation rules, the deadlines to notify the transactions, triggering disclosure obligations and incorporation of notices submitted to the CNMV's public registry).

### ***Disclosure of Net Short Positions***

In accordance with Regulation (EU) No. 236/2012 of the European Parliament and of the European Council of March 14, 2012 on short selling and certain aspects of credit default swaps (as further supplemented by several delegated regulations regulating technical aspects necessary for its effective enforceability and to ensure compliance with its provisions), net short positions on shares listed on the Spanish Stock Exchanges equal to, or in excess of, 0.2% of the relevant issuer's share capital and any increases or reductions thereof by 0.1% are required to be disclosed to the CNMV by no later than the first trading day following the transaction. If the net short position reaches 0.5%, and also at every 0.1% above that, the CNMV will disclose the net short position to the public.

Notification is mandatory even if the same position has been already notified to the CNMV in compliance with reporting requirements previously in force in Spain.

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The information to be disclosed is set out in Table 1 of Annex I of Delegated Regulation 826/2012, according to the format approved as Annex II of this Regulation. The information will be published, where appropriate, on a web page operated or supervised by the corresponding authority.

Moreover, pursuant to Regulation (EU) No. 236/2012, where the CNMV considers that (i) there are adverse events or developments that constitute a serious threat to financial stability or to market confidence (serious financial, monetary or budgetary problems, which may lead to financial instability, unusual volatility causing significant downward spirals in any financial instrument, etc.); and (ii) the measure is necessary and will not be disproportionately detrimental to the efficiency of financial markets in view of the advantages sought, it may, following consultation with the European Securities and Market Authority (“ESMA”), take any one or more of the following measures:

impose additional notification obligations by either (a) reducing the thresholds for the notification of net short positions in relation to one or several specific financial instruments; and/or (b) requesting the parties involved in the lending of a specific financial instrument to notify any change in the fees requested for such lending; and

restrict short selling activity by either prohibiting or imposing conditions on short selling.

In addition, according to Regulation (EU) No. 236/2012, where the price of a financial instrument has fallen significantly during a single day in relation to the closing price on the previous trading day (10% or more in the case of a liquid share), the CNMV may prohibit or restrict short selling of financial instruments for a period not exceeding the end of the trading day following the trading day on which the fall in price occurs.

Finally, Regulation (EU) No. 236/2012 also vests powers to ESMA in order to take measures similar to the ones described above in exceptional circumstances, when the purpose of these measures is to deal with a threat affecting several EU member states and the competent authorities of these member states have not taken adequate measures to address it.

## ***Shareholder Agreements***

Article 531 *et seq.* of the Spanish Corporation Act require parties to disclose those shareholders’ agreements in respect of Spanish listed companies that affect the exercise of voting rights at a general shareholders’ meeting or contain restrictions or conditions on the transferability of shares or bonds that are convertible or exchangeable into shares. If any shareholders enter into such agreements with respect to Telefónica’s shares, they must disclose the execution, amendment or extension of such agreements to Telefónica and the CNMV (together with the relevant clauses of said agreements) and file such agreements with the appropriate Commercial Registry. Failure to comply with these



disclosure obligations renders any such shareholders' agreement unenforceable and constitutes a violation of the Spanish Securities Market Act.

### *Acquisition of Own Shares*

Pursuant to Spanish corporate law, we may only repurchase our own shares within certain limits and in compliance with the following requirements:

the repurchase must be authorized by the general shareholders' meeting by a resolution establishing the maximum number of shares to be acquired, the minimum and maximum acquisition price and the duration of the authorization, which may not exceed five years from the date of the resolution; and

the repurchase, including any shares already held by us or a person acting on our behalf, must not bring our net worth below the aggregate amount of our share capital and legal reserves.

For these purposes, net worth means the amount resulting from the application of the criteria used to draw up the financial statements, subtracting the amount of profits directly imputed to that net worth, and adding the amount of share capital subscribed but not called and the share capital par and issue premiums recorded in our accounts as liabilities. In addition:

the aggregate par value of the shares directly or indirectly repurchased, together with the aggregate par value of the shares already held by us and our subsidiaries, must not exceed 10% of our share capital; and

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- the shares repurchased must be fully paid and must be free of ancillary contributions (*prestaciones accesorias*).

Voting rights attached to treasury shares will be suspended and economic rights (*e.g.*, the right to receive dividends and other distributions and liquidation rights), except the right to receive bonus shares, will accrue proportionately to all of our shareholders. Treasury shares are counted for the purpose of establishing the quorum for shareholders' meetings and majority voting requirements to pass resolutions at shareholders' meetings.

Regulation (EU) No. 596/2014 of April 16, repealing, among others, Directive 2003/6/EC of the European Parliament and the European Council of January 28, on insider dealing and market manipulation establishes rules in order to ensure the integrity of European Community financial markets and to enhance investor confidence in those markets. This regulation maintains an exemption from the market manipulation rules regarding share buyback programs by companies listed on a stock exchange in an EU Member State. Commission Regulation (EC) No. 2273/2003, of December 22, implemented the aforementioned directive with regard to exemptions for buyback programs. Article 5 of this Regulation states that in order to benefit from the exemption, a buyback program must comply with certain requirements established under such Regulation and the sole purpose of the buyback program must be to reduce the share capital of an issuer (in value or in number of shares) or to meet obligations arising from either of the following:

- debt financial instruments exchangeable into equity instruments; or
- employee share option programs or other allocations of shares to employees of the issuer or an associated company.

In addition, on December 19, 2007, the CNMV issued Circular 3/2007 setting out the requirements to be met by liquidity contracts entered into by issuers with financial institutions for the management of its treasury shares to constitute an accepted market practice and, therefore, be able to rely on a safe harbor for the purposes of market abuse regulations.

If an acquisition or series of acquisitions of shares of Telefónica reaches or exceeds or causes Telefónica's and its affiliates' holdings to reach or exceed 1% of Telefónica's voting shares, Telefónica must notify its final holding of treasury stock to the CNMV. If such threshold is reached as a result of a series of acquisitions, such reporting obligation will only arise after the closing of the acquisition which, taken together with all acquisitions made since the last of any such notifications, causes the Telefónica's and its affiliates holdings to exceed, 1% of Telefónica's voting shares. Sales and other dispositions of Telefónica's treasury stock will not be deducted in the calculation of such threshold. This requirement also applies if the stock is acquired by a majority-owned subsidiary of Telefónica.

Moreover, pursuant to Spanish corporate law, the audited financial statements of a company must include a reference regarding any treasury shares.

At December 31, 2015, we held 141,639,159 shares of treasury stock, representing 2.84690% of our capital stock. At December 31, 2014, we held 128,227,971 shares of treasury stock, representing 2.75332% of our capital stock. As a part of our shareholders' remuneration policy, we have implemented various share buyback programs since 2003. For further description about our shareholders' return, see "Item 8. Financial Information—Dividend Information and Share Buyback Programs."

At our annual general shareholders' meeting held on May 30, 2014, our shareholders extended their prior authorization to the Board of Directors to acquire our shares for an additional five years from the date of such meeting. The authorization also applies to companies under our control. Pursuant to the authorization, the aggregate nominal value of our shares held by us or any of our subsidiaries cannot exceed the limit established by applicable laws (which is, as of the date of this Annual Report, 10% of our outstanding capital).

### *Change of Control Provisions*

Certain antitrust regulations may delay, defer or prevent a change of control of Telefónica or any of its subsidiaries in the event of a merger, acquisition or corporate restructuring. In Spain, the application of both Spanish and European antitrust regulations requires that prior notice of domestic or cross-border merger transactions be given in order to obtain a "non-opposition" ruling from antitrust authorities.

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*Tender Offers*

Tender offers are governed in Spain by the Spanish Securities Markets Act (as amended by Law 6/2007 of April 12) and Royal Decree 1066/2007, of July 27, which have implemented Directive 2004/25/EC of the European Parliament and of the European Council of April 21. Tender offers in Spain may qualify as either mandatory or voluntary offers.

Mandatory public tender offers must be launched for all the shares of the target company or other securities that might directly or indirectly give the right to subscription thereto or acquisition thereof (including convertible and exchangeable bonds) at an equitable price and not subject to any conditions when any person acquires control of a Spanish company listed on the Spanish Stock Exchanges, whether such control is obtained:

· by means of the acquisition of shares or other securities that directly or indirectly give voting rights in such company;

· through agreements with shareholders or other holders of said securities; or

· as a result of other situations of equivalent effect as provided in the regulations (i.e., indirect control acquired through mergers, share capital decreases, target's treasury stock variations or securities exchange or conversion, etc.).

A person is deemed to have obtained the control of a target company, individually or jointly with concerted parties, whenever:

· it acquires, directly or indirectly, a percentage of voting rights equal to or greater than 30%; or

· it has acquired a percentage of less than 30% of the voting rights and appoints, in the 24 months following the date of acquisition of said percentage, a number of directors that, together with those already appointed, if any, represent more than one-half of the members of the target company's board of directors. Regulations also set forth certain situations where directors are deemed to have been appointed by the bidder or persons acting in concert therewith unless evidence to the contrary is provided.

Notwithstanding the above, Spanish regulations establish certain exceptional situations where control is obtained but no mandatory tender offer is required, including, among others:

subject to the CNMV's approval,

acquisitions or other transactions resulting from the conversion or capitalization of credits into shares of listed companies, the financial feasibility of which is subject to serious and imminent danger, even if the company is not undergoing bankruptcy proceedings, provided that such transactions are intended to ensure the company's financial recovery in the long term; or

in the event of a merger, provided that those acquiring control did not vote in favor of the merger at the relevant general shareholders' meeting of the offeree company and provided also that it can be shown that the primary purpose of the transaction is not the takeover but an industrial or corporate purpose; and

when control has been obtained after a voluntary bid for all of the securities, if either the bid has been made at an equitable price or has been accepted by holders of securities representing at least 50% of the voting rights to which the bid was directed.

For the purposes of calculating the percentages of voting rights acquired, the regulations establish the following rules:

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percentages of voting rights corresponding to (i) companies belonging to the same group of the bidder; (ii) members of the board of directors of the bidder or of companies of its group; (iii) persons acting for the account of or in concert with the bidder (a concert party shall be deemed to exist when two or more persons collaborate under an agreement, be it express or implied, oral or written, in order to obtain control of the offeree company); (iv) voting rights exercised freely and over an extended period by the bidder under proxy granted by the actual holders or owners of such rights in the absence of specific instructions with respect thereto; and (v) shares held by a nominee, such nominee being understood as a third party whom the bidder totally or partially covers against the risks inherent in acquisitions or transfers of the shares or the possession thereof, will be deemed to be held by the bidder (including the voting rights attaching to shares that constitute the underlying asset or the subject matter of financial contracts or swaps when such contracts or swaps cover, in whole or in part, against the risks inherent in ownership of the securities and have, as a result, an effect similar to that of holding shares through a nominee);

both the voting rights arising from the ownership of shares and those enjoyed under a usufruct or pledge or upon any other title of a contractual nature will be counted towards establishing the number of voting rights held;

the percentage of voting rights shall be calculated based on the entire number of shares carrying voting rights, even if the exercise of such rights has been suspended; voting rights attached to treasury shares shall be excluded; and non-voting shares shall be taken into consideration only when they carry voting rights pursuant to applicable law; and

acquisitions of securities or other financial instruments giving the right to the subscription, conversion, exchange or acquisition of shares which carry voting rights will not result in the obligation to launch a tender offer either until such subscription, conversion, exchange or acquisition occurs.

Notwithstanding the foregoing, upon the terms established in the regulations, the CNMV will conditionally dispense with the obligation to launch a mandatory bid when another person or entity, individually or jointly in concert, directly or indirectly holds an equal or greater voting percentage than the potential bidder in the target company.

The price of the mandatory tender offer is deemed equitable when it is at least equal to the highest price paid or agreed by the bidder or by any person acting in concert therewith for the same securities during the 12 months prior to the announcement of the tender offer. When the mandatory tender offer must be made without the bidder having previously acquired the shares over the above-mentioned 12-month period, the equitable price shall not be less than the price calculated in accordance with other rules set forth in the regulations. In any case, the CNMV may change the price so calculated in certain circumstances (extraordinary events affecting the price, evidence of market manipulation, etc.).

Mandatory offers must be launched within one month from the acquisition of the control of the target company.

Voluntary tender offers may be launched when a mandatory offer is not required. Voluntary offers are subject to the same rules established for mandatory offers except for the following:

they may be subject to certain conditions (such as amendments to the bylaws or adoption of certain resolutions by the target company, acceptance of the offer by a minimum number of securities, approval of the offer by the shareholders' meeting of the bidder and any other deemed by the CNMV to be in accordance with law), provided that such conditions can be met before the end of the acceptance period of the offer; and

they may be launched at any price, regardless of whether it is lower than the above-mentioned "equitable price". However, if they are not launched at an equitable price and if the tender offer shares representing at least 50% of the voting rights are tendered in the offer (excluding voting rights already held by the bidder and those belonging to shareholders who entered into an agreement with the bidder regarding the tender offer), the bidder may become obliged to launch a mandatory tender offer.

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In any case, by virtue of an amendment to the Spanish Securities Market Act operated by Law 1/2012, of June 22, the price in a voluntary tender offer must be the higher of (i) the equitable price and (ii) the price resulting from an independent valuation report, and must at least consist of cash as an alternative if certain circumstances have occurred during the two years prior to the announcement of the offer (basically, the trading price for the shares being affected by price manipulation practices, market or share prices being affected by natural disasters, *force majeure*, or other exceptional events, or the target company being subject to expropriation or confiscation resulting in a significant impairment of the company's real value).

Spanish regulations on tender offers set forth further provisions, including:

subject to shareholder approval within 18 months from the date of announcement of the tender offer, the board of directors of a target company will be exempt from the rule prohibiting frustrating action against a foreign bidder whose board of directors is not subject to an equivalent passivity rule;

defensive measures included in a listed company's bylaws and transfer and voting restrictions included in agreements among a listed company's shareholders will remain in place whenever the company is the target of a tender offer, unless the shareholders resolve otherwise (in which case any shareholders whose rights are diluted or otherwise adversely affected will be entitled to compensation at the target company's expense); and

squeeze-out and sell-out rights will apply provided that following a tender offer for all the target's share capital, the bidder holds securities representing at least 90% of the target company's voting capital and the tender offer has been accepted by the holders of securities representing at least 90% of the voting rights other than those held by or attributable to the bidder previously to the offer.

***Payment of Taxes***

Holders of ordinary shares will be responsible for any taxes or other governmental charges payable on their ordinary shares, including any taxes payable on transfer. The paying agent or the transfer agent, as the case may be, may, and upon instruction from Telefónica, will:

refuse to effect any registration of transfer of such ordinary shares or any split-up or combination thereof until such payment is made; or

withhold or deduct from any distributions on such ordinary shares or sell for the account of the holder thereof any part or all of such ordinary shares (after attempting by reasonable means to notify such holder prior to such sale), and



apply, after deduction for its reasonable expenses incurred in connection therewith, the net proceeds of any such sale to payment of such tax or other governmental charge. The holder of such ordinary shares will remain liable for any deficiency.

*Dividends*

Shareholders vote on final dividend distributions at the shareholders' meeting. Distributable profits are equal to:

- net profits for the year; plus
  
- profits carried forward from previous years; plus
  
- distributable reserves; minus
  
- losses carried forward from previous years; minus
  
- amounts allocated to reserves as required by law or by our bylaws.

The amount of distributable profits is based on our unconsolidated financial statements prepared in accordance with Spanish GAAP, which differ from the Consolidated Financial Statements prepared in accordance with IFRS included elsewhere in this Annual Report.

The Board of Directors can approve interim dividend payments without a prior shareholder vote on the issue. However, under those circumstances, the dividend is limited to distributable net profits of the current year and is subject to certain legal requirements.

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Unclaimed dividends revert to us five years from their date of payment.

***Registration and transfers***

Our shares are in registered book-entry form. Transfers executed through stock exchange systems are implemented pursuant to the stock exchange clearing and settlement procedures carried out by the Spanish clearing institution. Transfers executed outside of stock exchange systems, that is, over the counter, are implemented pursuant to the general legal regime for book-entry transfer, including registration by the Spanish clearing institution.

There are no restrictions with respect to the transfer of our shares.

***Liquidation rights***

Under Spanish law, upon our liquidation, the shareholders would be entitled to receive, on a pro rata basis, any assets remaining after the payment of our debts and taxes and liquidation expenses.

C. Material Contracts

Divestment in Telecom Italia and Termination of Contracts relating to such Investment.

On June 16, 2014, the Italian shareholders of Telco, S.p.A. (Assicurazioni Generali, S.p.A., Intesa Sanpaolo, S.p.A. Mediobanca, S.p.A.) requested the initiation of the process of demerger of such company, as provided in the relevant shareholders agreement.

The implementation of such demerger process, which was approved by the General Shareholders' Meeting of Telco held on July 9, 2014, was subject to obtaining all the required anti-trust and telecommunications approvals (including in Brazil and Argentina). Once the aforementioned approvals were obtained, the demerger deed was executed on June 17, 2015, becoming effective on June 18, 2015 after its registration in the Madrid Mercantile Registry. As a consequence of the demerger, the Telecom Italia ordinary shares held by Telco – which represented 22.3% of the

company's ordinary share capital – were allocated as follows: 14.72% was allocated to Telco TE, S.p.A., a newly created company owned by Telefónica; 4.31% to a newly created company owned by the Generali group; and 1.64% to each of the newly created companies owned by Intesa Sanpaolo and Mediobanca respectively.

Moreover, the shareholders' agreement in force between the shareholders of Telco ceased to have effect on June 18, 2015.

In accordance with the regulatory and competition commitments it had assumed, Telefónica completed the divestment of its entire stake in Telecom Italia, S.p.A. during this period.

#### Material Contract Related to Our Investment in China Unicom

On September 6, 2009, Telefónica and China Unicom entered into a subscription agreement, (the "Subscription Agreement"), pursuant to which each party conditionally agreed to invest the equivalent of 1 billion U.S. dollars in the other party through the acquisition of shares in the other party. Moreover, both parties entered into a strategic alliance agreement which provides for, among other areas for cooperation, joint procurement of infrastructure and client equipment, common development of mobile service platforms, joint provisions of service to multinational customers, roaming, research and development, sharing of best practices and technical, operational and management know-how, joint development of strategic initiatives in the area of network evolution, joint participation in international alliances and exchanges of senior management.

On October 21, 2009, the mutual share exchange pursuant to the Subscription Agreement was implemented through the subscription by Telefónica Internacional of 693,912,264 newly issued shares of China Unicom and a contribution in kind to China Unicom of 40,730,735 shares of Telefónica.

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Following the completion of the transaction, we increased our share of China Unicom's voting share capital from 5.38% to 8.06% and obtained the right to appoint a member to its board of directors, while China Unicom became owner of approximately 0.87% of our voting share capital at that date. Subsequently, after a capital reduction carried out by China Unicom, we reached a shareholding equivalent to 8.37% of the company's voting share capital.

Under the Subscription Agreement, we agreed with China Unicom that for a period of one year from completion of the acquisition of the mutual share exchange, we shall not, directly or indirectly, sell, transfer or dispose of any of the China Unicom shares held, directly or indirectly, by us or any of our subsidiaries (save for the transfer of such shares to any member of the Telefónica group). China Unicom has made an analogous undertaking with respect to its participation in our share capital.

In addition, subject to Telefónica or any of its subsidiaries holding in aggregate, directly or indirectly, not less than 5% of the issued share capital of China Unicom from time to time and to the extent not prohibited under applicable law, the articles of association of China Unicom and the Hong Kong Listing Rules, we shall be entitled to nominate one representative to the Board of Directors of China Unicom.

Finally, with effect from completion, and for so long as the strategic alliance agreement is in effect, China Unicom shall not (i) offer, issue or sell any significant number of its ordinary shares (including those held in treasury by the company itself, if any), or any securities convertible into or other rights to subscribe for or purchase a significant number of China Unicom's ordinary shares (including those held in treasury by the company itself, if any), to any of our current major competitors or (ii) make any significant investment, directly or indirectly, in any of our current major competitors. We have made similar undertakings.

The strategic alliance agreement between the parties terminates on the third anniversary and automatically renews thereafter for one year terms, subject to either party's right to terminate on six months' notice. Also, the strategic alliance agreement may be terminated by China Unicom if we sell our shares in China Unicom causing us to own less than 5% of the issued share capital of China Unicom or by us if China Unicom sells our shares and ceases to own at least 0.5% of our issued share capital. In addition, the strategic alliance agreement is subject to termination in the event either party is in default and automatically terminates on a change in control of China Unicom.

On January 23, 2011, Telefónica and China Unicom entered into an extension to their already existing strategic alliance agreement (the "Enhanced Strategic Alliance Agreement") in which both companies agreed to strengthen and deepen their strategic cooperation in certain business areas and through which, upon the terms and conditions set out thereof, each party agreed to invest the equivalent of 500 million U.S. dollars in ordinary shares of the other party toward the alliance. Furthermore, we agreed to propose the appointment of a director nominated by China Unicom.

Pursuant to the Enhanced Strategic Alliance Agreement, Telefónica, through its wholly-owned subsidiary, Telefónica Internacional acquired 282,063,000 ordinary shares of China Unicom through several transactions executed in the period between January 25, 2011, and September 7, 2011, investing an aggregate amount equivalent to approximately 500 million U.S. dollars (equivalent to 358 million euros).

Additionally, on January 28, 2011, China Unicom acquired 21,827,499 Telefónica shares at the agreed price of 17.16 euros per share, giving it ownership of 1.37% of the Company's capital (the arithmetic average of the closing price of Telefónica shares as quoted on the Madrid Stock Exchange for the thirty consecutive trading days ending on January 14, 2011), which represents a total price of 500 million U.S. dollars. In recognition of China Unicom's stake in Telefónica, the Company nominated Mr. Chang Xiaobing, who was designated by China Unicom, to the Board of Directors at the General Shareholders' Meeting held on May 18, 2011.

At December 31, 2011, Telefónica's shareholding in China Unicom amounted to 9.6% of its capital stock.

Since their strategic alliance agreement signed in September 2009, Telefónica and China Unicom have made significant progress in various areas of cooperation. In this respect, we believe that this agreement will enhance this alliance and deepen cooperation between the two companies in the areas of procurement, mobile service platforms, service to multinational customers, wholesale carriers, roaming technology/R&D, international business development, cooperation and sharing of best practices.

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On June 10, 2012, Telefónica, S.A. through its 100% subsidiary, Telefónica Internacional, S.A.U., and China United Network Communications Group Company Limited (“Unicom Parent”) through a 100% owned subsidiary, signed an agreement for the acquisition by this last company of 1,073,777,121 shares of China Unicom -Hong Kong- Limited, owned by Telefónica, equivalent to 4.56% of the issued share capital.

On July 21, 2012, the aforementioned agreement was complemented by a Supplemental Agreement which determined the acquisition of the shares at a price of HK\$10.02 per share, for a total amount of HK\$10,759,246,752.42 (approximately 1,142 million euros). The transaction was completed on July 30, 2012 after obtaining the relevant regulatory authorizations.

On November 10, 2014, Telefónica, through its 100% subsidiary Telefónica Internacional, S.A.U., sold 597,844,100 shares of China Unicom (Hong Kong) Limited (representing 2.5% of the share capital of that company), through a block trade process, at a price of HK\$ 11.14 per share, for a total amount of HK\$ 6,660 million, approximately 687 million euros at the exchange rate as at the date of the sale.

Further to the sale, Telefónica maintains its commitment to the strategic alliance with China Unicom.

As of the date of this Annual Report, Telefónica’s shareholding in China Unicom amounts to 2.51% of its capital stock and Mr. César Alierta, chairman of Telefónica, S.A. is a member of the Board of Directors of China Unicom.

Material Contract 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.

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 updates in line with inflation and deflation that vary from country to country, pursuant to the volume of services Atento has been providing to the entire Group.

In the case of an eventual failure to meet the annual turnover commitments that could result in compensation, which would be calculated based on the difference between the actual amount of turnover and the predetermined commitment, applying a percentage based on the Contract Center's business margin to the final calculation.

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

Agreement for the Acquisition of Global Village Telecom, S.A. and its holding company GVT Participações, S.A. ("GVT")

On September 19, 2014, Telefónica, S.A. signed an agreement with Vivendi, S.A., for the acquisition by Telefônica Brasil, S.A. of Global Village Telecom, S.A. and its holding company GVT Participações, S.A. (jointly "GVT") for a cash consideration of 4,663 million euros (through payment in cash and debt assumption), as well as the delivery of shares representing 12% of the share capital of the new Telefônica Brasil, S.A. (following its integration with GVT).

As part of the agreement, Vivendi, S.A. acquired 1,110 million ordinary shares in Telecom Italia from Telefónica, (which represented, as of such date, 8.2% of Telecom Italia's voting share capital and 5.7% of its total share capital), in exchange for 4.5% of the total share capital of Telefônica Brasil, S.A. (following its integration with GVT).

The cash consideration for the GVT Acquisition was financed through a capital increase of Telefônica Brasil, S.A. which was subscribed by Telefónica, S.A. in proportion to its stake. Telefónica, S.A. financed such subscription via its own capital increase.

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On May 28, 2015, once the relevant regulatory approvals were obtained, the Extraordinary General Shareholders' Meeting of Telefônica Brasil, S.A. held on May 28, 2015, approved the acquisition as well as the issue of shares of Telefônica Brasil to Vivendi, S.A., as partial payment of the purchase price of GVT. The acquisition of GVT was therefore completed.

Accordingly, since May 1, 2015, GVT is incorporated in the consolidation perimeter of the Telefónica Group by the global integration method.

Agreement for the divestment of Telefónica's operations in the UK (O2 UK)

On March 24, 2015, Telefónica signed an agreement with Hutchison for the acquisition by the latter of Telefónica's operations in the UK (O2 UK) for a price (firm value) of 10,250 million pounds sterling in cash (approximately 14,000 million euros at the exchange rate as of the date of the agreement), composed of (i) an initial amount of 9,250 million pounds sterling (approximately 12,640 million euros as of the date of the agreement) which would be paid at closing and (ii) an additional deferred payment of 1,000 million pounds sterling (approximately 1,360 million euros as of the date of the agreement) to be paid once the cumulative cash flow of the combined company in the United Kingdom has reached an agreed threshold. According to the sale agreement, the price will be adjusted by the debt, the working capital and other defined circumstances that may ultimately arise upon closing of the O2 UK divestiture.

