

Rating object	Rating information	
Telefónica S.A. Creditreform ID: 12436 Incorporation: 1924 Based in: Madrid, Spain Main (Industry): Telecommunication CEO: Mr. José María Álvarez-Pallete López <u>Rating objects:</u> Long-term Corporate Issuer Rating: Telefónica S.A. Long-term Corporate Issuer Rating: Telefónica Emisiones S.A.U. Long-term Corporate Issuer Rating: Telefónica Europe B.V. Long-term Local Currency (LT LC) Senior Unsecured Issues	Corporate Issuer Rating: BBB- / stable	Type: UpdateUpdate Unsolicited Public rating
	LT LC Senior Unsecured Issues: BBB- / stable	Other: n.r.
	Rating date: 5 May 2023 Monitoring until: withdrawal of the rating Rating methodology: CRA "Corporate Ratings" CRA "Non-Financial Corporate Issue Ratings" CRA "Rating Criteria and Definitions" Rating history: www.creditreform-rating.de	

Content

Preliminary Note	1
Summary	1
Relevant rating factors	2
Business development and outlook ...	5
Business risk	7
Financial risk.....	8
Issue rating.....	10
Financial ratio analysis	13
Appendix.....	14

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Summary

Company

Telefónica, S.A. (hereinafter also called Telefónica, the Group or the Company), with its consolidated subsidiaries comprising the Telefónica Group, is a leading multinational telecommunications company headquartered in Madrid, Spain. The Company offers a broad range of fixed and mobile telecommunications services with 383 million accesses in 12 countries, mainly in Europe and Latin America. Telefónica is active in the following businesses: fixed and wireless telephony, broadband, Internet, data traffic, Pay TV and other digital services, and operates under its main brand names Telefónica, Movistar, O2, and Vivo.

In 2022 the Group achieved revenues amounting to EUR 39,993 million (2021: EUR 39,277 million), an EBITDA of EUR 12,766 million (2021: EUR 22,033 million), and EAT of EUR 2,319 million (2021: EUR 10,717 million).

Rating result

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

The rating result of Telefónica, S.A. is based on its large scale and high degree of diversification, its leading position in many of its key markets, as well as its good liquidity profile and proven access to financial markets. Despite rising market volatility with disruptions across global supply chains, inflationary pressure on raw materials and rising interest rates, Telefónica delivered stable operating performance and positive developments in its key financial indicators in 2022. Telefónica's recent business divestitures strengthened its balance sheet position, with proceeds being directed mostly toward repaying outstanding financial debt.

Our assessment, however, is partially offset by continued political instability and economic weaknesses in Latin America, resulting in exchange rate volatility. An additional constraint is the high capex requirement to expand infrastructure assets (especially related to 5G network expansion) and invest in new joint ventures in the coming years, which could put pressure on Telefónica's financial performance. Nevertheless, as a leading telecommunications company in its core markets, we believe Telefónica is well-positioned to withstand potential operational and financial challenges and to prudently manage capex, ensuring both competitiveness and generation of positive free cash flows.

Outlook

The outlook for the ratings remains **stable**, based on our expectation that Telefónica will withstand the increasing competitiveness of the sector by focusing its investments in key markets in order to reduce complexity of operations and maximize efficiency gains, thus resulting in overall stable performance over the coming 12 months. Telefónica strengthened its financial profile after significant deleveraging in 2021, and is now in a better position to overcome a potential economic slowdown and increased market volatility during 2023.

Relevant rating factors

Table 1: Financials I Source: Telefónica S.A. Annual report 2022, standardized by CRA

Telefónica S.A. Selected key figures of the financial statement analysis Basis: Annual accounts and report of 31.12. (IFRS, Group)	CRA standardized figures ¹	
	2021	2022
Sales (million EUR)	39,277	39,993
EBITDA (million EUR)	22,033	12,766
EBIT (million EUR)	13,636	3,970
EAT (million EUR)	10,717	2,319
EAT w/o non-controlling interests (million EUR)	8,137	2,011
Total assets (million EUR)	93,586	93,619
Equity ratio (%)	13.83	16.99
Capital lock-up period (days)	67.08	73.09
Short-term capital lock-up (%)	39.39	32.22
Net total debt / EBITDA adj. (factor)	6.18	5.60
Ratio of interest expenses to total debt (%)	2.51	3.90
Return on Investment (%)	12.96	3.79

