

# Annual Report 2006



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# our body

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# our soul

## TELEFÓNICA IN 2006

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# Letter from the Chairman



Dear Shareholder,

Once again another year, the presentation of the 2006 fiscal year annual report gives me the unique opportunity to contribute a brief assessment of the results of our management and some reflections on Telefónica's perspectives.

I should express my optimism and satisfaction because 2006 was a year in which historical records were made at our company, thus marking a before and an after; and this, in an environment of the Information and Communication Technologies sector which is highly favorable for Telefónica, due to the opportunities that it is already offering and the solid starting position that our company enjoys.

Likewise, I would like to share with you the enthusiasm with which the Telefónica team of professionals is working on the transformation that is necessary so that our company guides the future of the sector, by anticipating the trends towards the new digital environment.

#### **Our results, the best in the sector**

In 2006, no other operator in the world can demonstrate better results than ours. Said results can be summarized in four basic ideas: more growth, more profitability, greater scale and greater diversity.

In the last year, there has been a quantitative and qualitative drive to continue offering the best combination of growth and return to the sector shareholder. This binomial is supported on some differential management results, which comfortably exceed the commitments made, and once again endorse our recognized credibility.

Organic growth constitutes one of our priority objectives because, among other things, it allows us to demonstrate that we are capable of making our markets and business grow

where we are, taking full advantage of the technological and demand cycles. In 2006 our revenue reached 52,901 million euros, with a 41.5% growth with respect to 2005, which in organic terms represents an inter annual increase of 7.8% . At the same time, the advance made in operating efficiency has made it possible for the Operating Income Before Depreciation and Amortization (OIBDA) to reach a total growth of 27% and an organic level of 6.4%.

On the other hand, I must mention that, for the first time, Telefónica has obtained the largest net profit in absolute value in the European telecommunications sector, in the amount of 6,233 million euros, 40.2% higher than in 2005. The free cash flow generation has grown 12.3% with respect to 2005, totaling 11,122 million euros.

This spectacular growth of the economic-financial variables is the result of the sustained increase in the principle operating variables, and in particular, the expansion of our customer base favored not only by the greater commercial activity developed during the last fiscal year, but also by the effect of the new incorporation of business in Europe and Latin America. All of this enables us to put the total number of accesses at higher than 203 million as of December 2006, 32% higher than that which was registered in December 2005. At the end of 2006, Telefónica had more than 145 mobile accesses, more than 42 million land lines, more than 8 million fixed broadband systems, and already more than a million cable television customers. In net terms, the company's customer base grew by almost 50 million accesses.

#### **A company of greater scale and diversity**

In a sector as competitive as ours, the ability to grow is the real challenge, but it is still more important to achieve diverse growth as far as markets and business. Telefónica is the company with the most international profile of all of the large integrated

operators, with a presence in 23 countries. Today, 38% of our revenue comes from Spain, 26% from the rest of Europe and 35% from Latin America.

The major lines of our management reflect this growth and diversification effort based on specific and outstanding facts, such as our consolidation as the first broadband operator in Latin America, and the acceleration of our mobile telephone park in this region, with an annual customer growth above 18%, which exceeds 83 million; the development of the cable television market; and in Europe, becoming the leader in the United Kingdom as far as the number of mobile customers, the launch of ADSL in Germany and, in Spain, maintaining our competitive position in mobile telephone and the reactivation of the ADSL demand driven by a convergent offer. Telefónica's successful development in 2006 in highly competitive markets demonstrates the solidity of our leadership.

Moreover, in 2006 we have moved considerably forward to our integration objectives, with the achievement of synergies valued at more than a billion euros. Around 80% of the previous amount corresponds to the synergies obtained in Latin America, as a result of the regionalization program begun in 2004, and the remaining 20%, comes almost entirely from O2, in its first year with Telefónica.

Our trust in the growth opportunities of the sector brought us to invest 8,003 million euros last year, 55.3% higher in volume than in 2005, clearly oriented at the growth businesses: broadband and mobility.

The best combination of growth and profitability in the sector. The value of these results acquires greater relevancy when compared with the performance of the sector in general. In 2006, Telefónica not only grew more than anyone, but it has also become a management benchmark. So, in 2006 the good results obtained have translated into a significant increase in value for our shareholders in such a way that, in the last year, the earnings per company share grew 43%, to 1.3 euros per share. This means that we are able to move remarkably forward with the commitment we made in 2005 to double the earnings per share in order to reach 1.82 euros per share in 2009.

In line with the previous objective, in 2006 there has been an even more attractive shareholder return policy, consisting of an interim dividend of 0.3 euros per share charged to the 2006 results, and 0.3 euros to be paid in the first semester of 2007, and a share repurchase program for their cancellation to be completed before the end of 2007 at a value of 2.7 billion euros.

Therefore, in 2006 total profitability for the Telefónica shareholder reached 31.16% versus the telecommunications sector average of 22%, represented by the Dow Jones Telco Index.

#### **A world-wide leader**

The successful development of our management herein described allows us to state that as of today, it is by the best integrated operator in the world.

From a financial standpoint, Telefónica is a fully privatized company, with more than 1.7 million direct shareholders, and it is included in the Dow Jones Global 50 Titans Index, which includes the 50 most important companies in the world. In aggregate value rankings, Telefónica closed 2006 as the third global telecommunications operator, and occupying the fourth position between the major Telecommunications, Media, Information Technologies and Internet companies.

Even though the global relative position reached is significant, our final objective is to be, not only bigger, but better. For this reason, Telefónica is and intends to continue being an industrial leader and sector benchmark, by taking maximum advantage of the opportunities created.

#### **A new vision: the spirit of progress**

Our activity is right in the heart of the sector where the new economic and social model for the XXI century is being developed. Telecommunications are in convergence with the companies that provide technology, content or information services to build the new digital environment; and this, is precisely what sustains our capacity to massively offer mobility and broadband.

We are in a renewed business, in which innovation in net based businesses constitute one of the principal growth engines. Our

role is to facilitate access to all of this innovation, offering customers personalized treatment, simplicity and reliability.

In this sense, in 2006 our vision was defined:

*"We want to enhance people's lives and the performance of businesses as well as the progress of the communities where we operate, by delivering innovative services based on information and communication technologies".*

#### **Integrated management with a regional focus**

At Telefónica, we understood long ago that to face the new dynamics of the business, a profound internal transformation of our culture and organization was necessary.

We have gone forward with integration, the required path to growth. With the union of fixed and mobile services, we have become a unique company, capable of responding to an also unique customer, who expects integral answers from us. We have directed our internal reorganization towards this, from a work model that empowers us and removes internal barriers in order to encourage the creation of value and the exploration of new growth opportunities and increased efficiency.

Generally speaking, it is a regional model with an integrated vision of the business, the processes and technology, which focuses on the customer. Telefónica shall renew its effort to strengthen its distribution network, brand and levels of customer service. We would like to offer the best customer experience in our markets. Furthermore, it will expand the product offering by supporting itself on innovation as demonstrated by services such as Imagenio or the new Telefónica R+D center in Barcelona, a benchmark in its field.

#### **Our commitment, renewed**

Telefónica faces 2007 at an excellent moment and with a privileged position in the sector. This, together with the development of the markets in which we operate allows us to set ambitious objectives, in accordance with our current position as leader and which we hope to maintain in the near future, given our forecasts for organic growth rates in the principal economic-financial variables, which are higher than those achieved in 2006.

At Telefónica, we work every day to meet our commitments, focusing on the customer's needs. And also to obtain recognition from the other stakeholder, offering our human capital stimulation and opportunities, ensuring our shareholders the best combination of profitability and growth, and acting as an engine for development in our society on a global as well as on a local level. This is the center of our corporate responsibility.

I believe that if we can boast about anything, it would be that we are a company that delivers. This is what we have always worked for at Telefónica. Therefore we will continue working for this reason.

On behalf of the Telefónica Board of Directors and our entire team, I would like to again, this year, thank you.



#### **César Alierta**

Chairman and CEO, Telefónica, S.A.

Telefónica's vision:

# Spirit of progress

"We want to enhance people's lives and the performance of businesses as well as the progress of the communities where we operate, by delivering innovative services based on information and communication technologies".

Defining a company's vision is no easy task. Firstly, conceptually, there is no academic or business consensus in terms of what a vision represents. Secondly, in practice, it is not always possible to gain a full understanding of the scope and potential provided by having a vision.

At Telefónica, following the acquisition of O2, we began a complex internal process to re-define the Company's vision. This process aimed to find an important value that Telefónica would be able to use as a focal point for people's conception of the company based on the following initial requirements:

- that it reflects a proposal that offers the company a real differential value;
- that it "speaks" to, or represent, and offer specific meanings for all the stakeholders;
- that it creates a value proposal for all types of Telefónica customers: individuals, homes, the self-employed, small and medium-sized enterprises, big businesses and institutions;
- that it makes sense in all the markets in which the Company operates: Spain, Europe and Latin America;
- that it makes the Telefónica brand a Master Brand for the group; ie, a brand to reflect its position as the world's third largest telecommunications group;
- that it offers support to Telefónica's commercial brands (especially Movistar and O2), standing for attributes of solidity, globalisation and innovation;
- that it acknowledges the diversity of a group; a multi-domestic, multi-product, multi-market, multi-brand and multilingual group;
- that all this ensures a vision that provides goals, whilst being credible, realistic and uniquely applicable to Telefónica.

## What does the vision mean for...?





## Our Values:

Telefónica is a company that is...

### Innovative

We make technology easy to use and understand. Innovation is a constant source of inspiration for everything we do; this allows us to anticipate the changes in the market and the expectations of our customers.

### Competitive

Innovation helps us to be more competitive. We are not content with what we have achieved. Our obligation is to take everything further, without ever giving anything up.

### Open

We are competitive, but we operate openly and transparently and are accessible to everyone. We are a company that gets involved and learns from the cultural and social realities of the communities in which we are present.

### Committed

We demonstrate our commitment by keeping our word and by knowing that the way we achieve things is just as important as things we achieve. Our goal is to gain everyone's trust.

### Trustworthy

Being trustworthy requires reliability and trust. Reliability aids differentiation, competitiveness, leadership and relationships with our audiences in the long term. Trust is earned, or not, through our reliability and our ability to keep to our commitments, or not.

## These requirements led to the vision that is presented here.

- What does it mean to enhance people's lives?  
Taking into consideration the progress of all the people and homes, satisfying all their communication needs, offering a wide range of products and services to improve their quality of life.
- What does it mean to enhance the performance of businesses? Taking into consideration the progress of all the companies: offering complete communication solutions.
- What does it mean to contribute to the progress of communities?  
Contributing to the development of a country by investing in communication infrastructure and networks, thus becoming a partner and ally for communities in consolidating the telecommunications sector.
- What does it mean to offer innovative services based on information and communication technology?  
Investing in R&D+i and creating future. It means exploring every possibility offered by information and communication technology and those offered by fixed and mobile communications... so as to be able to bring voice, data, systems, entertainment, complete solutions, tele-education, tele-medicine, tele-security, domotics, etc., to every corner of the country.

In these terms, the vision becomes a touchstone of enormous potential for integrating and guiding all activities at a group which, like Telefónica, already has a worldwide scale; above all, it now becomes the backbone for the whole of the organisation, bringing together the different areas, units and businesses at Telefónica.

## Spirit of progress:

### the balance between body (magnitudes) and soul (how we are)

According to this vision, progress for Telefónica represents an balance between its results and the way it manages itself. Progress for us is an balance between our capacities (financial power, leadership, experience, innovation, international leadership...) and the way we do things (culture, values, principles, motivations...).

Telefónica's progress is its customer's progress, of our shareholders, of our employees and of the societies in the countries in which we operate. And that is what makes us progress. What makes everyone progress.

That is why we say that Telefónica's progress is a balance between our body (our magnitudes) and our soul (how we are).

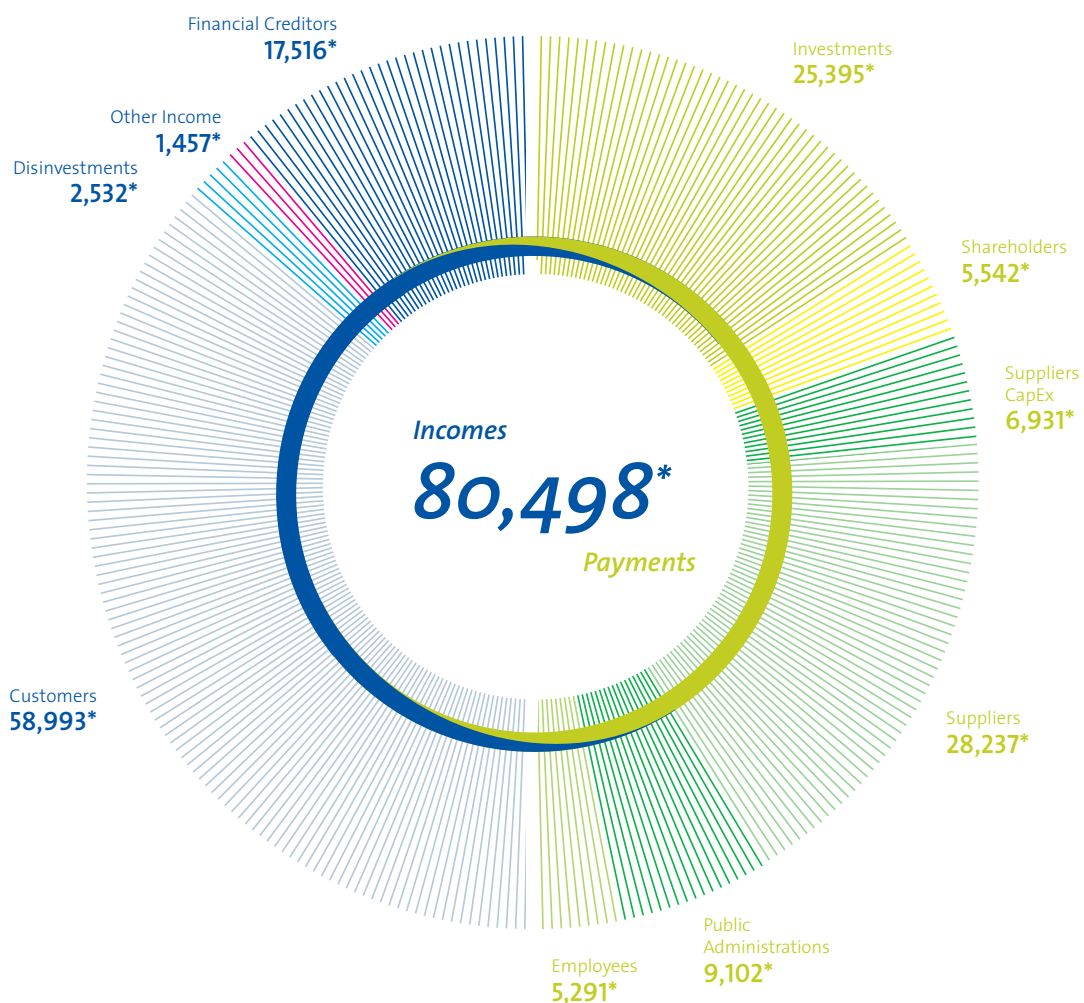
The vision as reality: Driving force of Progress

# Telefónica is a driving force for economic, technological and social development in the countries in which it operates

**Where does Telefónica's revenue go? In 2006, the company received almost 53 billion euros from its customers and more than 17.5 billion from financial creditors. In total, Telefónica generated revenue for a value of 80.5 billion euros.**



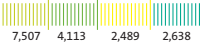


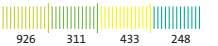


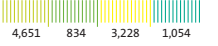





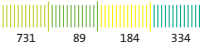


























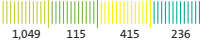












This revenue generated the payment of 5.29 billion to employees (6.6% of the total payments); 9.1 billion to Public Administrations (11%); 28.23 billion to commercial suppliers (35%); and 5.54 billion to shareholders (7%). This is the effect of wealth creation.