Completion of the transaction is subject to, among other conditions, the approval of the European Commission and the obtainment of waivers to some contractual provisions affected by the sale, including those related to network alliances, as well as change of control provisions under certain contractual arrangements with third parties. As of the date of this Annual Report, such conditions had not been met. The European Commission authorization process is ongoing.

These conditions must be satisfied by no later than June 30, 2016, however, this date may be extended until September 30, 2016, in specified circumstances.

D. Exchange Controls

Exchange Controls and Other Limitations Affecting Security Holders



***Ownership limitations***

There are no limitations with respect to the ownership of our assets or share capital except those derived from the application of the reciprocity principle as described above.

***Trading by us in our own shares or shares of companies under our control***

For information on the requirements applicable to the trading by us in our own shares or shares of companies under our control, see “—Memorandum and Articles of Association-Description of Our Capital Stock—Acquisition of own shares” above.

***Other restrictions on acquisitions of shares***

For information on reporting requirements and other restrictions “applicable to the acquisition of our shares see “—Memorandum and Articles of Association—Description of Our Capital Stock-Reporting requirements” and “—Trading by in our own shares or shares of companies under our control” above.

**Dividend and Liquidation Rights**

According to Spanish law and our bylaws, dividends may only be paid out of profits or distributable reserves if the value of our net worth is not, and as a result of such distribution would not be, less than our capital stock. Pursuant to Spanish law, we are required to reserve 10% of our fiscal year net income until the amount in our legal reserve reaches 20% of our capital. Our legal reserve is currently at 20%.

Dividends payable by us to non-residents of Spain ordinarily are subject to a Spanish withholding tax. For the tax implications of dividends to U.S. Holders (as defined below), see “—Taxation.”

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Upon our liquidation, our shareholders would be entitled to receive pro rata any assets remaining after the payment of our debts and taxes and expenses of such liquidation. Any change in the rights of shareholders to receive dividends and payment upon liquidation would require an amendment to our bylaws by resolution adopted by a general meeting of shareholders. If there were more than one class of shares, such amendment would also require the approval of each class of shareholders affected by the amendment.

Preemptive Rights and Increases of Share Capital

Pursuant to the Spanish Corporations Law, shareholders have preemptive rights to subscribe for any new shares and for bonds convertible into shares. Such rights may not be available under special circumstances if waived by a resolution passed at a general meeting of shareholders in accordance with Article 308 of the Spanish Corporations Law, or the Board of Directors, if authorized (Article 506 of the Spanish Corporation Act). Further, such rights, in any event, will not be available in the event of an increase in capital to meet the requirements of a convertible bond issue or a merger in which shares are issued as consideration. Such rights:

are transferable;

may be traded on the Automated Quotation System; and

may be of value to existing shareholders because new shares may be offered for subscription at prices lower than prevailing market prices.

Absent an exemption from registration, shares issuable upon exercise of rights must be registered under the Securities Act in order to be offered to holders of ADRs. If we decided not to register the shares, the rights would not be distributed to holders of ADRs. Pursuant to the Deposit Agreement, however, holders of ADRs are entitled to receive their proportionate share of the proceeds, if any, from sale by the Depositary of any rights accruing to holders of ADRs.

E. Taxation

The following is a general summary of the material Spanish and U.S. federal income tax consequences to U.S. Holders described below of the ownership and disposition of shares or ADSs. This summary is based upon Spanish and U.S. tax laws (including the U.S. Internal Revenue Code of 1986, as amended (the "Code"), final, temporary and proposed U.S. Treasury regulations, rulings, judicial decisions and administrative pronouncements), and the

Convention Between the United States of America and the Kingdom of Spain for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, signed February 22, 1990 (the "Treaty"), all as of the date hereof and all of which are subject to change or changes in interpretation, possibly with retroactive effect. In addition, the summary is based in part on representations of the Depository and assumes that each obligation provided for in or otherwise contemplated by the Deposit Agreement or any other related agreements will be performed in accordance with its terms.

As used herein, the term "U.S. Holder" means a beneficial owner of one or more shares or ADSs:

that is, for U.S. federal income tax purposes, one of the following:

- (a) a citizen or individual resident of the United States,
  - (b) a corporation (or other entity taxable as a corporation) created or organized in or under the laws of the United States or any state therein or the District of Columbia, or
  - (c) an estate or trust the income of which is subject to U.S. federal income taxation regardless of its source;
- who is entitled to the benefits of the Treaty;
- who holds the shares or ADSs as capital assets for U.S. federal income tax purposes;

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- who owns, directly, indirectly or by attribution, less than 10% of the share capital or voting stock of Telefónica; and
  - whose holding is not attributable to a fixed base or permanent establishment in Spain.

This summary does not address all of the tax considerations, including the potential application of the provisions of the Code known as the Medicare contribution tax, that may apply to holders that are subject to special tax rules, such as certain U.S. expatriates, insurance companies, tax-exempt organizations, certain financial institutions, persons subject to the alternative minimum tax, dealers and certain traders in securities, persons holding shares or ADSs as part of a straddle, hedging, conversion or integrated transaction, persons who acquired their shares or ADSs pursuant to the exercise of employee stock options or otherwise as compensation, persons owning shares or ADSs in connection with a trade or business outside of the U.S., partnerships or other entities classified as partnerships for U.S. federal income tax purposes or persons whose functional currency is not the U.S. dollar. Such holders may be subject to U.S. federal income tax consequences different from those set forth below.

If a partnership holds shares or ADSs, the tax treatment of a partner generally will depend upon the status of the partner and the activities of the partnership. A partner in a partnership that holds shares or ADSs is urged to consult its own tax advisor regarding the specific tax consequences of owning and disposing of the shares or ADSs.

For purposes of the Treaty and U.S. federal income tax, U.S. Holders of ADSs will generally be treated as owners of the underlying shares represented by such ADSs. Accordingly, no gain or loss will be recognized if a U.S. Holder exchanges ADSs for the underlying shares represented by those ADSs.

The U.S. Treasury has expressed concerns that parties to whom American depositary receipts are released before shares are delivered to the depositary, or intermediaries in the chain of ownership between holders and the issuer of the security underlying the American depositary receipts, may be taking actions that are inconsistent with the claiming of foreign tax credits by U.S. holders of American depositary receipts. Such actions would also be inconsistent with the claiming of the reduced rates of tax applicable to dividends received by certain non-corporate U.S. Holders. Accordingly, the availability of foreign tax credits to U.S. Holders of ADSs and the reduced tax rates for dividends received by certain non-corporate U.S. Holders of ADSs, each as described below, could be affected by actions taken by such parties or intermediaries.

This discussion assumes that Telefónica is not, and will not become, a passive foreign investment company (“PFIC”), as discussed below under “—U.S. Federal Income Tax Considerations—Passive foreign investment company rules.”

U.S. Holders of shares or ADSs should consult their own tax advisors concerning the specific Spanish and U.S. federal, state and local tax consequences of the ownership and disposition of shares or ADSs in light of their particular situations as well as any consequences arising under the laws of any other taxing jurisdiction. In particular, U.S. Holders are urged to consult their own tax advisors concerning their eligibility for benefits under the Treaty.

## **Spanish Tax Considerations**

### ***Taxation of dividends***

Under Spanish law, dividends paid by Telefónica to U.S. Holders of ordinary shares or ADSs are subject to Spanish Non-Resident Income Tax, withheld at source, at a rate of 19%. For these purposes, upon distribution of the dividend, Telefónica or its paying agent will withhold an amount equal to the tax due according to the rules set forth above.

However, under the Treaty, if you are a U.S. Holder, you are entitled to a reduced withholding tax rate of 15%.

To benefit from the Treaty-reduced rate of 15%, you must provide to Telefónica through its paying agent in Spain, before the tenth day following the end of the month in which the dividends were payable, a certificate from the U.S. Internal Revenue Service (“IRS”) stating that, to the best knowledge of the IRS, such U.S. Holders are residents of the United States within the meaning of the Treaty and entitled to its benefits.

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If this certificate is not provided within this period, you may afterwards apply for a refund of the amount withheld in excess of the rate provided for in the Treaty by following the procedures described in the next section.

***Spanish Refund Procedure***

According to Spanish Regulations on Non-Resident Income Tax, approved by Royal Decree 1776/2004 dated July 30, 2004, as amended, a refund for the amount withheld in excess of the Treaty-reduced rate can be obtained from the relevant Spanish tax authorities. To pursue the refund claim, if you are a U.S. Holder, you are required to file:

- the corresponding Spanish tax form,
- the certificate referred to in the preceding section, and
- evidence of the Spanish Non-Resident Income Tax that was withheld with respect to you.

The refund claim must be filed within four years from the date in which the withheld tax was collected by the Spanish tax authorities.

U.S. Holders are urged to consult their own tax advisors regarding refund procedures and any U.S. tax implications thereof.

***Taxation of capital gains***

For Spanish tax purposes, income obtained from the sale of ADSs or ordinary shares of Telefónica will be treated as capital gains. Spanish non-resident income tax is levied at a rate of 19% on capital gains obtained by persons not residing in Spain for tax purposes who are not entitled to the benefit of any applicable treaty for the avoidance of double taxation.

Notwithstanding the above, capital gains derived from the transfer of shares on an official Spanish secondary stock market by any holder who is resident in a country that has entered into a treaty for the avoidance of double taxation

with an “exchange of information” clause (the Treaty contains such a clause) will be exempt from taxation in Spain. If you are a U.S. Holder, under the Treaty capital gains arising from the disposition of ordinary shares or ADSs will not be taxed in Spain. You will be required to establish that you are entitled to the exemption from tax under the Treaty by providing to the relevant Spanish tax authorities a certificate of residence issued by the IRS stating that to the best knowledge of the IRS, you are a U.S. resident within the meaning of the Treaty.

### ***Spanish wealth tax***

Individual U.S. Holders who hold shares or ADSs located in Spain are subject to the Spanish Wealth Tax (Impuesto sobre el Patrimonio) (Spanish Law 19/1991), which imposes tax on property located in Spain on the last day of any year. As of January 1, 2017 a 100% tax allowance has been approved by Royal Legislative Decree 13/2011 dated September, 16, 2011 to any resident or non resident taxpayer.

### ***Inheritance and gift tax***

Transfers of shares or ADSs on death and by gift to individuals are subject to Spanish inheritance and gift taxes (Impuesto sobre Sucesiones y Donaciones), respectively, if the transferee is a resident of Spain for tax purposes, or if the shares or ADSs are located in Spain at the time of death, regardless of the residence of the heir or beneficiary. In this regard, the Spanish tax authorities may determine that all shares of Spanish corporations and all ADSs representing such shares are located in Spain for Spanish tax purposes. The state applicable tax rate, after applying relevant personal, family and wealth factors, generally ranges between 7.65% and 81.6% for individuals.

Gifts granted to corporations non-resident in Spain are subject to Spanish Non-Resident Income Tax at a rate of 19% on the fair market value of the shares as a capital gain. If the donee is a United States resident corporation, the exclusions available under the Treaty described in the section “—Taxation of Capital Gains” above will be applicable.

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*Expenses of Transfer*

Transfers of shares or ADSs will be exempt from any transfer tax (*Impuesto sobre Transmisiones Patrimoniales*) or value added tax. Additionally, no stamp tax will be levied on such transfers.

**U.S. Federal Income Tax Considerations**

*Taxation of dividends*

Distributions received by a U.S. Holder on shares or ADSs, including the amount of any Spanish taxes withheld therefrom, other than certain pro rata distributions of shares to all shareholders (including ADS holders), will constitute foreign-source dividend income to the extent paid out of Telefónica's current or accumulated earnings and profits (as determined for U.S. federal income tax purposes). Because Telefónica does not maintain calculations of its earnings and profits under U.S. federal income tax principles, it is expected that distributions generally will be reported to U.S. Holders as dividends. The amount of dividend income paid in euro that a U.S. Holder will be required to include in income will equal the U.S. dollar value of the distributed euro, calculated by reference to the exchange rate in effect on the date the payment is received by the Depositary (in the case of ADSs) or by the U.S. Holder (in the case of shares), regardless of whether the payment is converted into U.S. dollars on the date of receipt. If the dividend is converted into U.S. dollars on the date of receipt, a U.S. Holder will generally not be required to recognize foreign currency gain or loss in respect of the dividend income. A U.S. Holder may have foreign currency gain or loss if the dividend is converted into U.S. dollars after the date of its receipt. Gain or loss that a U.S. Holder realizes on a sale or other disposition of euro will be U.S.-source ordinary income or loss. Corporate U.S. Holders will not be entitled to claim the dividends-received deduction with respect to dividends paid by Telefónica. Subject to applicable limitations and the discussion above regarding concerns expressed by the U.S. Treasury, dividends received by certain non-corporate U.S. Holders will be taxable at rates applicable to long-term capital gains. Non-corporate U.S. Holders should consult their own tax advisors to determine whether they are subject to any special rules that limit their ability to be taxed at these favorable rates.

Spanish income taxes withheld from dividends on shares or ADSs at a rate not exceeding the rate provided in the Treaty will be creditable against a U.S. Holder's U.S. federal income tax liability, subject to applicable restrictions and limitations that may vary depending upon the U.S. Holder's circumstances and the discussion above regarding concerns expressed by the U.S. Treasury. Spanish taxes withheld in excess of the rate applicable under the Treaty will not be eligible for credit against a U.S. Holder's federal income tax liability. See "Spanish Tax Considerations—Taxation of dividends" above for a discussion of how to obtain the applicable treaty rate. Instead of claiming a credit, a U.S. Holder may elect to deduct foreign taxes (including the Spanish taxes) in computing its taxable income, subject to generally applicable limitations. An election to deduct foreign taxes (instead of claiming foreign tax credits) applies to all taxes paid or accrued in the taxable year to foreign countries and possessions of the United States. The limitations



on foreign taxes eligible for credit are calculated separately with respect to specific classes of income. The rules governing foreign tax credits are complex. Therefore, U.S. Holders should consult their own tax advisors regarding the availability of foreign tax credits in their particular circumstances.

***Taxation upon sale or other disposition of shares or ADSs***

A U.S. Holder will generally recognize U.S. source capital gain or loss on the sale or other disposition of shares or ADSs. Any such gain or loss will be long-term capital gain or loss if the U.S. Holder has held such shares or ADSs for more than one year. The amount of the U.S. Holder's gain or loss will be equal to the difference between such U.S. Holder's tax basis in the shares or ADSs sold or otherwise disposed of and the amount realized on the sale or other disposition, as determined in U.S. dollars.

As discussed under "Spanish Tax Considerations—Taxation of capital gains" above, gain realized by a U.S. Holder on the sale or other disposition of shares or ADSs will be exempt from Spanish tax on capital gains under the Treaty. If a U.S. Holder is eligible for the exemption from Spanish tax on capital gains but does not follow appropriate procedures for obtaining the exemption, such holder will not be entitled to credit the amount of Spanish tax on capital gains paid against its U.S. federal income tax liability. U.S. Holders should consult their own tax advisors regarding the potential Spanish tax consequences of a sale or other disposition of shares or ADSs and the procedures available for an exemption from such tax.

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***Passive foreign investment company rules***

Telefónica believes that it was not a PFIC for U.S. federal income tax purposes for its 2015 taxable year. However, because PFIC status depends upon the composition of a company's income and assets and the market value of its assets (including, among others, less than 25% owned equity investments) from time to time, there can be no assurance that Telefónica will not be considered a PFIC for any taxable year. If Telefónica were treated as a PFIC for any taxable year during which a U.S. Holder owned a share or ADS, certain adverse tax consequences could apply to the U.S. Holder.

In general, if Telefónica were treated as a PFIC for any taxable year during which a U.S. Holder owned a share or ADS, gain recognized by a U.S. Holder on a sale or other disposition of such share or ADS would be allocated ratably over the U.S. Holder's holding period for the share or ADS. The amounts allocated to the taxable year of the sale or other disposition and to any year before Telefónica became a PFIC would be taxed as ordinary income. The amount allocated to each other taxable year would be subject to tax at the highest rate in effect for individuals or corporations, as appropriate, and an interest charge would be imposed on the resulting tax liability. The same treatment would apply to any distribution in respect of shares or ADSs to the extent it exceeds 125% of the average of the annual distributions on shares or ADSs received by the U.S. Holder during the preceding three years or the U.S. Holder's holding period, whichever is shorter. Certain elections may be available that would result in alternative treatments (such as mark-to-market treatment) of the shares or ADSs.

In addition, if Telefónica were treated as a PFIC in a taxable year in which it pays a dividend or in the prior taxable year, the favorable dividend rates discussed above with respect to dividends paid to certain non-corporate U.S. Holders would not apply.

If Telefónica were a PFIC for any taxable year during which a U.S. Holder owned our shares or ADSs, the U.S. Holder will generally be required to file IRS Form 8621 with its annual U.S. federal income tax return.

***Information reporting and backup withholding***

Payments of dividends and sales proceeds that are made within the United States or through certain U.S.-related financial intermediaries generally are subject to information reporting and may be subject to backup withholding unless the U.S. Holder is a corporation or other exempt recipient or, in the case of backup withholding, the U.S. Holder provides a correct taxpayer identification number and certifies that it is not subject to backup withholding. The

amount of any backup withholding from a payment to a U.S. Holder will be allowed as a credit against the U.S. Holder's U.S. federal income tax liability and may entitle such U.S. Holder to a refund, provided that the required information is timely furnished to the IRS.

Certain U.S. Holders who are individuals and certain specified entities, may be required to report information relating to stock of a non-U.S. person, subject to certain exceptions (including an exception for stock held through a U.S. financial institution). U.S. Holders are urged to consult their tax advisors regarding the application, if any, of this legislation to their ownership of shares or ADSs.

#### F. Dividends and Paying Agents

Not Applicable.

#### G. Statements by Experts

Not Applicable.

#### H. Documents on Display

#### Where You Can Find More Information

We file Annual Reports on Form 20-F and furnish periodic reports on Form 6-K to the SEC. You may read and copy any of these reports at the SEC's public reference room in Washington, D.C. Please call the SEC at 1-800-SEC-0330 for further information on the public reference rooms. Our SEC filings are also available to the public from commercial document retrieval services. Some of our SEC filings are also available at the website maintained by the SEC at "<http://www.sec.gov>."

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Our ADSs are listed on the New York Stock Exchange under the symbol “TEF.” You may inspect any periodic reports and other information filed with or furnished to the SEC by us at the offices of the New York Stock Exchange, 20 Broad Street, New York, New York 10005.

As a foreign private issuer, we are exempt from the rules under the Exchange Act which prescribe the furnishing and content of proxy statements, and our officers, directors and principal shareholders are exempt from the reporting and “short-swing” profit recovery provisions contained in Section 16 of the Exchange Act.

We are subject to the informational requirements of the Spanish securities commission and the Spanish Stock Exchanges, and we file reports and other information relating to our business, financial condition and other matters with the Spanish securities commission and the Spanish Stock Exchanges. You may read such reports, statements and other information, including the annual and biannual financial statements, at the public reference facilities maintained in Madrid and Barcelona. Some of our Spanish securities commission filings are also available at the website maintained by the CNMV at <http://www.cnmv.es>.

We have appointed Citibank, N.A. to act as Depositary for the Telefónica ADSs. Citibank will, as provided in the Deposit Agreement, arrange for the mailing of summaries in English of such reports and communications to all record holders of the ADSs of Telefónica. Any record holder of Telefónica ADSs may read such reports and communications or summaries thereof at Citibank’s office located at 388 Greenwich Street, 14th Floor, New York, New York 10013.

I. Subsidiary Information

Not applicable.

Item 11. Quantitative and Qualitative Disclosures About Market Risk

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

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The main market risks affecting us are as follows:

*a) Exchange rate risk*

Exchange rate risk arises primarily from (i) our international presence, through our investments and businesses in countries that use currencies other than the euro (primarily in Latin America, but also 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.

*b) Interest rate risk*

Interest rate risk arises primarily from 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.

*c) Share price risk*

Share price risk arises primarily from changes in the value of our 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 our treasury shares and from equity derivatives.

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

Furthermore, we are 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 we operate, especially in Latin America.

We seek to actively manage 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 stabilizing cash flows, our income statement and, to a lesser extent, part of the value of our investments. In this way, we attempt to protect our solvency, facilitate financial planning and take advantage of investment opportunities.

We manage our exchange rate risk and interest rate risk in terms of net debt and net financial debt as calculated by us. We believe that these parameters are more appropriate to understanding our debt position. Net debt and net financial debt take into account the impact of our cash balance and cash equivalents including derivatives positions with a positive value linked to liabilities. Neither net debt nor net financial debt as calculated by us should be considered an alternative to gross financial debt (the sum of current and non-current interest-bearing debt) as a measure of our leverage. For a more detailed description on reconciliation of net debt and net financial debt to gross financial debt, see “Item 5. Operating and Financial Review and Prospects—Presentation of Financial Information—Non-GAAP financial information—Net financial debt and net debt.”

For a more detailed description on quantitative and qualitative disclosures about market risks see Note 16 to our Consolidated Financial Statements.

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## Item 12. Description of Securities Other Than Equity Securities

## D. American Depositary Shares

The Depositary of our ADR program is Citibank, N.A., and the address of its principal executive office is 388 Greenwich Street, 14th Floor, New York, New York 10013.

Our ADSs are listed on the New York Stock Exchange under the symbol “TEF.” Each ADS represents the right to receive one ordinary share of capital stock of 1.00 euros nominal value each, of Telefónica, S.A. The Depositary issues ADSs in the form of certificated ADSs (American Depositary Receipts, or ADRs) or uncertificated ADSs pursuant to the Deposit Agreement.

Under the terms of the Deposit Agreement, as of the date of this Annual Report, an ADS holder may have to pay to the Depositary the services fees specified in the table below:

Category	Depositary Actions	Associated Fee / By Whom Paid
(a) Depositing or substituting the underlying shares	Issuance of ADSs upon the deposit of shares	Up to 5.00 dollars for each 100 ADSs (or portion thereof) evidenced by the new ADSs delivered (charged to person depositing the shares or receiving the ADSs)(1)
(b) Receiving or distributing dividends	Distribution of cash dividends or other cash distributions; distribution of share dividends or other free share distributions; distribution of securities other than ADSs or rights to purchase additional ADSs	Up to 5.00 dollars for each 100 ADSs (or portion thereof) held (in the case of cash distributions, deducted from the relevant distribution; in the case of all other distributions, billed to the relevant holder)(2)
(c) Selling or exercising rights	Distribution or sale of securities	Up to 5.00 dollars for each 100 ADSs (or portion thereof) held (billed to the relevant holder)
(d) Withdrawing an underlying security	Acceptance of ADSs surrendered for withdrawal of deposited securities	Up to 5.00 dollars for each 100 ADSs (or portion thereof) evidenced by the ADSs surrendered (charged to person surrendering or to person to whom

withdrawn securities are being delivered)(1)

(e) Transferring, splitting or grouping receipts	Transfers	Up to 1.50 dollars per ADS so presented (charged to person presenting certificate for transfer)
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(f) General depositary services, particularly those charged on an annual basis	Other services performed by the Depositary in administering the ADSs	Up to 5.00 dollars for each 100 ADSs (or portion thereof) held on the applicable record date (billed to person holding ADSs on applicable record date established by the Depositary)(2)
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Certain fees and expenses incurred by the depositary bank and certain taxes and governmental charges in connection with:

- compliance with foreign exchange control regulations or any law or regulation relating to foreign investment;
- the Depositary or its custodian's compliance with applicable law, rule or regulation;
- stock transfer or other taxes and other governmental charges;
- cable, telex, facsimile transmission/delivery;
- expenses of the Depositary in connection with the conversion of foreign currency into U.S. dollars (which are paid out of such foreign currency);
- any other charge payable by Depositary or its agents.

(g) Expenses of the Depositary

Expenses payable at the sole discretion of the Depositary (billed or deducted from cash distributions to person holding ADSs on applicable record date established by the Depositary)

(1) In the case of ADSs issued by the Depositary into DTC or presented to the Depositary via DTC, the ADS issuance and cancellation fees will be payable to the Depositary by DTC Participant(s) receiving the ADSs from the Depositary or the DTC Participant(s) surrendering the ADSs to the Depositary for cancellation, as the case may be, on behalf of the beneficial owner(s) and will be charged by the DTC Participant(s) to the account(s) of the applicable beneficial owner(s) in accordance with the procedures and practices of the DTC participant(s) as in effect at the time.

(2) For ADSs held through DTC, the Depositary fees for distributions other than cash and the Depositary service fee are charged by the Depositary to the DTC Participants in accordance with the procedures and practices prescribed by DTC from time to time and the DTC Participants in turn charge the amount of such fees to the beneficial owners for whom they hold ADSs.



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The Depositary has agreed to reimburse or pay on behalf of Telefónica, S.A., certain reasonable expenses related to our ADS program and incurred by us in connection with the program (such as NYSE listing fees, legal and accounting fees incurred in connection with the preparation of Form 20-F and ongoing SEC compliance and listing requirements, distribution of proxy materials, investor relations expenses, etc.). The Depositary has covered all such expenses incurred by us during 2015 for an amount of 6 million dollars. The amounts the Depositary reimbursed or paid are not perforce related to the fees collected by the depositary from ADS holders.

As part of its service to us, the Depositary has agreed to waive certain expenses for the standard costs associated with the administration of our ADS program for the year ended December 31, 2015.

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Part II

Item 13. Defaults, Dividend Arrearages and Delinquencies

None.

Item 14. Material Modifications to the Rights of Security Holders and Use of Proceeds

Not applicable.

Item 15. Controls and Procedures

**Disclosure Controls and Procedures**

Our Chief Executive Officer and our Chief Financial Officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) as of the end of the period covered by this Form 20-F, have concluded that, as of such date, our disclosure controls and procedures were effective.

**Management's Annual Report on Internal Control over Financial Reporting**

The management of Telefónica is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) under the Exchange Act. Telefónica's internal control system is designed to provide reasonable assurance as to the reliability of financial reporting and the preparation of the published financial statements under generally accepted accounting principles.

Any internal control system, no matter how well designed, has inherent limitations, including the possibility of human error and the circumvention or overriding of the controls and procedures, which may not prevent or detect

misstatements.

Telefónica management assessed the effectiveness of Telefónica's internal control over financial reporting as of December 31, 2015. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO 2013 framework) in Internal Control – Integrated Framework. Telefónica management has excluded from the scope of its assessment of internal control over financial reporting the operations and related assets of GVT, which Telefónica consolidates from May 1, 2015. Total assets and total revenues subject to GVT's internal control over financial reporting represented 2% and 2%, respectively, of Telefónica's consolidated total assets and total revenues as of and for the year ended December 31, 2015. Based on its assessment and those criteria, Telefónica management believes that at December 31, 2015, Telefónica's internal control over financial reporting is effective.

