

BE MORE_ GLOBAL

Transform Telefónica through simplification

As a major catalyst to Telefónica's transformation into a Digital Telco, Global Resources is working on our infrastructure adaptation and executing a range of simplification projects set to maximize efficiencies while increasing the benefits from our economies of scale

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During 2013 Global Resources has contributed to the operational transformation of Telefónica, accelerating our networks modernization while increasing their coverage, simplifying and transforming our IT and creating value through an end to end global procurement model. It has been two years since Telefonica Global Resources (TGR) was created. Indeed, 2013 has been a key period, in which the global operating unit focused on the execution of a few but markedly relevant transverse projects. By and large, this set of initiatives have pursued to promote Telefonica transformation, seeking maximum efficiency through simplification, standardization and consolidation. Furthermore, TGR has also contributed to the improvement of overall operational and business processes, which have a direct impact on our customers' experience. Finally, Global Resources has properly managed some of the Company commitments and agreements with third parties in order to ensure its compliance while avoiding penalties.

Lines of progress

During 2013, Telefónica Global Resources has contributed to our operating businesses results through initiatives aimed at increasing efficiency,

with an emphasis on simplification, consolidation and accelerating our infrastructures evolution. All these initiatives are set to foster Telefónica transformation into a Digital Telco, along with technological modernization, leveraging our Company scale to increase and optimize the benefits. Thus, efficiency and execution have been two principles applied throughout TGR six global areas: Network and Operations, IT, Procurement, Global Services, Human Resources⁽¹⁾ and MSA Atento/Global CRM⁽²⁾.

Global Network and Operations Area

The global network area is working, jointly with all of our operating businesses, with all the technological levers in order to provide Telefónica with the best network, in a sustainable way both in terms of investment and operating costs, and with an emphasis on simplification (architectures, processes and supplier map). Our key global network and operations priorities already identified are the following ones:

- Accelerate ultra-fast network deployment making hyper-connectivity easier to our customers.

Action priorities

- Model for management, processes and global systems for Telefónica purchases

- Global management of the networks and operations, which has made possible:
 - Maintaining common requirements for next generation network procurement technologies
 - Standardising and simplify solutions and processes

- Brilliant IT that Powers a Digital Telefónica

Achievements

- €26,000M volume for procurement
- Implementation and development of the strategic transformation project for end-to-end procurement (End to end Strategic Sourcing)
- Enhancing service levels

- 60% of investment in ultra-broadband (LTE, FTTH, etc.) deployment.
- More than 5 million homes with fibre optics
- 60% of mobile network locations connected to the UBB *backhaul*
- Network sharing in five operations (Czech Republic, Colombia, United Kingdom, Spain and Brazil)
- First Network Virtualisation pilot in Brazil

- Installation of the first customer home equipment, defined and approved by Telefónica

- 6 DC
- 1,150 Applications and - 2,700 served decommissioned
- An Bold business transformation launched

Challenges

- Creating sustainable value
- Transform the traditional purchasing process:
 - Working in transversal teams
 - Global category focus
- Consolidation of the end-to-end procurement model
- Expansion of the scope of procurement throughout the entire supply chain