Furthermore, in 2006, the Company's sales and business volume represented an average of 1.5 of the GDP in the countries in which it operates.



\*Figures in millions of euros

The information published on this page has been obtained from internal cash flow evolution sources of the Telefónica Group, and verified by the auditor of the CR report. The mentioned data could be subject to variations as a result of subsequent events and evolutionary effects that could cause changes in their content. This information has been consolidated on a payments basis, whereas the information on the following page of income has been calculated on an accruals basis. For a detailed analysis of the consolidated financial statements of Telefónica Group, the audited information is included in the annual accounts report.

Economic Impact			GDP/Country	Magnitudes
<b>Spain</b>				
	Spain	Revenue  <b>20,053</b> Payments  <b>7,507 4,113 2,489 2,638</b>	2.1%	Employees: <b>57,058</b> Suppliers: <b>4,261</b> (88.20%) Accesses: <b>42,621</b>
<b>Latin America</b>				
	Argentina	Revenue  <b>2,259</b> Payments  <b>926 311 433 248</b>	1.3%	Employees: <b>19,398</b> Suppliers: <b>1,577</b> (94.93%) Accesses: <b>16,809</b>
	Brazil	Revenue  <b>7,644</b> Payments  <b>4,651 834 3,228 1,054</b>	1%	Employees: <b>65,993</b> Suppliers: <b>3,547</b> (99.01%) Accesses: <b>45,728</b>
	Chile	Revenue  <b>1,738</b> Payments  <b>812 230 216 343</b>	1.6%	Employees: <b>12,541</b> Suppliers: <b>1,702</b> (91.83%) Accesses: <b>8,538</b>
	Colombia	Revenue  <b>1,196</b> Payments  <b>731 89 184 334</b>	1.2%	Employees: <b>7,127</b> Suppliers: <b>1,471</b> (92.66%) Accesses: <b>10,190</b>
	Ecuador	Revenue  <b>282</b> Payments  <b>139 24 48</b>	0.9%	Employees: <b>747</b> Suppliers: <b>346</b> (79.48%) Accesses: <b>2,490</b>
	El Salvador	Revenue  <b>155</b> Payments  <b>85 14 28</b>	1.1%	Employees: <b>404</b> Suppliers: <b>538</b> (77.51%) Accesses: <b>953</b>
	Guatemala	Revenue  <b>168</b> Payments  <b>104 19 39</b>	0.7%	Employees: <b>463</b> Suppliers: <b>669</b> (79.22%) Accesses: <b>1,544</b>
	Mexico	Revenue  <b>1,092</b> Payments  <b>769 137 63 186</b>	0.2%	Employees: <b>11,485</b> Suppliers: <b>840</b> (92.74%) Accesses: <b>8,556</b>
	Nicaragua	Revenue  <b>64</b> Payments  <b>37 5 11</b>	1.5%	Employees: <b>304</b> Suppliers: <b>387</b> (71.83%) Accesses: <b>553</b>
	Panama	Revenue  <b>171</b> Payments  <b>76 14 32</b>	1.3%	Employees: <b>571</b> Suppliers: <b>596</b> (81.71%) Accesses: <b>939</b>
	Peru	Revenue  <b>1,422</b> Payments  <b>710 198 443 218</b>	2%	Employees: <b>12,301</b> Suppliers: <b>2,190</b> (89.00%) Accesses: <b>8,711</b>
	Uruguay	Revenue  <b>82</b> Payments  <b>64 9 13</b>	0,6%	Employees: <b>239</b> Suppliers: <b>191</b> (69,11%) Accesses: <b>777</b>
	Venezuela	Revenue  <b>2,072</b> Payments  <b>1,049 115 415 236</b>	1.6%	Employees: <b>6,882</b> Suppliers: <b>1,213</b> (90.52%) Accesses: <b>8,826</b>
<b>Europe</b>				
	Germany	Revenue  <b>3,404</b> Payments  <b>386 1,225</b>	0.1%	Employees: <b>5,335</b> Suppliers: <b>11,662</b>
	Ireland	Revenue  <b>872</b> Payments  <b>87 141</b>	0.5%	Employees: <b>1,787</b> Suppliers: <b>1,632</b>
	UK	Revenue  <b>6,787</b> Payments  <b>624 958</b>	0.4%	Employees: <b>13,028</b> Suppliers: <b>6,171</b> Accesses: <b>17,650</b>
	Czech Republic Including Slovakia Capex	Revenue  <b>2,130</b> Payments  <b>439 248 415 229</b>	1.9%	Employees: <b>9,276</b> Suppliers: <b>929</b> (89.99%) Accesses: <b>7,841</b>

Revenue, cost of human resources, payment of taxes in the country, purchases and investment (Capex) in millions of euros.

In the absence of tax information in the country, the figures are consolidated like those in the annual accounts. There is no information on purchases and taxes for the United Kingdom, Germany and Ireland.

% TEF Revenue / GDP: Ratio of Telefónica's revenues (contribution by the country to the consolidated revenue of the Telefónica Group) and the estimated GDP for the country (Source: FMI).

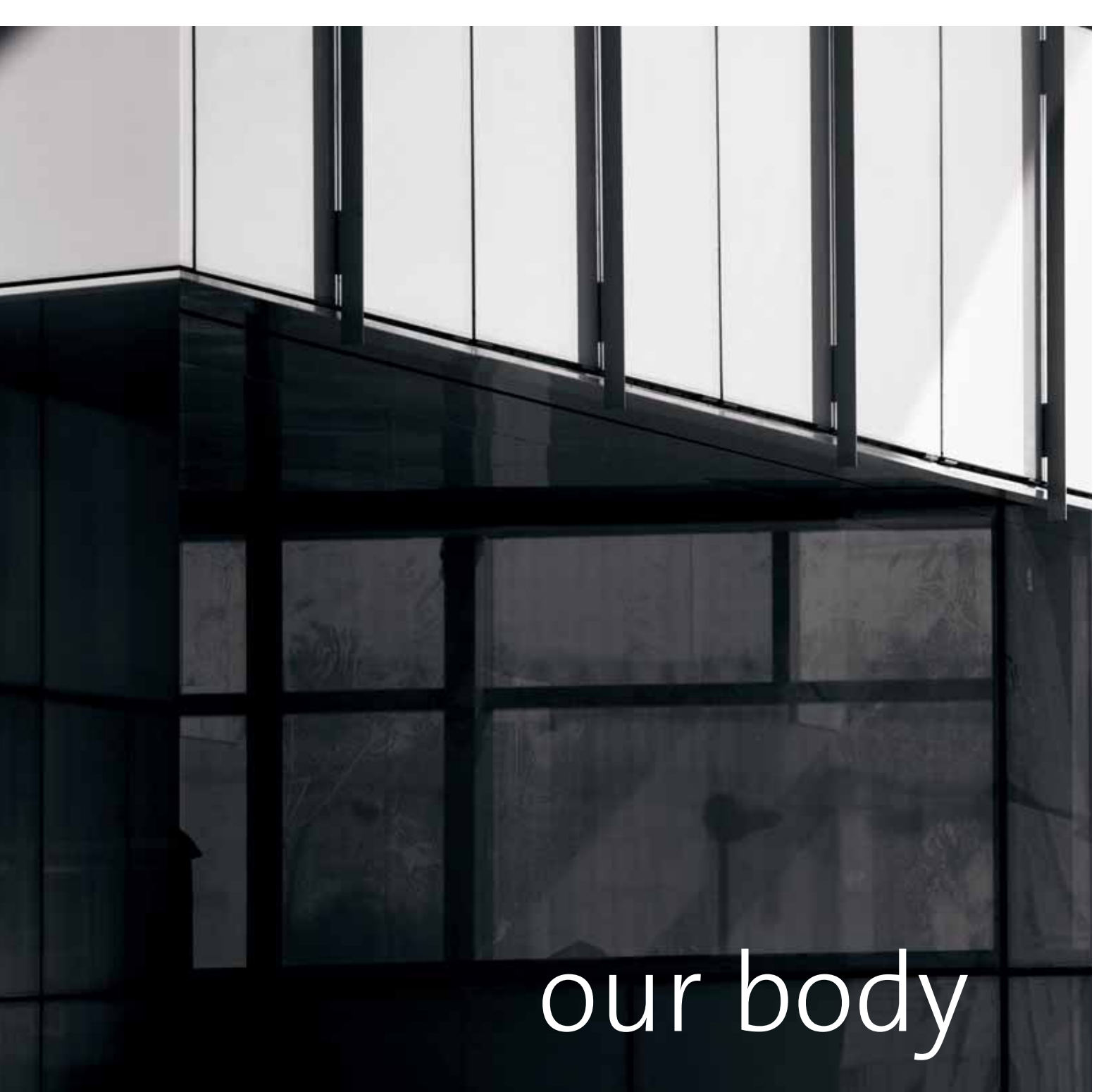
Employees: Direct employees of Telefónica Group in the country (as at December, 31, 2006).

Suppliers: Suppliers awarded contracts in the country in 2006.

Accesses: Equivalent to the number of fixed + mobile + ADSL + TV accesses (thousands).

(1)% awarded to local suppliers: percentage of contracts awarded to suppliers with registered address in the country with regard to the total number of contract awards, based on awarding volume.





# our body

## TELEFÓNICA IN 2006

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# Telefónica in 2006

## 01.1

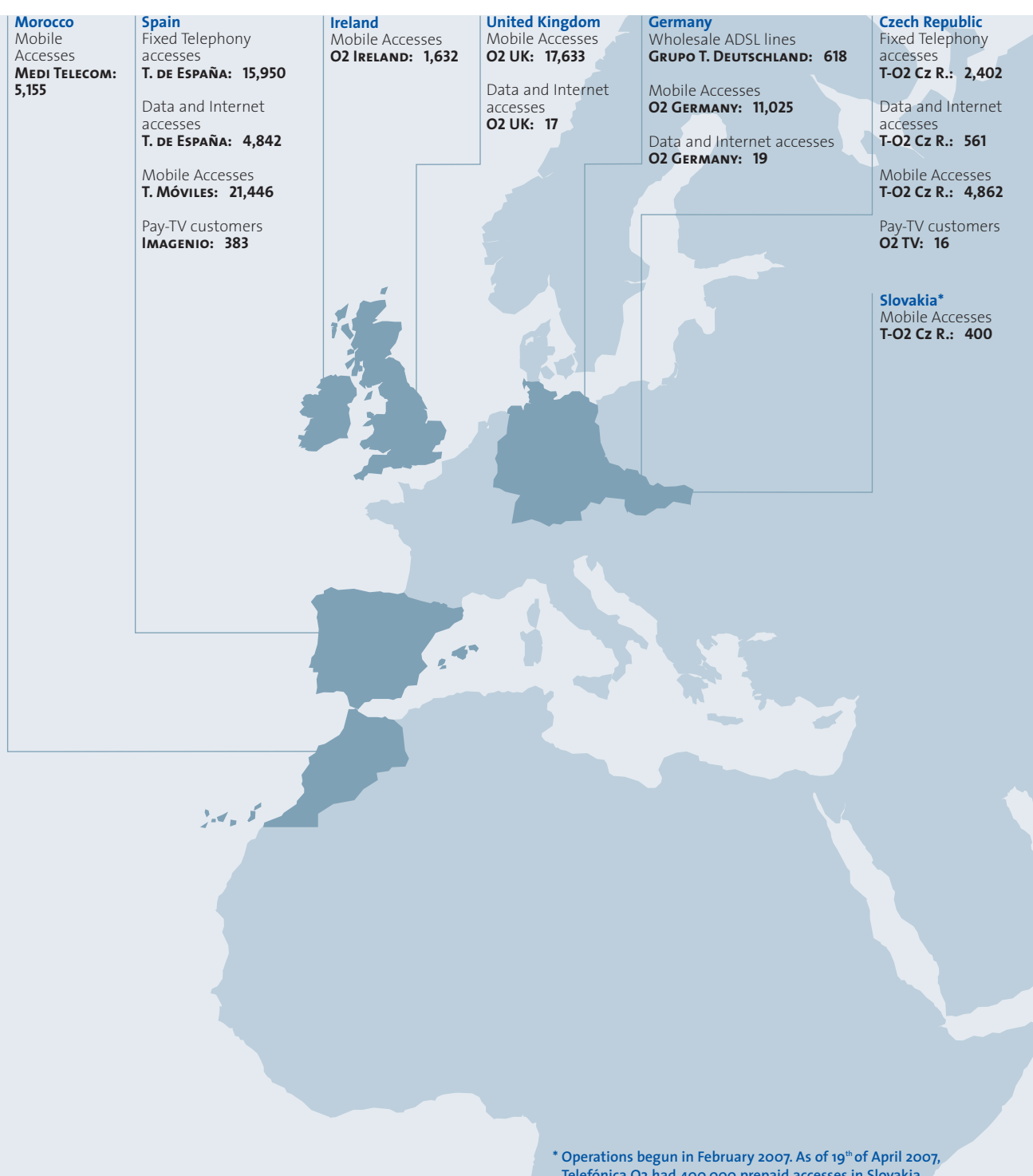
# Magnitudes

## Market Size

In thousands as at December 31 2006



Presence in more than **23** countries. **203** million customer accesses. **145** million mobile telephony accesses. **42.3** million fixed telephony accesses. **7.9** million Broadband accesses. **1 million** pay-television accesses. More than **62%** of its revenue comes from countries other than Spain. Revenue of more than **52.9** billion euros. **31.2%** shareholder returns in 2006. Market capitalization of **79.3** billion euros. **4.3** billion euros invested in R&D+i. More than **233,000** employees.