### **Report of the Independent Registered Public Accounting Firm**

Telefónica's independent registered public accounting firm, Ernst & Young, S.L., has issued a report on the effectiveness of the company's internal control over financial reporting. The report is included on page F-2.

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**Changes in Internal Control Over Financial Reporting**

There were no changes in our internal control over financial reporting during the period covered by this Annual Report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Item 16. [Reserved]

Item 16A. Audit Committee Financial Expert

Our Board of Directors has determined that Mr. Antonio Massanell Lavilla meets the requirements of an “audit committee financial expert” as such term is defined by the SEC.

Item 16B. Code of Ethics

Telefónica is governed by a code of business conduct and ethics called the Telefónica Business Principles. The Business Principles are binding on all employees globally, including senior officers, in their daily operations and on the Company in its relations with its stakeholders.

The standards set forth in the Telefónica Business Principles cover ethical issues such as honesty and trust, respect for the law, integrity and the respect of human rights, as well as how these ethical principles should be implemented in our relationships with our stakeholders: employees, customers, shareholders, suppliers and the communities we work in. Issues covered, amongst other, are professional development, health and safety, communications and advertising, corporate governance, risk management, anti-corruption, conflicts of interest, environmental protection, privacy and data protection, etc.

The Telefónica Business Principles are available and open to consultation for employees on the Telefónica Intranet site as well as for the general public on the Telefónica external website ([https://www.telefonica.com/en/web/about\\_telefonica/strategy/business-principles](https://www.telefonica.com/en/web/about_telefonica/strategy/business-principles)).

In 2015, the Company reinforced the description of its anti-corruption principles in the Integrity section. No waivers were granted in 2015.

For more information, please see “Item 16G. Corporate Governance - Code of Ethics.”

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Item 16C. Principal Accountant Fees and Services

Please see Note 21(d) to our Consolidated Financial Statements.

**The Audit and Control Committee's Pre-Approval Policies and Procedures**

The engagement of any service rendered by our external auditor or any of its affiliates must always have the prior approval of our Audit and Control Committee. Such Committee has developed a Pre-approval Policy regarding the engagement of professional services by our external auditor, in accordance with the Spanish Audit Law and the Sarbanes-Oxley Act. This Policy establishes the obligation to obtain prior approval from our Audit and Control Committee for any service to be rendered by our external auditor to Telefónica or any of its subsidiaries.

This Policy sets forth restrictions on engaging our external auditor for the performance of non-audit services, according to which the engagement of our external auditor for the provision of such services is only permitted when there is no other firm available to provide the needed services at a comparable cost and with a similar level of quality. Moreover, this Policy prohibits the engagement of our external auditor for the provision of certain type of services that would be considered as "prohibited services."

In addition, the Audit and Control Committee oversees the total amount of fees paid to our external auditor for the provision of non-audit services in order to assure that such fees do not exceed a certain percentage of the total amount of fees paid for the provision of audit services.

Item 16D. Exemptions from the Listing Standards for Audit Committees

Not applicable.

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## Item 16E. Purchases of Equity Securities by the Issuer and Affiliated Purchasers

The number of shares of treasury stock at December 31, 2015, amounted to 141,639,159 (128,227,971 at December 31, 2014). These treasury shares are directly owned by Telefónica, S.A.

Year ended December 31, 2015

Period of Fiscal Year	Total Number of Shares Purchased	Average Price Paid per Share (euro)	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs(1)
January 1 to January 31	9,000,000	11.54	19,597
February 1 to February 28	10,460,000	13.24	-
March 1 to March 31	10,125,000	12.69	113,449
April 1 to April 30	-	-	-
May 1 to May 31	10,560,180	13.11	-
June 1 to June 30	12,145,825	12.32	-
July 1 to July 31	4,600,000	12.90	13,177
August 1 to August 31	9,973,835	13.34	269,737
September 1 to September 30	33,405,693	11.38	320,389
October 1 to October 31	11,421,390	11.28	7,697,702
November 1 to November 30	10,219,527	11.93	301,199
December 1 to December 31	16,125,000	10.65	344,088
Total	138,036,450	11.98	9,079,338

(1) Under employee share plans a maximum of 9,079,338 shares could be assigned to employees participating in voluntary plans. See Note 19 to our Consolidated Financial Statements.

For a more detailed description of our plans or programs, see “Item 8. Financial Information—Dividend Information and Shareholders’ Return” and Note 19 to our Consolidated Financial Statements.

## Item 16F. Change in Registrant’s Certifying Accountant

During the years ended December 31, 2014 and 2015 and through the date of this Annual Report, the principal independent accountant engaged to audit our financial statements, Ernst & Young, S.L., has not resigned, indicated that it has declined to stand for re-election after the completion of its current audit or been dismissed. For each of the years ended December 31, 2014 and 2015, Ernst & Young, S.L. has not expressed reliance on another accountant or accounting firm in its report on our audited annual accounts for such periods.





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Item 16G. Corporate Governance

Significant Differences in Corporate Governance Practices

*Corporate governance guidelines*

In Spain, companies with securities listed on a Spanish Stock Exchange are expected to follow the Good Governance Code of Listed Companies (“the Code”) published in February 2015, which contains corporate governance and shareholder disclosure recommendations. Spanish listed companies are required by law to publish an Annual Report on Corporate Governance and a Report on the Compensation Policy of the Board of Directors. Additionally, Spanish listed companies are required to publish their corporate governance information on their websites. We base our corporate governance procedures on the recommendations of the Code. As part of our corporate governance procedures, we have adopted regulations for our Board of Directors that govern, among other things, director qualification standards, responsibilities, compensation, access to management information, the Board of Directors’ purpose and each of our Board Committee’s purpose and responsibilities. Moreover, we have a Regulation of the General Shareholders’ Meeting that aims to reinforce its transparency, providing shareholders with a framework guaranteeing and facilitating exercise of their rights. The Annual Report on Corporate Governance published by us provides a detailed explanation of our corporate governance procedures and explains the role and duties of our Board of Directors and Board Committees. Our Annual Report on Corporate Governance and the Report on the Compensation Policy of the Board of Directors of Telefónica, S.A. are available on our website at [www.telefonica.com](http://www.telefonica.com). None of the information contained on our website is incorporated in this Annual Report.

*Committees*

We have had an Audit and Control Committee since 1997. Our Audit and Control Committee is composed of five non-executive directors, all of whom are deemed Rule 10A-3 independent by our Board of Directors. The functions, composition and competencies of this Committee are regulated by the Board of Directors’ Regulations and are similar to those required by the New York Stock Exchange. The Audit and Control Committee shall consist of not less than three directors appointed by our Board of Directors. All Committee members shall be external directors. When appointing such members, our Board of Directors shall take into account the appointees’ knowledge and experience in matters of accounting, auditing and risk management.

We have had a Nominating, Compensation and Corporate Governance Committee since 1997, which is composed of five external directors. The functions, composition and competencies of this Committee are regulated by the Board of Directors’ Regulations and are very similar to those required by the NYSE. The Nominating, Compensation and

Corporate Governance Committee shall consist of not less than three directors appointed by the Board of Directors. All members of the Committee must be external directors and the majority thereof must be independent. 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.

Additionally we have a Regulation Committee, a Service Quality and Customer Service Committee, an Institutional Affairs Committee, an Innovation Committee and a Strategy Committee. The functions, composition and competencies are regulated by the Board of Directors' Regulations.

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***Independence of the Board***

As of the date of this Annual Report, we have 18 directors, out of which seven have been deemed independent by our Board of Directors attending to the director's classification contained in Good Governance Code of Listed Companies. A significant majority of our current directors, 15, are non-executive directors. We, in accordance with the Code, assess the independence of our directors. Among other things, independent directors: (i) shall not be, past employees or executive directors of any of the Group companies, unless three or five years have elapsed, respectively, (ii) shall not receive any payment or other form of compensation from us or our group on top of their directors' fees, unless the amount involved is not significant, (iii) shall not be partners, now or on the past three years, in the external auditor or in the firm responsible for the audit report, (iv) shall not be executive directors or senior officers of another company where one of our executive directors or senior officers is an external director, (v) shall not have material business dealings with us or any other company in our group, (vi) shall not be spouses, nor partners maintaining an analogous affective relationship, nor close relative of any of our executive directors or senior officers and (vii) shall not stand in any of the situations listed in (i), (v) or (vi) above in relation to a significant shareholder or a shareholder with board representation.

The classification 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 classification shall be reviewed annually by our Board of Directors after verification by the Nominating, Compensation and Corporate Governance Committee, and reported in the Annual Corporate Governance Report.

***Internal Audit Function***

We have an Internal Audit Department responsible for internal audit matters and for ensuring the efficiency of the internal audit control process of our different units. This Internal Audit Department reports directly to the Audit and Control Committee, thus supporting the adequate performance of all its functions.

***Non-Executive Director Meetings***

Pursuant to the NYSE listing standards, non-executive directors of U.S.-listed companies must meet on a regular basis without management present and the company must disclose a method for any interested parties to communicate directly with the non-executive directors. As a group, our non-executive directors do not meet formally without management present. Nevertheless, each of the Audit and Control Committee, the Nominating, Compensation and Corporate Governance Committee, the Institutional Affairs Committee, and the Innovation Committee is composed exclusively of non-executive directors, thus giving each of these committees, the chance to analyze and discuss any

matter related to our management, within its respective area of responsibility.

In addition, since May 2013, we have a lead independent director who acts as “Coordinating Independent Director”, who our By-laws grant the right to have a say on key elements of governance structure that most companies in Spain and around the world, reserve to the Board of Directors.

According to our By-laws (Art. 32) the independent director who acts as “Coordinating Independent Director”, shall carry out the following duties and tasks:

- a) Coordinate the work of the External Directors that the Company has appointed, in defense of the interests of all the shareholders of the Company, and echo the concerns of such Directors.
- b) Request the Chairman of the Board of Directors to call meetings of the Board where appropriate in accordance with the rules of corporate governance.
- c) Request, consequently, the inclusion of certain matters in the agenda of the meetings of the Board of Directors.
- d) Oversee the evaluation by the Board of Directors of the Chairman thereof.

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***Whistleblowing***

We have procedures in place that allow any employee to anonymously and confidentially report instances of fraud, alterations of financial information or specific risks to Telefónica and its subsidiaries.

***Code of Ethics***

The NYSE listing standards require U.S. companies to adopt a code of business conduct and ethics for directors, officers and employees, and promptly disclose any waivers of the code for directors or executive officers. In 2004 we adopted, as required by the Sarbanes-Oxley Act, a code of ethics that applied to our principal executive officer, principal financial officer and to our senior financial officers. In December 2006, we adopted a code of business conduct and ethics, the “Telefónica Business Principles,” which apply to all Telefónica Group employees. In March 2008, we decided to modify such Business Principles in order to incorporate within them all components of the code of ethics definition in Section 406 of Sarbanes Oxley Act, and consequently our code of ethics for senior officers was replaced by such Business Principles. These Principles were further modified in 2010 in order to include a new principle of privacy and data protection and in 2015 to reinforce certain anti-corruption principles.

We also have an Internal Code of Conduct for securities markets issues to prevent insider trading misconduct and to control possible conflicts of interest. In addition, the Regulations of the Board of Directors set out in detail our directors’ main obligations relating to conflicts of interest concerning business opportunities, misappropriation of our assets, confidentiality and non-competition.

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Part III

Item 17. Financial Statements

We have responded to Item 18 in lieu of responding to this Item.

Item 18. Financial Statements

Please see pages F-4 through F-189.

Item 19. Exhibits

Exhibit Number	Description
1.1	Amended and Restated bylaws (English translation)
4.1	Subscription Agreement, dated September 6, 2009 between Telefónica, S.A. and China Unicom (Hong Kong) Limited*
4.2	Enhanced Strategic Alliance Agreement dated January 23, 2011 between Telefónica, S.A. and China Unicom (Hong Kong) Limited **
4.3	Share Purchase Agreement for the Sale and Purchase of Shares in China Unicom (Hong Kong) Limited, dated June 10, 2012 and Supplemental Agreement, dated July 21, 2012, between Telefónica, Internacional S.A.U. and a 100% owned subsidiary of China United Network Communications Group Company Limited ***
4.4	Agreement for the Sale and Purchase of Customer Relationship Management business, Atento, dated October 11, 2012 ****
4.5	Stock Purchase Agreement and Other Covenants, dated September 18, 2014, by and among Vivendi, S.A., Société d'Investissements et de Gestion 72 S.A. and Société d'Investissements et de Gestion 108 SAS, as the sellers, Telefônica Brasil S.A., as purchaser, GVT Participações S.A., as target, Global Village Telecom S.A. and Telefónica, S.A. (1) *****
4.6	Long Term Incentive Plan Terms *****
4.7	Agreement for the sale and purchase of the entire issued share capital of Telefónica Europe plc. between Telefónica, S.A., Hutchison 3G UK Investments Limited and Hutchison 3G UK Holdings (CI) Limited dated March 24, 2015 (1)
8.1	Subsidiaries of Telefónica (see Note 1 to the Consolidated Financial Statements and Appendix VI thereto)
12.1	

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Certification of César Alierta Izuel, Chief Executive Officer of Telefónica, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

12.2 Certification of Miguel Escrig Meliá, Chief Financial Officer of Telefónica, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

13.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

15.1 Consent of Independent Registered Public Accounting Firm

\* Incorporated by reference to Telefónica's Schedule 13D/A filed on September 17, 2009.

\*\* Incorporated by reference to Telefónica's Schedule 13D filed on February 8, 2011.

\*\*\* Incorporated by reference to Telefónica's Schedule 13 D/A filed on June 13, 2012 and Schedule 13 D/A filed on August 1, 2012, respectively.

\*\*\*\* Incorporated by reference to Telefónica's Annual Report on Form 20-F for the fiscal year ended December 31, 2012.

\*\*\*\*\* Incorporated by reference to Telefónica's Annual Report on Form 20-F for the fiscal year ended December 31, 2013.

\*\*\*\*\* Incorporated by reference to Telefónica's Annual Report on Form 20-F for the fiscal year ended December 31, 2014.

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(1) Confidential treatment has been requested with respect to certain portions of this agreement. Confidential portions have been redacted and separately filed with the SEC.

We agree to furnish to the SEC upon request, copies of the instruments defining the rights of the holders of our long-term debt and of our subsidiaries' long-term debt.

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**SIGNATURES**

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and has duly caused and authorized the undersigned to sign this Annual Report on its behalf.

TELEFÓNICA, S.A.

By: /s/ César Alierta Izuel

Name: César Alierta Izuel

Title: Chief Executive Officer

TELEFÓNICA, S.A.

By: /s/ Miguel Escrig Meliá

Name: Miguel Escrig Meliá

Title: Chief Financial Officer

Date: February 26, 2016

2015

Consolidated Financial Statements (Consolidated Annual Accounts)

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

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Shareholders of

Telefónica, S.A.

We have audited Telefónica, S.A.'s internal control over financial reporting as of December 31, 2015, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). Telefónica, S.A.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on Telefónica, S.A.'s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As indicated in the accompanying Annual Report on Internal Control over Financial Reporting, Telefónica, S.A.'s assessment of the effectiveness of internal control over financial reporting did not include the internal controls of GVT, consolidated from May 1, 2015, which is included in the 2015 consolidated financial statements and constituted 2% of total assets as of December 31, 2015 and 2% of total revenues for the year then ended. Our audit of the internal control over financial reporting of Telefónica, S.A. also did not include an evaluation of the internal control over financial reporting of GVT.

In our opinion, Telefónica, S.A. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated statements of financial position of Telefónica, S.A. and subsidiaries as of December 31, 2015 and 2014, and the related consolidated statements of income, comprehensive income, changes in equity, and cash flows for each of the three years in the period ended December 31, 2015 and our report dated February 26, 2016 expressed an unqualified opinion thereon.

ERNST & YOUNG, S.L.

/s/ Ignacio Viota del Corte

Ignacio Viota del Corte

Madrid, Spain

February 26, 2016

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Shareholders of

Telefónica, S.A.

We have audited the accompanying consolidated statements of financial position of Telefónica, S.A. and subsidiaries as of December 31, 2015 and 2014, and the related consolidated statements of income, comprehensive income, changes in equity, and cash flows for each of the three years in the period ended December 31, 2015. These consolidated financial statements are the responsibility of Telefónica, S.A.'s Directors. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Telefónica, S.A. and subsidiaries as of December 31, 2015 and 2014, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2015, in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Telefónica, S.A.'s internal control over financial reporting as of December 31, 2015, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated February 26, 2016 expressed an unqualified opinion thereon.

ERNST & YOUNG, S.L.

/s/ Ignacio Viota del Corte

Ignacio Viota del Corte

Madrid, Spain

February 26, 2016

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## Consolidated Statements of financial position at December 31

Millions of euros	Note	2015	2014 (*)
<b>ASSETS</b>			
<b>A) NON-CURRENT ASSETS</b>			
Intangible assets	(Note 6)	91,398	99,448
Goodwill	(Note 7)	18,562	22,227
Property, plant and equipment	(Note 8)	21,745	25,437
Investments accounted for by the equity method	(Note 9)	30,549	33,156
Non-current financial assets	(Note 13)	74	788
Deferred tax assets	(Note 17)	10,008	10,973
<b>B) CURRENT ASSETS</b>		10,460	6,867
Inventories		31,576	22,900
Trade and other receivables	(Note 11)	1,360	934
Tax receivables	(Note 17)	8,301	10,637
Current financial assets	(Note 13)	1,341	1,749
Cash and cash equivalents	(Note 13)	2,971	2,932
Non-current assets and disposal groups classified as held for sale	(Note 2)	2,599	6,529
<b>TOTAL ASSETS (A+B)</b>		15,004	119
		122,974	122,348
	Note	2015	2014 (*)
<b>EQUITY AND LIABILITIES</b>			
<b>A) EQUITY</b>			
Equity attributable to equity holders of the parent and other holders of equity instruments	(Note 12)	27,556	30,321
Equity attributable to non-controlling interests	(Note 12)	17,891	21,135
<b>B) NON-CURRENT LIABILITIES</b>		9,665	9,186
Non-current interest-bearing debt	(Note 13)	60,549	62,318
Non-current trade and other payables	(Note 14)	47,117	50,688
Deferred tax liabilities	(Note 17)	2,381	2,384
Non-current provisions	(Note 15)	2,313	2,566
<b>C) CURRENT LIABILITIES</b>		8,738	6,680
Current interest-bearing debt	(Note 13)	34,869	29,709
Current trade and other payables	(Note 14)	12,953	9,094
Current tax payables	(Note 17)	14,235	16,951
Current provisions	(Note 15)	1,769	2,026
Liabilities associated with non-current assets held for sale	(Note 2)	1,971	1,595
<b>TOTAL EQUITY AND LIABILITIES (A+B+C)</b>		3,941	43
		122,974	122,348

(\*) Revised data as a consequence of the finalization of the purchase price allocation of E-Plus (see Note 5).

The accompanying Notes 1 to 24 and Appendices I to VII are an integral part of these consolidated statements of financial position.

## Consolidated income statements for the years ended December 31

Millions of euros	Notes	2015	2014 (*)	2013 (*)
<b>INCOME STATEMENTS</b>				
Revenues	(Note 18)	47,219	43,458	50,547
Other income	(Note 18)	1,841	1,521	1,491
Supplies		(12,910)	(11,750)	(13,758)
Personnel expenses	(Note 18)	(9,800)	(6,621)	(6,659)
Other expenses	(Note 18)	(14,936)	(12,827)	(14,144)
Depreciation and amortization	(Note 18)	(8,517)	(7,431)	(8,616)
<b>OPERATING INCOME</b>		<b>2,897</b>	<b>6,350</b>	<b>8,861</b>
<b>Share of loss of investments accounted for by the equity method</b>	<b>(Note 9)</b>	<b>(5)</b>	<b>(498)</b>	<b>(291)</b>
Finance income		2,090	981	923
Exchange gains		6,489	4,103	3,321
Finance costs		(4,400)	(3,460)	(3,598)
Exchange losses		(6,760)	(4,403)	(3,488)
Net financial expense	(Note 16)	(2,581)	(2,779)	(2,842)
<b>PROFIT BEFORE TAX</b>		<b>311</b>	<b>3,073</b>	<b>5,728</b>
Corporate income tax	(Note 17)	(13)	(260)	(1,201)
Profit after tax from continuing operations		298	2,813	4,527
Profit after tax from discontinued operations	(Note 23)	2,582	439	442
<b>PROFIT FOR THE YEAR</b>		<b>2,880</b>	<b>3,252</b>	<b>4,969</b>
Non-controlling interests	(Note 12)	(135)	(251)	(376)
<b>PROFIT FOR THE YEAR ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT</b>		<b>2,745</b>	<b>3,001</b>	<b>4,593</b>
Basic and diluted earnings (loss) per share from continuing operations attributable to equity holders of the parent (euros)	(Note 18)	(0.02)	0.50	0.87
Basic and diluted earnings per share from discontinued operations attributable to equity holders of the parent (euros)	(Note 18)	0.52	0.09	0.09
Basic and diluted earnings per share attributable to equity holders of the parent (euros)	(Note 18)	0.51	0.60	0.96

(\*) Revised data to reflect the results of Telefónica's operations in the United Kingdom as discontinued operations (see Note 23).

The accompanying Notes 1 to 24 and Appendices I to VII are an integral part of these consolidated income statements.



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Consolidated statements of comprehensive income for the years ended December 31	2015	2014 (*)	2013 (*)
Millions of euros			
Profit for the year	2,880	3,252	4,969
Other comprehensive income (loss)			
Gains (losses) on measurement of available-for-sale investments	415	(45)	32
Income tax impact	(123)	7	(10)
Reclassification of (gains) losses included in the income statement	(539)	–	51
Income tax impact	139	–	(15)
	(108)	(38)	58
(Losses) gains on hedges	(14)	(507)	831
Income tax impact	(37)	127	(247)
Reclassification of losses included in the income statement (Note 16)	207	163	121
Income tax impact	(58)	(49)	(36)
	98	(266)	669
Share of gains (losses) recognized directly in equity of associates and others	17	(27)	(29)
Income tax impact	(4)	3	4
Reclassification of losses included in the income statement	–	103	1
Income tax impact	–	(24)	–
	13	55	(24)
Translation differences (Note 12)	(6,771)	(2,810)	(6,454)
Total other comprehensive loss (income) recognized in the period (Items that may be reclassified subsequently to profit or loss)	(6,768)	(3,059)	(5,751)
Actuarial gains (losses) and impact of limit on assets for defined benefit pension plans	94	(173)	(49)
Income tax impact	(32)	38	1
	62	(135)	(48)
Total other comprehensive income (loss) recognized in the period (Items that will not be reclassified subsequently to profit or loss)	62	(135)	(48)
Total comprehensive loss (income) recognized in the year	(3,826)	58	(830)
Attributable to:			
Equity holders of the parent and other holders of equity instruments	(2,415)	(258)	(434)
Non-controlling interests	(1,411)	316	(396)
	(3,826)	58	(830)
Total comprehensive income (loss) attributable to equity holders of the parent and others of equity instruments arises from:			
Continuing operations	(5,348)	(1,111)	(744)
Discontinued operations	2,933	853	310
	(2,415)	(258)	(434)

(\*) Revised data reflect the results of Telefónica's operations in the United Kingdom as discontinued operations (see Note 23).

The accompanying Notes 1 to 24 and Appendices I to VII are an integral part of these consolidated statements of comprehensive income.

Consolidated  
statements of  
changes in  
equity for the  
year ended  
December 31,  
2015

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	Available-for-sale investments	Hedges	Equity of associates and others	Translation differences	Total
Financial position at December 31, 2014 (*)	4,657	460	(1,586)	6,351	984	22,656	55	(334)	24	(12,132)	21,133
Profit for the year	–	–	–	–	–	2,745	–	–	–	–	2,745
Other comprehensive income (loss) for the year	–	–	–	–	–	43	(108)	103	12	(5,210)	(5,160)
Total comprehensive income (loss) for the year	–	–	–	–	–	2,788	(108)	103	12	(5,210)	(2,415)
Dividends paid (Note 12)	111	–	–	–	–	(2,360)	–	–	–	–	(2,249)
Net movement in treasury shares	–	–	(1,511)	–	–	(75)	–	–	–	–	(1,586)
Acquisitions and disposals of non-controlling interests and business combinations (Note 5)	–	–	555	–	–	(1,297)	–	–	–	628	(114)
Capital increase (Note 12)	281	2,767	–	–	–	(41)	–	–	–	–	3,007
Capital reduction (Note (74) 12)	–	–	886	–	–	(812)	–	–	–	–	–
Undated Deeply Subordinated Securities (Note 12)	–	–	–	452	–	(247)	–	–	–	(84)	121
Other movements	–	–	–	–	–	(8)	–	–	–	–	(8)
Financial position at December 31,	4,975	3,227	(1,656)	6,803	984	20,604	(53)	(231)	36	(16,798)	17,893

2015

(\* Revised data due to the finalization of the purchase price allocation of E-Plus (see Note 5).

The accompanying Notes 1 to 24 and Appendices I to VII are an integral part of these consolidated statements of changes in equity.

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Consolidated  
statements of  
changes in equity  
for the year  
ended December  
31, 2014 and  
2013

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	Available-for-sale investments	Hedges	Equity of associates and others	Translation differences	Total
Financial position at December 31, 2013	4,551	460	(544)	2,466	984	22,517	94	(37)	(31)	(9,275)	21,1
Profit for the year	–	–	–	–	–	3,001	–	–	–	–	3,00
Other comprehensive income (loss) for the year	–	–	–	–	–	(121)	(39)	(297)	55	(2,857)	(3,25
Total comprehensive income (loss) for the year	–	–	–	–	–	2,880	(39)	(297)	55	(2,857)	(258
Dividends paid (Note 12)	106	–	–	–	–	(2,138)	–	–	–	–	(2,03
Net movement in treasury shares	–	–	(1,042)	–	–	(113)	–	–	–	–	(1,15
Acquisitions and disposals of non-controlling interests and business combinations (Note 5)	–	–	–	–	–	(307)	–	–	–	–	(307
Undated Deeply Subordinated Securities (Note 12)	–	–	–	3,885	–	(129)	–	–	–	–	3,75
Other movements	–	–	–	–	–	(54)	–	–	–	–	(54)
Financial position at December 31, 2014 (*)	4,657	460	(1,586)	6,351	984	22,656	55	(334)	24	(12,132)	21,1
Financial position at December 31, 2012	4,551	460	(788)	–	984	19,569	36	(715)	(7)	(3,629)	20,4

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Profit for the year	-	-	-	-	-	4,593	-	-	-	-	4,593
Other comprehensive income (loss) for the year	-	-	-	-	-	(48)	58	678	(24)	(5,691)	(5,002)
Total comprehensive income (loss) for the year	-	-	-	-	-	4,545	58	678	(24)	(5,691)	(434)
Dividends paid (Note 12)	-	-	-	-	-	(1,588)	-	-	-	-	(1,588)
Net movement in treasury shares	-	-	244	-	-	(92)	-	-	-	-	152
Acquisitions and disposals of non-controlling interests and business combinations (Note 5)	-	-	-	-	-	66	-	-	-	45	111
Undated Deeply Subordinated Securities (Note 12)	-	-	-	2,466	-	-	-	-	-	-	2,466
Other movements	-	-	-	-	-	17	-	-	-	-	17
Financial position at December 31, 2013	4,551	460	(544)	2,466	984	22,517	94	(37)	(31)	(9,275)	21,100

(\*) Revised data due to the finalization of the purchase price allocation of E-Plus (see Note 5).