General rating factors

- + Strong market position in Europe and Latin America (market leader or among the leading providers in several countries) and a high degree of geographical diversification
- + Leading global integrated broadband and telecommunications provider with a full range of services; adequate business mix
- + Employment of state-of-the-art technology (fiber rollouts, 5G, TV contents, bundled offers))
- + Significant size and scale
- + Entry barriers in the market (licenses, concessions and permits)
- + Proven access to debt capital markets

- Highly competitive markets
- Highly regulated business with corresponding obligations
- Dependency on economic trends
- Capital-intensive business with high ongoing investments (infrastructure and spectrum)

Reference:

The relevant rating factors (key drivers) mentioned in this section are predominantly based on internal analyses, evaluations from the rating process, the derived valuations of the analysts participating in the rating and, if applicable, other rating committee members. The fundamental external sources used are specified in the sections "Regulatory requirements" and "Rules on the presentation of credit ratings and rating outlooks".

Excerpts from the financial key figures analysis 2022:

- + Sales growth
- + Increased equity ratio
- + Improved net total debt / EBITDA adj.
- + Strong cash flow generation
- + Liquidity ratios

- Return on investment
- Ratio of interest expense to total debt
- EBIT(DA) interest coverage
- Asset coverage ratio

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

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

- Country risks: exposure to developing countries with unstable economies
- Foreign exchange risk: high exposure to currency fluctuations
- Cybercrime and continuous technological changes
- Interest rate risks

Current rating factors

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

- + Modest sales growth reported in 2022 for the first time since 2015
 - + Price actions in all markets and cost synergies from recent M&A transactions as well as continued efforts to increase efficiency-supported operating results and mitigated inflationary pressure in 2022
 - + Improved cash flow generation in 2022
 - + Solid liquidity position - maturities covered for the next 3 years
 - + Further reduction in financial debt
 - + Customer base expanded in all segments, due to higher broadband and mobile access
-
- Growing share of sales in volatile markets increases business risk
 - Challenging market conditions
 - Increased risks for the capital-intensive business model due to rising interest rates
 - Continuing high investment requirements to expand infrastructure for high-speed connectivity (5G and fiber network)

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

Prospective rating factors

- + Profitable sales growth
 - + Cost reductions, synergies leading to increased operating cash flow
 - + Positive effects from a change in the regulatory framework in relevant markets
 - + Extension of fiber network and further improvement of network quality
 - + Creation of new business models (NaaS, Application Programming Interface (APIs))
-
- Deterioration of operating performance due to increased competition – especially in the home market of Spain due to the merger of Orange and MásMóvil
 - Deterioration of economic situation and political instability in Latin America and Europe
 - Unexpected increase in capex/leveraging, in particular due to 5G investments (spectrum and infrastructure)
 - Negative regulatory changes

ESG-factors

ESG factors are factors related to environment, social issues and governance. For more information, please see the section "Regulatory requirements". CRA generally takes ESG relevant factors into account when assessing the rating object and discloses them when they have a significant influence on the creditworthiness of the rating object, leading to a change in the rating result or the outlook.

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

The telecommunications sector has higher exposure to social risks, including data privacy and security. On the other hand, the industry also entails many opportunities to exert a positive influence on society, being the enabler of digital transformation (smart cities, smart homes) and playing a key role in digital inclusion. By 2024, Telefónica aims to achieve 90-97% mobile broadband coverage in rural areas in Brazil, Germany and Spain.

The environmental risk for the telecommunication sector should not be underestimated, especially due to the growing demand for connectivity and digital services, resulting in an exponential rise in data traffic and, consequently, higher energy consumption and CO2 emissions. However, this will be mitigated in the future by efficiency gains from high-speed connectivity and more automated processes.

Since 2015, Telefónica has reduced its electricity and fuel consumption by 7.2% despite an increase of more than 7.4x in the data traffic managed in its network. In 2022, the Company reduced its carbon emissions (Scope 1 + 2) by 80% compared to 2015, reaching the 2030 target 8 years ahead of schedule. Telefónica has set itself the goal of becoming carbon-neutral by 2040. To achieve its goals, carbon reduction targets are part of the variable remuneration of its employees, including the Board of Directors. Nearly 27% of the Company's total financing is composed of ESG financing instruments. In 2024, financing linked to sustainability should represent between 30% and 35%.