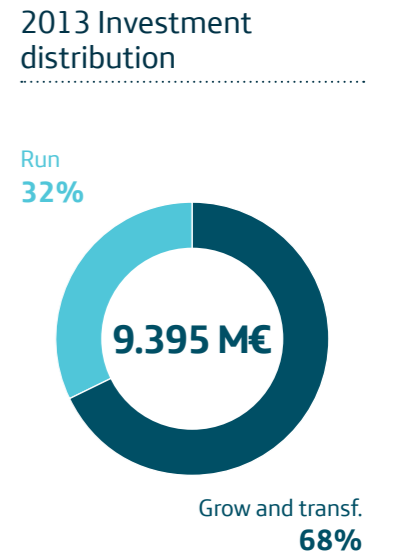
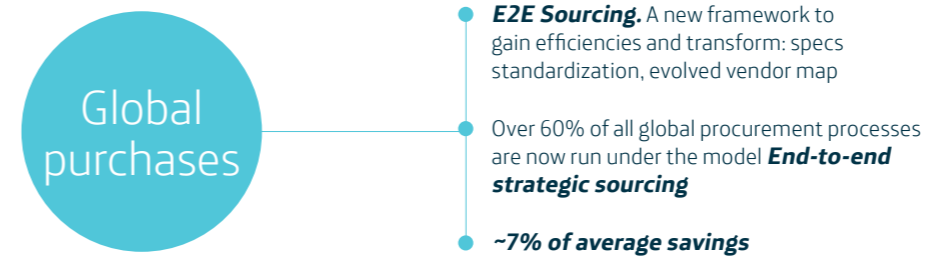
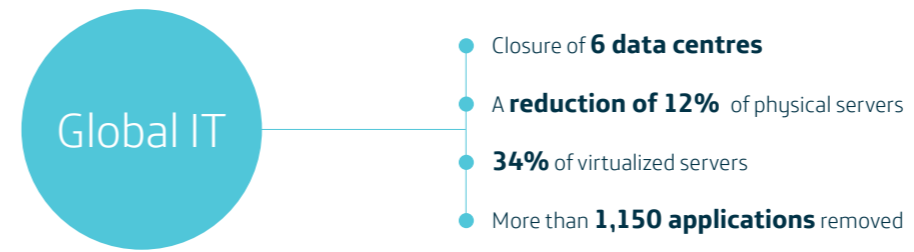
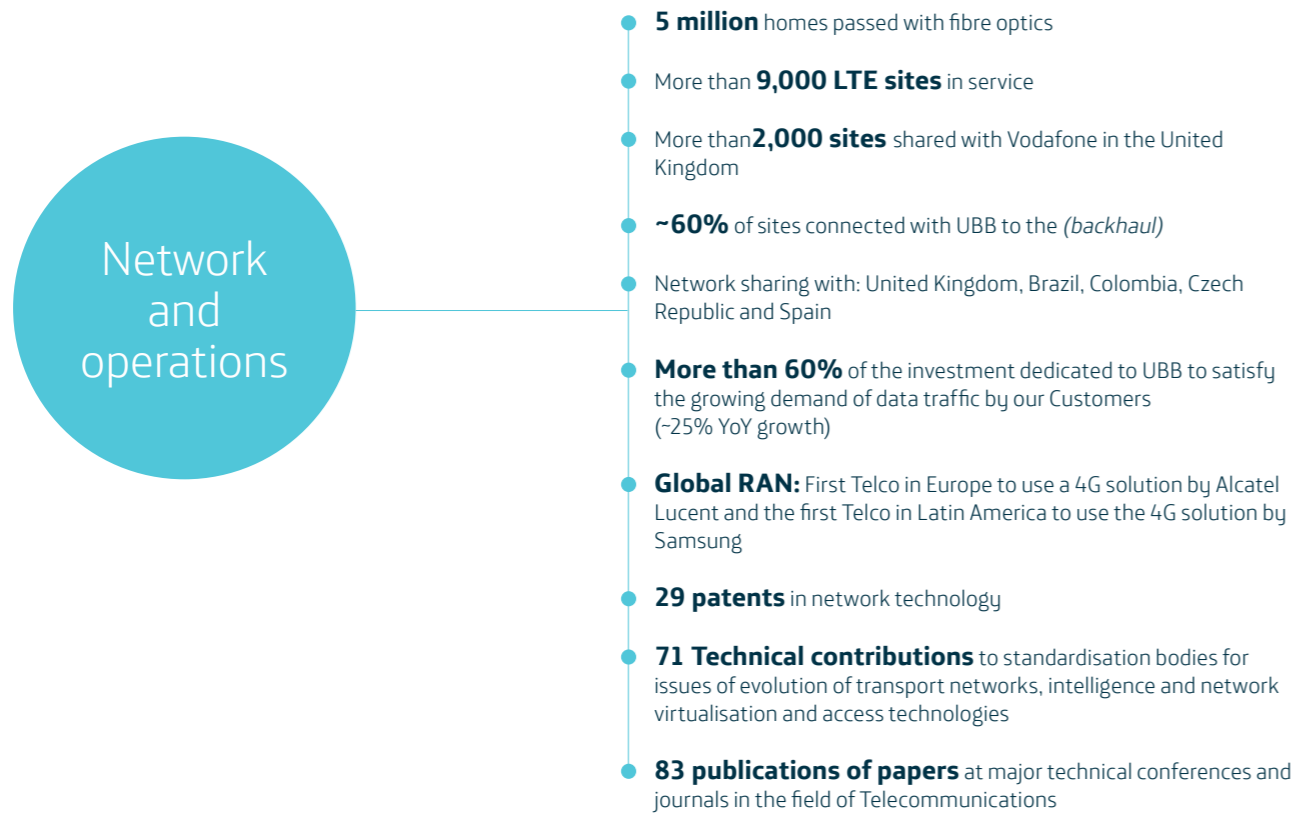
- Reduction in operating costs
- Accelerating the modernisation towards ultra-fast broadband networks that facilitate hyper-connectivity
- Reduction of *legacy* networks and an evolution towards all-IP networks
- Continuous improvement in the efficiency of networks and operations
- Transformation of network infrastructure in order to increase agility, flexibility and malleability
- Adaptation of network capabilities so as to provide support to the changing needs of customer and digital services that make virtualisation reality