The accompanying Notes 1 to 24 and Appendices I to VII are an integral part of these consolidated statements of changes in equity.

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Consolidated statements of cash flows for the years ended December 31				
Millions of euros	NOTES	2015	2014(*)	2013(*)
Cash received from customers		57,705	53,315	61,008
Cash paid to suppliers and employees		(42,800)	(38,825)	(43,923)
Dividends received		45	48	49
Net interest and other financial expenses paid		(2,455)	(2,553)	(2,464)
Taxes paid		(664)	(1,106)	(1,763)
Net cash flow provided by operating activities from continuing operations		11,831	10,879	12,907
Net cash flow provided by operating activities from discontinued operations	(Note 23)	1,784	1,314	1,437
Net cash flow provided by operating activities	(Note 20)	13,615	12,193	14,344
Proceeds on disposals of property, plant and equipment and intangible assets		254	310	330
Payments on investments in property, plant and equipment and intangible assets		(9,401)	(8,305)	(8,200)
Proceeds on disposals of companies, net of cash and cash equivalents disposed		373	3,614	260
Payments on investments in companies, net of cash and cash equivalents acquired		(3,178)	(5,014)	(368)
Proceeds on financial investments not included under cash equivalents		1,064	266	50
Payments on financial investments not included under cash equivalents		(286)	(198)	(356)
(Payments)/proceeds on placements of cash surpluses not included under cash equivalents		(584)	221	(321)
Government grants received		7	30	1
Net cash flow used in investing activities from continuing operations		(11,751)	(9,076)	(8,604)
Net cash flow used in investing activities from discontinued operations	(Note 23)	(1,166)	(892)	(1,296)
Net cash flow used in investing activities	(Note 20)	(12,917)	(9,968)	(9,900)
Dividends paid	(Note 12)	(2,775)	(2,328)	(2,182)
Proceeds from issue of share capital increase	(Note 12)	4,255	814	377
(Payments)/proceeds of treasury shares and other operations with shareholder	(Note 12)	(1,772)	(1,241)	(312)
Operations with other equity holders	(Note 12)	83	3,713	2,466
Proceeds on issue of debentures and bonds, and other debts	(Note 13)	1,602	4,453	5,634
Proceeds on loans, borrowings and promissory notes		8,770	4,290	3,212
Cancellation of debentures and bonds, and other debts	(Note 13)	(3,805)	(5,116)	(5,667)
Repayments of loans, borrowings and promissory notes		(9,844)	(8,604)	(6,232)
Financed operating payments and investments in property, plant and equipment and intangible assets payments		(126)	(22)	–
Net cash used in financing activities from continuing operations		(3,612)	(4,041)	(2,704)
Net cash provided by in financing activities from discontinued operations	(Note 23)	–	–	18
Net cash used in financing activities	(Note 20)	(3,612)	(4,041)	(2,685)
Effect of changes in exchange rates		(999)	(1,616)	(1,468)
Effect of changes in consolidation methods and others		(17)	(16)	(161)
Net increase (decrease) in cash and cash equivalents during the year		(3,930)	(3,448)	130

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CASH AND CASH EQUIVALENTS AT JANUARY 1		6,529	9,977	9,847
CASH AND CASH EQUIVALENTS AT DECEMBER 31	(Note 13)	2,599	6,529	9,977
RECONCILIATION OF CASH AND CASH EQUIVALENTS WITH THE STATEMENT OF FINANCIAL POSITION				
BALANCE AT JANUARY 1		6,529	9,977	9,847
Cash on hand and at banks		4,912	7,834	7,973
Other cash equivalents		1,617	2,143	1,874
BALANCE AT DECEMBER 31	(Note 13)	2,599	6,529	9,977
Cash on hand and at banks		1,262	4,912	7,834
Other cash equivalents		1,337	1,617	2,143

(\*) Revised data to reflect the cash flows of Telefónica UK as discontinued operation (see Note 23). The accompanying Notes 1 to 24 and Appendices I to VII are an integral part of these consolidated statements of cash flows.

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

Notes to the consolidated financial statements (consolidated annual accounts) for the year ended December 31, 2015

Note 1. Background and general information

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

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

Appendix VI 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.

The website [www.telefonica.com](http://www.telefonica.com) provides more information about the organizational structure of the Group, the sectors in which it operates and the products it offers.

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

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



Note 2. Basis of presentation of the consolidated financial statements

The accompanying consolidated financial statements were prepared from the accounting records of Telefónica, S.A. and of each of the companies comprising the Telefónica Group, whose separate financial statements were prepared in accordance with the generally accepted accounting principles prevailing 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) as issued by the International Accounting Standards Board (IASB), which for the purposes of the Telefónica Group are not different from those adopted by the European Union, to give a true and fair view of the consolidated equity and financial position at December 31, 2015, 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 figures in these consolidated financial statements are expressed in millions of euros, unless otherwise indicated, and therefore may be rounded. The euro is the Group's reporting currency.

The accompanying consolidated financial statements for the year ended December 31, 2015 were approved by the Telefónica, S.A.'s Board of Directors at its meeting on February 24, 2016 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.

Materiality criteria

These consolidated 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 IFRS conceptual framework, insofar as the Telefónica Group 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 statements for 2015 include the figures for 2014, 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, they also include those of 2013.

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The consolidated income statements, the statements of comprehensive income and the statements of cash flows for 2014 and 2013 have been revised to show the results of Telefónica United Kingdom as discontinued operations (see Note 23). In addition, the consolidated statement of financial position as of December 31, 2014 has been revised to show the finalization of the purchase price allocation of E-Plus (see Note 5).

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The main events and changes in the consolidation scope affecting comparability of the consolidated information for 2015 and 2014 (see Appendix I for a more detailed explanation of the changes in consolidation scope) are as follows:

*a) Agreement to sell Telefónica's operations in the United Kingdom*

On March 24, 2015 Telefónica, S.A. signed an agreement with the Hutchison 3G UK Investments Limited and Hutchison 3G UK Holdings (CI) limited (together, "Hutchison") to acquire Telefónica's operations in the United Kingdom (see Note 21).

In accordance with IFRS 5, the companies included in the agreement have been recognized as a disposal group held for sale from that date and its operations classified as discontinued operations (see Note 23). Therefore:

The consolidated assets and liabilities subject to the transaction have been reclassified under "Non-current assets and disposal groups held for sale" and "Liabilities associated with non-current assets and disposal groups held for sale", respectively, in the consolidated statement of financial position at December 31, 2015.

The non-current assets ceased to be amortized and depreciated for accounting purposes once they were reclassified as assets held for sale.

The results of Telefónica United Kingdom are reported under "Profit after tax from discontinued operations" in the consolidated income statements for 2015 and comparative periods.

The cash flows of Telefónica United Kingdom are reported separately from continuing operations in the consolidated statements of cash flows for 2015 and comparative periods.

*b) Acquisition of 100% stake in GVT*

Once the pertinent regulatory authorizations were obtained, Telefônica Brasil, S.A. acquired from Vivendi, S.A. the 100% of the share capital of Global Village Telecom, S.A. and its holding company GVT Participações, S.A. (collectively "GVT").

Consequently, the Group consolidates GVT from May 1, 2015 using the full consolidation method. The main impacts are detailed in Note 5.

*c) Acquisition of 56% stake in Distribuidora de Televisión Digital, S.A. (DTS)*

Once the pertinent regulatory authorizations were obtained, on April 30, 2015 Telefónica, through its subsidiary Telefónica de Contenidos, S.A.U. acquired 56% of the share capital of Distribuidora de Televisión Digital, S.A. (DTS) from Promotora de Informaciones, S.A. (PRISA).

Following the transaction, the Telefónica Group holds 100% of the share capital of DTS, which was incorporated in the consolidation perimeter from April 30, 2015 under the full consolidation method, in the Telefónica Spain segment. The 44% stake in DTS held prior to the transaction was accounted for by the equity method. The main impacts of this transaction are explained in Note 5.

*d) Demerger of Telco and sale of the ownership interest in Telecom Italia, S.p.A.*

In 2015 the demerger of Telco, S.p.A. was formalized, thereafter Telefónica received the assets and liabilities equivalent to its interest in this entity (see Note 13), which were presented as a financial asset available for sale at 2014 year end.

In this same period, Telefónica divested of its entire stake in Telecom Italia, S.p.A., in accordance with the regulatory and competition commitments assumed, and settled the shareholders loan assumed.

The related transactions with this divestment are described in detail in Note 13.

*e) Acquisition of E-Plus*

Telefónica finalized the E-Plus Mobilfunk GmbH & Co KG (E-Plus) purchase on October 1, 2014, once the approval of the European Commission was obtained and the share capital increase by Telefónica Deutschland Holding, A.G. to finance the operation was completed.

Following the acquisition of E-Plus, the Telefónica Group's stake in Telefónica Deutschland Holding, A.G. decreased from 76.83% to 62.1%. The Group consolidates E-Plus from October 1, 2014 using the full consolidation method. The main impacts are detailed in Note 5.

*f) Sale of ownership interest in Telefónica Ireland, Ltd.*

In June 2013 Telefónica reached an agreement with Hutchison Whampoa Group for the sale of Telefónica's 100% participation in Telefónica Ireland, Ltd. for 850 million euros, including an initial cash consideration of 780 million euros to be paid at the closing of the transaction, and an additional deferred payment of 70 million euros to be settled based on the completion of agreed financial objectives.

The sale was concluded on July 15, 2014, once the pertinent regulatory authorizations were obtained.

*g) Sale of ownership interest in Telefónica Czech Republic, a.s.*

On November 5, 2013 Telefónica reached an agreement to sell 65.9% of Telefónica Czech Republic, a.s. to PPF Group N.V.I. for an equivalent amount of approximately 2,467 million euros in cash at the date of the agreement.

The transaction was completed in January 2014, once the pertinent regulatory authorization was obtained, and the entity was removed from the consolidation scope as of January 1, 2014. The impact to Equity attributable to non-controlling interests in 2014 was a 666 million euros decrease.

*h) Individual Suspension Plan*

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Telefónica de España, S.A.U., Telefónica Móviles España, S.A.U. and Telefónica Soluciones de Informática y Comunicaciones de España, S.A.U. have signed the 1st Collective Agreement of Related Companies (CEV), wholly backed by the largest labor unions. Said agreement considers, among other elements, measures for individual suspension of the employment relationship in the period 2016 and 2017, applying principles of voluntariness, universality, non-discrimination and social responsibility. After signing the agreement, the registration to join the Plan was opened.

The current value of the payment flows of this Plan as of December 31, 2015 is 2,896 million euros before taxes, reflected in “Personnel expenses” of the accompanying consolidated income statement for 2015 (see notes 15 and 18).

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### 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 "Indice 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 190.8%, 64.1% and 56.2% for 2015, 2014 and 2013, 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 198.699 bolivars per U.S. dollar (SIMADI), 49.988 bolivars per U.S. dollar (SICAD II) and 6.3 bolivars per U.S. dollar (SICAD I) as of December 31, 2015, 2014 and 2013, respectively.

#### b) Translation methodology

The income statements and statements of cash flows of the Group's foreign subsidiaries (except Venezuela) were translated into euros at the average exchange rates for the year.

#### 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:

Expenditures incurred in developing new products to be available for sale or use within the Group's own network, and whose future economic viability is reasonably certain ("Development costs"), are amortized on a straight-line basis over the period during which the related development project is expected to generate economic benefits, upon its completion.

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.

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

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 cash flows deriving from the use of the asset or its cash generating unit, as applicable, are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

The Group bases the calculation of impairment on the business plans of the various cash generating units to which the assets are allocated. The projected cash flows, based on 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 fulfilment 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 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 investments

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.

Financial assets which the Group intends to hold for an indefinite period of time and could be sold at any time in response to needs for liquidity requirements or in response to changes in market conditions are classified as available-for-sale. These investments are presented as non-current assets, unless it is probable and feasible that they will be sold within 12 months.

##### 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.

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 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 wireline 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 “Trade and other payables” 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.

Connection fees arising when customers connect to the Group’s network are deferred and recognized in the income statement throughout the average estimated customer relationship period, which varies by type of service. All related costs, except those related to network expansion, as well as administrative expenses and overhead, are recognized in the income statement as incurred.

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 wireline-wireless and wireless-wireline 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 wireline, wireless, internet and television businesses it is determined whether it is necessary to separate the separately identifiable elements and apply the corresponding revenue recognition policy to each element. Total package revenue is allocated among the identified elements based on their respective fair values (i.e. the fair value of each element relative to the total fair value of the package).

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.

Additionally, when allocating the package revenue to the elements, amounts contingent upon delivery of undelivered elements are not allocated to delivered elements.

All expenses related to bundled promotional packages are recognized in the income statement 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 analyses are disclosed for the most relevant situations (see notes 7 and 15).

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. 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 or unforeseen transactions that could affect tax balances.

#### Provisions

The amount of the provision is determined based on the best estimate of the outflow of resources required to settle the obligation, bearing in mind all available information at the statement of financial position date, including the opinions of independent experts such as legal or financial counsel.

Given the uncertainties inherent in the estimates used to determine the amount of provisions, actual outflows of resources may differ from the amounts recognized originally on the basis of the estimates.

#### Revenue recognition

##### *Connection fees*

Connection fees generated when customers connect to the Group's network are deferred and recognized as revenue over the average estimated customer relationship period.



The estimate of the average customer relationship period is based on the recent history of customer churn. Potential changes in estimates could lead to changes in both the amount and timing of the future recognition of revenues.

*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 fair values.

Determining fair values for each identified element requires estimates that are complex due to the nature of the business.

A change in estimates of fair values could affect the apportionment of revenue among the elements and, as a result, the date of recognition of revenues.

Exchange rate used to translate the financial statements of our Venezuelan subsidiaries

As of December 31, 2015, there are multiple exchange mechanisms and three published exchange rates legally available for translation of the financial statements of the Venezuelan subsidiaries.

We review, on a regular basis, the economic conditions in Venezuela and the specific circumstances of our Venezuelan operations. Assessment of the exchange rate that 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 BsF-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 a material impact on the conversion rate used for our Venezuelan subsidiaries' financial statements, affecting the net monetary position of assets (liabilities) denominated in BsF.

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, 2015 are consistent with those used in the preparation of the Group's consolidated annual financial statements for the year ended December 31, 2014, except for the adoption, on January 1, 2015, of new amendments to standards published by the International Accounting Standards Board (IASB) and adopted by the European Union for application in Europe, noted below:

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## · Defined Benefit Plans: Employee Contributions – Amendments to IAS 19

These amendments clarify the requirements that relate to how contributions from employees or third parties that are linked to service should be attributed to periods of service. In addition, the amendments clarify that, if the amount of the contributions is independent of the number of years of service, an entity is permitted to recognise such contributions as a reduction in the service cost in the period in which the service is rendered. The application of these amendments had no impact on the Group's consolidated financial position or results.

## · Improvements to IFRS 2010-2012

## · Improvements to IFRS 2011-2013

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. These improvements do not have a significant impact on the results or financial position of the Group.

New standards and amendments to standards issued but not effected as of December 31, 2015

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

<b>Standards and amendments</b>	<b>Mandatory application: annual periods beginning on or after</b>
Improvements to IFRS 2012-2014	January 1, 2016
IFRS 14 <i>Regulatory Deferral Accounts</i>	January 1, 2016
Amendments to IFRS 11 <i>Accounting for Acquisitions of Interests in Joint Operations</i>	January 1, 2016
Amendments to IAS 16 and IAS 38 <i>Clarification of Acceptable Methods of Depreciation and Amortization</i>	January 1, 2016
Amendments to IAS 16 and IAS 41 <i>Agriculture: Bearer Plants</i>	January 1, 2016
Amendments to IAS 1 <i>Disclosure Initiative</i>	January 1, 2016
Amendments to IFRS 10, IFRS 12 and IAS 28 <i>Investment Entities: Applying the Consolidation Exception</i>	January 1, 2016
Amendments to IAS 7 <i>Disclosure Initiative Recognition of Deferred Tax</i>	January 1, 2017
Amendments to IAS 12 <i>Assets for Unrealised Losses</i>	January 1, 2017
IFRS 9 <i>Financial instruments</i>	January 1, 2018

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IFRS 15	<i>Revenues from Contracts with Customers</i>	January 1, 2018
IFRS 16	<i>Leases</i>	January 1, 2019
Amendments to IFRS 10 and IAS 28	<i>Sale or Contribution of Assets between an Investor and its Associate or Joint Venture</i>	Deferred
		Indefinitely

Based on the analyses made to date, the Group estimates that the adoption of most of these standards, amendments and improvements will not have a significant impact on the consolidated financial statements in the initial period of application. However, IFRS 15 is likely to have an impact in the timing and amount of revenue recognition in connection with certain bundled revenue transactions. The Group is currently assessing the impact of the application of this standard. Also, the changes introduced by IFRS 9 will affect financial instruments and transactions with financial instruments carried out on or after January 1, 2018. In addition to this, IFRS 16 requires a company to report on the statement of financial position lease assets and lease liabilities for all leases (other than short-term leases and leases of low-value assets). Based on the number of lease arrangements in the Group, changes introduced by IFRS 16 are expected to have a significant impact in the Group's financial statements.

Note 4. Segment information

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

As described in Note 2.a), Telefónica's companies in the UK have been recognized as a disposal group held for sale and its operations classified as discontinued operations. Therefore, the Group's comparative information of 2014 and 2013 was revised to reflect this new situation.

A breakdown of the results and cash flows for discontinued operations, along with the assets and liabilities held for sale, are included in Note 23.

These segments include the information relating to wireline, wireless, cable, data, internet and television businesses and other digital services in accordance with each location. "Other companies and eliminations" includes the companies belonging to the transverse areas as well as other Group companies and eliminations in the consolidation process.

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

The Group manages borrowing activities and taxes centrally. Therefore, it does not disclose the related assets, liabilities, revenue and expenses by reportable segments. In addition, revenue and expenses arising from intra-group invoicing for the use of the trademark and management services have been eliminated from the operating results of each Group segment. These adjustments have no impact on the Group's consolidated results.

Inter-segment transactions are carried out at market prices.

Telefónica uses operating income before depreciation and amortization (OIBDA) to track the performance of the business and to establish operating and strategic targets. OIBDA is calculated by excluding depreciation and amortization from operating income to eliminate the impact of investments in fixed assets that cannot be directly controlled by management in the short term. Therefore, it is considered to be more important for investors as it provides a gauge of segment operating performance and profitability using the same measures utilized by management. This metric also allows for comparisons with other companies in the telecommunications sector without consideration of their asset structure.

OIBDA is a commonly reported measure and is widely used among analysts, investors and other interested parties in the telecommunications industry, although not a measure explicitly defined in IFRS, and therefore, may not be comparable to similar indicators used by other companies. OIBDA should not be considered as an alternative to operating income as a measurement of our consolidated operating results or as an alternative to consolidated cash flows from operating activities as a measurement of our liquidity.

The following table presents income and capital expenditures information regarding the Group's operating segments comprising continuing operations:

2015						
Millions of euros	Telefónica		Telefónica		Other companies and eliminations	Total Group
	Spain	Germany	Brazil	Hispanoamérica		
Revenues	12,402	7,888	11,060	14,387	1,482	47,219
External revenues	12,194	7,874	11,027	14,147	1,977	47,219
Inter-segment revenues	208	14	33	240	(495)	–
Other operating income and expenses	(10,066)	(6,030)	(7,487)	(10,031)	(2,191)	(35,805)
OIBDA	2,336	1,858	3,573	4,356	(709)	11,414
Depreciation and amortization	(1,898)	(2,128)	(1,916)	(2,241)	(334)	(8,517)
Operating income	438	(270)	1,657	2,115	(1,043)	2,897
Capital expenditures	1,827	2,230	2,105	3,060	356	9,578
2014 (*)						
Millions of euros	Telefónica		Telefónica		Other companies and eliminations	Total Group
	Spain	Germany	Brazil	Hispanoamérica		
Revenues	12,023	5,522	11,231	13,155	1,527	43,458
External revenues	11,832	5,500	11,200	13,013	1,913	43,458
Inter-segment revenues	191	22	31	142	(386)	–
Other operating income and expenses	(6,352)	(4,789)	(7,688)	(9,087)	(1,761)	(29,677)
OIBDA	5,671	733	3,543	4,068	(234)	13,781
Depreciation and amortization	(1,805)	(1,426)	(1,762)	(2,034)	(404)	(7,431)
Operating income	3,866	(693)	1,781	2,034	(638)	6,350
Capital expenditures	1,732	849	2,933	2,842	325	8,681

(\*) Revised data (see Note 2).

2013 (\*)

Millions of euros	Telefónica Spain	Telefónica Germany	Telefónica Brazil	Telefónica Hispanoamérica	Other companies and eliminations	Total Group
Revenues	12,959	4,914	12,217	16,855	3,602	50,547
External revenues	12,734	4,876	12,186	16,736	4,015	50,547
Inter-segment revenues	225	38	31	119	(413)	–
Other operating income and expenses	(6,619)	(3,606)	(8,277)	(11,324)	(3,244)	(33,070)
OIBDA	6,340	1,308	3,940	5,531	358	17,477
Depreciation and amortization	(1,903)	(1,231)	(2,109)	(2,524)	(849)	(8,616)
Operating income	4,437	77	1,831	3,007	(491)	8,861
Capital expenditures	1,529	666	2,127	3,118	565	8,005

(\*) Revised data (see Note 2).

The following table presents segment assets, liabilities and investments accounted for by the equity method:

2015

Millions of euros	Telefónica Spain	Telefónica Germany	Telefónica Brazil	Telefónica Hispanoamérica	Companies held for sale	Other companies and eliminations	Total Group
Investments accounted for by the equity method	2	–	2	2	–	68	74
Fixed assets	15,364	16,780	22,169	14,504	–	2,039	70,856
Total allocated assets	21,320	19,913	28,308	21,623	15,004	16,806	122,974
Total allocated liabilities	13,411	6,471	7,911	14,384	3,941	49,325	95,443

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2014(\*)

Millions of euros	Telefónica Spain	Telefónica Germany	Telefónica Brazil	Telefónica Hispanoamérica	Telefónica UK	Other companies and eliminations	Total Group
Investments accounted for by the equity method	2	–	3	2	2	779	788
Fixed assets	14,057	16,716	21,795	14,922	11,173	2,157	80,820
Total allocated assets	18,520	21,235	28,570	21,800	14,105	18,118	122,348
Total allocated liabilities	9,599	6,662	8,898	14,480	4,740	47,648	92,027

(\*) Revised data (see Note 2).

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The composition of segment revenues, detailed by the main countries in which the Group operates, is as follows:

Millions of euros Country	2015			2014 (*)			2013 (*)			Total		
	Fixed	Mobile	Other and elims.	Fixed	Mobile	Other and elims.	Fixed	Mobile	Other and elims.			
Spain	9,359	4,337	(1,294)	12,402	8,543	4,556	(1,076)	12,023	8,861	5,121	(1,023)	12,959
Germany	1,043	6,832	13	7,888	1,138	4,375	9	5,522	1,235	3,673	6	4,914
Brazil	4,154	6,906	–	11,060	3,613	7,618	–	11,231	4,125	8,092	–	12,217
Hispanoamérica	4,070	10,347	(30)	14,387	3,604	9,578	(27)	13,155	4,272	13,020	(437)	16,855
Argentina	1,376	2,539	–	3,915	1,055	2,008	–	3,063	1,247	2,434	–	3,681
Chile	928	1,292	–	2,220	842	1,247	–	2,089	988	1,495	–	2,483
Peru	1,200	1,566	–	2,766	1,077	1,427	–	2,504	1,121	1,333	–	2,454
Colombia	566	942	–	1,508	629	1,090	–	1,719	652	1,053	–	1,705
Mexico	–	1,783	–	1,783	–	1,649	–	1,649	–	1,580	–	1,580
Venezuela and Central America	–	1,379	–	1,379	–	1,420	–	1,420	–	4,228	–	4,228
Remaining operators and segment eliminations	–	846	(30)	816	1	737	(27)	711	264	897	(437)	724
Other and inter-segment eliminations				1,482				1,527				3,602
Total Group				47,219				43,458				50,547

Note: In some operating business of Telefónica Hispanoamérica segment, the breakdown of revenues presented allocating intercompany eliminations to fixed and mobile businesses.

(\*) Revised data (see Note 2).

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

**Business combinations**

**Acquisition of GVT**

On September 19, 2014 Telefónica, S.A. signed an agreement with Vivendi, S.A. for the acquisition by Telefônica Brasil, S.A. of Global Village Telecom, S.A. and its holding company GVT Participações, S.A. (jointly "GVT") for a cash consideration of 4,663 million euros (through payment in cash and debt assumption), as well as delivery of shares representing 12% of the share capital of the new Telefônica Brasil, S.A. resulting from the integration with GVT.

Once the pertinent regulatory authorizations were obtained, the Extraordinary General Shareholders Meeting of Telefônica Brasil, S.A. held on May 28, 2015, approved the acquisition.

The sale and purchase agreement contemplates a contingent consideration regarding a legal deposit set up by GVT. In September 2014, GVT requested the cancellation of the deposit and the return of the amount deposited. The amount recovered based on a final ruling will be returned to Vivendi. The ultimate date for this is up to 15 years. The fair value of the contingent consideration on the acquisition date is 102 million euros.

As a consequence of the acquisition of GVT, the stake of Telefónica Group in Telefônica Brasil decreased from previous 73.96% to 65.59%.

The share capital increase at Telefônica Brasil, S.A. and the aforementioned dilution of the Group's percentage stake had an adverse net effect on "Equity attributable to the parent Company" in the amount of 456 million euros and an increase on "Equity attributable to non-controlling interests" in the amount of 4,257 million euros. These figures include an impact of dilution in the non-controlling interests amounting to 102 million euros.