Governance issues are more likely to arise for companies operating in emerging markets, due to a lesser degree of regulation and higher political instability. Telefónica has repeatedly made use of anticompetitive practices in order to protect its presence in key markets, recently having a lawsuit filed against it by the Brazilian Competition Authority (Cade) in BRL 121 million (EUR 21 million) for cartel arrangements with two other mobile operators. Nevertheless, Telefónica claims to follow the best standards of corporate governance, with the board of directors largely composed of independent members, a high level of transparency of financial information, disclosure of formal policies concerning remuneration and appointment of senior executives and board members, and the existence of additional committees (Nominating, Compensation, Corporate Governance; Audit and Control; Sustainability; Strategy and Innovation; Regulation and Institutional Affairs).

Overall, we consider Telefónica to be well positioned with regard to ESG factors, but we do not identify any significant influence on the rating. In the future, ESG factors may have an impact on our rating assessment, depending on the company's achievement of its targets and regulatory changes.

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

Best-case scenario: BBB-

In our best-case scenario for one year, we assume a rating of BBB-. This is based on our expectation that the Company will maintain leverage at lower levels, while strategic new acquisitions will strengthen its business model, preserving its presence in its main markets. A rating upgrade, however, is constrained by the Company's low key financial ratios, especially its analytical equity ratio.

Worst-case scenario: BB+

In our worst-case scenario for one year, we assume a rating of BB+. This could be the case if operations deteriorate significantly due to a potential economic slowdown and further currency depreciations in the Company's main operating markets, as well as due to fierce competition in the industry. In this scenario, we also consider a reversal in its path towards deleveraging, and a certain deterioration in the Company's internal cash generation.

Please note:

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

Business development and outlook

Despite the challenging market environment, Telefónica achieved slight revenue growth of 1.8% (2021: -8.8%) to EUR 39,993 million in 2022 (2021: EUR 39,277 million), its first reported revenue growth since 2015. Revenues increased organically (considering 50% of the results of VMO2 in 2021 and 2022) by 4.0% in 2022 (2021: 2.0%). Enforced price adjustments and positive currency effects helped Telefónica mitigate the negative effects of inflation in its relevant markets. In addition, Telefónica was able to significantly expand its customer base from 369.1 million total accesses in the previous year to 383.1 million in 2022, which also contributed to revenue growth. It should be noted, however, that the main share of access growth in absolute terms was recorded in the largest subsegment, mobile accesses (which accounts for around 76% of Telefónica's total accesses), and that the growth resulted largely from the acquisition of mobile accesses of the Oi Group in April 2022.

Table 2: The development of business of Telefónica S.A. | Source: Annual Report 2022, standardized by CRA

Telefónica S.A.					
In million EUR	2020	2021	2022	Δ 21/22	Δ % 21/22
Sales	43,076	39,277	39,993	716	1.8%
EBITDA	15,240	22,033	12,766	-9,267	-42.1%
<i>EBITDA-Marge</i>	<i>35.4%</i>	<i>56.1%</i>	<i>31.9%</i>	<i>-24.2 p.p.</i>	<i>--</i>
EBIT	4,321	13,636	3,970	-9,666	-70.9%
<i>EBIT-Marge</i>	<i>10.0%</i>	<i>34.7%</i>	<i>9.9%</i>	<i>-24.8 p.p.</i>	<i>--</i>
EBT	2,583	12,095	2,960	-9,135	-75.5%
EAT	1,957	10,717	2,319	-8,398	-78.4%

Despite modest sales growth, adjusted EBITDA decreased by EUR 9,267 million or 42.1% to EUR 12,766 million in the 2022 fiscal year. This was largely due to the exceptionally high other operating result in 2021 (EUR 14,703 million), which was positively influenced by one-off asset sales totaling approximately EUR 10,995 million. Higher material expenses were offset by disproportionately lower personnel expenses due to a change in the scope of consolidation in 2021 and the associated reduction in restructuring expenses. EBIT decreased significantly year-on-year by 70.9% to EUR 3,970 million due to positive special items in 2021, with increased depreciation and amortization representing an additional burden in 2022. Against the backdrop of generally rising interest rates, interest expenses and total financing costs increased significantly to EUR 3,030 million (2021: EUR 2,028 million), which had a negative impact on individual financial ratios in our analysis. However, the increased interest expenses are offset by disproportionately higher interest income of EUR 1,803 million (2021: EUR 614 million), including from interest on late payments in connection with a delayed tax refund in Spain of EUR 526 million, which lead to an improved financial result compared to previous years and put the increased interest expenses into perspective in the overall analysis. In addition, Telefónica recorded a positive investment result (EUR 217 million), primarily from the new joint venture VMED O2 UK Ltd. established with Liberty Global in 2021. Looking at the original business development, overall positive revenue and operating profit development compared to the previous year is to be noted in 2022.