- Simplifying the *legacy* applications to obtain operating stability and to reduce complexity and redundancy
- Find a balance between business transformation and internal IT transformation
- Having a single customer database a 360° vision of them
- Be an online self-service company



First worldwide Telco in network virtualisation

(1) The issues related to global Human Resources area are described in a separate chapter of this report.
 (2) MSA (Master Service Agreement) Atento/GCRM: Global Customer Relationship Management.



The first step towards a Digital Telco is the Business transformation based on standardized systems and processes

→ Legacy reduction (obsolete and expensive equipment) combined with a transition to an All IP network.

→ Simplification and Transformation of Operation Support Systems (OSS).

→ Network virtualization, curbing the restrictions that are now imposed us by hardware, thanks to the decoupling of the physical from the controlling layer.

Global IT Area

With a stronger Global agenda, IT has focused in 2013 on setting the right foundation for a deeper Digital and Business Transformation in 2014 while providing at the same time efficiencies through consolidating infrastructure and operations. Intense execution in all pillars of the strategy has translated in a year of accelerated transformation beating objectives while improving service levels.

→ Consolidate to become more efficient by taking advantage of our global scope, focusing on the consolidation of infrastructure in strategic Data Centres, the unification of operations, the unified experience for all employees and the

standardisation of corporate applications for *back-office*.

→ Applications. Automate, standardise and modernise business through simplification and transformation of business processes and applications, standardising our own integrations and those with third parties and ensuring maximum reuse of the Group's experience (learn & leverage) to become a Digital Telco so that our customer value proposition is simple to understand and appealing, providing the business with agility and the digital capabilities that it requires.

→ Drive the transformation of Telefónica into a Digital Telco, paving the way from traditional IT to i3, this being, to focus on product innovation, integration with services and take full advantage of customer information.

Global Procurement Area

Manages Telefónica sourcing by means of global processes and systems, centralising negotiations with suppliers in Telefónica Global Services, headquartered in Munich. The new end to end Sourcing strategic model enables the

transformation of the traditional procurement process, introducing new levers to generate further savings, with the contribution of cross-functional teams focused on global categories.

Global Services Area

The Global Services Area contributes to the support services transformation, by promoting a global shared services model. This evolution is based on a global approach to processes, building upon already existing service capabilities in both Latin America and Europe. The aim is to achieve processes consistency and control, increased efficiency and cost reduction, while fully benefiting from the usage of new technologies.

MSA Atento/Global CRM area seeks to ensure compliance with the Master Service Agreement signed with Atento when the Company sold it, while aiming to improve efficiency, effectiveness and quality of our customer service and sales channels (mostly telephone).