GVT is headquartered in Brazil where it provides mostly fixed telephony, data, multimedia and pay TV services. With this acquisition, Telefónica Group reinforces its leadership position in the telecommunications sector in Brazil. The combination of Telefônica Brasil and GVT infrastructures, product portfolio and commercial network will maximize the penetration of products in the mobile and fixed segments of both customer basis, as well as increase presence in corporate customers and small and medium size companies. Additionally synergies can be obtained as consequence of operating expenses reduction and less investment in transmission networks and the Company can take advantage of

economy of scale related to set up costs and duplicated satellite infrastructure.

The table below sets out the consideration transferred, the fair values of the assets and liabilities identified at the acquisition date, and the goodwill generated.

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Millions of euros

Gross cash consideration (date of the agreement)	4,663
Contingent consideration	102
Fair value of 12% of Telefônica Brasil transferred	2,476
Consideration transferred	7,241
Price adjustment for net debt and hedges	(2,168)
Intangible assets	835
Customer relationships	751
Rest of intangible assets	84
Property, plant and equipment	2,374
Deferred tax assets	182
Accounts receivable	282
Other assets	256
Cash and cash equivalents	116
Financial debt	(2,102)
Trade and other payables	(202)
Provisions	(208)
Other liabilities	(217)
Fair value of net assets	1,316
Goodwill (Note 7)	3,757

Customer relationships were valued using the MEEM (“Multiple Excess Earnings Method”), which is based on calculating the discounted cash flows reflecting the economic benefits attributable to the customer base after consideration of all value contributions of other assets.

At the acquisition date contingent liabilities recognized at fair value amounted to 153 million euros. The deductibility of the goodwill for tax purposes amounts 3,660 million of euros.

The breakdown of accounts receivable’s fair value at the date of acquisition was as follows:

Millions of euros	Gross contractual value	Impairment	Preliminary fair value
Customers	379	(97)	282

The contribution of GVT to revenues since its incorporation to the consolidation perimeter to December 31, 2015 was 1,084 million euros. This contribution would have been 1,591 million euros if GVT had been consolidated the whole year. The contribution of GVT to the profit for the year, after the impact of the amortization of the assets identified in the purchase price allocation, has been a 30 million euros loss.

At the date of authorization for issue of the accompanying consolidated financial statements, the purchase price allocation process is provisional. It is expected that this analysis will be concluded in the coming months and no later

than twelve months from the acquisition date as established in the standard.

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**Acquisition of 56% of DTS**

On May 6, 2014 Telefónica submitted a binding offer for the acquisition of 56% of the share capital of Distribuidora de Televisión Digital, S.A. (DTS) owned by PRISA. On June 2, 2014, the parties signed the sale and purchase agreement, subject to competence authorities' clearance.

Once the relevant competence authorizations were obtained, on April 30, 2015 the acquisition by Telefónica was completed (through its subsidiary Telefónica de Contenidos, S.A.U.) for an initial consideration of 707 million euros, subject to the finalization of the working capital and net debt adjustments. According to the sale and purchase agreement, Telefónica paid 80% at the acquisition date.

On October 20, 2015 Telefónica and PRISA reached an agreement on certain price adjustments, whereby on November 3, 2015 Telefónica paid 123 million euros to PRISA. In addition, Telefónica paid 7 million euros in February 2016, resulting on a total consideration of 695 million euros. At the date of authorization for issue of these financial statements, there is one unresolved adjustment, which could lead to an increase in the price to Telefónica of up to 29 million euros.

After the acquisition of a 22% stake from Mediaset España Comunicación, S.A. on July 4, 2014, the Group had a stake of 44% in DTS registered under the equity method (see Note 9); this is therefore a step acquisition. Hence the consideration has been calculated as the result of adding to the price paid for the 56% acquired the fair value of the previous stake, which at the date of acquisition did not differ materially from the net carrying amount.

DTS had 1.4 million pay TV customers at the date of acquisition and more than 25 years of experience in the sector. With its acquisition, Telefónica reinforces its position as a global video company, becoming the company of reference in the pay TV business in Spain, reinforcing its contents offer and acquiring new global capacities in the TV business.

The table below sets out the total consideration, the fair values of the assets acquired and liabilities assumed identified at acquisition date, and the goodwill generated.

Millions of euros

<b>Cash payment 56% stake</b>	<b>695</b>
<b>Fair value of the prior stake</b>	<b>739</b>
Intangible assets	378
Customer relationships	362
Other	16
Property, plant and equipment	91

Deferred tax assets	454
Trade and other receivables	137
Other assets	213
Financial debt	(350)
Trade and other payables	(367)
Other liabilities	(66)
Fair value of net assets	<b>490</b>
Goodwill (Note 7)	<b>944</b>

Customer relationships were valued using the MEEM (“Multiple Excess Earnings Method”), which is based on calculating the discounted cash flows reflecting the economic benefits attributable to the customer base after consideration of all value contributions of other assets.



DTS was integrated in the consolidation perimeter from April 30, 2015 under full consolidation method. DTS contribution to revenues since its incorporation to the consolidation perimeter to December 31, 2015 amounted 520 million euros. This contribution would have been 843 million euros if DTS had been consolidated the whole year. The contribution of DTS to the profit for the year, after the impact of the amortization of the assets identified in the purchase price allocation, has been a 23 million euros loss.

None of the goodwill recognized is expected to be deductible for income tax purposes.

At the date of authorization for issue of the accompanying consolidated financial statements, the purchase price allocation process is provisional. This analysis is due to conclude in the coming months and no later than twelve months from the acquisition date as established in the standard. Furthermore, there is one unresolved adjustment to the purchase price, which affects the value of the pre-existing relationships with DTS.

#### **Finalization of the purchase price allocation of E-Plus**

On October 1, 2014, following the share capital increase by Telefónica Deutschland to finance the purchase of E-Plus, the latter was finally acquired by Telefónica Deutschland.

The purchase price allocation in the consolidated financial statements as of December 31, 2014 was provisional. In 2015 the preliminary purchase price allocation was reviewed within the twelve-month period and recorded retrospectively to the acquisition date on the basis of a final valuation. The accompanying consolidated statement of financial position as of December 31, 2014 was revised, in line with the provisions of IFRS 3. The impact on the profit for the year 2014 (before non-controlling interests) amounted to 32 million euros and was recorded against “retained earnings”.

An agreement on the final purchase price was reached with KPN in December 2015. The original purchase price was reduced overall by 134 million euros. 30 million euros of this figure was adjusted against goodwill within the twelve-month period. A sufficiently secure agreement on the final purchase price was not reached at the end of the aforementioned twelve-month period foreseen in the accounting regulation, therefore estimates based on partial agreements and expert opinions were used in order to determine the purchase price for the final goodwill calculation. The remaining amount, 104 million euros, has been recognised in “other operating income” as it arose after the twelve-month period since the date of acquisition (see Note 18).

The following table gives an overview of the differences between the preliminary and the final purchase price allocation:

Millions of euros	Preliminary fair values at acquisition date	Final fair values at acquisition date	Differences
Intangible assets	4,328	4,182	(146)
Customer relationships	2,718	2,857	139
Frecuency usage rights	1,342	1,057	(285)
Rest of intangible assets	268	268	-
Property, plant and equipment	1,931	1,742	(189)
Inventories	21	21	-
Trade and other receivables	677	677	-
Other financial assets	19	19	-
Other non-financial assets	93	93	-
Cash and cash equivalents	396	396	-
Deferred revenue	(220)	(220)	-
Provisions	(254)	(254)	-
Interest-bearing debt	(505)	(528)	(23)
Current trade and other payables	(709)	(709)	-
Fair value of net assets	5,777	5,419	(358)
Goodwill (Note 7)	1,686	2,014	328
Cash payment	4,936	4,906	(30)
Fair value of the T. Deutschland shares purchased by KPN	2,527	2,527	-
Purchase price	7,463	7,433	(30)
Purchase price adjustments outside measurement period	-	(104)	(104)
Final purchase price	7,463	7,329	(134)

The adjustments in the valuation of the assets resulted mainly from new insights into the requirements of the “Federal Network Agency” and, as a consequence, from more detailed analysis of the fair value of the licences acquired. In addition, new insight relating to the underlying market conditions resulted in reduced values for the acquired property, plant and equipment.

## **Transactions with non-controlling interests**

**2015**

### **Acquisition from Vivendi of 4.5% of Telefônica Brasil**

On June 24, 2015 in accordance with the commitments undertaken in the acquisition agreement with GVT, Telefónica proceeded to deliver (through its fully-owned subsidiary Telco TE, S.p.A.) 1,110 million ordinary shares in Telecom Italia, S.p.A. representing 8.2% of the voting equity of Telecom Italia, S.p.A. (equivalent to 5.7% of its share capital) to Vivendi, S.A. and received from Vivendi, S.A. all of the ordinary shares and part of the preference shares of Telefônica Brasil, S.A. which Vivendi, S.A. had received from the sale of GVT, which jointly represent 4.5% of the share capital of Telefônica Brasil, S.A. The fair value of the Telecom Italia, S.p.A. shares delivered to Vivendi as part of the consideration has been calculated on the basis of their market price at the date of the approval of the operation, amounting to 1,264 million euros. The difference between the aforementioned value and the valuation of the minority interest in Telefônica Brasil had an adverse effect on “Equity attributable to the parent Company” in the amount of 277 million euros.

After the acquisition of the 4.5% stake of Telefônica Brasil, S.A. from Vivendi, S.A., the stake of Telefónica Group increased to 70.13% (70.22% considering Telefônica Brasil, S.A. treasury shares).

### **Agreement with Vivendi for the exchange of shares of Telefônica Brasil for treasury shares of Telefónica, S.A.**

In September 2015, after the regulatory approval from CADE, Telefónica delivered to Vivendi 46.0 million of its treasury shares representing 0.95 % of its share capital with an effect on treasury shares and in retained earnings in the amount of 555 million euros and 69 million euros, respectively (see Note 12), in exchange for 58.4 million preferred shares of Telefônica Brasil, S.A. (received by Vivendi, S.A. in the context of the acquisition of GVT Participações, S.A.) representing approximately 3.5% of the share capital of Telefônica Brasil, S.A.

After the acquisition the stake of Telefónica Group increased to 73.6%.

Under this agreement, Vivendi, S.A. committed, among other obligations: (i) to refrain from selling the Telefónica shares during specified periods (lock up), and (ii) to comply with certain restrictions that, in case of sale, and once the lock up periods have lapsed, would ensure an orderly sale of such shares.

## 2014

No material transactions with non-controlling interests were carried out that were significant for the Group in 2014, except for those detailed above regarding E-Plus acquisition (see Note 12.h).

## 2013

### *Sale of 40% of the stake in Telefónica's subsidiaries in Guatemala, El Salvador, Nicaragua and Panama*

In April 2013 Telefónica reached an agreement with Corporación Multi Inversiones to sell 40% of Telefónica's stake in its subsidiaries in Guatemala, El Salvador, Nicaragua and Panama, through Telefónica Centroamérica Inversiones, S.L.

The closing of the transaction was on August 2, 2013, upon the fulfillment of the sale conditions. The value of the sale amounted to 500 million U.S. dollars (equivalent to 377 million euros on the date of closing of the sale), plus payment of an additional variable amount of up to 72 million U.S. dollars, depending to the evolution and operational performance of the transferred assets.

The Telefónica Group maintains control of these companies, and therefore the transaction had no impact on the consolidated income statement at its completion, as it is a transaction with non-controlling interests. The impact of this transaction on the consolidated equity was a 111 million euros increase in "Equity attributable to equity holders of the parent and other holders of equity instruments", and a 283 million euros increase in "Equity attributable to non-controlling interests".

## Note 6. Intangible assets

The composition of and movements in net intangible assets in 2015 and 2014 are as follows:

Millions of euros	Balance at 12/31/2014	Additions	Amortization	Disposals	Transfers and others	Translation differences and hyperinflation adjustments	Inclusion of companies	Transfer Non-current assets classified as held for sale	Balance at 12/31/2015
Service concession arrangements and licenses	13,346	387	(1,053)	–	748	(1,352)	–	(2,038)	10,038
Software	2,905	759	(1,460)	(15)	647	(216)	76	(43)	2,653
Customer base	3,499	–	(525)	–	113	(202)	1,113	(245)	3,753
Other intangible assets	1,430	60	(145)	(4)	(135)	(83)	24	(408)	739
Intangible assets in process	1,047	1,454	–	–	(1,018)	(13)	–	(91)	1,379
Total intangible assets	22,227	2,660	(3,183)	(19)	355	(1,866)	1,213	(2,825)	18,562
Millions of euros	Balance at 12/31/2013	Additions	Amortization	Disposals	Transfers and others (*)	Translation differences and hyperinflation adjustments	Inclusion of companies (*)	Exclusion of companies	Balance at 12/31/2014
Service concession arrangements and licenses	12,034	1,294	(1,154)	–	57	58	1,057	–	13,346
Software	3,044	665	(1,432)	(5)	632	(143)	144	–	2,905
Customer base	1,022	–	(349)	–	(53)	22	2,857	–	3,499
Other intangible assets	1,487	40	(256)	(4)	12	30	121	–	1,430
Intangible assets in process	961	389	–	–	(314)	8	3	–	1,047
	18,548	2,388	(3,191)	(9)	334	(25)	4,182	–	22,227

Total  
intangible  
assets

(\* Revised data (see Note 5).

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The gross cost, accumulated amortization and impairment losses of intangible assets at December 31, 2015 and 2014 are as follows:

Balance at 12/31/2015				
Millions of euros	Gross cost	Accumulated amortization	Impairment losses	Intangible assets
Service concession arrangements and licenses	17,238	(7,200)	–	10,038
Software	13,156	(10,500)	(3)	2,653
Customer base	5,843	(2,090)	–	3,753
Other intangible assets	2,185	(1,441)	(5)	739
Intangible assets in process	1,381	–	(2)	1,379
Intangible assets	39,803	(21,231)	(10)	18,562
Balance at 12/31/2014				
Millions of euros	Gross cost (*)	Accumulated amortization (*)	Impairment losses	Intangible assets
Service concession arrangements and licenses	22,012	(8,666)	–	13,346
Software	14,168	(11,260)	(3)	2,905
Customer base	6,113	(2,612)	(2)	3,499
Other intangible assets	3,647	(2,212)	(5)	1,430
Intangible assets in process	1,046	–	1	1,047
Intangible assets	46,986	(24,750)	(9)	22,227

(\*) Revised data (see Note 5).

“Inclusion of companies” in 2015 mainly corresponds to the acquisitions of GVT and DTS (see Note 5).

“Inclusion of companies” in 2014 corresponds to the acquisition of E-Plus. These figures have been revised (see Note 5).

“Additions” and “Amortization” in 2014 includes 141 and 440 million euros, respectively, from Telefónica in United Kingdom.

“Transfer non-current assets classified as held for sale” in 2015 mainly correspond to the reclassification of intangible assets of Telefónica in United Kingdom (see Note 23).

“Transfer and others” in 2015 includes additions and amortization for 9 and 117 million euros, respectively, from Telefónica in United Kingdom until they were reclassified as assets held for sale.

Outstanding among “Additions” of intangible assets in process in 2015 is the acquisition by Telefónica Germany of LTE block for 1,198 million euros:

- 700 MHz: two 10 MHz blocks
- 900 MHz: two 10 MHz blocks
- 1800 MHz: two 10 MHz blocks

The acquired frequencies at 900 MHz and 1.8 GHz can be used from January 1, 2017. The use of the acquired frequencies at 700 MHz is expected from the date they are vacated by the broadcasting companies.



The spectrum licenses in the 800 MHz and 900 MHz acquired by Telefónica Móviles España in 2011 for 793 million euros were transferred from “Intangible assets in process” to “Service concession arrangements and licenses” since they are available for the company from February 4 and March 31, 2015, respectively.

During exercise 2015, the investment effort reflects the acquisition of LTE licenses in Argentina (196 million euros), Ecuador (127 million euros), Spain (49 million euros), México (8 million euros) and Chile (6 million euros).

Outstanding among “Additions” in 2014 is the acquisition by Telefónica Brazil of a LTE block in the 700 MHz band, for 889 million euros. Additions in 2014 include also LTE licenses acquired by Telefónica Hispanoamérica amounting to 405 million euros.

Details of the principal concessions and licenses with which the Group operates are provided in Appendix VII.

“Other intangible assets” includes the amounts allocated to trademarks acquired in business combinations, of 1,045 million euros and 2,119 million euros at December 31, 2015 and 2014, respectively 594 million euros and 1,133 million euros, respectively, net of the related accumulated amortization).

The impact of the monetary adjustments due to hyperinflation in Venezuela is included under “Translation differences and hyperinflation adjustments”.

## Note 7. Goodwill

The movement in this heading assigned to each Group segment was the following:

2015						
Millions of euros	Balance at 12/31/14	Acquisitions	Write-offs	Transfers	Translation differences and hyperinflation adjustments	Balance at 12/31/15
Telefónica Spain	3,332	944	–	–	–	4,276
Telefónica Brazil	8,407	3,757	–	–	(2,819)	9,345
Telefónica Germany	4,787	–	–	–	–	4,787
Telefónica United Kingdom	5,296	–	–	(5,672)	376	–
Telefónica Hispanoamérica	3,365	–	–	–	(178)	3,187
Others	250	8	(104)	–	(4)	150
<b>Total</b>	<b>25,437</b>	<b>4,709</b>	<b>(104)</b>	<b>(5,672)</b>	<b>(2,625)</b>	<b>21,745</b>

2014					
Millions of euros	Balance at 12/31/13	Acquisitions	Other movements	Translation differences and hyperinflation adjustments	Balance at 12/31/14
Telefónica Spain	3,332	–	–	–	3,332
Telefónica Brazil	8,392	–	–	15	8,407
Telefónica Germany (*)	2,779	2,014	(6)	–	4,787
Telefónica United Kingdom	4,948	–	–	348	5,296
Telefónica Hispanoamérica	3,748	–	–	(383)	3,365
Others	235	1	–	14	250
<b>Total</b>	<b>23,434</b>	<b>2,015</b>	<b>(6)</b>	<b>(6)</b>	<b>25,437</b>

(\*) Revised data (see Note 5).

The amount in “Acquisitions” of the Telefónica Spain segment for 2015 corresponds to the acquisition of DTS (see Note 5). The amount for Telefónica Brazil corresponds to the acquisition of GVT (see Note 5).

The goodwill allocated to Telefónica United Kingdom has been reclassified as “Non-current assets and disposal groups classified as held for sale” (see Note 23).

Furthermore, and as a consequence of the above, write-offs in 2015 related to the partial adjustment of the goodwill generated on the acquisition of Telefónica Digital Inc. due to the lower value of the asset, which was determined according to the allocation of the relative value that Telefónica United Kingdom operations represent on it, with a balancing entry in “Profit after taxes from discontinued operations” (see Note 23).

The amount in “Acquisitions” of the Telefónica Germany segment for 2014 corresponds to the acquisition of E-Plus. The consolidated statement of financial position at December 31, 2014, has been revised to reflect the ending of allocation of the acquisition costs of E-Plus (see Note 5).

In order to test for impairment, goodwill has been allocated to the different cash-generating units (CGUs), which are grouped into the following reportable operating segments:

	12/31/2015	12/31/2014
<b>Telefónica Spain</b>	<b>4,276</b>	<b>3,332</b>
<b>Telefónica Brazil</b>	<b>9,345</b>	<b>8,407</b>
<b>Telefónica Germany (*)</b>	<b>4,787</b>	<b>4,787</b>
<b>Telefónica United Kingdom</b>	<b>-</b>	<b>5,296</b>
<b>Telefónica Hispanoamérica</b>	<b>3,187</b>	<b>3,365</b>
Chile	933	978
Peru	766	788
Mexico	532	558
Argentina	255	349
Others Telefónica Hispanoamérica	701	692
<b>Others</b>	<b>150</b>	<b>250</b>
<b>TOTAL</b>	<b>21,745</b>	<b>25,437</b>

(\*) Revised data (see Note 5).

Cash flow projections for a five-year period after closing are used to perform the impairment test at year-end, for which the strategic plans approved by the Board of Directors of Telefónica, S.A. of the various cash-generating units (CGU) to which goodwill is allocated are used as the basis. These strategic plans cover the 2016-2018 period. Therefore, in order to complete the five years of cash flows indicated above, an additional two-year normalization period of the strategic plan is added to the analysis of the cash flow projections, on the basis of the main operating variables until the appropriate parameters to obtain the terminal values are reached; the consensus of analysts' forecasts is used as a reference for this. From the sixth year a constant growth rate is applied.

The process of preparing the CGUs' strategic plans takes into consideration the current condition of each CGU's market, analyzing the macroeconomic, competitive, regulatory and technological climate together with each CGU's competitive positioning and growth opportunities given market projections. A growth target is then defined for each CGU in terms of market share, which is a critical factor when forecasting future revenues. The operating resources and fixed asset investments that need to be assigned in order to reach the growth target are estimated following a basic premise of boosting operating efficiency, with a view to increase operating cash flow over the life of the plan. In this process, the Group has also assessed the level of fulfillment of the strategic plans in the past.

#### **Main assumptions used in calculating value in use**

Value in use is calculated for the various CGUs based on the aforementioned approved business plans and taking into account subsequently certain variables such as the OIBDA margin and the Capital Expenditure ratio for non-current assets, expressed as a percentage of revenue, and discount and finally perpetuity growth rates. Following is a description of the principal variables considered for each CGU with significant goodwill (Brazil, Spain and Germany).



*OIBDA margin and long-term Capital Expenditure (CapEx) ratio*

In the case of Spain, the long-term OIBDA margin (42%) is consistent with analysts' forecasts over a three year horizon, at 44%. For Germany, it has been applied analysts' long-term forecasts (30%), adjusted for the outlook for the market on which it is listed.

With respect to the ratio of CapEx over revenues, over the term of the strategic plan, the Group's European operators invest at a percentage of revenue that lies at the bottom end of the range for peers in the region. However, the valuation used in the impairment test for Germany incorporates the opinions of Telefónica Group and Telefónica Deutschland analysts with regard to investment needs (around 13%).

The OIBDA margin for Brazil is in line with the average of analysts' three year forecasts for peers in emerging markets, at approximately 36%, and also considers analysts' long-term opinions about Brazil. Over the term of the strategic plan, the operator will invest a percentage at the lower end of the range for its peers. However, this is also in line with the investment needs identified by analysts (16.3%). The final figures for Brazil indicated above do not include the effect, within the five-year time horizon, of the synergies included, as mentioned in Note 5, which have been considered in the valuation of the company.

*Discount rate*

The discount rate, applied to measure free cash flow, is the weighted average cost of capital (WACC), determined by the weighted average cost of equity and debt according the finance structure established for each CGU.

This rate is calculated using the capital asset pricing model (CAPM), which takes into account the asset's systemic risk, and the 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. The main underlying data used in these calculations are obtained from independent and renowned public external information sources.

The discount rates applied to the cash flow projections in 2015 and 2014 for the main CGUs are as follows:

Discount rate in local currency	2015	2014
<b>Spain</b>	6.1%	6.1%
<b>Brazil</b>	11.9%	10.9%
<b>Germany</b>	5.3%	5.5%

There were no significant changes to these rates for European operators compared to the previous year.

The main variation relates to Brazil, where the cost of capital increased by 1 p.p., in line with analysts' expectations, which put the cost of capital for the Brazilian operator at slightly lower levels. This increase results from higher equity costs, mainly explained by the increase in Brazil's political risk premium, and higher external finance costs.

*Perpetuity growth rate*

Cash flow projections as from the sixth year are calculated using an expected constant growth rate ( $g$ ), considering the consensus estimates among analysts 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, adjusted for any specific characteristics of the business.

The perpetuity growth rates applied to the cash flow projections in 2015 and 2014 for the main CGUs are as follows:

Perpetuity growth rate	2015	2014
in local currency		
<b>Spain</b>	0.7%	0.8%
<b>Brazil</b>	5.0%	4.8%
<b>Germany</b>	1.0%	1.2%

There were no significant changes in the perpetuity growth rates for 2015 compared to those used in 2014.

In the case of Brazil, the perpetuity growth rate is in line with the Brazilian Central Bank's medium-term inflation target (4.5%, within a range of  $\pm 2$  p.p.) and is below the analyst consensus for the Strategic Plan horizon (around 6%-7%) and below the forecast nominal GDP growth rate (which oscillates around 7%). A conservative outlook has been maintained, in line with analysts' expectations.

### Sensitivity to changes in assumptions

The Group carries out a sensitivity analysis of the impairment test by considering reasonable changes in the main assumptions used in such test. For each CGU with significant goodwill (Brazil, Spain and Germany) the following maximum increases or decreases, expressed in percentage points (p.p.) were assumed:

Changes in key assumptions, Germany		
		Brazil
In percentage points (p.p.)	Spain	
<b>Financial variables</b>		
Discount rate	+/- 0.5	+/- 1
Perpetuity growth rates	+/- 0.25	+/- 0.5
<b>Operating variables</b>		
OIBDA Margin	+/- 2	+/- 2
Ratio of CapEx/Revenues	+/- 1	+/- 1

As a result of the sensitivity analysis performed at year-end 2015 there are no significant risks arising from reasonably possible changes in the financial and operating variables, considered individually, except in the case of Brazil, where a 100 b.p. increase in WACC, similar to that in 2015 (when the Brazilian real depreciated by 32% against the euro), could result in a negative impact in the profit for the year attributable to equity holders of the parent of around 585 million euros. On the other hand, a change of 0.70 p.p. in the discount rate is required for the carrying amount of the CGU Telefónica Brazil to equal its recoverable amount as of December 31, 2015.



The sensitivity analysis revealed no significant risks for the other main CGUs. In Spain and Germany there is a comfortable gap between the recoverable value and the carrying amount.