## Only two Chinese companies manage more accesses than Telefónica Telefónica is the third company in the world by number of customer accesses

Telefónica has closed financial year 2006 with over 200 million customers, only two years after overcoming the barrier of 100 million customers.

Telefónica registered customer growth in all the services it offers: fixed telephony, broadband, mobile telephony and pay-TV.

### Fixed Telephony

The telecommunications market has been changing in recent years, thereby offering clients alternatives to traditional fixed telephone access.

Telefónica continues working to fight the fall in fixed lines, having closed 2006 with 42.3 million fixed accesses managed by the group, which implies a net gain of 1.5 million with regard to the previous year.

In Spain the fixed telephony market share is at 82.5%, almost two points below that of 2005. However, the voice market share has remained stable throughout the year, at around 66%.

Brazil is the second fixed telephony access market for Telefónica, with 12.1 million customers (-1.9%), of which approximately 19% are prepaid lines or lines with consumption limits.

Peru registered significant growth in fixed telephony accesses (+6.4%) as a consequence of the campaigns carried out during the year and the increase in sales services.

### Broadband

Telefónica leverages its solid position in the market to seize the opportunities offered by the new digital environment.

Fixed broadband accesses reached 8 million, with a year-on-year growth rate of 41.1% and a net gain of 2.3 million accesses.

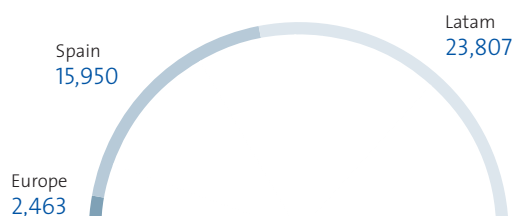
In 2006, Telefónica has positioned itself as the first DSL operator in Latin America, with over 3.7 million broadband accesses in the region.

In Spain Telefónica manages over 3.7 million retail accesses to broadband Internet, with a net gain of 1.5 million in the financial year. One of the elements that have most contributed to this growth are the combined offers (dúo, trío...) which have surpassed 2.7 million subscriptions.

Telefónica O2 Europe registered a 93.4% growth in the number of broadband accesses as a result of the gain of 179,000 lines in the Czech Republic and the launch of the DSL offer in Germany.

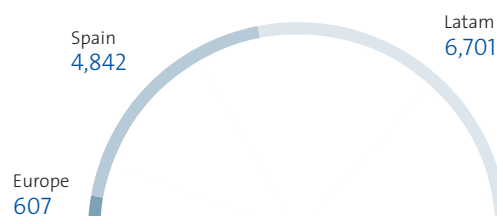
#### Fixed telephony accesses

Data in thousands



#### Broadband accesses

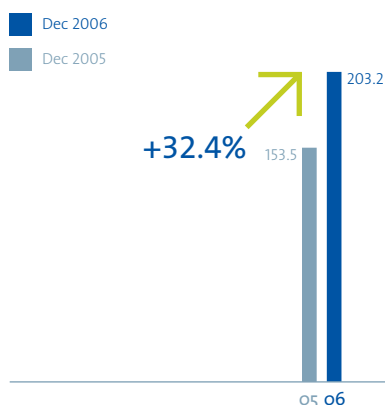
Data in thousands





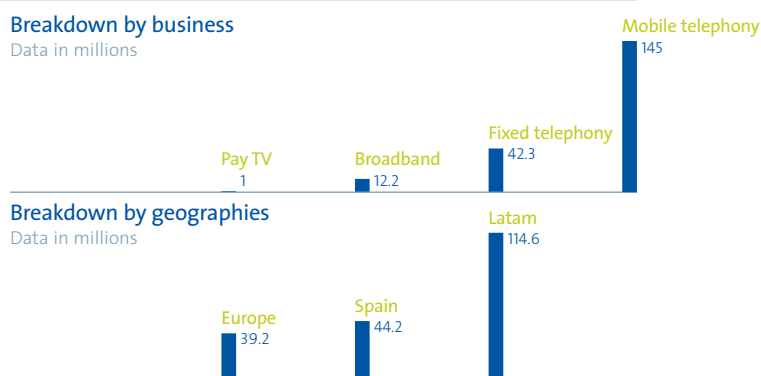
## Total accesses

In millions



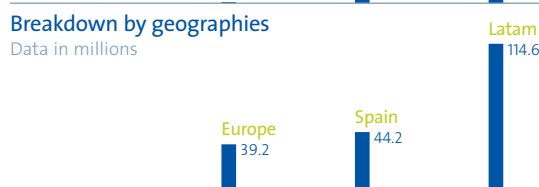
## Breakdown by business

Data in millions



## Breakdown by geographies

Data in millions



## Mobile Telephony

Mobility is one of the attributes most valued by clients when it comes to using telecommunications services. Growth in the customer base, initiatives to encourage consumption and commercial efficiency are the main tools with which to compete in the market.

In financial year 2006, mobile telephony has been the main growth lever Telefónica, with a net gain of 45.7 million, thereby placing the access base at 145.1 million (+46.6% increase with regard to 2005). The organic growth of the mobile customer base was approximately 14.7%.

Our leadership in these two highly competitive markets allows us to take our solutions to other regions. In Latin America we have reached the figure of 83.3 million mobile customers (+18% compared to 2005).

Telefónica maintains its competitive position in Spain, with a market share of over 45%. On the other hand, Telefónica O2 is the market leader in the United Kingdom with over 17 million clients.

## Pay-TV

Content distribution is one of the added-value services on which Telefónica wishes to build its integrated value offer for its customers.

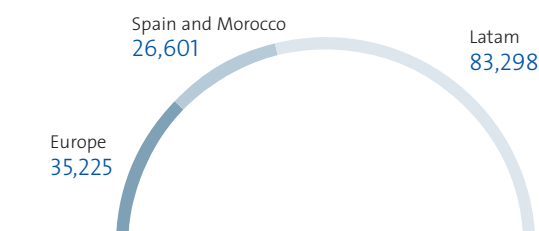
At the close of financial year 2006, we had over one million pay-TV customers, with a year-on-year growth of 55.7%.

In Spain, Telefónica's Imagenio service reached 383,000 TV customers at year-end 2006, with a growth of 85% compared to the previous year, having reached a market share of 10%.

In financial year 2006, Telefónica consolidated its offer of satellite TV (DTH) in Chile and Peru, reaching 120,000 customers. In addition, it prepared the future launch of the service in Brazil.

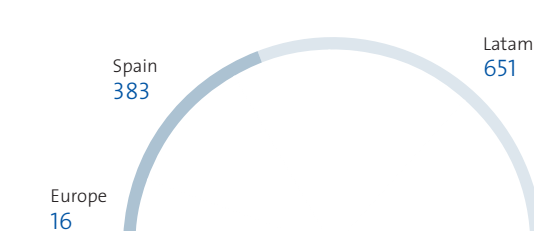
## Mobile telephony accesses

Data in thousands



## Pay TV accesses

Data in thousands



## Revenues from external markets amounted to 62% of total in 2006

# Telefónica is present in over 23 countries and has the most balanced geographic profile of all telecommunications companies

**By region, Telefónica's profile is now more balanced than in 2005, given that the countries external to the domestic market increased their contribution to the group's consolidated revenues to 62.1% and to consolidated OIBDA, to 56.2%.**

**This geographic balance, together with the convergence of services and technologies, has configured a new organisational structure based around three geographic regions: Spain, Latin America and Europe.**

### Organisational Profile

The Corporate Centre is responsible for the global strategy and the corporate policy strategy, the management of common activities and the coordination of the activities of the regional business units.

#### Telefónica España

Its main activity is providing fixed telephony, mobile and broadband services in Spain.

#### Telefónica O2 Europa

Its main activity is to provide fixed telephony, mobile and broadband services in Europe. This business unit has operations in the United Kingdom, Ireland, Germany, the Czech Republic and Slovakia.

#### Telefónica Latinoamérica

Its main activity is to provide fixed telephony, mobile and broadband services in Latin America, with presence in all key markets in Latin America.

It offers services in Argentina, Brazil, Chile, Colombia, Ecuador, El Salvador, United States, Guatemala, Mexico, Nicaragua, Panama, Peru, Puerto Rico, Uruguay and Venezuela. In addition, it manages the office of Telefónica in China and the alliance with China Netcom.

#### Telefónica España

Telefónica España is the leading telecommunications operator in the Spanish market, with nearly 16 million fixed telephony accesses, 4.4 million data accesses and 21 million mobile accesses.

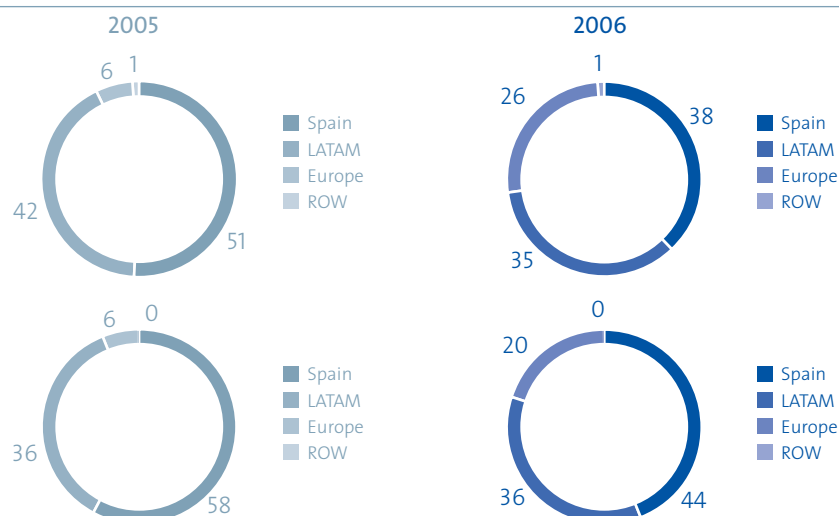
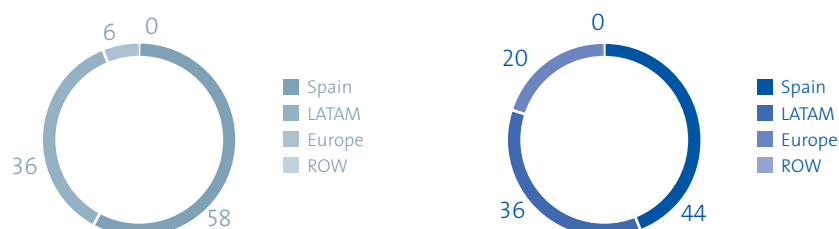
In 2006, this business unit contributed 19.75 billion euros to Telefónica's total revenues, representing 37.9% of the total.

The main growth levers of the fixed telephony business are revenues from Internet and broadband, information technologies and data services. The percentage of lines with broadband access is 23.5% of the total (16.9% in 2005).

On its part, the mobile telephony business registered a year-on-year growth rate of 4.1 %, mainly due to growth of revenues for services and client base.

Telefónica's Imagenio service reached 383,000 pay-TV clients at the close of 2006, representing a growth of 85% compared to the previous year, and reaching a market share of 10%.

## A highly diversified financial performance

Revenues  
by regionOIBDA  
by region

## Telefónica Latinoamérica

At the close of financial year 2006, Telefónica Latinoamérica was managing more than 23 million fixed telephony accesses, 5.9 million data and Internet accesses and over 83 million mobile accesses.

Latin America is the main lever of growth for the Group, with an organic client growth rate of 13.4%, which, together with the increases in boundary, imply revenues of 18.09 billion euros.

In 2006 we have reinforced our competitive position in Colombia and in the region through the acquisition of Colombia Telecom.

Revenue from mobile services grew 19.9% from 2005, with important contributions from Venezuela, Argentina and Mexico.

Fixed business lines increased revenues by a total of 14.5%, thanks to that fact that the larger contribution from Internet and broadband compensated the lower revenues from the traditional business.

## Telefónica O2 Europa

In 2006, we have successfully incorporated O2 to Telefónica, and at the same time, we have reinforced its competitive position in Europe. This is confirmed by the annual growth rate in the client base of 7.9%, which indicates the successful integration of O2 in Telefónica, and our ability to strengthen its competitive position.

Currently, Telefónica O2 Europe contributes 27% of the group's revenues (13.16 billion euros)<sup>1</sup> and groups the operations of the United Kingdom, Germany, Ireland and the Czech Republic.

In the United Kingdom, Telefónica O2 achieved a growth rate of 14.7% in revenues from services, sustained by the increase in the client base and the ARPU.

In Germany, the year-on-year growth rate registered was 6.7%, whereas in the Czech Republic revenues grew by 0.4% thanks to the growth in mobile telephony (+6.1%). Telefónica O2 Czech Republic has become the first experience of an integrated operator of Telefónica.

In addition, in 2007, we have launched commercial operations in Slovakia.

	Revenues by region		OIBDA by region	
	2005	2006	2005	2006
Spain	51%	37%	57%	43%
LatAm	42%	35%	36%	36%
Europe	6%	27%	6%	20%
ROW	1%	1%	1%	1%

(1) Only 11 months until Dec. 2006

# Telefónica is already the European operator offering the best combination of growth and profitability in the sector

**In financial year 2006, Telefónica achieved the best results in its history, positioning itself as a world leader in the telecommunications sector.**

**These results are the consequence of three simultaneous lines of action:**

- **Revenue growth by 41.5%, reaching 52.9 billion euros.**
- **Improvement in shareholder profitability, reaching 31.9%.**
- **Cash flow generation, which reached 11.12 billion euros, 12.3% more than in 2005.**

## Revenue growth\*

Telefónica's revenue grew by 40.2% with regard to 2005, reaching 52.9 billion euros, benefiting from the diversification of regions businesses and market cycles that have resulted in gaining more clients, with greater consumption and more services.

Of this growth, the incorporation of O2, Telefónica O2 Czech Republic, Telefónica Telecom and Iberbanda contribute 32.1 percentage points.