In addition, Telefónica continues to benefit from a solid liquidity profile with cash and cash equivalents of EUR 9.7 billion and undrawn committed credit facilities of EUR 11.7 billion at the end of December 2022, sufficient to cover all financial debt maturing within the next three years, and in line with its strategy. After a steady decline in cash flow on operations in recent years, Telefónica was able to return to an increase in operating cash flow in 2022 and increase free

cash flow to EUR 4,566 million (2021: EUR 2,648 million) by reducing capital expenditures. Against the backdrop of the uncertain economic situation and a further increase in interest rates, we see the Company's improved internal financing strength as a stabilizing factor for the rating.

For the current fiscal year, Telefónica expects slight growth (low single digit growth) in revenues and OIBDA (operating income before depreciation and amortization) in terms of organic growth, which takes into account 50% of the results generated by the VMO2 joint venture. Capital expenditures (excluding spectrum) are expected to be roughly 14% of sales (2022: 14.8%) and dividends per share are expected to remain stable, which should have a positive overall impact on cash flow. We consider the outlook to be plausible, but see some uncertainty against the backdrop of continuing difficult market conditions, rising interest rates and an associated deterioration in the economic outlook.

As the telecommunications sector becomes more and more saturated, the ability to differentiate and improve customers' digital experience will become a key competitive advantage. In our view, Telefónica's future performance will depend on how rapidly the Company is able to adjust its business model to the surge of disruptive technologies and fast-changing consumer trends, and will require continued high amounts of investment. Thus, organic operating results growing above the market-average, resulting in a reversal of the company's market share decline, along with the maintenance of a good level of creditworthiness, could exert a positive influence on the ratings.

Structural risk

Telefónica, S.A. is one of the world's leading providers in the telecommunication market, with an access base totaling 383,1 million. The Group was created in 1924 under the name Compañía Telefónica Nacional de España and is located in Madrid, Spain.

Telefónica Group's organizational structure reflects the needs of each of its businesses in order to best serve both residential and business customers, and is aligned with the aim to increase efficiency and maximize value for the Group. Telefónica operates the following geographical segments: Telefónica Spain, Telefónica Brazil, Telefónica Deutschland, Telefónica Hispam (Argentina, Chile, Peru, Colombia, Mexico, Ecuador, Venezuela and Uruguay) and the UK market via a new established Joint Venture named Virgin Media - O2 UK (VMED O2), created from the merger of Liberty Media's fixed assets and O2 UK's mobile assets.

In addition to the local operators listed, Telefónica has created two independent global businesses, Telefónica Tech and Telefónica Infra, as part of its 2019 adjusted strategic direction to accelerate growth ambitions and maximize the value of its infrastructure. Telefónica Tech's business includes cloud services development, cybersecurity, internet of things (IoT) and big data, with a focus on the B2B segment. Through organic and external growth, a subgroup has been created that operates in Telefónica's markets as well as in other markets, generating double-digit growth p.a. in recent years, according to the Company. Telefónica Infra, as a globally operating unit, manages the various infrastructure assets of the Telefónica Group (most recently the Telxius mobile towers were sold), expands the fiber optic network in the markets relevant to Telefónica and develops innovative investment models for the operating business units. In order to reduce the necessary investment costs in the course of fiber-optic expansion, external investors are increasingly involved as part of a FiberCo model, which we view positively from a financial perspective. In addition, at least in the EU, consideration is being given to obliging over-the-top companies (streamers, hyperscalers, etc.) to contribute to the costs of network expansion

(broadband roll-out). The results of the EU Commission's current consultation on this matter remain to be seen.

Other superordinate functions, such as marketing, support for major customers, network design, globally managed platforms, but also accounting, finance, legal and regulatory compliance, as well as ESG, are, for logical reasons, managed centrally in order to generate added value for the Group.

Pursuant to Telefónica's Corporate Bylaws, the administration of the company falls to the Board of Directors, its Chairman, Executive Commission and, if any, one or several CEOs. The Company's Board of Directors is composed of 15 members and is supported by several committees responsible for examining and monitoring key areas. The executive team of the Group is composed of 17 members. As of 31 December 2022, the average number of employees was 103,638 (2021: 103,934).