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## Note 8. Property, plant and equipment

The composition of and movement in the items comprising net "Property, plant and equipment" in 2015 and 2014 were the following:

Millions of euros	Balance at 12/31/14	Additions	Depreciation	Disposals	Transfers and others	Translation differences and hyperinflation adjustments	Inclusion of companies	Transfer Non-current assets classified as held for sale	Balance at 12/31/15
Land and buildings	5,065	59	(456)	(38)	347	(219)	92	(126)	4,724
Plant and machinery	23,637	1,621	(4,494)	(43)	3,894	(2,102)	2,225	(2,297)	22,441
Furniture, tools and other items	1,311	232	(384)	(29)	279	(92)	113	(406)	1,024
PP&E in progress	3,143	5,006	–	(4)	(4,970)	(263)	35	(587)	2,360
Total PP&E	33,156	6,918	(5,334)	(114)	(450)	(2,676)	2,465	(3,416)	30,549

  

Millions of euros	Balance at 12/31/13	Additions	Depreciation	Disposals	Transfers and others(*)	Translation differences and hyperinflation adjustments	Inclusion of companies(*)	Exclusion of companies	Balance at 12/31/14
Land and buildings	5,234	70	(468)	(43)	360	(131)	43	–	5,065
Plant and machinery	21,246	1,290	(4,349)	(22)	4,758	(814)	1,528	–	23,637
Furniture, tools and other items	1,328	178	(540)	(25)	382	(20)	8	–	1,311
PP&E in progress	3,232	5,522	–	(9)	(5,616)	(149)	163	–	3,143
Total PP&E	31,040	7,060	(5,357)	(99)	(116)	(1,114)	1,742	–	33,156

(\*)Revised data (see Note 5).

The gross cost, accumulated depreciation and impairment losses of property, plant and equipment at December 31, 2015 and 2014 are as follows:

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Balance at December 31, 2015

Millions of euros	Gross cost	Accumulated depreciation	Impairment losses	PP&E
Land and buildings	11,036	(6,309)	(3)	4,724
Plant and machinery	85,578	(63,009)	(128)	22,441
Furniture, tools and other items	5,257	(4,221)	(12)	1,024
PP&E in progress	2,377	–	(17)	2,360
Total PP&E	104,248	(73,539)	(160)	30,549

Balance at December 31, 2014

Millions of euros	Gross cost (*)	Accumulated depreciation (*)	Impairment losses	PP&E
Land and buildings	11,493	(6,427)	(1)	5,065
Plant and machinery	91,877	(68,181)	(59)	23,637
Furniture, tools and other items	6,487	(5,165)	(11)	1,311
PP&E in progress	3,155	–	(12)	3,143
Total PP&E	113,012	(79,773)	(83)	33,156

(\*) Revised data (see Note 5).

“Inclusion of companies” in 2015 corresponds to GVT and DTS (see Note 5).

“Inclusion of companies” in 2014 corresponds to the acquisition of E-Plus (see Note 5).

“Additions” and “Amortization” in 2014 includes 626 and 678 million euros, respectively, from Telefónica in United Kingdom.

“Transfer non-current assets classified as held for sale and others” in 2015 mainly correspond to the reclassification of property, plant and equipment of Telefónica in United Kingdom (see Note 23).

“Transfer and others” in 2015 includes additions and amortization for 203 and 169 million euros, respectively, from Telefónica in United Kingdom until they were reclassified as assets held for sale.

Investment by Telefónica Spain in property, plant and equipment in 2015 and 2014 amounted to 1,575 and 1,500 million euros, respectively. Fiber optic was rolled out rapidly, and by year-end 2015 Telefónica Spain reached more than 14 million premises passed in Spain, and had invested more in LTE networks.

Investment by Telefónica Germany in 2015 and 2014 amounted to 739 and 656 million euros, respectively. The operator continues to focus on its LTE roll-out strategy, securing 75% coverage in 2015.

Investment by Telefónica Brazil in 2015 and 2014 amounted to 1,824 and 1,798 million euros, respectively. This was mainly in expanding the coverage of 3G and 4G mobile networks, and improvements to the quality, and roll out and connection of the fiber network in the fixed line business.

Investment by Telefónica Hispanoamérica in 2015 and 2014 amounted to 2,562 and 2,282 million euros, respectively. This was mainly in the roll out of 3G and 4G networks and the fiber transport network, together with upgrades to the quality of broadband and pay TV services.

“Disposals” include the impact of sale of towers in 2015 and 2014 (see Note 18).

The impact of the monetary adjustments due to hyperinflation in Venezuela is included under “Translation differences and hyperinflation adjustments”.

Telefónica Group companies have 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. In addition, as part of its commercial activities and network roll-out, the Group maintains several property acquisition commitments. The timing of scheduled payments in this regard is disclosed in Note 18.

Property, plant and equipment deriving from finance leases amounted to 557 million euros at December 31, 2015 (419 million euros at December 31, 2014). The most significant finance leases are disclosed in Note 22.

## 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 income statements is as follows:

Millions of euros

	12/31/2015	12/31/2014
Investments accounted for by the equity method	74	788
Loans to associates and joint ventures	21	16
Receivables from associates and joint ventures for current operations	7	43
Financial debt, associates and joint ventures	391	21
Payables to associates and joint ventures (Note 14)	294	724

Millions of euros

	2015	2014 (*)	2013 (*)
Share of (loss) of investments accounted for by the equity method	(5)	(498)	(291)
Revenue from operations with associates and joint ventures	17	305	410
Expenses from operations with associates and joint ventures	85	501	548
Financial income with associates and joint ventures	–	49	38
Financial expenses with associates and joint ventures	1	–	–

(\*) Revised data (see Note 2).

The table above includes the transactions with the companies of the Telecom Italia Group until the classification of the investment in Telco, S.p.A. as available-for-sale financial asset. In 2015 Telefónica sold its stake in Telecom Italia, S.p.A., according to the regulatory and competition commitments assumed (see Notes 13 and 21).

The detail of the movement in investments in associates in 2015 and 2014 was the following:

	Millions of euros
Investments accounted for by the equity method	
Balance at 12/31/13	2,424
Additions	382
Disposals	(697)
Translation differences and other comprehensive income	(20)
Income (loss)	(510)
Dividends	(34)
Transfers and other	(757)
Balance at 12/31/14	788
Additions	57
Translation differences and other comprehensive income	(5)
Income (loss)	(5)
Dividends	(11)
Transfers and other	(750)
Balance at 12/31/15	74

On April 30, 2015 the acquisition of the 56% of DTS Distribuidora de Televisión Digital, S.A. was completed (see Note 5). From this transaction, DTS and its subsidiaries are incorporated to the Telefónica Group consolidation perimeter under full consolidation method. Until April 30, 2015, the previous stake held by Telefónica Group (44%) was registered under equity method. This movement was registered in “Transfers and other” for 739 million euros (see Note 5).

The Group had reached the 44% stake in DTS in July 2014 after the acquisition to Mediaset España Comunicación, S.A. (“Mediaset”) of 22% of the share capital of DTS for 295 million euros. A payment of 30 million euros was also agreed in return for a waiver by Mediaset of preferential purchase rights to the stake held by PRISA in this company. Pursuant to the agreement, Mediaset would receive an additional amount of 10 million euros in the event that Telefónica closed the acquisition of the 56% stake of DTS held by PRISA (consequently paid in 2015) and, in that case, an amount of up to 30 million euros depending on the evolution of the Pay-TV customers of the Group.

In November 2014 Telefónica, through its subsidiary Telefónica Internacional, S.A.U., sold shares representing 2.5% of the share capital of China Unicom (Hong Kong) Limited for 687 million euros at the exchange rate of the date of the transaction. Following this transaction, the remainder of Telefónica’s China Unicom investment (equivalent to 2.51% of its share capital) was reclassified as an available-for-sale financial asset (see Note 13); nevertheless, a representative from Telefónica remains on China Unicom’s board of directors, and vice versa.

On June 16, 2014 the three Italian shareholders who, together with Telefónica, S.A., form the shareholder structure of Telco, S.p.A., requested that a demerger process be initiated for this company in accordance with that established in the Shareholders’ Agreement. The implementation of this demerger process, approved at the Telco, S.p.A. General Shareholders’ Meeting on July 9, 2014, is subject to prior approval by the competition and telecommunication

authorities where necessary, including those in Brazil and Argentina.

At a meeting on December 22, 2014, the Brazilian telecommunications regulator (ANATEL) approved the demerger on condition of suspension of Telefónica's voting rights in Telecom Italia, S.p.A. and its subsidiaries, among certain other measures. Telefónica has agreed with the aforementioned suspension of voting rights and has offered the presentation of a formal statement to ANATEL in this regard. Therefore, on the same date Telefónica ceased to have significant influence through its indirect holding in Telecom Italia, S.p.A. and reclassified this investment as an available-for-sale financial asset (see Note 13). The quoted price of Telecom Italia, S.p.A. shares at the reference date was 0.89 euros per share. The impact of the value adjustment of the stake in Telco, S.p.A., together with its contribution to results for the year, led to a negative impact of 464 million euros in 2014 "Share of loss of investments accounted for by the equity method".

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The breakdown of the main investments accounted for by the equity method and key financial highlights for the last 12-month period available at the time of preparation of the consolidated financial statements for 2015 and 2014 are as follows:

December 31, 2015

Millions of euros

COMPANY	% holding	Total assets	Total liabilities	Operating revenue	Profit (loss) for the year	Carrying amount
Telefónica Factoring	50%	360	321	55	27	20
Telefónica Consumer Finance	50%	249	221	19	2	14
Other						40
TOTAL						74

December 31, 2014

Millions of euros

COMPANY	% holding	Total assets	Total liabilities	Operating revenue	Profit (loss) for the year	Carrying amount
DTS, Distribuidora de Televisión Digital, S.A.	44%	1,265	622	1,168	(210)	703
Telefónica Factoring	50%	282	244	48	24	19
Telefónica Consumer Finance	50%	127	100	5	(3)	13
Other						53
TOTAL						788

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## Note 10. Related parties

**Significant shareholders**

A summary of significant transactions between the Telefónica Group and the companies of Banco Bilbao Vizcaya Argentaria, S.A. (BBVA) and those of Caja de Ahorros y Pensiones de Barcelona (“la Caixa”), significant shareholders of the Company with stakes in Telefónica, S.A. of 6.07% and 5.01%, respectively, at December 31, 2015, is as follows:

All of these transactions were carried out at market prices.

Millions of euros	BBVA	La Caixa
2015		
Finance costs	24	1
Leases	1	–
Receipt of services	5	13
Purchase of goods	1	53
Total costs	31	67
Finance income	15	1
Contracts of management	1	–
Dividends received <sup>(1)</sup>	16	N/A
Services rendered	35	52
Sale of goods	6	64
Other income	17	–
Total revenue	90	117
Finance arrangements: loans and capital contributions (borrower)	534	422
Finance arrangements: loans and capital contributions (lender)	–	6
Guarantees	317	39
Commitments	1	79
Finance arrangements: loans and capital contributions (lessee)	54	50
Dividends	212	113
Factoring operations	164	150

<sup>(1)</sup> At December 31, 2015, Telefónica holds a 0.69% stake in the share capital of Banco Bilbao Vizcaya Argentaria, S.A. (see Note 13.a).

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Millions of euros	BBVA	La Caixa
2014		
Finance costs	26	2
Receipt of services	8	59
Other expenses	3	–
Total costs	37	61
Finance income	14	19
Dividends received	14	N/A
Services rendered	61	95
Sale of goods	5	2
Other income	3	–
Total revenue	97	116
Finance arrangements: loans and capital contributions (borrower)	417	31
Guarantees	529	75
Commitments	32	67
Finance arrangements: loans and capital contributions (lender)	1,107	1,173
Dividends <sup>(1)</sup>	194	98
Factoring operations	112	–

<sup>(1)</sup> The shares received by la Caixa for the scrip dividend paid in December 2014 should be considered in addition to the amount included in this file.

In addition, the nominal value of outstanding derivatives held with BBVA and la Caixa in 2015 amounted to 19,824 and 1,241 million euros, respectively (24,730 million euros held with BBVA and 1,221 million euros held with la Caixa in 2014). 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. The fair value of these same derivatives in the statement of financial position is 948 and -26 million euros, respectively, in 2015 (762 and -36 million euros, respectively, in 2014).

#### Other related parties

The most significant balances and transactions with associates and joint ventures are detailed in Note 9.

During the financial year to which these accompanying consolidated 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 21.f and Appendix II of these consolidated financial statements.

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A member of Telefónica, S.A.'s Board of Directors is also board member of Abertis Infraestructuras, S.A., parent of Abertis. Telefónica has signed agreements with Abertis, through its subsidiary On Tower Telecom Infraestructuras S.A. (previously Abertis Tower, S.A.), by virtue of which Telefónica Spain has sold mobile phone towers in 2015 and 2014, respectively, at a price of 44 million euros in 2015 and 224 million euros in 2014, generating a gain of 38 million euros in 2015 and a gain of 193 million euros in 2014.

An agreement has also been signed through which On Tower Telecom Infraestructuras S.A. leases certain space in the aforesaid infrastructures for Telefónica Móviles España, S.A.U. to install its communications equipment.

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A representative from Telefónica remains on China Unicom's board of directors, and vice versa (see Note 9). In addition, Telefónica maintains an industrial alliance with this company. On December 18, 2015 a joint venture with China Unicom was incorporated, for the development of Big Data services in China using "Smart Steps" technology, developed by Telefónica. Telefónica's stake in this company is 45% through Telefónica Digital España, S.L.; China Unicom Broadband Online Limited Corp. owns the remaining 55% stake. The share capital of the company amounts to 16 million euros approximately, which at December 31, 2015 is pending payment.

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## Note 11. Trade and other receivables

The breakdown of this consolidated statement of financial position heading at December 31, 2015 and 2014 is as follows:

Millions of euros	12/31/2015	12/31/2014 (*)
Trade receivables billed	7,232	9,172
Trade receivables unbilled	2,632	2,529
Impairment of trade receivables	(2,531)	(2,757)
Other receivables	478	614
Short-term prepayments	490	1,079
Total	8,301	10,637

(\*) Revised data (see Note 5).

Public-sector net trade receivables at December 31, 2015 and 2014 amounted to 349 million euros and 437 million euros, respectively.

The movement in impairment of trade receivables in 2015 and 2014 is as follows:

	Millions of euros
Impairment provision at December 31, 2013	2,598
Allowances	808
Amounts applied	(801)
Inclusion of companies	152
Impairment provision at December 31, 2014	2,757
Allowances	721
Amounts applied	(664)
Inclusion of companies	146
Transfers	(227)
Translation differences and other	(202)
Impairment provision at December 31, 2015	2,531

“Transfer” includes the classification of impairment of trade receivable as “Non-current assets and disposal groups classified as held for sale” of Telefónica in United Kingdom (see Note 23).

The balance of trade receivables billed net of impairment losses at December 31, 2015 amounted to 4,701 million euros (6,415 million euros at December 31, 2014), of which 2,464 million euros were not yet due (4,162 million euros at December 31, 2014).

Net balance of trade receivables billed of 259 million euros and 207 million euros are over 360 days due at December 31, 2015 and 2014, respectively. They are mainly with the public sector.

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Note 12. Equity

**a) Share capital and share premium**

**2015**

On April 20, 2015, the public deed evidencing the share capital increase granted by Telefónica, S.A. was registered with the Commercial Registry of Madrid for a nominal value of 281,213,184 euros recorded as “share capital”. The difference with the effective amount issued, amounting 3,048,350,914.56 euros was recorded as Share premium.

On July 24, 2015, the public deed of the share capital reduction was registered, cancelling 74,076,263 of the own shares, reducing the company’s share capital by 74,076,263 euros.

On December 10, 2015, the public deed of a share capital increase of 110,857,946 euros was executed, during which 110,857,946 ordinary share with a par value of 1 euro each were issued, with a charge to reserves, as part of the scrip dividend shareholder remuneration deal. Share capital amounts to 4,975,199,197 euros subsequence to this increase.

At December 31, 2015, Telefónica, S.A.’s share capital amounted to 4,975,199,197 euros and consisted of 4,975,199,197 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’).

**2014**

On December 9, 2014, the deed of a share capital increase of 106,179,744 euros was executed, during which 106,179,744 ordinary shares with a par value of 1 euro each were issued, with a charge to reserves, as part of the scrip dividend shareholder remuneration deal. Share capital amounts to 4,657,204,330 euros subsequent to this increase.

**Authorizations by Shareholders’ Meeting**



With respect to authorizations given regarding share capital, 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 period of five years 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 Section 506 of the Spanish Enterprises Act. However, the power to exclude preemptive rights is limited to 20% of the Company's share capital on the date of adoption of this resolution.

Furthermore, on May 30, 2014, 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 period of five years 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).

In addition, at the May 30, 2014 Shareholders' Meeting of Telefónica, S.A., authorization was given for the Board of Directors to issue debentures, bonds, notes and other fixed-income securities and hybrid instruments, including preferred shares at one or several times within a maximum period of five years 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 whatever may be the forms admitted in law, 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. This delegation also includes warrants or other similar securities that might give the right to directly or indirectly subscribe or acquire shares of the Company, 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, at any given time, the sum of 25,000 million euros or the equivalent in another currency. For promissory notes, the outstanding balance of promissory notes issued under this authorization will be calculated for purposes of the aforementioned limit. Also for purposes of the foregoing limit, in the case of warrants, the sum of the premiums and exercise prices of the warrants for each issuance that is approved under this delegation shall be taken into account.

## b) Dividends

### Dividends distribution in 2015 and capital increase

Approval was given at the Board of Directors' Meeting of April 29, 2015 to pay a gross 0.40 euros dividend per outstanding share against 2015 profit. This dividend was paid on May 12, 2015 and the total gross amount paid was 1,912 million euros.

In accordance with Article 277 of the Spanish Companies Law, the following table presents the mandatory statement of accounts prepared to confirm the existence of sufficient liquidity to pay the dividend at the date of its approval.

Liquidity statement	Millions of euros
Income from January 1 through March 31, 2015	2,201
Mandatory appropriation to reserves	-
Distributable income	2,201
Proposed interim dividend (maximum amount)	(1,975)

### Cash position

Funds available for distribution:	
Cash and cash equivalents	3
Unused credit facilities	9,314
Proposed interim dividend (maximum amount)	(1,975)
Difference	7,342

At its meeting held on November 13, 2015, the Executive Commission of Telefónica, S.A.'s Board of Directors agreed to carry out the execution of the increase in paid-up capital, related to the shareholders compensation by means of a scrip dividend, approved by the Annual General Shareholder's Meeting of Telefónica, S.A. held on June 12, 2015.

Thus, each shareholder received one free allotment right for each Telefónica share held. Such free allotment rights were traded on the Continuous Market in Spain during a period of 15 calendar days. Once this trading period ended, the shareholders of 20.01% of the free-of-charge allotment rights accepted the irrevocable purchase commitment assumed by Telefónica, S.A. Cash payment to these shareholders was made on December 7, 2015, representing an impact in equity of 337 million euros.

The shareholders of 79.99% of the free-of-charge allotment rights were entitled, therefore, to receive new shares of Telefónica, S.A. Nevertheless, Telefónica, S.A. has waived the subscription of new shares corresponding to its treasury shares, so the final number of shares issued in the capital increase was 110,857,946 shares with a nominal value of 1 euro each.

**Proposed distribution of profit attributable to equity holders of the parent**

Telefónica, S.A. generated 8 million euros of profit in 2015.

The Company's Board of Directors will submit the following proposed distribution of 2015 profit for approval at the Shareholders' Meeting:

	Millions of euros
Goodwill reserve	2
Legal reserve	1
Interim dividend	5
Total	8

Telefónica, S.A.'s Board of Directors also proposes for approval at the Shareholders' Meeting that the difference between the distributable profit of year 2015 and interim dividend is registered against voluntary reserves in the amount of 1,907 million euros.

**Dividends distribution in 2014 and capital increase**

Approval was given at the Board of Directors' Meeting of April 25, 2014 to pay a gross 0.40 euros dividend per outstanding share against 2014 profit. This dividend was paid on May 7, 2014 for a gross amount of 1,790 million euros.

At its meeting held on November 14, 2014, the Executive Commission of Telefónica, S.A.'s Board of Directors agreed to carry out the execution of the increase in paid-up capital, related to the shareholders compensation by means of a scrip dividend, approved by the Annual General Shareholder's Meeting held on May 30, 2014.

Thus, each shareholder received one free allotment right for each Telefónica share held. Such free allotment rights were traded on the Continuous Market in Spain during a period of fifteen calendar days. Once this trading period ended, the shareholders of 15.8% of the free-of-charge allotment rights accepted the irrevocable purchase commitment assumed by Telefónica, S.A. Cash payment to these shareholders was made on December 8, 2014, representing an impact in equity of 242 million euros.

The shareholders of 84.2% of the free-of-charge allotment rights were entitled, therefore, to receive new shares of Telefónica, S.A. Nevertheless, Telefónica, S.A. has waived the subscription of new shares corresponding to its treasury shares, so the final number of shares issued in the capital increase was 106,179,744 shares with a nominal value of 1 euro each.

### **Dividends distribution in 2013**

At its meeting of May 31, 2013, Telefónica, S.A.'s Board of Directors resolved to pay a dividend with a charge to unrestricted reserves of a fixed gross 0.35 euros per outstanding share carrying dividend rights. This dividend was paid in full on November 6, 2013, and the total amount paid was 1,588 million euros.

**c) Other equity instruments**

**Undated deeply subordinated securities**

**Issued in 2015**

On March 30, 2015, Colombia Telecomunicaciones S.A. ESP issued subordinated perpetual notes in an aggregate principal amount of 500 million U.S. dollars (equivalent to 452 million euros) and subject to a call option exercisable by Colombia Telecomunicaciones S.A. ESP starting on the fifth anniversary of the issuance date. The securities will bear interest on their principal amount as follows:

from and including March 30, 2015 (the “Issue Date”) to but excluding March 30, 2020 (the “First Call Date”), the (i) securities will bear interest at a rate of 8.50% per annum, payable semi-annually in arrears on each interest payment date; and

from and including the First Call Date to but excluding the redemption date, if any, for each reset period the (ii) securities will bear interest at a rate equal to the relevant Five Year Swap Rate expressed as a percentage, plus the initial margin; plus

a. in respect of reset periods commencing on or after the First Call Date: 0.25%; plus

in respect of reset periods commencing on or after March 30, 2035: a further 2.75% (unless the issuer’s Standard & Poor’s credit rating shall have been upgraded to investment grade and is effective at March 30, 2035, then such 2.75% increase shall only become effective for reset periods commencing on or after March 30, 2040).

**Issued in 2014**

On March 25, 2014, Telefónica Europe, B.V. issued undated deeply subordinated reset rate guaranteed securities in an aggregate principal amount of 1,750 million euros. This issue entails two tranches: one of them subject to a call option exercisable by Telefónica Europe, B.V. starting on the sixth anniversary of the issuance date in an aggregate principal amount of 750 million euros (the “Sixth-Year Non-Call Securities”), and the other subject to a call option exercisable by Telefónica Europe, B.V. starting on the tenth anniversary of the issuance date in an aggregate principal amount of 1,000 million euros (the “Tenth-Year Non-Call Securities”). In both tranches there is an early redemption option for the issuer.

The Sixth-Year Non-Call Securities will accrue a fixed coupon at a rate of 5% annually as from the issuance date up to March 31, 2020 (not inclusive). From March 31, 2020 (inclusive) onwards, the Sixth-Year Non-Call Securities will accrue a fixed coupon equal to the applicable 6 year euro swap rate plus a margin of: (i) 3.804% per year as from March 31, 2020 up to March 31, 2024 (not inclusive); (ii) 4.054% per year as from March 31, 2024 up to March 31, 2040 (not inclusive); and (iii) 4.804% per year as from March 31, 2040.

The Tenth-Year Non-Call Securities will accrue a fixed coupon at a rate of 5.875% annually as from the issuance date up to March 31, 2024 (not inclusive). From March 31, 2024 (inclusive) onwards, the Tenth-Year Non-Call Securities will accrue a fixed coupon equal to the applicable 10 year euro swap rate plus a margin of: (i) 4.301% per year as from March 31, 2024 up to March 31, 2044 (not inclusive); (ii) 5.051% per year as from March 31, 2044.

On December 4, 2014, Telefónica Europe, B.V. issued undated deeply subordinated reset rate guaranteed securities in an aggregate principal amount of 850 million euros and subject to a call option exercisable by Telefónica Europe, B.V. starting on the fifth anniversary of the issuance date. The Securities will accrue a fixed coupon at a rate of 4.20% annually as from the issuance date up to December 4, 2019 (not inclusive). From December 4, 2019 (inclusive) onwards, the Securities will accrue a fixed coupon equal to the applicable 5 year swap rate plus a margin of: (i) 3.806% per year as from December 4, 2019 up to December 4, 2024 (not inclusive); (ii) 4.056% per year as from December 4, 2024 up to December 4, 2039 (not inclusive); and (iii) 4.806% per year as from December 4, 2039.

In all issuances of subordinated perpetual instruments, the issuer has an option to defer the payment of coupons; holders of these securities cannot call for payment.

As the repayment of principal and the payment of coupons depend solely on Telefónica's decision, these subordinated perpetual instruments are equity instruments and are presented under "Other equity instruments" in the accompanying consolidated statement of changes in equity.

In 2015, the payment of the coupons related to the undated deeply subordinated in an aggregate amount, net of tax effects, of 248 million euros, was recorded as "Retained earnings" in the consolidated statements of changes in equity.

#### **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. The notes could be converted at the option of the noteholders or the issuer at any time from the 41<sup>st</sup> day after the issue date up to the 25<sup>th</sup> trading day prior to the maturity date. The minimum conversion price of the notes will be equal to 11.9 euros per share and the maximum conversion price will be equal to 14.5775 euros per share, resulting in a premium equal to 22.5% over the minimum conversion price.

These notes mandatorily convertible were compound instruments that have been split into its two components: a debt component amounting 215 million euros, corresponding to the present value of the coupons; and an equity component, for the remaining amount, due to the issuer option to convert the treasury shares to a fix ratio, included in the heading "other equity instruments". The first coupon was paid in September 2015 amounting to 73 million euros.



**d) Legal reserve**

According to the consolidated 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, 2014, the Company had duly set aside this reserve, amounting to 984 million euros. At December 31, 2015, after the capital increase carried forward in 2015, the Company needs to increase the legal reserve by 11 million euros. The proposed distribution of 2015 profit includes an allocation of 1 million euros regarding this concept.

**e) Retained earnings**

These reserves include undistributed profits of companies comprising 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 revaluation reserves and reserve for cancelled 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 Royal Decree-Law 7/1996 dated June 7 and may be used, free of tax, to offset any losses incurred in the future and to increase capital. Also 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, an amount of 8 million euros was reclassified to "Retained earnings" in 2015 (8 million euros in 2014 and 7 million euros in 2013), corresponding to revaluation reserves subsequently considered unrestricted. At December 31, 2015, this reserve amounts to 93 million euros (101 million euros at December 31, 2014).

**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. In 2015, a reserve for cancelled share capital amounting to 74 million euros was recorded, the same amount as the capital reduction made in the year. No additional amounts were added to this reserve in 2014, and the cumulative amount of the reserve for cancelled share capital at December 31, 2015 and 2014 was 656 and 582 million euros, respectively.