Achievements

Telefónica Global Resources has contributed to the steady improvement of the Company performance indicators, making progress, on the one hand, in the transformation of infrastructure and applications and, on the other hand, in the implementation of simplification projects, to maximize efficiencies and optimize the benefits of Telefónica's scale. In addition, Global Resources plays a major role in the 10+2 initiatives from the transformation agenda, defined by the Company, leading three of them:

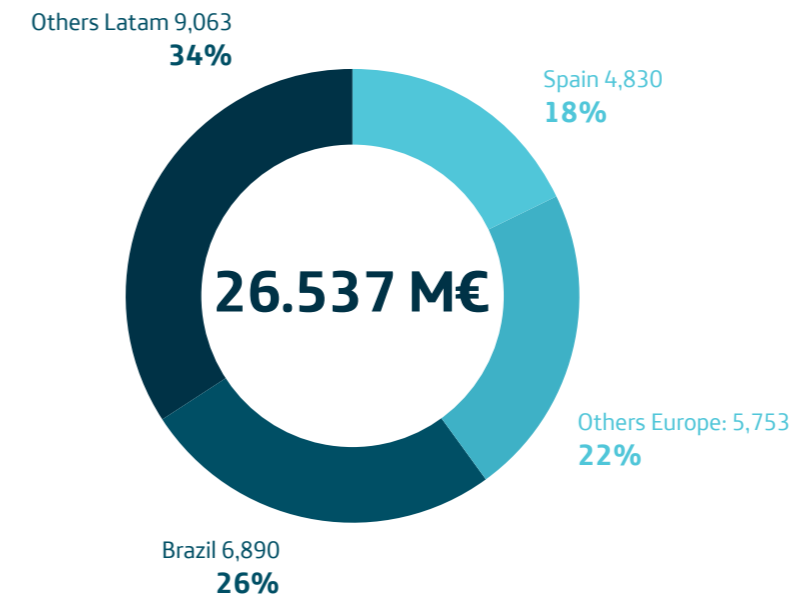
- Have the best network
- Transform our IT
- Refresh and merit our talent

Network optimisation and evolution is another keys objectives due to is relevance for services and contents distribution

End-to-end procurement



Distribution of procurement allocations



In 2013, procurement globally negotiated €22,000M of the €26,000M awarded to providers

Global Network and Operations Area

This has driven a transformation towards a Digital Telco and also the improvement of efficiency, developing a series of capabilities that enable Telefónica's network to be a differential element, due to the services that can be offered from it. Some of the most important initiatives in 2013 were:

- Optimising and driving the deployment of FTTH and LTE in the various operations of Telefónica, resting upon, when it has been necessary, any infrastructure sharing agreements.
 - There have been deployments of LTE in the United Kingdom, Germany, Spain, Brazil, Chile, Mexico, Colombia and Peru.
 - Currently, over 60% of the base stations are connected to the transport network (*backhaul*) with ultra broadband connections (UBB).
 - Regarding FTTH, Spain has over 3.5 million homes passed and in Brazil over 1.4 million.
 - On the other hand, the Networks sharing has gained momentum in five countries: Czech Republic, Colombia, United Kingdom, Spain and Brazil, through respective agreements with

America Movil in LatAm, with Vodafone in the United Kingdom and in Spain with Yoigo for mobile networks.

- Launching of the first network virtualisation pilot in Brazil. First works on Customer Premises Equipment virtualisation has began. Telefónica is the first Telco in the world to do so.
- Evolution and optimization of architecture of the transport network from a global perspective.
- Global definition of the specifications of fixed access equipment at customer premises and the first installation within the various operations of the Group. Also, it has been approved the high performance platforms with full FTTH and VDSL support.
- Global homogenization of solutions and processes for network operations. A global agreement has been utilised to make use of a tool for dispatch and management of activities concerning technicians in the field. It has deployed a comprehensive tool to automate part of the activities of the network operations centre. It has implemented a standard technical support model in all the operations for the six major network providers.