Telefónica is a listed company with approximately 1.1 million shareholders. Its most significant shareholders are Banco Bilbao Vizcaya Argentaria, S.A. (BBVA) (4.87%), CaixaBank, S.A. (3.50%), and Blackrock, Inc. (4.48%).

Telefónica has a Risk Management Framework based on the model established by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), which establishes appropriate controls to evaluate and manage all relevant business risks, operational risks, financial risks and risks related to litigation and regulatory compliance.

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

Business risk

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

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

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

The Company is also exposed to country risks such as political, economic, regulatory and currency risks, mainly due to its operations in several non-investment-grade countries and countries with hyperinflationary economies, such as Argentina and Venezuela. In 2022, foreign exchange rates had a positive impact on Telefónica's reported results, mainly due to the appreciation of the Brazilian real against the euro.

Nevertheless, due to the increasing share of sales in volatile and thus riskier countries - Brazil and Hispam together account for around 46% (2021: 39%) of sales - an increased business risk must be noted, which has a dampening effect on our rating estimate.

In the telecommunications business, network quality and prices are key to remaining competitive. Furthermore, as in most European markets, convergent offers (mobile, fixed, and cable TV), and the demand for new content is continuously on the increase, forcing the Company to develop new business areas (content creation).

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

In addition, it must be taken into account that the traditional telecommunications business is undergoing dynamic change. New networks must be designed to be open to competition and to be future-proof, so that third parties must be granted access to the network. In the future, networks will be similar to software platforms, which make available the main functions of the networks via connectors or APIs (application programming interface), thus enabling new business models (e.g., Network as a Service (NaaS)). An innovative change in the telecommunications business requires regulatory changes, which can slow development.

Overall, we see a positive track record in the implementation of the strategy already adapted in 2019 and which is still valid, which has strengthened the Group's business model and competitiveness, although the targeted profitable growth was rather subdued. Due to the high technological and financial requirements, especially with regard to the network expansion (fiber optics and 5G), the high intensity of competition, the increasing share of revenues in riskier countries and overall challenging environment with high inflation and rising interest rates, we nevertheless continue to assess the business risk of the Telefónica Group as slightly increased.

Financial risk

For analytical purposes, CRA makes adjustments to the original balance sheet values of companies. Due to these adjustments and generally CRA's own calculation methods of key figures, they may differ from the original values and information provided by Telefónica.

Based on the consolidated figures for the fiscal year 2022, we assess the creditworthiness of Telefónica S.A. as satisfactory. The adjusted equity ratio increased to 17.0% in the past fiscal year (2021: 13.8%), but can still be seen as an improvement. In addition to EAT, other comprehensive income also exerted a positive effect, benefiting in particular from positive currency translation differences. We consider the payout ratio of around 64% to be somewhat inappropriate in view of the low equity ratio.

Telefónica Group's financial liabilities totaled EUR 47,756 million as of December 31, 2022 (2021: EUR 50,365 million) and consisted largely of bonds of EUR 32,167 million (2021: EUR 35,408 million), lease liabilities of EUR 8,677 million (2021: EUR 8,070 million) and other financial liabilities of EUR 6,912 million (2021: EUR 6,887 million). Of the total financial liabilities, EUR 6,040 million (2021: EUR 8,684 million) was due in the short term. Overall, the maturity structure of the Group's financing is relatively balanced and does not reveal any significant cluster risks. Taking into account the cash and cash equivalents of EUR 7,245 million reported as of December 31, 2022 (2021: EUR 8,580 million), net financial liabilities (including leasing) amounted to EUR 40,511 million (2021: EUR 41,785 million). If only net financial debt (incl. leasing) is seen in relation to EBITDA adj., the result is a reasonable figure of 3.2x (2021: 3.6x). The analytical ratio net total debt / EBITDA adj., which relates to total adjusted debt less cash and cash equivalents, showed a value of 5.6x (2021: 6.2x), despite improvement, an increased value for the rating level indicated here.