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**f) Translation differences**

The breakdown of the accumulated contribution of translation differences at December 31 is as follows:

Millions of euros	2015	2014	2013
Brazilian real	(9,884)	(5,552)	(5,556)
Venezuelan bolivars	(3,141)	(2,923)	27
Pound sterling	(1,404)	(1,901)	(2,455)
Other currencies	(2,369)	(1,756)	(1,291)
Total Group	(16,798)	(12,132)	(9,275)

**g) Treasury share instruments**

At December 31, 2015, 2014 and 2013, Telefónica, S.A. held the following treasury shares:

	Number of shares	Euros per share		Market value(*)	%
		Acquisition price	Trading price		
Treasury shares at 12/31/15	141,639,159	11.69	10.24	1,450	2.84690%
Treasury shares at 12/31/14	128,227,971	11.68	11.92	1,528	2.75332%
Treasury shares at 12/31/13	29,411,832	11.69	11.84	348	0.64627%

(\*) Millions of euros

In 2015, 2014 and 2013 the following transactions involving treasury shares were carried out:

	Number of shares
Treasury shares at 12/31/12	47,847,810
Acquisitions	113,154,549
Disposals	(131,590,527)
Treasury shares at 12/31/13	29,411,832
Acquisitions	100,723,415
Disposals	(129,177)
Employee share option plan	(1,778,099)
Treasury shares at 12/31/14	128,227,971
Acquisitions	138,036,450
Disposals	(47,824,300)
Employee share option plan	(2,724,699)
Capital reduction	(74,076,263)

Treasury shares at 12/31/15 141,639,159

Treasury shares purchases in 2015 amounted to 1,654 million euros (1,176 million euros and 1,216 million euros in 2014 and 2013, respectively).

Treasury shares disposed of in 2015, 2014 and 2013 amounted to 593 million euros, 1 million euros and 1,423 million euros, respectively.

The main sale of treasury shares in 2015 was the exchange with Vivendi, S.A. of 46 million of Telefónica, S.A.'s treasury shares, for 58.4 million preferred shares of Telefônica Brasil, S.A., amounting to 555 million euros (see Note 5).

On June 30, 2015, the second phase of the Telefónica, S.A. long-term incentive plan called "Performance and Investment Plan 2012-2015" ("PIP 2012-2015") ended. According to the level of "Total Shareholder Return" (TSR) achieved, 77%, 2,724,699 shares were delivered (see Note 19).

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Telefónica Centroamericana Inversiones, S.L.								
Other	76	(8)	–	(2)	(4)	-	(3)	59
Total	9,186	4,368	(1,830)	(641)	135	(1,561)	8	9,665

Millions of euros	Balance at 12/31/2013	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 12/31/2014
Telefónica Czech Republic, a.s.	666	–	(666)	–	–	–	–	–
Telefônica Brasil, S.A.	3,491	–	–	(269)	423	(5)	16	3,656
Telefónica Deutschland Holding, A.G. (*)	1,962	3,615	–	(122)	(277)	–	–	5,178
Telefónica Colombia Telecomunicaciones, S.A., ESP	(165)	–	–	–	91	7	17	(50)
Telefónica Centroamericana Inversiones, S.L.	283	6	–	(14)	9	41	1	326
Other	60	10	–	(1)	5	4	(2)	76
Total	6,297	3,631	(666)	(406)	251	47	32	9,186

(\*) Revised data (see Note 5)

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Millions of euros	Balance at 12/31/2012	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 12/31/2013
Telefónica Czech Republic, a.s.	813	–	(46)	(100)	63	(64)	–	666
Telefônica Brasil, S.A.	4,373	–	–	(522)	335	(694)	(1)	3,491
Telefónica Deutschland Holding A.G.	2,084	–	–	(117)	(1)	(1)	(3)	1,962
Telefónica Colombia Telecomunicaciones, S.A., ESP	(139)	–	–	–	(37)	21	(10)	(165)
Telefónica Centroamericana Inversiones, S.L.	–	283	–	–	11	(12)	1	283
Other	69	1	–	–	5	(13)	(2)	60
<b>Total</b>	<b>7,200</b>	<b>284</b>	<b>(46)</b>	<b>(739)</b>	<b>376</b>	<b>(763)</b>	<b>(15)</b>	<b>6,297</b>

Revenues, OIBDA, capital expenditure and the main items of the statement of financial position for the main companies of the Telefónica Group with non-controlling interests, Telefónica Brazil and Telefónica Germany, are included in the Note 4. The statements of cash flows of these companies are as follows:

Millions of euros	2015	2014	2013
Telefônica Brasil			
Net cash flow provided by operating activities	2.893	3.138	3.480
Net cash flow used in investing activities	(4.111)	(2.544)	(2.022)
Net cash flow used in financing activities	1.530	(1.096)	(1.597)
	312	(502)	(139)

Millions of euros	2015	2014	2013
Telefónica Germany			
Net cash flow provided by operating activities	2.081	1.620	1.473
Net cash flow used in investing activities	(2.180)	(4.081)	(681)
Net cash flow used in financing activities	(1.023)	3.530	(321)
	(1.122)	1.069	471

**2015**

In 2015, “Sales of non-controlling interests and inclusion of companies” reflects the effect of the capital increase in Telefônica Brasil, S.A. for the acquisition of GVT, and the changes in the investment percentages related to the same operation (see Note 5). Additionally, it is meaningful the changes in the investment percentages in Colombia Telecomunicaciones, pursuant to amendment n° 1 of the Framework investment Agreement executed with the Colombian Government (see Note 21.b).

## **2014**

In 2014, “Sales of non-controlling interests and inclusion of companies” reflects the effect of the capital increase in Telefónica Deutschland Holding, A.G. for the acquisition of E-Plus, and the changes in the investment percentages related to the same operation, amounting to 3,627 million euros, revised data to reflect the finalization of the purchase price allocation of E-Plus (see Notes 2 and 5). The removal of Telefónica Czech Republic, a.s. from the scope of consolidation is also significant (see Note 2).



**2013**

In 2013, “Sales of non-controlling interests and inclusion of companies” reflects the effect of the sale of 40% of the investment through Telefónica Centroamérica Inversiones, S.L. in Guatemala, El Salvador, Nicaragua and Panama, with an impact of 283 million euros (see Note 5).

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## Note 13. Financial assets and liabilities

## 1.- Financial assets

The breakdown of financial assets of the Telefónica Group at December 31, 2015 and 2014 is as follows:

December 31, 2015												
Millions of euros	Fair value through profit or loss		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	Available-for-sale	Hedges	Level 1 (Quoted prices)	Level 2 (Other directly observable market inputs)	Level 3 (Inputs not based on observable market data)					
Non-current financial assets	2,340	238	1,823	2,975	1,511	5,847	18	3	2,629	10,008	10,008	
Investments	–	–	1,289	–	1,068	221	–	–	–	1,289	1,289	
Long-term credits	–	238	534	–	79	675	18	–	1,714	2,486	1,900	
Deposits and guarantees	–	–	–	–	–	–	–	3	1,420	1,423	1,423	
Derivative instruments	2,340	–	–	2,975	364	4,951	–	–	–	5,315	5,315	
Impairment losses	–	–	–	–	–	–	–	–	(505)	(505)	–	
Current financial assets	859	116	85	1,540	448	2,152	–	10	2,960	5,570	5,570	
Financial investments	859	116	85	1,540	448	2,152	–	10	361	2,971	2,971	
Cash and cash equivalents	–	–	–	–	–	–	–	–	2,599	2,599	2,599	
Total financial assets	3,199	354	1,908	4,515	1,959	7,999	18	13	5,589	15,578	15,578	

December 31, 2014

Millions of euros	Fair value through profit or loss		Measurement hierarchy							Rest of financial assets at amortized cost	Total carrying amount	Total fair value
	Held for trading	Fair value option	Available-for-sale	Hedges	Level 1 (Quoted prices)	Level 2 (Other directly observable market inputs)	Level 3 (Inputs not based on observable market data)	Held-to-maturity investments				
Non-current financial assets	2,453	245	1,875	3,046	1,492	6,114	13	137	3,217	10,973	10,973	
Investments	–	–	1,278	–	1,170	108	–	–	–	1,278	1,278	
Long-term credits	–	245	597	–	84	745	13	47	2,248	3,137	2,642	
Deposits and guarantees	–	–	–	–	–	–	–	90	1,471	1,561	1,561	
Derivative instruments	2,453	–	–	3,046	238	5,261	–	–	–	5,499	5,499	
Impairment losses	–	–	–	–	–	–	–	–	(502)	(502)	–	
Current financial assets	500	97	63	571	423	808	–	9	8,221	9,461	9,461	
Financial investments	500	97	63	571	423	808	–	9	1,692	2,932	2,932	
Cash and cash equivalents	–	–	–	–	–	–	–	–	6,529	6,529	6,529	
Total financial assets	2,953	342	1,938	3,617	1,915	6,922	13	146	11,438	20,434	20,434	

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.

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.

## a) Non-current financial assets

The movement in items composing “Non-current financial assets” in 2015 and 2014 is as follows:

Millions of euros	Investments	Long-term credits	Deposits and guarantees	Derivative financial assets	Impairment provision	Total
Balance at 12/31/13	<b>550</b>	<b>3,476</b>	<b>1,432</b>	<b>2,667</b>	<b>(350)</b>	<b>7,775</b>
Acquisitions	58	916	161	423	(5)	1,553
Disposals	(21)	(451)	(148)	(16)	6	(630)
Translation differences	(5)	18	(25)	124	5	117
Fair value adjustments	(113)	35	103	2,538	–	2,563
Transfers and others	809	(857)	38	(237)	(158)	(405)
Balance at 12/31/14	<b>1,278</b>	<b>3,137</b>	<b>1,561</b>	<b>5,499</b>	<b>(502)</b>	<b>10,973</b>
Acquisitions	156	1,067	140	489	(30)	1,822
Disposals	(2,349)	(732)	(146)	(26)	(1)	(3,254)
Inclusion of companies	–	28	160	–	–	188
Translation differences	(7)	(82)	(411)	81	30	(389)
Fair value adjustments	522	(41)	119	586	–	1,186
Transfers and others	1,689	(891)	–	(1,314)	(2)	(518)
Balance at 12/31/15	<b>1,289</b>	<b>2,486</b>	<b>1,423</b>	<b>5,315</b>	<b>(505)</b>	<b>10,008</b>

**Investments**

“Investments” includes the fair value of investments in companies where Telefónica does not exercise significant control and for which there is no specific disposal plan for the short term (see Note 3.i).

At December 31, 2015 the Telefónica Group’s shareholding in China Unicom (Hong Kong) Limited is 2.51%, valued at 672 million euros (662 million euros at December 31, 2014).

Additionally, the Telefónica Group’s shareholding in Banco Bilbao Vizcaya Argentaria, S.A. (BBVA) amounts to 298 million euros (347 million euros at December 31, 2014), representing 0.69% of its share capital at December 31, 2015.

As of December 31, 2014, the stake in Telco, S.p.A. was 66% amounting to a book value of 73 million euros (registered as available-for-sale financial asset). The demerger of Telco, S.p.A. was formalized on June 17, 2015. Thereafter, the ordinary shares in Telecom Italia, S.p.A. held by Telco, S.p.A. (equivalent to 22.3% of the company's ordinary share capital) were assigned to shareholders, whereby the new company Telco TE, S.p.A., fully-owned by Telefónica (consolidated under the full integration method), received shares equivalent to 14.72% of the ordinary share capital of Telecom Italia. "Transfers and others" of the above table mainly includes the impact of the aforementioned demerger (see Note 9).

In compliance with the commitments undertaken in the acquisition agreement of GVT, Telefónica delivered 1,110 million ordinary shares in Telecom Italia, S.p.A. (representing 8.2% of the ordinary shares in the company) to Vivendi, S.A. in exchange for 4.5% of the share capital in Telefônica Brasil, S.A. (see Note 5).

Also, Telco TE, S.p.A. signed a sale and purchase agreement with a financial entity to transfer 872 million ordinary shares in Telecom Italia, S.p.A., representing 6.5% of the ordinary shares of the latter, for approximately 1,025 million euros (see Note 21).

Likewise, Telefónica arranged several hedging instruments which will allow Telefónica, S.A. to repurchase the shares of Telecom Italia, S.p.A. that are necessary to meet its exchange obligations under the mandatory exchangeable bonds for shares of Telecom Italia, S.p.A., issued by Telefónica, S.A. in July 2014. These instruments are recorded under caption "Derivative instruments" of financial liabilities on the accompanying disclosure.

The positive impact in the Net financial expense for the first six months of 2015 related with the transactions with Telecom Italia shares described above amounted to 380 million euros.

In “Transfers and others” in 2014 there was mainly the reclassification as “non-current financial assets available-for-sale” of our investment in China Unicom (Hong Kong) Limited and Telco, S.p.A. (see Note 9), consolidated until that moment by the equity method.

At year-end the Group assessed the securities in its portfolio of listed available-for-sale assets individually for impairment. The analysis did not uncover the need to recognize any significant impairment losses.

### Long-term credits and impairment provision

Million euros	12/31/2015	12/31/2014
Long-term trade receivables	472	825
Long-term prepayments	371	338
Long-term receivables for indirect taxes	104	112
Other long-term credits	1,539	1,862
Total	2,486	3,137

“Other long-term credits” includes long-term financial assets of the subsidiary Seguros de Vida y Pensiones Antares, S.A., fundamentally fixed-income securities, amounting to 747 million euros and 816 million euros at December 31, 2015 and 2014, respectively. These assets are mainly intended to cover the obligations from the defined benefit plans of Telefónica de España (ITP and Survival), though they do not qualify as “plan assets” under IAS 19 (see Note 15).

“Other long-term credits” in 2014 included the deferred account receivable generated from the sale of Telefónica Czech Republic, a.s. (see Note 2), in the amount of 217 million euros. This same item amounts to 86 million euros on a current basis. The sale agreement contemplates a payment schedule that extends to January 2018. In November 2015, the Company agreed with PPF Group, N.V.I. an early prepayment of the total outstanding amount.

In “Transfers and others” in 2015 there was the reclassification as “Non-current assets and disposal groups classified as held for sale” of the credits in Telefónica United Kingdom, amounted to 240 million euros.

Impairment provision for long-term credits amounted to 505 and 502 million euros at December 31, 2015 and December 31, 2014, respectively.

### Derivative financial assets

In “Transfers and others” in 2015 there was the reclassification to short-term derivative financial assets relating to Telefónica, S.A., amounting to 1,292 million euros.

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b) Current financial assets

This heading includes the following items:

Short-term investments in financial instruments recognized at fair value to cover commitments undertaken by the Group's insurance companies, amounting to 396 million euros at December 31, 2015 (377 million euros at December 31, 2014), recorded at fair value.

Derivative financial assets with a short-term maturity or not used to hedge non-current items in the consolidated statement of financial position, in the amount of 2,140 million euros (813 million euros in 2014).

Short-term deposits and guarantees amounting to 263 million euros at December 31, 2015 (179 million euros at December 31, 2014).

Short-term credits amounting to 153 million euros (1,527 million euros at December 31, 2014, including principal plus interests of Telco, S.p.A.'s bond totaling 1,307 million euros).

Moreover, on February 27, 2015 Telco, S.p.A., repaid in full the banking debt owed and the subordinated bond with the available funds from the shareholders loans (2,555 million euros, out of which 1,687 million euros correspond to Telefónica according to its stake in the company). After Telco, S.p.A. demerger previously mentioned, the liability resulting from the loan granted to Telefónica was transferred to Telco TE, S.p.A. In June 2015 the shareholders loan was fully repaid.

Current investments of cash surpluses which, given their characteristics, have not been classified as "Cash and cash equivalents."

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.



## 2.- Financial liabilities

The breakdown of financial liabilities at December 31, 2015 and the corresponding maturities schedule is as follows:

Millions of euros

Maturity	Current						Non-current total	Total
	2016	2017	2018	2019	2020	Subsequent years		
Debentures and bonds	7,826	6,719	4,091	1,965	2,773	20,183	35,731	43,557
Promissory notes & commercial paper	1,515	–	–	–	112	188	300	1,815
Total Issues	9,341	6,719	4,091	1,965	2,885	20,371	36,031	45,372
Loans and other payables	3,284	1,070	2,121	1,520	1,214	2,154	8,079	11,363
Derivative instruments (Note 16)	328	672	331	256	799	949	3,007	3,335
Total	12,953	8,461	6,543	3,741	4,898	23,474	47,117	60,070

The estimate of future payments for interest on these financial liabilities at December 31, 2015 is as follows: 2,352 million euros in 2016, 2,045 million euros in 2017, 1,623 million euros in 2018, 1,381 million euros in 2019, 1,155 million euros in 2020 and 6,650 million euros in years after 2020. For floating rate financing, the Group mainly estimates future interest using the forward curve of the various currencies at December 31, 2015.

The amounts shown in this table take into account the fair value of derivatives classified as financial liabilities (i.e., those with a negative mark-to-market) and exclude the fair value of derivatives classified as current financial assets, for 2,140 million euros, and those classified as non-current, for 5,315 million euros (i.e., those with a positive mark-to-market).

As stated in Note 20, the Group has entered into agreements to extend payment terms with various suppliers, and with factoring companies when such payments are discounted. The corresponding amount pending payment as of December 31, 2015, is recognized in “Loans and other payables” (927 million euros).

The composition of these financial liabilities, by category, at December 31, 2015 and 2014 is as follows:

December 31, 2015

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	–	–	360	–	360	–	45,012	45,372	48,761
Loans and other payables	–	–	–	–	–	–	11,363	11,363	11,267
Derivative instruments	2,582	–	753	146	3,189	–	–	3,335	3,335
Total financial liabilities	2,582	–	1,113	146	3,549	–	56,375	60,070	63,363

December 31, 2014

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	–	–	–	–	–	–	44,730	44,730	49,434
Loans and other payables	–	–	–	–	–	–	11,420	11,420	11,580
Derivative instruments	2,562	–	1,070	105	3,527	–	–	3,632	3,632
Total financial liabilities	2,562	–	1,070	105	3,527	–	56,150	59,782	64,646

The calculation of the fair values of the Telefónica Group's debt instruments required an estimate, for each currency and subsidiary, of the credit spread curve using the prices of the Group's bonds and credit derivatives.

At December 31, 2015, some of the financing arranged by Telefónica Group companies in Latin America (Brazil, Chile, Panama and Guatemala) which amount to approximately 3% 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 a Telefónica, S.A. level. Some of the financing arranged by Colombia Telecomunicaciones, S.A., ESP is subject to compliance with a financial covenant, that, once it has been reached, the amount of any new additional indebtedness is limited to approximately 250 million euros equivalents, primarily for operational purposes, without a breach has taken place.

Part of the amount owed by the Telefónica Group includes restatements to amortized cost at December 31, 2015 and 2014 as a result of fair value interest rate and exchange rate hedges.

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## a) Issues

The movement in issues of debentures, bonds and other marketable debt securities in 2015 and 2014 is as follows:

Millions of euros	Debenture and bond issues	Short-term promissory notes and commercial paper	Other non-Current Marketable debt securities	Total
Balance at 12/31/13	42,080	1,279	59	43,418
New issues	4,453	27	–	4,480
Redemptions, conversions and exchanges	(5,057)	(805)	(59)	(5,921)
Revaluation and other movements	2,751	2	–	2,753
Balance at 12/31/14	44,228	502	–	44,730
New issues	1,602	1,308	–	2,910
Redemptions, conversions and exchanges	(3,805)	–	–	(3,805)
Revaluation and other movements	1,532	5	–	1,537
Balance at 12/31/15	43,557	1,815	–	45,372

**Debentures and bonds**

At December 31, 2015, the nominal amount of outstanding debentures and bonds issues was 41,252 million euros (42,083 million euros at December, 31, 2014). Appendix III presents the characteristics of all outstanding debentures and bond issues at year-end 2015, as well as the significant issues made in the year.

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.

**Short-term promissory notes and commercial paper**

The main programs for issuance of promissory notes and commercial paper are the following:

At December 31, 2015, Telefónica Europe, B.V. had a program for issuance of commercial paper, guaranteed by Telefónica, S.A., for up to 3,000 million euros. The outstanding balance of commercial paper issued under this program at December 31, 2015 was 1,431 million euros, issued at an average interest rate of 0.089% for 2015 (496 million euros issued in 2014 at an average rate of 0.36%).

At December 31, 2015, 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, 2015 is 66 million euros (6 million euros in 2014).

On March 13, 2015 Telefónica Germany, GmbH & Co. OHG made an issuance of debt instruments in the local market (*schuld Scheindarlehen* and *namenschuldverschreibung*) for an aggregate amount of 300 million euros with different maturity terms until 2032.

### **Other long-term marketable debt securities**

On October 31, 2012, an offer to purchase the preferred securities of Telefónica Finance USA, LLC. was launched. Holders accepting such offer would receive, concurrently and in connection with, Telefónica's ordinary shares and they would subscribe new debt securities of Telefónica. As a result of this offer, on November 29, 2012, the Group purchased 1,941,235 preferred securities (representing 97.06% of total). On June 30, 2014, the remaining 58,765 preferred securities were fully redeemed at face value of 1,000 euros. There were no outstanding preferred securities after this redemption.

#### **b) Interest-bearing debt**

The average interest rate on outstanding loans and other payables at December 31, 2015 was 2.31% (2.88% in 2014). 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, 2015 and 2014 and their nominal amounts are provided in Appendix V.

Interest-bearing debt arranged or repaid in 2015 mainly includes the following:

On January 9, 2015, Telefónica Europe, B.V. made an early repayment for 844 million dollars (equivalent to 714 million euros) of its long-term credit facility dated August 28, 2012 and originally scheduled to mature in 2023. This financing was guaranteed by Telefónica, S.A.

On January 30, 2015, Telefónica Finanzas, S.A.U. repaid in full the outstanding amount under the loans facilities arranged with the European Investment Bank (EIB) for 375 and 100 million euros. These financings were guaranteed by Telefónica, S.A.

On February 19, 2015, Telefónica, S.A. signed a 2,500 million euros syndicated credit facility maturing in 2020, even though by mutual agreement between the parties could be extended to a maximum maturity in 2022. At December 31, 2015 the outstanding amount of this financing was 500 million euros. This agreement entered into effect on February 26, 2015 cancelling in advance the syndicated loan facility of Telefónica Europe, B.V. dated on March 2, 2012 with two tranches of 756 million euros and 1,469 million pounds sterling originally scheduled to mature in 2017. On the same date, Telefónica, S.A. signed an amendment to its 3,000 million euros syndicated credit facility arranged on February 18, 2014 maturing in 2019 in which was included an option by mutual agreement between the parties to extend the maturity up to 2021. At December 31, 2015 the outstanding amount of this financing was 700 million euros.

On March 2, 2015, Telefônica Brasil, S.A. repaid in full its loan facility arranged with the European Investment Bank (EIB) on October 31, 2007 for 265 million dollars (equivalent to 236 million euros).

On April 15, 2015, Telefónica Europe, B.V. made an early repayment of its long-term credit facility arranged on January 5, 2012 for 375 million dollars (equivalent to 354 million euros) and originally scheduled to mature in 2022. This financing was guaranteed by Telefónica, S.A.

On June 25, 2015, Telefónica, S.A. signed an amendment to its 2,000 million euros bilateral loan arranged on June 26, 2014 modifying the maturity date to June 26, 2018 and including an amortization schedule. On July 1, 2015 an early repayment for 500 million euros was made of which original maturity was in 2017.

On June 30, 2015, Telefónica, S.A. signed a long-term loan for an aggregate amount of 200 million euros and maturing in 2020. At December 31, 2015 the outstanding amount under this loan was 200 million euros.

On October 12, 2015, Telefónica del Perú, S.A.A. signed a 1,050 million Peruvian Nuevos Soles (equivalent to 283 million euros) credit facility maturing in 2020. At December 31, 2015, there was no outstanding amount under this facility.

On November 17, 2015, Telefónica, S.A. signed a 3,000 million euros syndicated credit facility maturing in 2018. At December 31, 2015 there was no outstanding amount under this facility.

On December 11, 2015, Telefónica, S.A. signed a long-term credit facility for an aggregate amount of 750 million dollars (equivalent to 689 million euros) at a fixed rate with the guarantee of the Swedish Export Credits Guarantee Board (EKN) which matures in 2026. At December 31, 2015, there was no outstanding amount under this facility.

On December 11, 2015, Telefónica, S.A. signed a long-term credit facility for an aggregate amount of 500 million euros at a fixed rate with the guarantee of the Finnish Export Credits Guarantee Board (Finnvera) which matures in 2026. At December 31, 2015 there was no outstanding amount under this facility.

During 2015, Telefónica, S.A. made an early repayment for 328 million euros of its syndicated loan (tranche A3) arranged on July 28, 2010 and originally scheduled to mature on July 28, 2016. At December 31, 2015 there was no outstanding amount under this loan.

During 2015, Telefónica, S.A. repaid in full the outstanding amount under its syndicated loan arranged on April 21, 2006 (amounted to 700 million euros) of which 350 million euros were originally scheduled to mature in 2017.

During 2015, Telefónica, S.A. drew down 198 million dollars (equivalent to 182 million euros) and repaid 105 million dollars (equivalent to 96 million euros) of its 1,001 million dollars long-term credit facility arranged on February 22, 2013 and maturing in 2023. At December 31, 2015 the outstanding amount of this facility was 786 million dollars (equivalent to 722 million euros).

During 2015, Telefónica, S.A. drew down 353 million dollars (equivalent to 324 million euros) and repaid 59 million dollars (equivalent to 54 million euros) of its 734 million dollars long-term credit facility arranged on August 1, 2013 and maturing in 2023. At December 31, 2015 the outstanding amount of this facility was 487 million dollars (equivalent to 447 million euros).

During 2015, GVT, S.A. repaid in full the outstanding amount under its 790 million euros syndicated credit facility arranged on March 12, 2015.

At December 31, 2015, the Telefónica Group presented availabilities of financing from different sources amounting approximately to 13,684 million euros (of which 12,497 million euros maturing in more than twelve months) (11,545 million euros at December 31, 2014).



## Loans by currency

The breakdown of “Loans and other payables” by currency at December 31, 2015 and 2014, along with the equivalent value of foreign-currency loans in euros, is as follows:

Currency	Outstanding balance (in millions)			
	Currency		Euros	
	12/31/15	12/31/14	12/31/15	12/31/14
Euro	5,798	5,077	5,798	5,077
US dollar	2,596	3,683	2,384	3,033
Brazilian Real	5,218	3,010	1,228	933
Colombian Peso	5,131,558	5,592,388	1,497	1,925
Pounds Sterling	–	140	–	180
Other currencies			456	272
Total Group			11,363	11,420

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## Note 14. Trade and other payables

The composition of “Trade and other payables” is as follows:

Millions of euros	12/31/2015		12/31/2014 (*)	
	Non-current	Current	Non-current	Current
Trade payables	–	7,187	–	8,770
Other payables	1,462	5,648	1,507	6,016
Deferred revenue	919	1,106	877	1,441
Payable to associates and joint ventures (Note 9)	–	294	–	724
Total	2,381	14,235	2,384	16,951

(\*) Revised data (see Note 5).