The organic growth of 7.8% positions Telefónica at the head of the sector; characterised by the positive contribution of all businesses, especially the mobile services in Latin America and Europe and the growing contribution from of fixed broadband business.

By regions, Spain's contribution represents 37%, which means that Telefónica is the integrated operator with the most business outside its domestic market. 36% of its business comes from Latin America, and 26% from the rest of Europe.

## Business profitability\*

In the current telecommunications market, customers and new competitors demand increasing levels of efficiency and flexibility.

In financial year 2006, Telefónica proved its capacity for growth, maintaining excellent profitability. Thus, Telefónica's operating income before depreciation and amortization (OIBDA) increased 27.0% with regard to the previous year, amounting to 19.13 billion euros.

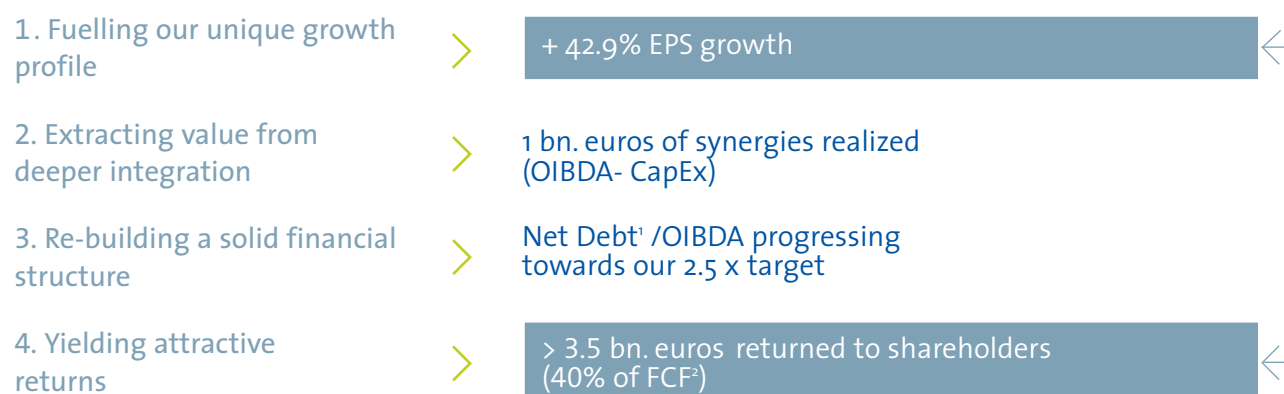
OIBDA margin, as at close of 2006, was at 36.2%, representing a year on year fall of 4.1 percentage points, mainly affected by the incorporation of O2 from the month of February.

The organic OIBDA growth was 6.4% excluding the provisions for the 2007 redundancy programme and pension plan for managers.

By regions, Spain's contribution to the consolidated OIBDA is reduced to 43.8%, showing a more balanced profile than twelve months ago (67.9%).

\* For a detailed analysis of the consolidated financial statements of Telefónica Group, please refer to the audited information included in the annual accounts.

#### 4 areas of management focus that delivered tangible results



<sup>1</sup> Including financial commitments

<sup>2</sup> FCF post minorities

### Cash flow generation\*

Discipline in investment management combined with expenditure curbing has contributed to increasing Telefónica's cash flow generation capacity<sup>1</sup> to 11.12 billion euros, representing an annual growth of 12.3%.

This growth in cash flow generation has been compatible with the growth of CapEx investments (8 billion euros) and with the financial expenses derived from the net financial debt, which amounted to 52.15 billion euros as at close of 2006.

This cash flow generation has made it possible to devote 2.63 billion euros to dividend payments, 2.40 billion euros to the purchase of own shares of Telefónica S.A. and 830 million euros to paying off commitments acquired by the group, mainly derived from staff reduction schemes.

### Shareholder returns\*

In 2006, Telefónica achieved the best results in its history, positioning itself as a world leader in the telecommunications sector. The company's net profit has grown by 40.2% with regard to 2005, reaching the record figure of 6.23 billion euros.

Returns for Telefónica shareholders in 2006 reached 1.304 euros per share, representing a year on year growth of 42.9%.

Throughout the financial year, the total profitability for Telefónica shareholders reached 31.2%, nine percentage points above the DJ Telco Index profitability (+22.2%).

Total returns for Telefónica shareholders	+ 31.2 %
Total returns for DJTelco for shareholders	+ 22.2 %

Source: Bloomberg

<sup>1</sup> Free cash flow understood as OIBDA - CapEx

\* For a detailed analysis of the consolidated financial statements of Telefónica Group, please refer to the audited information included in the annual accounts.

With a value of 80 billion euros

## Telefónica is now positioned among the five leading operators worldwide in terms of market capitalization

In the financial year 2006, Telefónica has positioned itself as fifth company worldwide in terms of market capitalization, reaching 79.3 billion euros.

With these figures, Telefónica is the only operator worldwide to fulfil, year after year, its commitments to investors in terms of revenues, OIBDA, Operating Income and CAPEX.

Furthermore, shareholders have benefited from the ability to generate value: earnings per share increased by 43% in 2006, reaching 1.304 euros per share.

### Share Performance

During 2006, Telefónica's share performance presented a positive profitability of 26.8%, in a context of widespread increases in the leading international stock markets. Telefónica's 26.8% increase to 16.12 euros/share, has been far higher than that of the rest of the reference sector in Europe (Dow Jones Europe Stoxx Telecommunications +16.9%) and that of the Eurostoxx-50 general index (+15.1%). The Ibex-35 was increased by 31.8%.

Similarly, the relative performance of Telefónica in 2006 was also better than that of its European counterparts, which ended the year with negative profitability in the case of Telecom Italia (-6.9%), Deutsche Telekom (-1.7%) and France Telecom (-0.2%) or lower profitability in the case of Vodafone (+12.9%), with the exception of BT, which was increased by 35.4%.

### Worldwide Ranking

#### Market Capitalization 2005

At 31st December 2005

	Company	Millions of dollars
1	Vodafone	133,240
2	AT&T	95,836
3	China Mobile	93,805
4	Verizon	83,281
5	NTTDocomo	74,544
6	Telefónica	74,113
7	Saudi Telecom	73,816
8	NTT	71,749
9	Deutsche Telekom	70,034
10	Sprint Nextel	69,016

#### Market Capitalization 2006

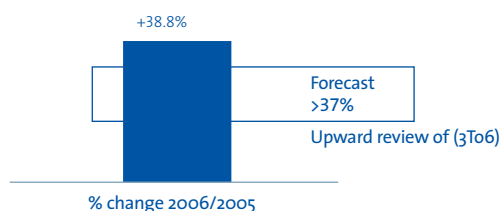
At 31st December 2006

	Company	Millions of dollars
1	China Mobile	176,061
2	Vodafone	146,289
3	AT&T	137,384
4	Verizon	108,723
5	Telefónica	104,722
6	BellSouth	85,932
7	América Móvil	81,006
8	Deutsche Telekom	80,371
9	NTT	77,751
10	NTTDocomo	74,176

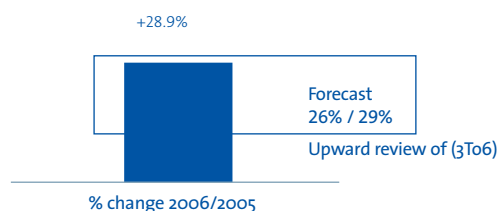
Source: Bloomberg

Fulfilment of commitments<sup>1</sup>

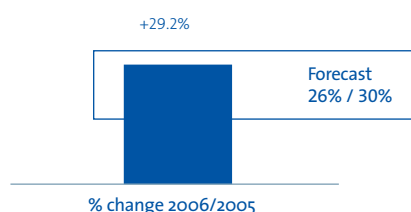
## Revenue Growth



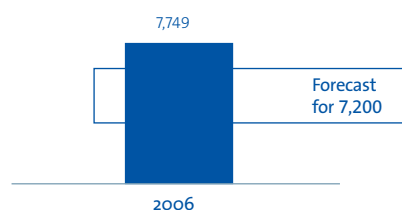
## OIBDA Growth



## OI Growth



## CapEx



## Borrowing Power

In the financial year 2006, Telefónica took advantage of its borrowing power to boost its growth. The increase from 83.9% total average net debt (54,315 million euros at 31st December 2006, including early retirement commitments) and the financial costs figure for 2006 represents an average cost of 5.0% over the total average net debt for the year.

## Aggregate Value of Telefónica

The aggregate value of Telefónica is calculated by adding the market capitalization for Telefónica in 2006 and its net debt. As a result, Telefónica closed 2006 as one of the three leading companies worldwide in terms of company aggregate value (market capitalization + net debt), moving up from sixth position the previous year.

## Ability to fulfil commitments

In 2006, Telefónica has once more fulfilled its investor commitments, upholding the company's credibility in the financial markets. Therefore, on the one hand, the increase in revenue (+38.8%) exceeded forecasts communicated by Telefónica (>37%); on the other hand, the OIBDA growth (+28.9%) was in the upper part of the band communicated by the company (+26% - +29%); furthermore, the increase in the Operating Income (OI) (+29.2%) was also in the upper part of the band communicated by the company (+26% - 30%); and finally, Telefónica managed to combine its growth with an increase in CapEx investments, above what was communicated (7,749 million euros compared with 7,200 which was predicted).

<sup>1</sup> 2006 objectives take on types of change from 2005. Published base figures include six months of Telefónica O2 Czech Republic (consolidated from July 2005) and includes TPI as a discontinued operation. It excludes changes at the perimeter of consolidation with the exception of the O2 Group (included in February-December 2006). To calculate objectives, the OIBDA and OI excludes other incomes/exceptional expenses not foreseen in 2006. Workforce restructuring and the sale of property project are included as incomes/operating costs. With the aim of comparing, other incomes/exceptional expenses registered in 2005 are also eliminated from the published data. The allocation of funds from the purchase of O2 has not been taken into account in calculating the OI objective.

## With an investment in R&D+i of over 4.3 billion euros Telefónica drives innovation in the markets where it operates

**According OECD criteria, during financial year 2006, Telefónica devoted 4.3 billion euros to technological innovation, 588 million of which were spent on R&D. In addition, Telefónica acts as a driving force for direct innovation, with over 1,700 people of its workforce working in the field of innovation, and encourages indirect and induced innovation in over 6,800 people who collaborate with the company.**

### Technological Innovation

Telefónica is currently in a unique position within the telecommunications sector to seize the opportunities that arise, thanks to its permanent commitment to innovation. The sector is currently offering excellent opportunities, which must be leveraged, with broadband and new consumer habits, and growing added value demand from the consumers.

In 2006 Telefónica increased its technological innovation investment by 48.3%, devoting a total of 4.3 billion euros, according to the criteria established by the Organisation for Economic Co-operation and Development (OECD).

39.5% of this amount was devoted to technological innovation in Spain, 38%, in Latin America and 23% in the rest of Europe.

This commitment to innovation has led to the launch of 179 new products and services during financial year 2006 and has increased the intellectual and industrial property portfolio to 3,160 registrations. In the year 2006, 296 new registrations were filed before a Notary, corresponding to the same number of new products developed. In addition, 18 new patents and 19 utility models were registered.

### Research and Development

For a company that seeks to set itself apart from its competitors and achieve a higher acceptance in the current market, it does not suffice to acquire technology; it is also necessary to promote its own research and development activities.

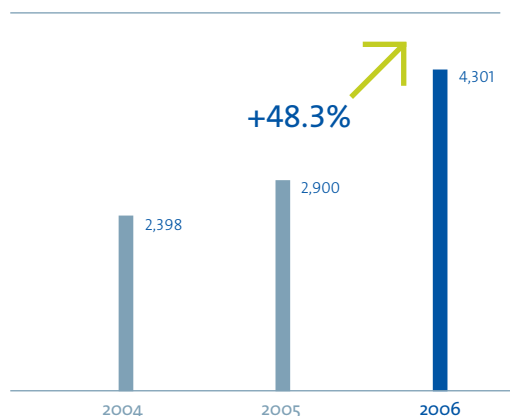
During 2006, Telefónica devoted 588 million euros to R&D+i activities, which amounts to 1.1% of our turnover. According to data published by the European Commission corresponding to financial year 2005, we are the leading Spanish company in R&D+i efforts.

Telefónica was responsible for 5.6% of the business efforts in R&D+i carried out in Spain and for 21% of the efforts carried out in the Information and Communication Technologies sector in 2005, according to the latest data published by the Spanish National Institute of Statistics (INE in its Spanish acronym) and by the Spanish Association of ICT Companies (AETIC).

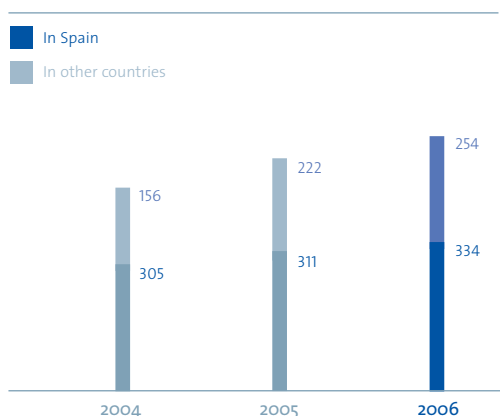
Telefónica's R&D+i activity generates employment for over 8,500 people, 1,700 of which are employed directly by Telefónica. By region, 3,500 professionals innovate for Telefónica in Spain and almost 5,000 do so in other markets.



**Total Investment in Technological Innovation**  
Millions of euros



**Total Research and Development Investment**  
Millions of euros



### Telefónica I+D

Approximately 35% of Telefónica's research and development activity is carried out directly by Telefónica I+D, a fully-owned subsidiary of Telefónica. This company acts as the driving force for innovation of the group, it develops new future-oriented services and identifies emerging technological options.

In 2006, Telefónica I+D worked on 1,781 projects, developed products, services and processes, and carried out applied research financed by the corporation. This activity is indicative of the interest in promoting the company's own applied research and development activities. These projects were implemented by a staff of 1,186 professionals employed directly and 1,378 people employed indirectly.

During the last year, the company accelerated the transformation of its laboratories into a Network of Centres of Excellence. It currently has offices in Barcelona, Granada, Huesca, Madrid, Valladolid, Sao Paulo and Mexico and is working on the extension and specialisation of these centres, in order to optimise its technological efficiency and attract local scientific and technological talent.

### Innovation in collaboration

Telefónica is aware of the need to be in contact with all the players that take part in the innovation process.