We view the reduction of financial liabilities in recent years as positive, even though the level of debt can still be described as high on the overall balance sheet. Against this background, the currently rising interest rate levels are associated with higher risks for Telefónica than for companies with lower levels of debt. In 2022, Telefónica reported significantly higher finance costs of EUR 3,030 million (2021: EUR 2,028 million) which were, however, offset by significantly higher finance income of EUR 1,803 million (2021: EUR 614 million), so that the overall financial result improved against the prior year. In addition to higher interest expenses, finance expenses also include significantly higher hedging effects, and aside from higher interest income, financial income mainly includes other financial income from special effects, such as interest on arrears from a delayed tax refund in Spain. With regard to interest rate risks, along with the Company's balanced maturity structure, it should be taken into account in relative terms that approximately 88.3% (2021: 95.4%) of Telefónica's calculated net financial debt (2022: EUR 26,687 million; 2021: EUR 26,086 million) has a medium- to long-term fixed interest rate.

Existing purchase and other contractual obligations of approximately EUR 12,285 million must be taken into account, in addition to the financial liabilities, which cannot be canceled without penalty costs.

The Group has extensive access to several sources of financing as well as to capital markets. Telefónica also has factoring agreements. Financing arranged by Telefónica Group companies in Latin America (Peru; approx. 1% of gross debt) is partly subject to compliance with financial covenants. As of 31 December 2022, according to annual statements, all covenants had been met.

Telefónica, S.A. has a full and unconditional guarantee on issues made by Telefónica Emisiones, S.A.U. and Telefónica Europe, B.V., both of which are wholly owned finance subsidiaries of Telefónica S.A. and are subject to our corporate issuer / issue rating. The Group has a program for the issuance of commercial paper up to EUR 5,000 million, of which EUR 500 million had been used as of 31 December 2022. The corporate promissory notes program of EUR 500 million, which can be increased to up to EUR 2000 million, had no outstanding balance at the end of 2022.

Telefónica also had a solid liquidity position with cash and cash equivalents of EUR 9.7 billion and undrawn committed credit facilities of EUR 11.7 billion at the end of December 2022, sufficient to cover all financial debt maturing within the next three years. After a steady decline in cash flow from operations in recent years, Telefónica saw an increase in cash flow from operations in 2022 and increased free cash flow to EUR 4,566 million (2021: EUR 2,648 million) by reducing capital expenditures. Against the backdrop of the uncertain economic situation and

further increase in interest rates, we see the Company's improved internal financing strength as a stabilizing factor for the rating.

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

Issue rating

Further issuer ratings

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

Telefónica Emisiones S.A.U.

Telefónica Europe B.V.

Telefónica, S.A. is guarantor of the companies listed above and of the notes that have been issued under the Euro Medium Term Note (EMTN) program of Telefónica Emisiones S.A.U., with the last base prospectus of 06.04.2022 and with the latest supplement of 04.11.2022, and the Issue of Telefónica Europe B.V. – with the last prospectus of 19.03.2019.

Telefónica Emisiones S.A.U. and Telefónica Europe B.V. are direct wholly-owned subsidiaries of Telefónica, S.A. and are consolidated into the Group's annual accounts. As directly wholly-owned subsidiaries and financing vehicles of Telefónica, S.A. the activities of Telefónica Emisiones S.A.U. and Telefónica Europe B.V. are directly related to the financing needs of the Company, which in turn depend on the development of the operating business and the investments in the Group. Additionally, the business development of Telefónica Emisiones S.A.U. and Telefónica Europe B.V. relies on the ability of Telefónica, S.A. to service the payment obligations arising from inter-company loans granted by the subsidiary to the parent company. Overall, the future development of Telefónica Emisiones S.A.U. and Telefónica Europe B.V. will be determined by the business development, strategy, and capital and investment needs of the parent company, taking into account its specific and general business risks. In this respect, we consider a consolidated view of the business development and outlook for the rating assessment of Telefónica Emisiones S.A.U. and Telefónica Europe B.V. as appropriate. Based on these economic, financial and liability relationships between Telefónica, S.A., Telefónica Emisiones S.A.U., and Telefónica Europe B.V., we have set the rating of Telefónica Emisiones S.A.U. and Telefónica Europe B.V. equal to the rating of Telefónica, S.A.. Hence, the rating for Telefónica Emisiones S.A.U and Telefónica Europe B.V. is **BBB- / stable**.

Issue rating details

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

eligible marketable assets. The ECB list of eligible marketable assets can be found on the website of the ECB.

As mentioned above, the notes of Telefónica Emisiones S.A.U. have been issued within the framework of the Euro Medium Term Note (EMTN) program, of which the latest base prospectus dates from 11 April 2023. The note of Telefónica Europe B.V. has been issued with the prospectus dates from 19 March 2019.