“Deferred revenue” principally includes the amount of deferred revenue from sales of prepaid cards, from handsets transferred to the distributor, rights of use on the cable network, activation fees not yet recognized in the income statement and loyalty campaigns.

At December 31, 2015, non-current “Other payables” comprise the deferred portion of the payment for acquiring the spectrum use license in Mexico in 2010, for an equivalent of 710 million euros (849 million euros at December 31, 2014), the deferred portion of the payment for the refarming of the radioelectric spectrum acquired in 2014 by Telefónica Brazil, amounting to an equivalent of 117 million euros (237 million euros at December 31, 2014, see Appendix VII) and the deferred portion of the payment for the use license spectrum acquired in Germany in 2015, amounting to 109 million euros.

The detail of current “Other payables” at December 31, 2015 and 2014 is as follows:

Millions of euros	Balance at 12/31/2015	Balance at 12/31/2014 (*)
Dividends pending payment to non-controlling interests	229	231
Payables to suppliers of property, plant and equipment	3,207	3,890
Short term debt for spectrum acquisition	394	272
Accrued employee benefits	747	821
Advances received on orders	216	216
Other non-financial non-trade payables	855	586
Total	5,648	6,016

(\*) Revised data (see Note 5).

“Other non-financial non-trade payables” at December 31, 2015 includes Telefónica, S.A.’s irrevocable commitment to pay a 325 million euros donation to Fundación Telefónica to provide this entity with the financing required to implement the social programs and activities it currently performs or could initiate in the short and mid term to fulfill its purpose as a foundation (see Note 18).

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**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:

2015	Number of days
<b>Weighted average maturity period</b>	<b>49</b>
Ratio of payments	50
Ratio of outstanding invoices	36
Million of euros	
Total Payments	6,397
Outstanding invoices	710

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 2015 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 practice, the Telefónica Group’s 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 2015 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 the rendering of services, or occasional processing issues.

## Note 15. Provisions

The amounts of provisions in 2015 and 2014 are as follows:

Millions of euros	12/31/2015			12/31/2014		
	Current	Non-current	Total	Current	Non-current	Total
<b>Employee benefits</b>	<b>1,007</b>	<b>5,366</b>	<b>6,373</b>	<b>1,021</b>	<b>3,426</b>	<b>4,447</b>
Termination plans	707	1,876	2,583	956	2,430	3,386
Post-employment defined benefit plans	–	684	684	–	872	872
Other benefits	300	2,806	3,106	65	124	189
<b>Other provisions</b>	<b>964</b>	<b>3,372</b>	<b>4,336</b>	<b>574</b>	<b>3,254</b>	<b>3,828</b>
<b>Total</b>	<b>1,971</b>	<b>8,738</b>	<b>10,709</b>	<b>1,595</b>	<b>6,680</b>	<b>8,275</b>

In 2015 the Group recorded a provision in the amount of 3,212 million euros (652 million euros in 2014) in order to increase the efficiency for the future representing a further step towards the initiatives focusing on the simplification and transformation of Telefónica. Of this amount, 2,896 million euros relates to the present value of the estimated flows of payments under the Telefónica Spain Individual Suspension Plan described below.

#### Telefónica Spain Individual Suspension Plan

Telefónica de España, S.A.U., Telefónica Móviles España, S.A.U. and Telefónica Soluciones de Informática y Comunicaciones de España, S.A.U. have signed the 1st Collective Agreement of Related Companies (CEV), wholly backed by the largest labor unions. This agreement considers, among other elements, 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. After the signature of the convention, the Company opened the registration to join the Plan.

This plan is based on mutual agreement between the company and the employees, and implies the possibility of voluntarily suspending the employment relationship for an initial three-year period, renewable for consecutive three-year periods until the retirement age. The employees who meet the age and seniority requirements may enter into the Individual Suspension Plan (PSI) in the periods opened for this purposes in 2016 and 2017.

The current value of the forecast payments to meet the commitments of this program (applying certain hypothesis about estimated number of accessions and future reintegration ratio) is estimated to be 2,896 million euros, of which 192 million euros are classified as current provision. This figure was calculated using actuarial criteria (PERM/F-2000C tables, combined with the invalidity table published in the 1977 ministerial order), updated using a continuous zero coupon curve. The corresponding provision is recognized under “Other provisions” in the above table, with a balancing entry in the consolidated income statement under “Personnel expenses”.

The discount rate used for these provisions at December 31, 2015, was 1.20%, with an average length of the Plan of 6 years.

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**Termination plans**

The movement in provisions for post-employment plans in 2015 and 2014 is as follows:

Millions of euros	Total
Provisions for post-employment plans at 12/31/2013	3,465
Additions	525
Retirements/amount applied	(733)
Transfers	(14)
Inclusion of companies	12
Translation differences and accretion	131
Provisions for post-employment plans at 12/31/2014	3,386
Additions	217
Retirements/amount applied	(1,031)
Transfers	(14)
Translation differences and accretion	25
Provisions for post-employment plans at 12/31/2015	2,583

**Telefónica Spain**

Concerning the 2003-2007 labor force reduction plan in Telefónica de España, concluded with 13,870 employees taking part, provisions recorded at December 31, 2015 and 2014 amounted to 268 and 454 million euros, respectively. The amount for this provision classified as current totaled 119 million euros at December 31, 2015.

Concerning the 2011-2013 labor force reduction plan in Telefónica de España, concluded with 6,830 employees taking part, provisions recorded at December 31, 2015 and 2014 amounted to 1,700 and 2,097 million euros, respectively. The amount for this provision classified as current totaled 377 million euros at December 31, 2015.

The companies bound by these commitments calculated provisions required at 2015 and 2014 year-end using actuarial assumptions pursuant to current legislation, including the PERM/F- 2000 C mortality tables and a high quality credit market based interest rate.

The discount rate used for these provisions at December 31, 2015 was 0.80%, with an average length of the plans of 3.1 years.

**Telefónica Germany**

Within the context of transformation of Telefónica Deutschland following the purchase of E-Plus (see Note 5) in a bid to increase profitability by securing operational synergies, a provision for employee restructuring was made in 2014 amounting 321 million euros (additional 4 million euros in 2015). This provision amounted to 174 million euros at December 31, 2015.

**Telefónica, S.A.**

Additions in 2015 include a 120 million euros provision for a voluntary termination program for employees of Telefónica, S.A., which finishes in 2017.

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**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:

12/31/2015

Millions of euros	Spain	Germany	Brazil	Hispanoamérica	Others	Total
Obligation	552	198	449	31	15	1,245
Assets	–	(122)	(637)	–	(10)	(769)
Net provision before asset ceiling	552	76	(188)	31	5	476
Asset ceiling	–	–	206	–	–	206
Net provision	552	76	20	31	5	684
Net assets	–	–	2	–	–	2

12/31/2014

Millions of euros	Spain	United Kingdom	Germany	Brazil	Hispanoamérica	Others	Total
Obligation	593	1,529	201	624	37	11	2,995
Assets	–	(1,567)	(112)	(838)	–	(11)	(2,528)
Net provision before asset ceiling	593	(38)	89	(214)	37	–	467
Asset ceiling	–	–	–	350	–	3	353
Net provision	593	9	89	141	37	3	872
Net assets	–	47	–	5	–	–	52

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The movement in the present value of obligations in 2015 and 2014 is as follows:

Millions of euros	Spain	United Kingdom	Germany	Brazil	Hispano		Total
					américa	Other	
Present value of obligation at 12/31/2013	567	1,251	93	585	93	9	2,598
Translation differences	–	95	–	(1)	(68)	1	27
Current service cost	3	–	4	1	11	–	19
Interest cost	15	58	4	63	2	–	142
Actuarial losses and gains	59	147	47	26	4	1	284
Benefits paid	(51)	(22)	(2)	(50)	(5)	–	(130)
Inclusion of companies	–	–	55	–	–	–	55
Present value of obligation at 12/31/2014	593	1,529	201	624	37	11	2,995
Translation differences	–	108	–	(146)	(15)	1	(52)
Current service cost	8	–	7	2	6	–	23
Interest cost	8	–	4	61	3	1	77
Actuarial losses and gains	(8)	–	(12)	(44)	4	2	(58)
Benefits paid	(49)	–	(2)	(48)	(4)	–	(103)
Transfers	–	(1,637)	–	–	–	–	(1,637)
Present value of obligation at 12/31/2015	552	–	198	449	31	15	1,245

Movements in the fair value of plan assets in 2015 and 2014 are as follows:

Millions of euros	United Kingdom	Germany	Brazil	Other	Total
Fair value of plan assets at 12/31/2013	1,236	91	804	6	2,137
Translation differences	95	–	–	2	97
Expected return on plan assets	59	4	88	1	152
Actuarial losses and gains	118	(1)	(6)	1	112
Company contributions	81	9	–	1	91
Benefits paid	(22)	(2)	(48)	–	(72)
Inclusion of companies	–	11	–	–	11
Fair value of plan assets at 12/31/2014	1,567	112	838	11	2,528
Translation differences	111	–	(202)	(2)	(93)
Expected return on plan assets	–	3	86	1	90
Actuarial losses and gains	–	(1)	(42)	–	(43)
Company contributions	–	9	1	–	10
Benefits paid	–	(1)	(45)	–	(46)
Inclusion of companies	–	–	1	–	1
Transfers	(1,678)	–	–	–	(1,678)
Fair value of plan assets at 12/31/2015	–	122	637	10	769

The amount in “Inclusion of companies” corresponds to the post-employment defined benefit plan of E-Plus employees (see Note 5).



The Group's principal defined-benefit plans are:

a) ITP (Spain)

Telefónica Spain reached an agreement with its employees whereby it recognized supplementary pension payments for employees who had retired as of June 30, 1992, equal to the difference between the pension payable by the social security system and that which 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-updateable and 60% of the payments are transferable to the surviving spouse, recognized as such as of June 30, 1992, and to underage children.

The amount for this provision totaled 291 million euros at December 31, 2015 (326 million euros at December 31, 2014).

b) Survival (Spain)

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 261 million euros at December 31, 2015 (267 million euros at December 31, 2014).

As detailed in Note 13, the Group has long-term financial assets to cover the obligations of these two defined benefit plans.

The discount rate used for these provisions at December 31, 2015, was 1.5%, with an average length of the plans of 8 years.

The main actuarial assumptions used in valuing these plans are as follows:

Survival		ITP	
12/31/2015	12/31/2014	12/31/2015	12/31/2014

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Discount rate	0.246%-2.154%	0.494%-2.011%	0.246%-2.154%	0,494%-2,011%
Expected rate of salary increase	0% - 0.5%	0% - 0.5%	–	–
Mortality tables	PERM/F-2000C - OM77	PERM/F-2000C - OM77	90% PERM 2000C/98% PERF 2000 C	90% PERM 2000C/98% PERF 2000 C

The table below shows the sensitivity of the value of termination, post-employment and Individual Suspension Plan obligations 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
-272	-226	271	229

Variations of less than -100bp are considered for terms of less than ten years to prevent very negative rates (<-20bp).

A 100 b.p. increase in the discount rate would reduce the value of the liabilities by 271 million euros and have a positive impact on income statement of 229 million euros before tax. However, a 100 b.p. decrease in the discount rate would increase the value of the liabilities by 272 million euros and have a negative impact on income statement of 226 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 16).

**Telefónica UK Pension Plan**

The assets and liabilities of Telefónica United Kingdom are classified as held for sale in the statement of financial position at December 31, 2015 (see Note 23).

The Telefónica UK Pension Plan provides pension benefits to the various companies of the Telefónica Group in UK coming from the O2 Group. The Plan is comprised of defined contribution and defined benefit sections. The defined benefit sections were closed to future accrual with effect from February 28, 2013. The companies continued to provide retirement benefits through the defined contribution sections of the Plan.

The key figures of the defined benefit plans of Telefónica United Kingdom are shown below:

Millions of euros	12/31/2015	12/31/2014
Obligation	1,613	1,529
Assets	(1,753)	(1,567)
Net provision before asset ceiling	(140)	(38)
Asset ceiling	—	—
Net provision	5	9
Net assets	145	47

The number of beneficiaries of these plans at December 31, 2015 and 2014 are 4,548 and 4,563 respectively. At December 31, 2015, the weighted average duration of the Plan was 23 years.

The main actuarial assumptions used in valuing the Plan are as follows:

	12/31/2015	12/31/2014
Nominal rate of pension payment increase	3.15%	3.05%
Discount rate	3.80%	3.70%
Expected inflation	3.35%	3.20%
Mortality tables	95% S2NA, CMI 2015 1%	95% S2NA, CMI 2014 1%

Fair value of Plan assets is as follows:

Millions of euros	12/31/2015	12/31/2014
Shares	350	328
Bonds	1,293	1,205
Cash equivalents	108	34
Total	1,751	1,567

At December 31, 2015, reasonably possible changes to one of the following actuarial assumptions, holding other assumptions constant, 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)	94
Expected inflation (0.25% increase)	83
Life expectancy (1 year longer)	40

**Telefónica Brazil pension plans**

Telefónica Brazil sponsors the following post-employment benefit plans:

Plans	Management entity	Sponsor
Health plans PBS Assistidos (PBS-A)		
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
Pension plans CTB	Telefônica Brasil	Telefônica Brasil
Planes PBS	Visão Prev	Telefônica Brasil
Planes PREV	Visão Prev	Telefônica Brasil
Planes VISAO	Visão Prev	Telefônica Brasil and Telefónica Data

The main actuarial assumptions used in valuing these plans are as follows:

	12/31/2015	12/31/2014
Discount rate	12.53% - 13.63%	11.17% - 11.31%
Nominal rate of salary increase	6.69%	6.69%
Expected inflation	4.00%	5.00%
Cost of health insurance	8.15% - 9.18%	8.15%
Mortality tables	AT 2000 M/F	AT 2000 M/F

On September 30, 2015, the Conselho Deliberativo da Sistel approved, pursuant to a court judgment, the creation of a fund (Fundo de Compensação e Solvência) formed from the capital of the special reserve under the PBS-A plan, to bridge the shortfall existing in another of the plans managed by the body and sponsored by Telefônica Brasil, known as PAMA. The ruling requires the sponsoring companies, including Telefônica Brasil, to maintain the coverage of the original PAMA plan and to rectify any deficits that may arise. This transfer of reserves has led to a real reduction in future contributions, which has had a positive impact on Other comprehensive income for the year 2015, in the amount of 430 million Brazilian reais (101 million euros, approximately), 284 million reais net of tax (67 million euros, approximately)

The valuations used to determine the value of obligations and plan assets, where appropriate, were performed as of December 31, 2015 by external and internal actuaries. The projected unit credit method was used in all cases.



The sensitivity to variations in the discount rate of the plans of Telefónica Brasil is shown in the following table:

	Present value of the discounted obligation at the current rate	Present value of the obligation by increasing the rate by 0.5%	Present value of the obligation by reducing the rate by 0.5%
Pension plans	354	341	368
Health plans	95	90	100
Total obligation	<b>449</b>	<b>431</b>	<b>468</b>

### Other provisions

The movement in “Other provisions” in 2015 and 2014 is as follows:

	Millions of euros
Other provisions at December 31, 2013	3,086
Additions and accretion	1,149
Retirements/amount applied	(853)
Inclusion of companies	197
Transfers	366
Translation differences and other	(117)
Other provisions at December 31, 2014	3,828
Additions and accretion	1,799
Retirements/amount applied	(873)
Inclusion of companies	220
Transfers	(60)
Translation differences and other	(578)
Other provisions at December 31, 2015	4,336

At December 31, 2005, the “Other provisions” item for Telefónica United Kingdom has been restated as “Liabilities associated with non-current assets and disposal groups held for sale” (see Note 23) in the amount of 125 million euros, of which 111 million euros correspond to provisions for dismantling of assets.

“Other provisions” include the provisions for dismantling of assets recognized by Group companies in the amount of 695 million euros (883 million euros at the 2014 year end), of which 394 million euros correspond to Telefónica Germany (501 million euros at the 2014 year end).

In addition to the employee restructuring plan in Telefónica Deutschland described above, this company made provisions of 69 and 87 million euros in 2015 and 2014, respectively, primarily to cover the costs linked to the

cancellation of certain contracts as a result of the integration with E-Plus (see Note 5).

At December 31, 2015, Telefónica Brazil has the following provisions for an amount of 1,494 million euros equivalent to cover the risks to which it is exposed:

Provisions for disputes regarding federal, state and municipal taxes totaling approximately 817 million euros (813 million euros at December 31, 2014).

Provisions for labor-related contingencies of approximately 284 million euros (315 million euros at December 31, 2014), which basically relate to claims filed by former and outsourced employees.

Civil claims by private consumers and consumer associations regarding services rendered, and other legal proceedings related with normal operations. Certain administrative proceedings are also in progress concerning disputes about obligations established in sector regulations. The amount accrued for these matters totals approximately 393 million euros (373 million euros at December 31, 2014).

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 17).

In addition, a provision has been made in the amount of EUR 377 million relating to the goodwill amortized for tax on the purchase of the companies of the O2 Group subject to the transfer agreement (see Note 17). The provision relating to the goodwill of Vivo amortized for tax, which was recognized as a deferred tax liability at December 31, 2014, amounts to EUR 75 million at December 31, 2015.

With respect to the European Commission Decision of July 4, 2007 concerning Telefónica Spain's broadband pricing policy, on July 10, 2014 the European Union Court of Justice dismissed the appeal submitted by Telefónica, S.A. and Telefónica de España, maintained the fine and terminated the appeal (see Note 21). Consequently the Group paid a fine of 152 million euros and 58 million euros of interest. Provision for this item totaled 205 million euros at December 31, 2013.

Given the nature of the risks covered by these provisions, it is not possible to determine a reliable schedule of potential payments, if any.

Note 16. 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 Group companies are as follows:

***Exchange rate risk***

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), 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 long-term 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***

The Telefónica Group is also exposed to liquidity risk if a mismatch arises between its financing needs (including operating and financial expense, 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.

Furthermore, the Telefónica Group 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 the Telefónica Group operates, especially in Latin America.

### **Risk management**

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

For a more detailed description on reconciliation of net debt and net financial debt 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 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. 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 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.

At December 31, 2015, net debt in Latin American currencies was equivalent to approximately 6,778 million euros. However, the Latin American currencies in which this debt is denominated is not distributed in proportion to the cash flows 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, 2015, the Telefónica Group's net debt denominated in dollars was equivalent to 1,302 million euros.

Pound sterling-denominated net debt at December 31, 2015, amounted to 6,988 million euros equivalent, with a significant increase over the year in the context of the agreement for the sale of Telefónica's operation in the United Kingdom .

The Telefónica Group also manages exchange rate risk by seeking to reduce significantly the negative impact of any remaining exchange rate exposure affecting the Group's exchange rate differences 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.

Exchange rate management in 2015 produced a negative impact in the amount of 620 million euros (disregarding the effect of monetary correction), mainly due to the fluctuation in the exchange rate of the Venezuelan bolivar from 49.988 to 199 bolivars per dollar and, to a lesser extent, the difficulty in covering commercial positions in US dollars in Argentina, compared to the negative impact of 293 million euros recognized in 2014.

The following table illustrates the sensitivity of foreign currency gains and 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 2015 was considered constant during 2016; b) in calculating 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, whose breakdown is considered constant in 2016 and identical to that existing at the end of 2015. In both cases, Latin American currencies are assumed 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
<b>All currencies vs EUR</b>	<b>10%</b>	<b>33</b>	<b>(112)</b>
USD vs EUR	10%	(2)	(21)
European currencies vs EUR	10%	-	(187)
Latin American currencies vs USD	10%	35	96
All currencies vs EUR	(10)%	(33)	112
USD vs EUR	(10)%	2	21
European currencies vs EUR	(10)%	-	187
Latin American currencies vs USD	(10)%	(35)	(96)

The exchange position of the Venezuelan bolivar affects the estimates made by the Group of the net asset value of the foreign currency position related to investments in Venezuela, the negative impact of which on the 2015 financial statements amounted to 535 million euros.

The Group's monetary position in Venezuela at December 31, 2015 is a net creditor position of 72,646 million Venezuelan bolivars (equivalent to approximately 336 million euros). It had a debtor position until July; nevertheless the average exposure in 2015 has been a creditor position, which led to a higher financial expense in the amount of 348 million euros due to the effect of the monetary correction for inflation during the year.

### Interest rate risk

The Telefónica Group's financial expenses are exposed to changes in interest rates. In 2015, the rates applied to the largest amount of short-term debt were mainly based on the Euribor, the Brazilian SELIC, the US dollar and pound sterling Libor, the Mexican UDI and the Colombian UVR. In nominal terms, at December 31, 2015, 49.1% of Telefónica's net debt (or 58% of long-term net debt) was pegged to fixed interest rates for a period greater than one year, compared to 70% of net debt (70% of long-term net debt) in 2014. Of the remaining 50.9% (net debt at floating rates or at fixed rates maturing in under one year), 4 percentage points had interest rates collared in a period over one year (or 2% of long-term debt), while at December 31, 2014 this was the case for 10 percentage points of net debt at floating rates or with fixed rates maturing within one year (3% of long-term net debt).

In addition, early retirement and Individual Suspension Plan liabilities (see Note 15) were discounted to present value over the year, based on the curve for instruments with very high credit quality. The decrease in interest rates has increased the market value of these liabilities. However, this increase was nearly completely offset by the increase in the value of the hedges on these positions.

Net financial expenses amounted to 2,581 million euros in 2015, 7.1% lower than the previous year. Excluding exchange rate differences, costs improved by 21.2% (528 million euros) to 1,961 million euros. Negative foreign



exchange differences amounted to 620 million euros, primarily due to adoption of the SIMADI exchange rate for the Venezuelan bolivar. The lower cost of debt in euros explains 146 million euros of this improvement, due to lower fixed rate debt and capture of the reduction in short-term rates. The divestment of the entire holding in Telecom Italia, S.p.A. generated a positive variation of 404 million euros. Other effects resulted in losses of 22 million euros. These included the monetary correction for inflation in Venezuela, net of higher currency costs in Latin America, costs for updating contingencies, and other gains and losses on equities. The effective cost of debt over the last twelve months, excluding exchange rate differences and the positive impact of the divestment of Telecom Italia, S.p.A., stood at 4.69%, down 57 basis points year-on-year.

To illustrate the sensitivity of financial expenses to variability in short-term interest rates, a 100 basis points increase in interest rates in all currencies in which Telefónica has financial positions at December 31, 2015 has been assumed, and a 100 basis points decrease in interest rates in all currencies except those currencies with low interest rates, in order to avoid negative rates (euro, pound sterling and the US dollar) and a constant position equivalent to that prevailing at the end of 2015.

To illustrate the sensitivity of equity to variability in interest rates, a 100 basis point increase in interest rates in all currencies and terms of the curve, in which Telefónica holds financial positions at December 31, 2015 was assumed, as well as a 100 basis point decrease in all currencies and terms (except those below 1% in order to avoid negative rates). Cash flow hedge positions were also considered as they are fundamentally the only positions where 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	(245)	145
-100bp	75	98

### Share price risk

The Telefónica Group is exposed to changes in the value of equity investments from changes in the value of derivatives associated with such investments, from convertible or exchangeable instruments issued by Telefónica Group, from Share-based payments plans, from treasury shares and from 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 as a result of the higher number of shares delivered under such plan outstanding.

During 2015, a new long-term incentive Plan consisting of the delivery of shares of Telefónica, S.A. aimed at members of the Executives of Telefónica Group was launched denominated Performance Share Plan (PIP). Furthermore 2014 Ordinary General Shareholders' Meeting approved a Global incentive Telefónica, S.A. shares purchase Plan for the Employees of the Telefónica Group.

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, 2015 to cover shares deliverable under the PIP or the Global Employee Share Plan. The net asset value of the treasury shares could increase or decrease depending on variations in Telefónica, S.A.'s share price.

## 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.

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The Telefónica Group must be able to pay all commitments over the next 12 months without accessing new 2. borrowing or tapping the capital markets (although drawing upon firm credit lines arranged with banks), assuming budget projections are met.

At December 31, 2015, the average maturity of net financial debt (49,921 million euros) was 5.15 years.

At December 31, 2015, gross financial debt scheduled to mature in 2016 amounted to approximately 11,275 million euros (which includes the net position of derivative financial instruments and certain current payables). 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 2016, and c) undrawn credit facilities arranged with banks whose original maturity is over one year (an aggregate of more than 12,497 million euros at December 31, 2015), providing flexibility to the Telefónica Group with regard to accessing capital or credit markets in the next 12 months. For a further description of the Telefónica Group's liquidity and capital resources in 2015, see Note 13.2 Financial Liabilities 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):

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, 2015, the Telefónica Group's Latin American companies had net debt not guaranteed by the parent company of 4,646 million euros, which represents 9.3% of net debt. 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, 1,252 million euros from Latin America companies have been received in 2015, of which 846 million euros were from dividends and 406 million euros were for other items.

In this regard, it is worth noting that since February 2003, Venezuela has had an exchange control mechanism in place, managed by the Centro Nacional de Comercio Exterior (CENCOEX). The body has issued a number of regulations (“providencias”) governing the modalities of currency sales in Venezuela at official exchange rates. Foreign companies which are duly registered as foreign investors are entitled to request approval to acquire currencies at the official exchange rate by the CENCOEX, in line with regulation number 056, article 2, section c) "Remittance of profits, income, interest and dividends from international investment" Telefónica Venezolana, C.A. (formerly Telcel, C.A.), a Telefónica Group subsidiary in Venezuela, obtained the aforementioned requested approval on 295 million Venezuelan bolivars in 2006, 473 million Venezuelan bolivars in 2007 and 785 million Venezuelan Bolivars in 2008. At December 31, 2015, payment of two dividends agreed by the company in the amount of 5,882 million Venezuelan bolivars is pending approval by the CENCOEX.

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## 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 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.

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 credit risk management as a key element to achieve its business and customer base growth targets in a manner that is both sustainable and consistent with Telefónica Corporate Risk Management Policy. This management approach relies on the active monitoring of the risk-reward balance in the commercial operations and the adequate separation between the risk ownership areas and risk management areas.