#### Collaboration with the University

The promotion of the relationship between Universities and Businesses is a priority goal for Telefónica. During 2006, Telefónica carried out more than 100 initiatives with Universities and awarded 600 grants.

The 14 Telefónica Chairs financed in Spain developed 69 technological innovation projects and issued 32 publications in 2006.

#### Collaboration with Public Administrations

Telefónica I+D is the leading Spanish company in terms of participation in projects of the 6th EU Framework Programme, with 111 initiatives funded with over 70 million euros. This makes Telefónica the most participative European telecommunications operator in this programme.

#### Movilforum

Movilforum is an initiative launched six years ago to promote collaboration with the business world, making available to companies its platforms and networks to carry out tests, terminals and training courses.

It currently has 4,900 partner members and 115 registered companies in Spain. In 2007, there are plans to export the model to Latin America.

Accumulating indirect and induced employment, Telefónica would be providing employment for more than half a million people

## Telefónica generates direct employment for more than 233,000 professionals

**By region, Latin America represents 60.87% of the total physical workforce. Spain, with 24.29%, is the second region by size. Finally, Europe represents 14.4% of the total workforce.**

**Atento is the company which provides the largest number of professionals, with more than 106,000 of the total.**

### Evolution of the Workforce

Telefónica closed the financial year 2006 with a workforce of almost 235,000 professionals, which is a 13.3% increase over the previous year. The area with the highest growth with respect to 2005 is Europe, whose workforce has been doubled in just one year with the acquisition of the O2 Group.

The most significant changes affecting the workforce during the year are the following:

- Variation of the Workforce as a result of business growth: 11% increase in the Atento workforce and consolidation of the "Telefónica O2 Europa" business unit.
- Integration of Business Lines: in line with the geographic restructuring of the Group into three large regions, integrating fixed and mobile operations.
- Divestment of Companies: as a result of the process of selling the TPI Group, the figures for TPI are not included in 2006.
- Completion of the Employment Regulation Plan in Telefónica de España, approved by the Ministry of Employment and Social Affairs. It had 3,304 sign-ups in 2006.

### Characteristics of the Workforce

The distribution of the Telefónica workforce by functions, without taking into account the Atento staff, indicates that 36.8% is dedicated to commercial functions, 49% to production functions and 14.2% to support functions. Our objective is to increase the workforce dedicated to commercial functions, reaching 50% by 2010.

49.5% of the workforce of the Telefónica Group is made up of women, whereby Atento stands out with 67.2%. This increase in the female workforce is essentially due to the incorporation of the O2 Group.

The average length of service of the Telefónica workforce is 5.6 years, and the average age is 33.2. Atento records the shortest length of service of the workforce with an average of 1.3 years and an average age of 25.

As for the transient nature of the workforce, 84.6% of our equivalent workforce has a fixed or indefinite contract (85% in 2005). The rest is divided between employees with a temporary contract (14.6%) and grants (0.7%). Atento is the company which registers the highest levels of temporality in the Telefónica Group, with 32% of the equivalent workforce.

The level of hierarchization of the equivalent workforce lies at 7%. This figure is the percentage that represents senior management, management and intermediary positions over the total.

## Physical Workforce by Region

	2005	2006	% Growth (06/05)
Spain	60,405	57,058	-5.54
Europe	14,326	33,818	136.06
LATAM	131,968	142,983	8.35
Rest of the World	942	1,041	10.51
<b>Total Telefónica Group</b>	<b>207,641</b>	<b>234,900</b>	<b>13.13</b>

## Indirect Employment

In relation to indirect employment generated during 2006, we created more than 64,000 indirect jobs in Spain and more than 100,000 in Latin America. On the whole, this indirect employment corresponds to the subcontracting of activities to collaborating companies. These collaborators are devoted to the performance of work awarded by Telefónica, such as the setting up and maintenance of telephony plants for public use, supply and maintenance of telecommunications products and services.

Telefónica requires these companies to fulfil the employment contracts and agreement for the sector. Telefónica signed an agreement with collaborating companies at the beginning of 2002 limiting the subcontracting of activities of the collaborating companies themselves, enabling only 30% of services to be subcontracted to third parties.

The risk increases when these companies, in turn, subcontract services to other companies. To ensure the fulfilment of working conditions, as of 2007, Telefónica shall carry out regular audits in these collaborating companies to ensure that they fulfil the provisions of the law.

## Physical Workforce

December 2006

Country	excluding Atento	including Atento
<b>Spain</b>	<b>42,453</b>	<b>57,058</b>
<b>Europe</b>	<b>33,818</b>	<b>33,818</b>
Germany	5,335	5,335
Ireland	1,787	1,787
United Kingdom	13,028	13,028
Czech Republic	9,276	9,276
Rest of Europe	4,392	4,392
<b>Latin America</b>	<b>52,205</b>	<b>142,983</b>
Argentina	14,635	19,398
Brazil	12,812	65,993
Chile	5,533	12,541
Colombia	3,873	7,127
Mexico	2,241	11,485
Peru	7,536	12,301
Venezuela	2,288	6,882
Central America	1,776	4,549
Rest of America	1,511	2,707
<b>Rest of the world</b>	<b>0</b>	<b>1,041</b>
<b>Total Telefónica Group</b>	<b>128,476</b>	<b>234,900</b>

With the Telefónica brand as a backbone element

## In 80 years of history, Telefónica has surpassed other companies that were leaders in the past

Telefónica was created in 1924, owned by a North American multi-national (ITT), in Spain. In 80 years of history, Telefónica has surpassed, one by one, the companies which were its historical reference in the past.

Today, Telefónica is the third telecommunications company worldwide in terms of customer accesses, with more than 203 million; it operates in more than 23 countries; it has a workforce of more than 233,000 employees; and maintains its identity as the leading Spanish multinational company under the Telefónica brand.

### 1924

The Compañía Telefónica Nacional de España (CTNE) was created in Madrid as a subsidiary of the International Telephone and Telegraph Corporation (ITT) of New York. There were 78,124 telephones in existence



### 1928

Alfonso XIII and the President of the United States, Calvin Coolidge, inaugurated the commencement of transatlantic telephone communications



### 1945

The Spanish State nationalized 79.6% of the total shares of CTNE owned by ITT



### 1953

The first million telephones in Spain were reached. Only eleven countries worldwide had achieved this figure

### 1960



The CTNE was now the leading company in the country with 100,000 shareholders, 10.4 billion pesetas in capital and 32,000 employees in its workforce

1 million customers

## 1974

The CNTE celebrated its 50th anniversary. Just a few years later, the increased demand for data transmission circuits would favour the development of the TESIS system

## 1967

Satellite communications were initiated. Telefónica opened the Satellite Communications Ground Station in Buitrago de Lozoya



## 1971

Telefónica began operating the first European Data Transmission Special Network. The 5 millionth telephone was installed



5 million customers

## 1985



The new image and company name was adopted: Telefónica de España, S.A.

## 1978

The 10 millionth telephone was installed



10 million customers

## 1988

The (LOT) Ley de Ordenación de las Telecomunicaciones (Telecommunications Act) came into force

## 1987



Telefónica began trading on the New York Stock Exchange

## 1990

Telefónica launched the analogue mobile service, MovilLine, reaching a coverage of 98% of the territory and the population in three years



Telefónica acquired stakes and took over the running of CTC and ENTEL, in Chile, and the Argentine operator



## 1993

With the beginning of the commercialisation of the first Spanish satellite, Hispasat, Telefónica, present in 6 American countries, took the leap into participation in trans-European networks

## 1998

The Telefónica-led consortium won the tender to acquire Telesp, which operates in the state of Sao Paulo



Telefónica presented its new corporate identity

*Telefónica*

## 1999

Broadband was initiated through ADSL technology

**Línea ADSL** »

Telefónica was fully privatised and was organised as a holding to manage global business lines

## 1994

Launch of digital mobile telephony

**MoviStar**

Entrance of Telefónica in Peru



## 1995

Internet boom  
Telefónica launched Infovía



First partial privatisation of Telefónica

32 million customers

## 2002

Telefónica began divestiture in the media. Its Digital TV platform was merged

## 2006

Telefónica purchased 51% of Colombia Telecom



telecom

## 2004

Acquisition of BellSouth's mobile telephony assets in Latin America



Telefónica was structured for integrated customer management, creating three geographical areas: Spain, Latin America and Europe

Telefónica acquired the European assets of the O2 mobile telephony operator in the United Kingdom, Germany and Ireland



Award of the mobile license in Slovakia

## 2003

Telefónica and Portugal Telecom set up a joint venture which combined their mobile telephony assets in Brazil



## 2000

Operation Verónica. Telefónica carried out a public offering of shares in Telefónica de Argentina, Telesp and Tele Sudeste (Brazil), and Telefónica del Perú. This paved the way for Telefónica's integrated management of fixed telephony operations in Latin America

## 2005

Purchase of 5% of the share capital social in China Netcom



Acquisition of Cesky Telecom



Global launch of the new Movistar Identity



68 million customers

100 million customers

200 million customers

## Group Structure

Three integrated general divisions are created for Spain, Europe and Latin America

**In 2006, Telefónica adopted an integrated regional management model.**

**Telefónica provides the Company with a more flexible and dynamic structure to reinforce its leadership and extend its competitive advantage in the sector. The key to the new Telefónica structure lies in strengthening its customer orientation and taking advantage of its scale.**

Throughout recent years, Telefónica has concentrated its telecommunications business, strengthening its presence in fixed and mobile telephony markets, and focusing its business model on satisfying all its customers' communication needs. This restructuring was manifested through the approval of the new Company management structure by the Board of Directors of Telefónica S.A. at its meeting in July 2006.

The different operations of the Telefónica Group, in a total of 23 countries, are organised around three geographical regions: Spain, Latin America and Europe. In addition, there are other areas of activity with specific functions to support the companies dedicated to offering telecommunication services

The new Telefónica is a stronger and more flexible company which, following the changes experienced in recent years and the consolidation of its acquisitions in Latin America and Europe, moves from a privileged position to strengthen its leadership and take advantage of opportunities in the sector and the competitive advantage over its competition.

From this position of strength, which is reflected by excellent financial and business results, significant presence in Europe and leadership in Spain and Latin America, the Company is adopting a new management model designed to follow the path of growth in revenue and profitability; fully develop advantages of scale and diversity and guide the convergence process between fixed and mobile telephony from an integrated and clearly customer orientated vision of the business.

### Corporate Centre

The Corporate Centre is responsible for the global strategy and corporate policies, for the management of common activities and the coordination of the activities of the business units.

The new organizational structure revolves around the promotion of the General Director of Coordination, Business Development and Synergies and a regional integrated business division, which guarantees proximity to the customer. The mission of the General Director of Coordination, Business Development and Synergies, responsible for the areas of Strategy, Budgeting and Control, Sales, Infrastructures and Information Systems, Logistics, Purchasing and Human Resources, is to guarantee the integrated operation of Telefónica as a single, customer orientated company.

The General Director of Corporate Finance and Development reports to the Chairman, and is responsible for the management of the Company's activities in all regions, inorganic growth strategies through acquisitions and potential disinvestment in non-strategic assets.

With respect to corporate support functions, the Board approved the creation of the Technical General Secretary of the Presidency who, reporting to the Chairman, assumes the responsibilities of the areas of Corporate Communication and Institutional Relations and Fundación Telefónica. The Board's Legal General Secretary is responsible for Legal Services, also reporting directly to the Chairman.





## Business Units

Today, the different markets in which Telefónica is present have their own rate of growth and degrees of competitiveness. Therefore, following the reincorporation of Telefónica Móviles in Telefónica, the Company wanted to ensure an entire market vision, assigning single heads to the fixed and mobile businesses, defining strategies adapted to the regional reality and seeking growth in revenue and profitability in each geographical area.

This same vision has led to the creation of three business units, with the same level as a General Direction of Telefónica S.A. (Telefónica España, Telefónica Europa and Telefónica Latinoamérica) and with responsibility on the integrated business; that is, fixed and mobile assets.

### Telefónica España

Its main activity is providing fixed, mobile and broadband telephony services in Spain. Today, it manages more than 16 million fixed telephony accesses, 4.4 million data and Internet accesses and more than 21 million mobile accesses.

### Telefónica Latinoamérica

Its main activity is providing fixed, mobile and broadband telephony services in Latin America, with presence in all of the key markets of Latin America.

At the close of 2006, it managed more than 21 million fixed telephony accesses, 5.9 million data and Internet accesses and more than 83 million mobile accesses.

Countries in which services are offered: Argentina, Brazil, Chile, Colombia, Ecuador, El Salvador, United States, Guatemala, Mexico, Nicaragua, Panama, Peru, Puerto Rico, Uruguay and Venezuela. It also manages the Telefónica office in China and the alliance with China Netcom.

### Telefónica O2 Europa

Its main activity is providing fixed, mobile and broadband telephony services in Europe. This business unit develops its operations in the United Kingdom, Ireland, Germany, the Czech Republic and Slovakia.

At the close of 2006, Telefónica O2 Europa managed 35.2 million mobile accesses, 2.4 million fixed accesses and 607,000 data and Internet accesses.

## Other Lines of Activity

Atento provides customer assistance services through contact centres or multi-channel platforms. It has call centres in Spain, Argentina, Brazil, Chile, Colombia, El Salvador, Guatemala, Morocco, Mexico, Peru, Puerto Rico and Venezuela. At the close of 2006, it employed more than 106,000 professionals.

gestiona is dedicated to offering management support services in the following areas: economic-financial, administration, human resource management, logistics, integral management of buildings and services. It develops activities in Spain, Argentina, Brazil, Chile and Peru.

Telefónica I+D is oriented towards the creation of services, the management of networks, services and businesses, with special attention to technological innovation of a strategic nature or non-existent in the market.

The company acts as a driving force for the company's innovation, developing new forward looking services and identifying emerging technological opportunities. It has a network of Centres of Excellence with headquarters in Spain, Brazil and Mexico.