Global IT Area

In 2013, established the foundation so that in 2014 it could be developed into the business transformation towards a Digital Telco. All this brought about the committed efficiencies, due to the initiatives that enabled the consolidation of infrastructure and operations. During the year, it had been focusing on the execution, in hastening the transformation, exceeding the set targets and at the same time improving service levels. In short, some of the most important achievements in IT, during 2013 were:

- Improved operational performance with higher availability ratios and reduced number of critical incidents.
- Set the strategy and path for bold Global business transformation with IT applications at the core. Argentina Full Stack launched with prepay already in production and plan agreed to launch several other countries in 2014
- Simplified IT landscape with 1,150 Applications and 2.700 physical servers decommissioned.
- Strategic DC's live & driving transformation with Europe midrange already launched, 6 DCs released in LatAm and increasing the overall Virtualization ratios.
- For the first time, Reduced IT Costs.

→ Extended production Shared Services to Chile and aligned in UK through TEF shared services company (TGT) and plan agreed to expand to several other countries in 2014.

Global Procurement Area

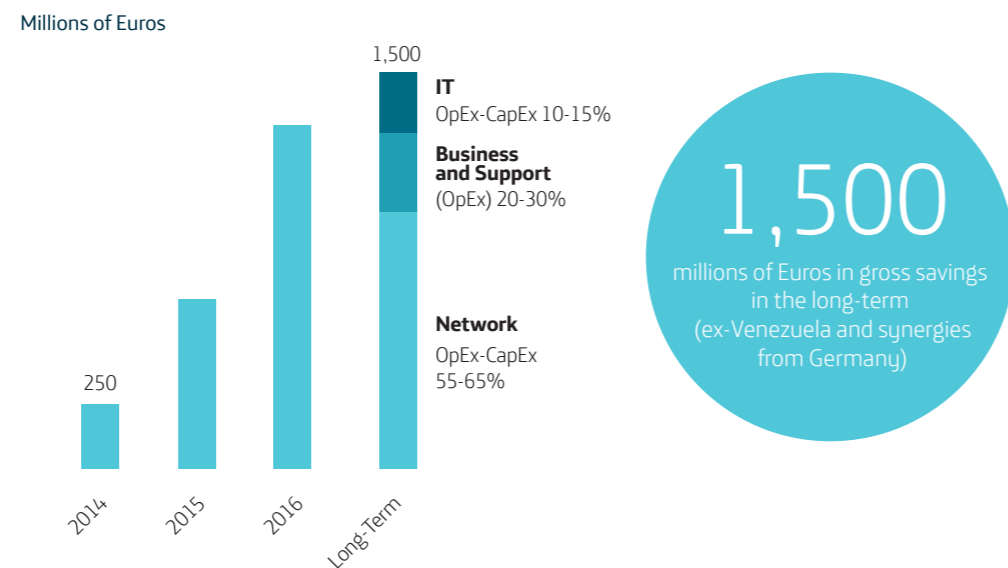
In 2013, over €26,000M were attributed, of which over €22,000M were traded globally. Furthermore, Global Purchasing area made significant progress in the implementation and development of the strategic transformation project for end-to-end sourcing, looking for a complete vision of purchasing management, from the needs assessment phase, influencing specifications and model definition, until the formalisation of commitments with suppliers (issuing orders / reception / acceptance, etc.). During 2013, this model was applied to the main products and services that we purchase (radio access network, or RAN, client devices, call centre services, maintenance of applications, etc.) focusing on the application of non-traditional negotiation leverage, standardisation and simplification of specifications, and the compliance of the model (with fully integrated systems).

Also, as part of the end-to-end sourcing (E2E sourcing), and contributing to the transformation towards a Digital Telco, in 2013 Telefónica progressed in the use of electronic processing tools with our suppliers, issuing more than

A total of €18,500M were electronically negotiated with suppliers

⁽¹⁾ Full-Stack is the term used to refer to pre-integrated IT market solutions that provide the core of BSS/OSS (Business Support Systems/Operating Support Systems) applications and that follow the TM Forum standards.