The notes under consideration are senior unsecured, and rank at least pari passu among themselves and with all other present and future unsecured obligations of the issuers. Additionally, the notes benefit from a negative pledge provision and a cross default mechanism.

Result corporate issue rating

We derive the unsolicited corporate issue ratings of the EUR-denominated debt securities of Telefónica Emisiones S.A.U. and Telefónica Europe B.V. from the unsolicited corporate issuer ratings of the issuers, using our rating methodology for non-financial corporate issues. The bond conditions / issue prospectuses did not give rise to any extraordinary reason for applying notching to the issuer rating. In the present case, we have set the unsolicited corporate issue ratings as equivalent with the unsolicited corporate issuer rating of Telefónica Emisiones S.A.U. and Telefónica Europe B.V. (BBB-). The outlook is also **stable**.

Other types of debt instruments or issues denominated in other currencies by the issuers have not been rated by CRA. For a list of all currently valid ratings and additional information, please consult the website of Creditreform Rating AG.

Overview

Table 3: Overview of CRA Ratings | Source: CRA

Rating Category	Details	
	Date	Rating
Telefónica S.A. (Guarantor)	05.05.2023	BBB- / stable
Telefónica Emisiones S.A.U. (Issuer)	05.05.2023	BBB- / stable
Telefónica Europa B.V. (Issuer)	05.05.2023	BBB- / stable
Long-term Local Currency (LC) Senior Unsecured Issues of Telefónica Emisiones S.A.U and Telefónica Europe B.V.	05.05.2023	BBB- / stable

Table 4: Overview of 2023 Euro Medium Term Note Programme | Source: Base Prospectus dated 11.04.2023

Overview of 2023 EMTN Programme			
Volume	EUR 40,000,000,000	Maturity	Depending on respective bond
Issuer / Guarantor	Telefónica Emisiones S.A.U. (Issuer) Telefónica, S.A. (Guarantor)	Coupon	Depending on respective bond
Arranger	BNP Paribas	Currency	Depending on respective bond
Credit enhancement	none	ISIN	Depending on respective bond

Table 5: Overview of EUR 500 million issue due 2033 | Source: Prospectus dated 19.03.2019

Overview of EUR 500 million issue due 2033			
Volume	EUR 500,000,000	Maturity	2033
Issuer / Guarantor	Telefónica Europe B.V. (Issuer) Telefónica, S.A. (Guarantor)	Coupon	5.875%
Arranger	--	Currency	EUR
Credit enhancement	none	ISIN	XS0162869076

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

Financial ratio analysis

Table 6: Financial key ratios | Source: Telefónica S.A. annual report 2022, structured by CRA

Asset structure	2019	2020	2021	2022
Fixed asset intensity (%)	68.38	53.85	65.91	68.04
Asset turnover	0.51	0.47	0.44	0.44
Asset coverage ratio (%)	62.81	76.51	74.26	69.31
Liquid funds to total assets	6.17	6.40	9.17	7.74
Capital structure				
Equity ratio (%)	4.29	0.72	13.83	16.99
Short-term debt ratio (%)	32.30	32.50	27.75	25.63
Long-term debt ratio (%)	38.66	40.48	35.12	30.17
Capital lock-up period (in days)	61.67	50.96	67.08	73.09
Trade-accounts payable ratio (%)	8.36	6.87	7.71	8.55
Short-term capital lock-up (%)	41.89	47.63	39.39	32.22
Gearing	20.89	128.50	5.57	4.43
Leverage	15.86	38.41	13.35	6.49
Financial stability				
Cash flow margin (%)	24.18	21.94	20.29	21.95
Cash flow ROI (%)	12.18	11.01	8.68	9.56
Total debt / EBITDA adj.	6.12	5.75	6.91	6.18
Net total debt / EBITDA adj.	5.72	5.38	6.18	5.60
ROCE (%)	9.17	13.18	6.88	7.78
Total debt repayment period	5.52	-94.20	2.62	5.90
Profitability				
Gross profit margin (%)	73.68	71.81	70.75	69.60
EBIT interest coverage	1.67	1.79	6.72	1.31
EBITDA interest coverage	5.45	5.66	10.86	4.21
Ratio of personnel costs to total costs (%)	16.36	12.01	16.81	13.55
Ratio of material costs to total costs (%)	27.65	29.61	30.61	31.74
Cost income ratio (%)	92.87	92.76	76.17	92.79
Ratio of interest expenses to total debt (%)	2.98	2.78	2.51	3.90
Return on investment (%)	3.70	4.22	12.96	3.79
Return on equity (%)	27.30	81.06	157.93	16.08
Net profit margin (%)	3.37	4.45	26.76	5.69
Operating margin (%)	9.45	9.83	34.05	9.74
Liquidity				
Cash ratio (%)	19.11	19.69	33.04	30.19
Quick ratio (%)	70.91	113.73	92.68	91.45
Current ratio (%)	97.89	142.00	122.87	124.67