# Governing bodies

## Composition of the Board of Directors

### Executive Chairman

Mr. César Alierta Izuel

### Vice Chairmen

Mr. Isidro Fainé Casas

Mr. Gregorio Villalabeitia Galarraga

### Directors

Mr. Fernando de Almansa Moreno-Barreda

Mr. José M<sup>a</sup> Álvarez-Pallete López

Mr. David Arculus

Mr. Maximino Carpio García

Mr. Carlos Colomer Casellas

Mr. Peter Erskine

Mr. Alfonso Ferrari Herrero

Mr. Gonzalo Hinojosa Fernández de Angulo

Mr. Pablo Isla Álvarez de Tejera

Mr. Julio Linares López

Mr. Antonio Massanell Lavilla

Mr. Vitalino Manuel Nafría Aznar

Mr. Enrique Used Aznar

Mr. Antonio Viana-Baptista

### Secretary (Non-Director)

Mr. Ramiro Sánchez de Lerín García-Ovies

### Vice Secretary (Non-Director)

Mr. Antonio Hornedo Muguiro

## Executive Commission

### Executive Chairman

Mr. César Alierta Izuel

### Vice Chairmen

Mr. Isidro Fainé Casas

Mr. Gregorio Villalabeitia Galarraga

### Vocals

Mr. Maximino Carpio García

Mr. Carlos Colomer Casellas

Mr. Peter Erskine

Mr. Julio Linares López

Mr. Antonio Viana-Baptista

### Secretary

Mr. Ramiro Sánchez de Lerín García-Ovies

## Composition of the Committees of the Board of Directors

### Audit and Control Committee:

Mr. Maximino Carpio García (Chairman)  
Mr. Antonio Massanell Lavilla  
Mr. Gonzalo Hinojosa Fernández de Angulo  
Mr. Gregorio Villalabeitia Galarraaga

### Nominating, Compensation and Corporate Governance Committee:

Mr. Alfonso Ferrari Herrero (Chairman)  
Mr. Maximino Carpio García  
Mr. Pablo Isla Alvarez de Tejera  
Mr. Gonzalo Hinojosa Fernández de Angulo

### Human Resources and Corporate Reputation Committee:

Mr. Pablo Isla Alvarez de Tejera (Chairman)  
Mr. Alfonso Ferrari Herrero  
Mr. Antonio Massanell Lavilla  
Mr. Enrique Used Aznar

### Regulation Committee:

Mr. Enrique Used Aznar (Chairman)  
Mr. Fernando de Almansa Moreno-Barreda  
Mr. Julio Linares López  
Mr. Gregorio Villalabeitia Galarraaga

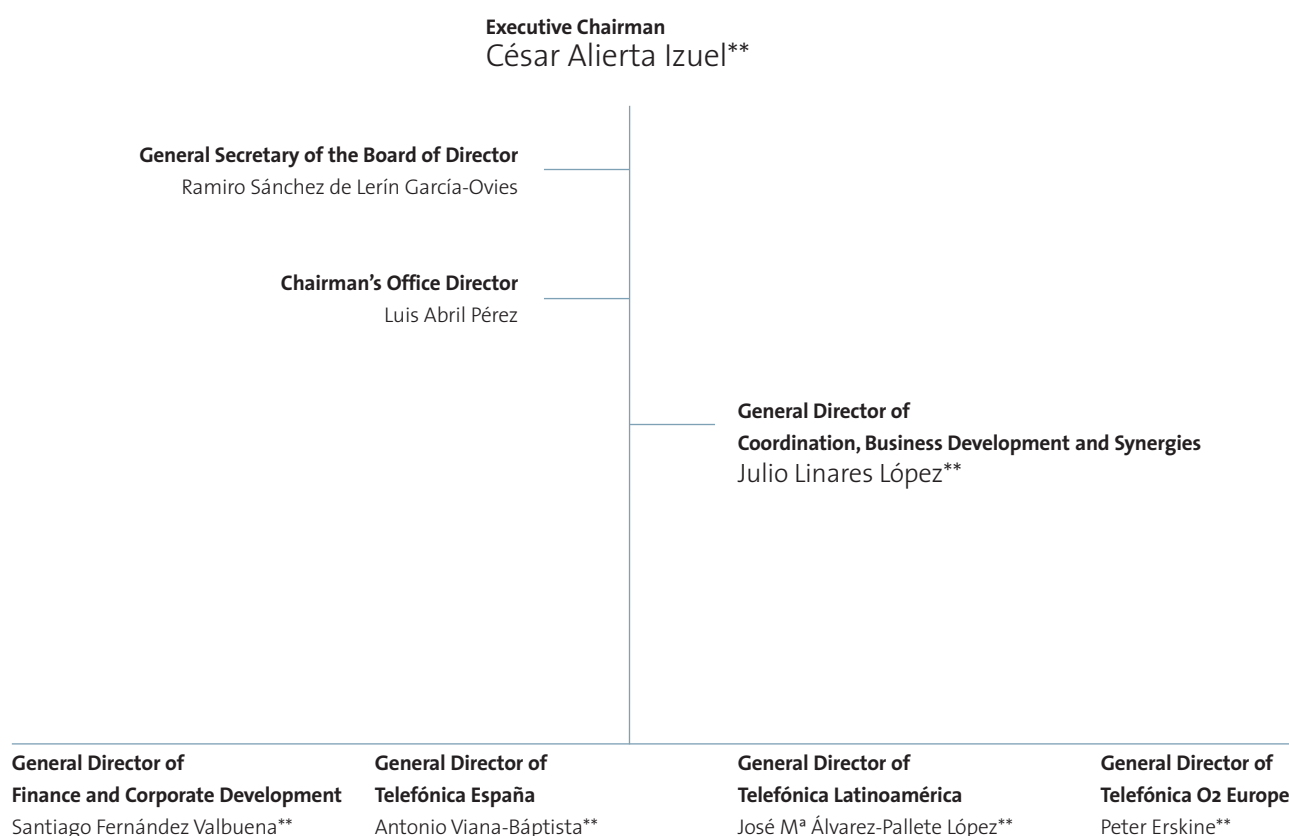
### Serve Quality and Customer Service Committee:

Mr. Gonzalo Hinojosa Fernández de Angulo (Chairman)  
Mr. Carlos Colomer Casellas  
Mr. Antonio Massanell Lavilla

### International Affairs Committee:

Mr. Fernando de Almansa Moreno-Barreda (Chairman)  
Mr. Alfonso Ferrari Herrero  
Mr. Gonzalo Hinojosa Fernández de Angulo  
Mr. Enrique Used Aznar  
Mr. Gregorio Villalabeitia Galarraaga

## Organisational Structure\*



\* December 2006

\*\* Member of the Executive Committee

# Group structure

## Telefónica Group

	% Part
Telefónica de España	100.00
Telefónica Móviles <sup>1</sup>	100.00
Telefónica Latinoamérica	100.00
Telefónica de Contenidos	100.00
Grupo Atento	91.35
Telefonica O2 Europa	100.00

<sup>1</sup> Telefónica Móviles has been absorbed by Telefónica S.A.

## Telefónica de España Group

	% Part
Telyco	100.00
Telefónica Telecomunic. Públicas	100.00
Telefónica Soluciones Sectoriales	100.00
T. Soluciones de Informatica y Comunicaciones de España	100.00

Note: Terra Networks España and Telefónica Empresas España has been absorbed by merger with Telefónica de España.

## Telefónica Latinoamérica Group

	% Part
Telesp <sup>1</sup>	87.95
Telefónica del Perú <sup>2</sup>	98.18
Telefónica de Argentina	98.03
TLD Puerto Rico	98.00
Telefónica Chile <sup>3</sup>	44.89
Telefónica Telecom <sup>4</sup>	52.03
Terra Networks Perú	99.99
Terra Networks México	99.99
Terra Networks USA	100.00
Terra Networks Guatemala	100.00
Terra Networks Venezuela	100.00
Terra Networks Brasil	100.00
Terra Networks Argentina	99.99
Terra Networks Chile	100.00
Terra Networks Colombia	99.99
Telefónica Data Argentina	97.92
Telefónica USA <sup>5</sup>	100.00
T. Intern. Wholesale Serv. (TIWS) <sup>6</sup>	100.00

<sup>1</sup> Effective participation 88.01%.

<sup>2</sup> Telefónica Empresas Perú has been absorbed by T.del Perú as of May 1st 2006.

<sup>3</sup> CTC has changed its name.

<sup>4</sup> Colombia Telecom has changed its name.

<sup>5</sup> Company name change. Was previously Telefónica Data USA

<sup>6</sup> Telefónica, S.A. owns 92.51% and Telefónica DataCorp owns 7.49%.

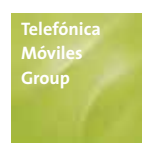
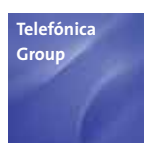
Note: Telefónica Empresas Brasil has been absorbed by Telesp

## Telefónica O2 Europe

	% Part
O2 UK	100.00
O2 Alemania	100.00
O2 Irlanda	100.00
Manx	100.00
Airwave	100.00
Be	100.00
Telefónica O2 República Checa <sup>1</sup>	69.41

<sup>1</sup> Company owned through Telefónica S.A.

Note: Telefónica Deutschland absorbed by O2 Germany



## Telefónica Móviles Group

	% Part
Telefónica Móviles España	100.00
Brasilcel <sup>1</sup>	50.00
T. Móviles Argentina	100.00
T. Móviles Perú	98.53
T. Móviles México	100.00
TM Chile	100.00
T. Móviles El Salvador	99.08
T. Móviles Guatemala	100.00
Telcel (Venezuela)	100.00
T. Móviles Colombia	100.00
Otecel (Ecuador)	100.00
T. Móviles Panamá	99.99
T. Móviles Uruguay	100.00
Telefonía Celular Nicaragua	100.00
Telefónica Móviles Chile	100.00
Group 3G (Alemania)	57.20
IPSE 2000 (Italia) <sup>2</sup>	45.59
3G Mobile AG (Suiza)	100.00
Medi Telecom	32.18
Mobipay España	13.36
Mobipay Internacional	50.00
T. Móviles Soluciones y Aplicac. (Chile)	100.00
Tempos 21	43.69

<sup>1</sup> Joint Venture which fully consolidates the subsidiary Vivo, S.A., through participation at Vivo Participações, S.A. (62.94%)

<sup>2</sup> Additionally, Telefónica Group holds a 4.08% of IPSE 2000 through Telefónica DataCorp.

Note: Radiocomunicaciones Móviles SA (Argentina) has been absorbed by Móviles Argentina

## Atento Group

	% Part
Atento Teleservicios España, S.A.	100.00
Atento Brasil, S.A.	100.00
Atento Argentina, S.A.	100.00
Atento de Guatemala, S.A.	100.00
Atento Mexicana, S.A. de C.V.	100.00
Woknal (Uruguay)	100.00
Centro de Contacto Salta	100.00
Mar de Plata Gest y Contactos, S.A.	100.00
Atento Perú, S.A.C.	99.46
Atento Chile, S.A.	77.95
Atento Maroc, S.A.	100.00
Atento El Salvador, S.A. de C.V.	100.00

## Telefónica de contenidos Group

	% Part
Telefé	100.00
Endemol <sup>1</sup>	99.70
Telefónica Servicios de Música	100.00
Telefónica Servicios Audiovisuales	100.00
Hispasat	13.23

<sup>1</sup> Ownership held by Telefónica S.A. Endemol Holding NV is the parent company of Endemol Group and owns 75% of Endemol NV, company quoted in the Amsterdam Stock Exchange.

## Other participations

	% Part
Lycos Europe	32.10
Sogecable <sup>1</sup>	16.76
Portugal Telecom <sup>2</sup>	9.84
China Netcom Group <sup>3</sup>	5.00
BBVA	1.07
Amper	6.10

<sup>1</sup> Telefónica de Contenidos, S.A. holds 15.63% and Telefónica, S.A. holds 1.13%.

<sup>2</sup> Telefónica Group's effective participation. Telefónica Group's participation would be 9.96% if we exclude the minority interests.

<sup>3</sup> Ownership held by Telefónica Latinoamérica

1

2

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12

## January

Telefónica provides employees with information about competitors and the markets.

Telefónica Móviles launches the first mobile which operates in Spanish, galician, basque and catalan

The European commission approves the acquisition of O2 by Telefónica

Telefónica Móviles accessible incorporates sign language to assist consultations for deaf people

Teachers working with Telefónica España provide one million teaching hours during 2005

Telefónica Empresas involved in Latin America's most important IP telephony project for tax administration in Peru

Fundación Entorno awards Telefónica one of its European environmental prizes

Telefónica I+D participates in a European project to reduce the digital divide in Latin America

César Alierta opens the largest Mexican art exhibition held outside Mexico in Chile

Telefónica de España offers free landline connection to immigrants

## February

The Telefónica Móviles brand campaign one of the best in the last 20 years

Telefónica de España becomes a mobile telephone distributor

Telefónica introduces the basque government's new citizen service model

Telefónica sets up the most southern fiber optic network in the world

Telefónica Móviles launches its first GSM services in Peru

Telefónica I+D collaborates with the European space agency in a study on satellite services in Latin America and Africa

Telefónica Móviles is the sector's most influential brand in Latin America

The e-domus employee portal celebrates its 5th birthday

Telefónica I+D is awarded the AHCET prize for a study into teleworking

Telefónica Móviles Argentina has more than 8 million customers in Argentina

## March

Telefónica Móviles launches the first mobile location service with GPS technology in Peru

Telefónica Móviles Mexico and Nextel join up their networks for sending text messages.

Telefónica Servicios Audiovisuales introduces the Asturias television channel

César Alierta receives the European telecom prize.