Savings from the new operating model



The proper exploitation of the synergies may cut costs by about €1,500M

€18,500M in electronic ordering and receiving more than 1.4 million electronic invoices, which totalled 28,500M electronically traded euros.

Global Services Area

In 2013, it decisively pushed forward the global project of shared services. New Economic-Financial (accounting and fixed assets) services were launched for operators in Latin America (Chile, Mexico, Ecuador, Uruguay and CAM) and for Human Resources (Help Desk, Payroll and Staff Administration, Training and Selection) from regional centres in Argentina and Peru, generating higher average savings of 25% on the originating cost of the activity. Additionally, in 2013 we continued with the deployment of the of the Zero Back Office (ZBO) operation model, which attempts to minimize as much as possible the internal dedication needs for administrative activities.

Challenges

Telefónica has a unique position to capture opportunities of growth from the digital world, increasing our relevance in the *digital lives* of customers. For this, a relevant pillar will be our key assets, such as networks, our infrastructure, IT, etc. Global Resources will contribute to this ambition to drive our technological transformation through three priorities:

- (i) Accelerate the modernisation of our network.
- (ii) Simplify operations.

(iii) Reduce technological obsolescence (networks, systems, etc.).

We also have a synergy plan that will significantly enhance our operating efficiency, in order to achieve gross long-term savings of up to €1,500M, through a new well-defined operational model for three major areas:

- **Network:** A more integrated plant, that generates efficiencies and delivers the highest quality.
- **IT:** Implementing shared services and global management initiatives to reduce costs and to support business.
- **Support and Business:** Adopt global processes and concentrate operations in regional centres. Reduce business costs by being more digital.

The **Networks** are essential so that Telefónica can progress in its transformation into a Digital Telco, monetize growth in data traffic and, in turn, be able to adequately manage any associated costs to deal with this growth. In order to do this, we must continue to advance the deployment of an ultra-fast broadband network that facilitates hyper-connectivity, reduce our technological obsolescence (*legacy*) to offer excellent quality to our customers, services such as on an all-IP network and also offer to simplify and transform systems support for operations.

In addition, Telefónica must continue to support common models and common processes that achieve efficiencies through our scope. Finally,



Inauguración de 'Alcalá Data Center'.

network virtualisation is another essential tool that will allow the network architectures to evolve in order to provide more efficient and flexible networks, by allowing network functions to become more independent from *hardware* and also facilitate the consolidation of infrastructure.

From Continuity and consistency in Strategy & Execution is giving us the momentum that will enable a deeper transformation in the business in terms of Digital capabilities (customer 360° view, omni-channel, data-sharing, bundling, real-time marketing, etc.) and efficiencies. IT will continue increasing Transformation investment in 2014 while containing Run & Grow costs.

The main challenges that we face in the IT field, with the support of the Company's leaders, and those that are key to the successful implementation of the projects are:

- Business Leadership appetite for transformation is key for the successful execution of the projects. We must balance transforming Infrastructure & Applications at the same time to ensure minimal duplicated & wasted effort.
- This intensity of change will create operational challenges and we must be rational and see these in the long term

During 2014, Global Procurement area will increase its scope including all aspects related with Supply Chain, managing all their activities in an integrated way, from the demand side to the logistical management. They will also consolidate

the E2E Sourcing model, with focus on global electronic portfolio development .

Some of the key Global Procurement area challenges for 2014 include the E2E Sourcing model consolidation, through a better alignment with the operators and the technical areas and, simultaneously, expanding the Procurement scope to the whole supply chain.

Finally, Global Services main challenges for 2014 are to increase transfer volumes and centralization of activities on already migrated processes, and also identify new opportunities in processes and territories so our global model gets more consistency and extend its scope that allows us to accelerate further efficiencies while becoming a benchmark for BPO (Business Process Outsourcing), without deteriorating Telefónica's processes quality and control. Additionally, we want to get deeper in value creation models through an end-to-end processes vision we operate, in order to maximize our scope, while considering the whole ecosystem (internal and outsourced operations, managed budgets and suppliers).

Telefónica wishes to convert itself into a player that is even more integrated in the 'digital life' of its customers