Appendix

Rating history

The rating history is available under <https://www.creditreform-rating.de/en/ratings/published-ratings.html>.

Table 7: Corporate issuer rating of Telefónica S.A. | Source: CRA

Event	Rating date	Publication date	Monitoring period	Result
Initial Rating	18.04.2018	20.04.2018	28.11.2019	BBB- / stable

Table 8: Corporate issuer rating of Telefónica Emisiones S.A.U. | Source: CRA

Event	Rating date	Publication date	Monitoring period	Result
Initial Rating	18.04.2018	20.04.2018	28.11.2019	BBB- / stable

Table 9: Corporate issuer rating of Telefónica Europe B.V. | Source: CRA

Event	Rating date	Publication date	Monitoring period	Result
Initial Rating	18.04.2018	20.04.2018	28.11.2019	BBB- / stable

Table 10: LT LC senior unsecured issues issued by Telefónica Emisiones S.A.U. | Source: CRA

Event	Rating date	Publication date	Monitoring period	Result
Initial Rating	18.04.2018	20.04.2018	28.11.2019	BBB- / stable

Table 11: LT LC senior unsecured issues issued by Telefónica Europe B.V. | Source: CRA

Event	Rating date	Publication date	Monitoring period	Result
Initial Rating	18.04.2018	20.04.2018	28.11.2019	BBB- / stable

Regulatory requirements

The rating² was not endorsed by Creditreform Rating AG (Article 4 (3) of the CRA-Regulation).

The present rating is, in the regulatory sense, an unsolicited rating that is public. The analysis was carried out on a voluntary basis by Creditreform Rating AG, which was not commissioned by the Issuer or any other third party to prepare the present rating.

The rating is based on the analysis of published information and on internal evaluation methods for the assessment of companies and issues. The rating object was informed of the intention of creating or updating an unsolicited rating before the rating was determined.

² In these regulatory requirements the term "rating" is used in relation to all ratings issued by Creditreform Rating AG in connection to this report. This may concern several companies and their various issues.

The rating object participated in the creation of the rating as follows:

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

A management meeting did not take place within the framework of the rating process.

The information gathered were sufficient to meet the requirements of Creditreform Rating AG's rating methodologies.

The rating was conducted based on the following rating methodologies and the basic document.

Rating methodology	Version number	Date
Corporate Ratings	2.4	July 2022
Non-financial Corporate Issue Ratings	1.0	October 2016
Rating Criteria and Definitions	1.3	January 2018

The documents contain a description of the rating categories and a definition of default.

The rating was carried out by the following analysts:

Name	Function	Mail-Address
Artur Kapica	Lead-analyst	A.Kapica@creditreform-rating.de
Sabrina Mascher de Lima	Analyst	S.Mascher@creditreform-rating.de

The rating was approved by the following person (person approving credit ratings, PAC):

Name	Function	Mail-Address
Philipp Beckmann	PAC	P.Beckmann@creditreform-rating.de

On 5 May 2023, the analysts presented the rating to the rating committee and the rating was determined. The rating result was communicated to the company on 8 May 2023. There has not been a subsequent change to the rating.

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

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

ESG-factors

You can find out whether ESG factors were relevant to the rating in the upper section of this rating report "Relevant rating factors".

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

Conflict of interests

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

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

No ancillary services in the regulatory sense were carried out for this rating object.

Rules on the presentation of credit ratings and rating outlooks

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

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

Corporate issuer rating:

1. Annual report
2. Website
3. Internet research

Corporate issue rating:

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

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

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

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

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

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

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

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

In accordance with Article 11 (2) EU-Regulation (EC) No 1060/2009, a registered or certified credit rating agency shall make available, in a central repository established by ESMA, information on its historical performance data including the rating transition frequency and information about credit ratings issued in the past and on their changes. Requested data are available at the [ESMA website](#).

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

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