Telefónica Móviles enters the ftse4good Corporate Responsibility Index

Telefónica I+D presents Telefónica Móviles España's mobile television pilot in Brussels

Telefónica participates in the preparation of the national research strategic agenda

Telefónica presents its new image in Puerto Rico

The Fundación presents the virtual recreation of Atapuerca

The O2 acquisition is the reward for the most important operation of the year



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## April

Telefónica introduces its cardioprotection service throughout Spain

Telefónica develops the first financial application residing in the mobile SIM card

Telefónica connects more than 100,000 children from Nicaragua to internet free of charge

Telefónica is one of the companies worldwide which best informs its shareholders

Telefónica Móviles promotes the on-line training of its operators in Latin America

Lucent takes on the worldwide launch of Imagenio

Telefónica closes the acquisition of Colombia Telecom

Telefónica Servicios Audiovisuales introduces the Extremadura television channel

Telefónica de España publishes its first Corporate Responsibility Report

## May

Warner Bros. reaches its first video-on-demand agreement in Spain with Telefónica

'Emoción' incorporates the google search engine and introduces a flat rate

Telefónica I+D introduces a system to define rates in Mexico, based on customer behaviour patterns

Telefónica is the best considered company for its social action

Telefónica Móviles surpasses the milestone of 20 million customers in Spain

Telefónica Moviles and O2 present 'my Europe', a set of important roaming advantages for customers

Telefónica exceeds 186 million accesses

Telefónica Empresas is the first Spanish company with information security management system certification

César Alierta presents the Telefónica transformation project up until 2009 to investors

## June

The "gold share" disappears

Telefónica Peru is awarded the prize for the best corporate governance in private enterprise

Atento México is one of the best companies in the country to work for, according to the Great Place to Work Institute

Telefónica launches Speedy voice in Brazil, a service which combines high speed internet access and calls

Clients of Telefónica España can use their wi-fi devices in Germany

Telefónica has more than two and a half million ADSL clients in Latin America

Telefónica Móviles broadcasts a live concert from the mobile phone for the first time in Spain

Telefónica introduces interactive radio for the mobile phone

Telefónica Móviles announces the launch of Blackberry in various Latin American countries

Telefónica sponsors the first seminar on telecommunications in China



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## July

The Czech Republic's first integrated operator is officially established: Telefónica O2 Czech Republic

Telefónica Wholesale joins forces with Inmarsat to offer mobile broadband throughout the world

Telefónica España participates in the development of the Cesky Telecom new generation network

Telefónica extends broadband to more than 1,700 rural areas of Spain

Telefónica Peru launches a satellite television service

Telefónica Móviles and Fox create the largest Spanish language mobile telephony television contents community

Méditel obtains a UMTS licence in Morocco

Telefónica launches a new device which enables analogue terminals to be connected to IP voice

Telefónica integrates O2 international traffic into its network

Fundación Telefónica participates in the "until when?" Aid plan for abused women programme in Peru

Experts from all over the world meet at Telefónica I+D to define mobile web standards

Telefónica sells its subsidiary Telefónica Información y Publicidad (TPI)

## August

Telefónica presents its first audited corporate responsibility report in Peru

Telefónica O2 obtains a third generation mobile telephone licence in Slovakia

The Czech Republic now has 400,000 clients with ADSL

Telefónica is recognised in Chile as the leading company in sustainability reports

Telefónica receives the "institutional investor 2006" prize for its investor relations

Distrito C is ready to produce solar energy

The Proniño Programme doubles its coverage in Argentina to help more than 3,000 children in 2006

Telefónica Argentina is awarded a prize for the "leading communications company"

## September

Telefónica O2 Czech Republic presents its services under the O2 brand

Telefónica España evaluates its management system in line with the European excellence model

Telefónica Móviles launches the largest space devoted to the leading edge in music, art, technology, films and leisure in Barcelona

Telefónica Móviles Argentina launches a service to make payments via mobile phone

Telefónica ratified its presence in the Dow Jones Sustainability Index, as a leading company in corporate responsibility.

Telefónica is the first European operator to offer a television series for all mediums

Telefónica O2 Germany integrates its mobile telephony and IP services on the same unit

Telefónica launches IP telephony for companies in Latin America

Telefónica sets up a new digital production system for the news programmes of Televisión Española

Telefónica sponsors the Cio meeting 2006, in which more than 80 experts on information technologies participate





# Shareholder information

Earnings per share increased by 42.9% in 2006

## Return for shareholders stood at 31.16%

**In 2006, all of the variables that reflect the returns for shareholder evolved favourably: the share closed 2006 at 16.12 euros / share, representing an increase of 26.8%; earnings per share increased by 42.9%; the dividend amounted to 0.55 euros per share. As a result, the total returns for shareholders in 2006 stood at 31.16%.**

### Returns for Shareholders

Returns for shareholders in 2006 were 31.16%. This return is a result of two parameters: on the one hand, the favourable stock performance recorded in 2006, period in which the Telefónica share increased by 26.8%, and, on the other hand, the payment of two dividends for the sum of 0.25 and 0.30 euros per share. The performance of these two variables is detailed below.

#### Shareholder Remuneration in 2006

In 2006, the Telefónica Group has been consolidated as the European incumbent operator with the greatest growth and profitability in the sector. During 2006, a new shareholder remuneration policy, which is more attractive and more competitive in the long term, was announced, and which aims to double, by 2009, both earnings per share and dividend per share from the 0.91 euros and 0.5 euros per share corresponding to 2005.

On 12th May 2006, a dividend for a gross value of 0.25 euros per share was paid out as a result of the profits for 2005.

On 10th November 2006, a dividend of 0.3 euros per share was paid, charged against the results of the financial year 2006. These returns will be complemented during the first quarter of 2007, when a dividend of 0.3 euros per share will be paid.

On the other hand, the share buyback programme for a value of 2,700 million euros will be completed by the end of 2007 and the shares will be cancelled. On 22<sup>nd</sup> January 2006, Telefónica's treasury stock stood at 79,030,886 own shares, which represents 1.606% of the Company's current share capital.

### Earnings for a shareholder that purchased 100 Telefónica shares on 1st January 2006

	Number of Shares	Net Amount
Value of 100 shares on 1st January 2006	100.00	1,271.00
Cash Dividend 2005	100.00	0.25 €/share (gross)
Cash Dividend 2006	100.00	0.30 €/share (gross)
Value of 100 shares on 1st January 2007	100.00	1,612.00
Total value of portfolio of 100 shares		1,667.00
<b>Earnings 2006</b>		<b>31.16%</b>

## Evolution of share performance in 2006

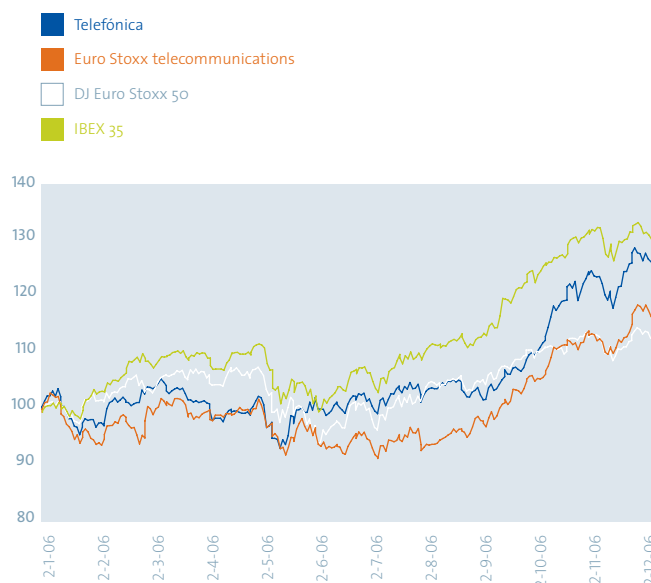
During 2006, Telefónica's share performance presented a positive profitability of 26.8%, in a context of widespread increases in the leading international stock markets. Telefónica's 26.8% increase to 16.12 euros/share, has been far higher than that of the rest of the reference sector in Europe (Dow Jones Europe Stoxx Telecommunications +16.9%) and that of the Eurostoxx-50 general index (+15.1%). The Ibex-35 was increased by 31.8%. Similarly, the relative performance of Telefónica in 2006 was also better than that of its European counterparts, which ended the year with negative profitability in the case of Telecom Italia (-6.9%), Deutsche Telekom (-1.7%) and France Telecom (-0.2%) or lower profitability in the case of Vodafone (+12.9%), with the exception of BT, which was increased by 35.4%.

The increase in 2006 of both Telefónica and the telecommunications sector was produced from October, as its performance had been negative until then. This change was brought about by a sectoral rotation among investors towards the telecommunications sector, due, among other reasons, to a greater visibility of the regulatory situation for interconnection rates and relatively attractive valuations with respect to other sectors.

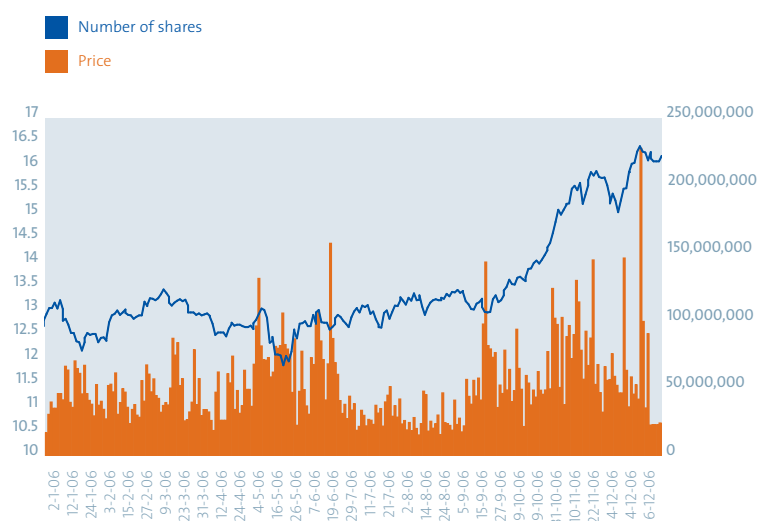
The main factors which account for Telefónica's favourable evolution in 2006 include its greater growth profile, above average for the sector, profitability, financial discipline, geographical and business diversification, credibility by meeting the financial objectives set by the Group and attractive remuneration for shareholders.

The average daily trading volume on the Spanish stock market in 2006 was 53.4 million shares, up from the 44.5 million shares traded in 2005. The Company's market capitalisation at the end of 2006 was 79,329 million euros (104,722 million dollars).

Stock Performance 2006



Price / Volume



## Stock Exchanges where Telefónica shares are traded

- Spanish Trading System ( within the “Ibex 35” index) and the four Spanish Stock Exchanges (Madrid, Barcelona, Bilbao and Valencia)
- London Stock Exchange
- Paris Stock Exchange
- Frankfurt Stock Exchange
- Tokyo Stock Exchange
- New York Stock Exchange
- Buenos Aires Stock Exchange
- Lima Stock Exchange
- Sao Paulo Stock Exchange

## Returns for Shareholders

In the financial year 2006, Telefónica obtained the best results in its history, positioning it as a world leader in the telecommunications sector. The net profit for the company increased by 40.2% with respect to 2005, reaching a record figure of 6,233 million euros. As a result, earnings for Telefónica shareholders were 1.304 euros per share in 2006, with an inter-annual growth of 42.9%.

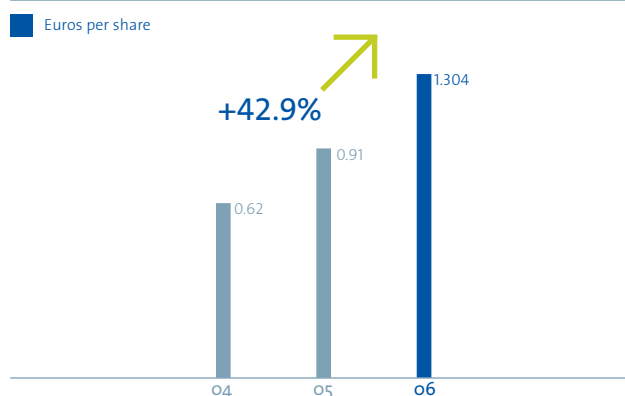
## Share Capital

The latest share capital modification took place in June 2005 as a result of the reduction of the capital with the amortisation of treasury stock shares (for an amount of 34,760,964 euros), placing corporate share capital at 4,921,130,397 euros, which was maintained throughout financial year 2006.

## Number of Shareholders

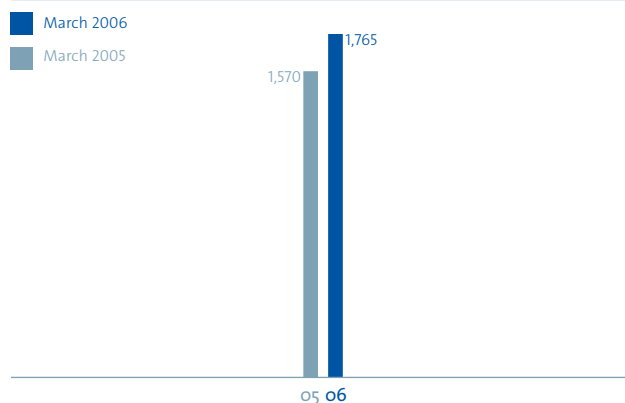
According to the information obtained from the “Sociedad de Gestión de los Sistemas de Registro, Compensación y Liquidación de Valores” (Securities, Recording, Clearing and Settlement Systems Management Company) (Iberclear), dated 2nd March 2007, the number of shareholders in Telefónica, according to separate records in favour of legal and natural persons, amounted to 1,765,599 shareholders.

### Earnings per share



### Number of Shareholders

Figures in thousands



## Shares held by members of the Board of Directors<sup>1</sup>

April 2007

	Direct shareholding	Indirect shareholding	Number of shares
Mr. César Alierta Izuel <sup>1</sup>	1,910,333	78,000	1,988,333
Mr. Isidro Fainé Casas	144,978	0	144,978
Mr. Gregorio Villalabeitia Galarraga	55	0	55
Mr. Fernando de Almansa Moreno-Barreda	19,349	0	19,349
Mr. José María Álvarez-Pallete López	15,715	1,036	16,751
Mr. David Arculus	10,500	0	10,500
Mr. Maximino Carpio García	10,247	494	10,741
Mr. Carlos Colomer Casellas	564	25,700	26,264
Mr. Peter Erskine	500	0	500
Mr. Alfonso Ferrari Herrero	1,883	103,480	105,363
Mr. Gonzalo Hinojosa Fernández de Angulo	39,476	390,000	429,476
Mr. Pablo Isla Álvarez de Tejera	401	0	401
Mr. Julio Linares López	25,756	2,207	27,963
Mr. Antonio Massanell Lavilla	2,274	0	2,274
Mr. Vitalino Manuel Nafria Aznar	300	0	300
Mr. Enrique Used Aznar	36,000	34,000	70,000
Mr. Antonio Viana-Baptista	103,567	0	103,567
<b>Total</b>	<b>2,321,898</b>	<b>634,917</b>	<b>2,956,814</b>

<sup>1</sup> On 5th March 2007, the Chairman of Telefónica, César Alierta, announced to the CNMV, the acquisition of 8,200,000 European call options on Telefónica S.A. redeemable shares for differences, expiring on 2nd March 2011 and with a price of 22 euros.

## Significant Shareholdings<sup>1</sup>

As Telefónica shares are recorded by the book entry system and therefore the company does not keep a shareholders' registry, it is therefore difficult to know the exact ownership structure.

There are, however, certain shareholders with shareholdings that can be considered significant, in accordance with the Ministerial Order 3722/2003, of 26th December, which are listed below:

In any case, according to the information available in the Company, there is currently no natural or legal person that exercises, or may exercise control, directly or indirectly, individually or jointly, over Telefónica, according to the terms established in Article 4 of the Spanish Securities Exchange Act (Ley del Mercado de Valores).

## Significant Shareholdings<sup>1</sup>

	Percentage	Total shares	Percentage	Direct shareholding shares	Percentage	Indirect shareholding shares
BBVA	6.437%	316,764,189	6.43%	316,735,246	0.00%	28,943
La Caixa	5.080%	249,981,747	1.18%	58,103,174	3.90%	191,878,573

<sup>1</sup> 31/12/2006

# Operating Risk

Telefónica has a corporate model, allowing operating risks to be evaluated and controlled based on the best international practices

Telefónica constantly monitors the most significant risks that could affect the Company. For this purpose, it has a Corporate Model that is applied periodically and homogeneously in the companies of the Group, allowing the evaluation of both the importance of each of the risks, and the degree of control over these risks. This is all based on the system proposed in the COSO reports (Committee of Sponsoring Organizations of the Treadway Commission), which establish an integrated framework for internal control and risk management.

Therefore, the Group has a risk map that allows the identification of the potential conflicts which require specific control and monitoring, prioritised in accordance with their importance.

Furthermore, the model has a matrix that includes all the operational processes where each of the risks considered are managed, in order to allow the evaluation of the established controls and be able to have reasonable certainty that they will not arise.

Telefónica has initiated the necessary work to modify the risk measurement parameters, moving from the current ones (degree of importance and control level), to impact and probability of occurrence in line with the international best practices, or in other words, adapting the current COSO I model to COSO II.

The Internal Auditing Office identifies these risks and processes. It is responsible for the internal control of the Group. Telefónica's Audit and Control Committee is periodically informed of the activities and results of this Office.

By virtue of the model in force, Telefónica has identified 50 Risks, which are classified in the following categories:

## Business Process Risks

- Operational Risks: those which may affect the Group's efficiency and effectiveness in operating processes and service provision, customer satisfaction and the reputation of the companies within the Group.
- Integrity Risks: those related to internal and external fraud which the Group companies may face.
- Management and Human Resources Risks: those related, among others, to administration, management and leadership, authority limitations, etc.
- Technological Risks: including, markets subject to intense technological renovation, supply failures from suppliers, risks associated to unexpected network interruptions, etc.
- Financial Risks: highly competitive markets, strongly regulated markets, services provided under licence or concession, country risk (investments in Latin America), exchange rate or interest rate risk management, risks associated with partners of the Group, risks associated with acquisitions and business integration, etc.

## Information Risks

- Operating Information.
- Financial Information.
- Strategic Evaluation.

## Contextual Risks

- Competition.
- Shareholders relations.
- Availability of resources.
- Political, economic, legal and fiscal environment.
- Regulations and changes in the sector.

## Risk Reduction Systems

The internal control framework of the Telefónica Group is based on the COSO model (Committee of Sponsoring Organizations of the Treadway Commission), whose main objectives are:

- Efficacy and efficiency of operations.
- Safeguarding assets.
- Reliability of financial information.
- Compliance with laws and regulations.

In addition to the controls established in each operating process, Telefónica has the following specific control elements:

- An Internal Audit structure which performs its functions in accordance with the professional criteria and regulations of the International Institute of Internal Auditors. Telefónica is the first Spanish company to obtain quality certification from the institute.
- An external auditor verifies the Company's annual accounts and those of all of the major companies within the Telefónica Group. The auditor makes recommendations in relation to internal control in the case of the most significant companies.

To establish appropriate and homogenous control systems, the Company has a set of regulations by which basic control aspects are regulated.

The following are particularly noteworthy:

- Control regulations on the process of preparing financial and accounting information. This process is regulated by means of handbooks, instructions and established regulations.
- Control regulations on Company information and its financial information and accounting system.
- Regulations on external representation and links with the companies of the Group.
- Minimum environmental regulations.

On the other hand, Telefónica has an Intervention Unit, responsible for its control and monitoring, whose functions include the control of the application of funds, control of the relevant operations, control of travel and representation expenses, implementation of basic controls in the major risk processes, etc.

Furthermore, the Telefónica Group has units which control certain specific risks. Specifically, all those related to Risks and Insurance, Reputation, Regulation, Quality and Human Resources.

Similarly, and due to the fact that the company is listed on the New York Stock Exchange, Telefónica must fulfil the requirements established by the Sarbanes-Oxley Act and its regulations.

The reporting channel, created by the Audit and Control Committee of the Board of Directors, has been in operation since 2005, with the objective of enabling any employee to anonymously report, if so desired, on the internal control of the financial situation, accounting system or auditing of the accounts.

Finally, in 2006 the Board of Directors approved the unification of the Ethical Codes of the different companies of the Group in a new Code of Business Principles to be applied homogeneously in all of the countries in which Telefónica operates.

## Supervision of the Control Mechanisms

The Board of Directors of Telefónica S.A. has established an Audit and Control Committee, whose functions, competences and regulations are defined in the Articles of Association and the Regulation of the Board of Directors. They respond to both legal requirements and the good corporate governance recommendations issued by national and international organisations.

Unless dealing with specific issues, the meetings shall be attended by the External Auditor and representatives of the Finance, Internal Audit and Strategy, Budgeting and Control Departments. Occasionally, other directors are invited to deal with specific issues. The Chairman and the members of the Audit and Control Committee of Telefónica S.A. may access the conclusions of the Internal Audit and information related to the fulfilment of the recommendations.

## Supervision of the Regulations affecting the Sector

Most of the Telefónica Group's companies operate in the telecommunications sector, and are subject to regulation in almost all of the countries in which the Company is present. The described internal control model includes, among its basic objectives, compliance with those laws and regulations affecting the Telefónica Group in its activity. More specifically, units carry out specific controls over this type of risks, particularly through the legal services and regulation areas of the Group companies.



## Telefónica actively manages the financial market risks to stabilize cash flows, the income statement and its share capital

Telefónica Group is exposed to several financial market risks, as a result of (i) its ordinary business, (ii) the debt undertaken to finance its operations, (iii) stakes in companies, and (iv) other financial instruments related to the previous points.

The main financial risks that affect the Group's companies are:

### Exchange Rate Risk

This risk arises mainly due to the international presence of Telefónica, with investments and operations in countries with currencies other than the euro (mainly in Latin America, but also in the Czech Republic and the United Kingdom), and due to debt in currencies other than those of the countries where business is carried out or where the companies that have undertaken the debt are based.

### Interest Rate Risk

This risk is related to the variation of (i) the financial costs of debt with a variable interest rate (or with short term maturity, and foreseeable renewal), as a consequence of the variation in interest rates, and of (ii) the value of long term liabilities with fixed interest rates.

### Share Price Risk

This is the risk related to the variation of the value of the share stakes that can be subject to operations, of the derivatives of those stakes, of the company's own treasury stock, and of share derivatives.

### Liquidity Risk

It arises due to the possibility of imbalance between the need for funds (for operating and financial expenses, investment, debt maturity and committed dividends) and the sources of these funds (income, divestitures, financing commitments to financial bodies, and capital market operations). The cost of obtaining funds can also be affected by variations in credit margins (of interest rates) required by the lenders.

### Country Risk

It consists in the possibility of asset value loss or to the reduction of flows generated or sent to the parent company, as a consequence of political, economic and social instability in the countries where Telefónica Group operates, especially in Latin America.

Telefónica Group actively manages these risks, with a view to stabilising:

- Cash flows, in order to aid the financial planning and to take advantage of the investment opportunities that arise,
- Financial Results, in order to aid investors in their understanding and predictions,
- The value of the company's equity, protecting the value of investments made.

In cases where these aims are mutually exclusive, the financial management of the group decides which aim should take prevalence.

In its risk management, Telefónica uses derivative financial instruments, mainly on exchange rates, interest rates and shares.

## Exchange Rate Risk

The main aim of the exchange rate risk management policy is to compensate (at least partially) possible loss in the value of assets related to Telefónica's business caused by depreciation of currencies with regard to the euro, with the savings generated by the lower value in euros of the debt in foreign currency (due to the depreciation of the currency). The degree of coverage (percentage of foreign currency debt with regard to asset value) implemented tends to be proportionally greater:

- the greater the estimated correlation between the asset value and the foreign currency exchange rate,
- the lower the estimated cost of the coverage (calculated as the spread between the additional financial costs for financing in the local currency and the expected depreciation of the currency with regard to the euro).
- the higher the liquidity of the currency and derivatives market.

In general, the estimated correlation between the asset value and the currency exchange rate is greater the greater the weight of cash flow generated in the first years as a percentage of the estimated value for the asset.

On December 31, the debt in Latin American currencies reached almost 7,306 million euros. However, this debt is not shared out uniformly as a proportion of the cash flow generated in each country. This means that their future effectiveness as protection against exchange rate risks will depend on where eventual depreciations occur.

In addition, the protection against losses in value of Latin American assets due to currencies is complemented with debt in dollars, both in Spain (associated with the investment while the coverage is considered effective) and in the countries in question, in the absence of a financing market in local currency or a deep enough coverage market. As of December 31, 2006, the Group's

debt in dollars amounted to the equivalent of 1,462 million euros after accounting for the effect of derivatives contracted and financial assets in dollars.

For the protection of the investment in the Czech Republic, the Group has a debt in Czech crowns for the equivalent, at December 31, 2006, of 1,997 million euros.

Likewise, the exchange rate risk management is carried out by seeking to minimise the negative impact on the Financial Results, without prejudice to remaining flexible if required. The need for this flexibility may arise for three reasons: (i) due to the narrowness of some derivatives markets or due to the difficulty of obtaining financing in local currency, which does not allow for low cost coverage (as is the case in Argentina); (ii) due to financing by means of intra-group loans, with an accounting treatment of the foreign currency risk different from that applied to financing through capital contributions; (iii) due to company decisions.

In 2006, positive results were obtained through exchange rate management, amounting to the sum of 61 million euros. This was due mainly to positions protecting against any eventual weakness in the U.S. dollar. Profit obtained from exposure to Latin American currencies was reduced because the variations in the exchange rates of the different Latin American currencies against the U.S. dollar compensated each other.

In addition to this, in 2006, Telefónica completed the acquisition of 100% of O2, Plc. This acquisition was financed by means of a multi-currency loan which was refinanced during 2006 mainly by means of bond issue and long-term loans. The strategy for refinancing linked to liquidity-risk management is discussed below. The final currency composition of the liability resulting from the acquisition takes into account that part of the value of the company is due to its business operations in the euro zone (Germany and Ireland) and the corresponding part, therefore, is

financed in euros. With respect to the UK businesses, and given the lack of perfect correlation between the value of the business and the pound-euro exchange rate, around 70% of the acquisition value of O2 Plc has been financed in pounds (by means of debt or derivative instruments) amounting to a sum equivalent to 11,095 million euros.

## Interest Rate Risk

The financial costs of Telefónica are exposed to variations in interest rates. In 2006, short-term interest rates with the greatest volume of exposed debt were mainly the Euribor, the pound Libor (due to the acquisition of O2 plc), the Brazilian SELIC rate, the dollar Libor and the Chilean UF. At December 31, 2006, 45.4% of the total debt (or 46.3% of the long-term debt), had its interest rate fixed for more than a year. Of the remaining 54.6% (floating debt or debt at a fixed interest rate with a maturity of under a year), 41.1 percentage points had a fixed interest rate for a term exceeding a year (representing 23% of the long-term debt), whereas at December 31, 2005, 66% of the long-term debt had a fixed interest rate. The new debt undertaken in the course of the year, especially that linked to the acquisition of O2 plc, has also meant exposure to interest rates in force at the time of the acquisition or of the coverage, both in the short and the long term. Similarly, the financial updating of early retirement liabilities was carried out in the course of the year according to the interest rate curve of the swap market. The increase in interest rates has implied a drop in value of these liabilities.

Net financial results for 2006 amounted to 2,734 million euros, 68.0% more than in 2005. Excluding results due to exchange rate variations, the figures would be 2,777 in 2006 and 1,793 in 2005, which would entail an increase of 55.9% in the adjusted financial costs for 2006 compared with 2005. This increase is due to two opposing factors. On the one hand, the 83.9% rise in the total net average debt (54,315 million euros at December 31, 2006, including early retirement commitments) would represent an increase of 1,372 million euros. On the other hand, financial

expenditure has been reduced by 369 million euros as a result of the 47 million euro reduction in expenditure related to positions accounted at market value, and due to the reduction of 109 basic points in the average cost of the Group's debt (2006 versus 2005) generating savings of 322 million euros, due mainly to the fact that the debt increase figures with interest rates lower than the average for 2005. The figure for financial expenditure in 2006 shows an average of 5.0% over the total net average debt for the year, and 5.1% excluding results due to exchange rate variations.

## Share Price Risk

One of the equity risks to which Telefónica is exposed is that which arises from its own share prices, as a consequence of the share buyback program announced in October 2003 and renewed in April 2005, for an estimated amount of 6 billion euros up to and including 2007, subject to cash flow generation and the evolution of share prices. In May 2006, it was announced that Telefónica would continue with the present buyback program for a remaining total of 2,700 million euros up to the end of 2007.

At December 31, 2006, Telefónica, S.A. held over 75 million own shares and options to purchase over 85 million own shares (see Note 12), with maturity in the first half of 2007. This option strategy offers a certain degree of protection against a possible scenario where share prices rise, purchases become more expensive and fewer shares can be purchased with the previously established amount. The maximum financial losses that can be incurred with this strategy is the premium paid for the option if, at maturity, the share price were to be lower than the exercise price; however, if this happens, Telefónica would be able to purchase its shares on the market at a lower price.

In the meeting held on June 21, 2006, the General Shareholders Board of Telefónica S.A., voted in favour of the implementation of a long-term bonus scheme aimed at Executive Board Members and Management Personnel of Telefónica S.A. and other companies of Telefónica Group, consisting of awarding the participants selected for the scheme, upon fulfilment of the established requirements, with a number of Telefónica S.A. shares as variable remuneration (explained in Note 20.e).

The maximum number of shares assigned at the close of 2006 (first cycle) was 6,530,615 shares (Note 20.e). According to the scheme, the shares may be (a) Telefónica S.A. shares from their own portfolio, which may have been purchased or may be purchased by Telefónica S.A. or by any other company belonging to the Group, having fulfilled the legal requirements established to this effect; or (b) newly issued shares. The possibility of awarding shares to employees in the future, depending on the relative shareholder remuneration, implies a risk because there may be an obligation to award the maximum number of shares at the close of each cycle, which (if the purchases are made on the market) might in the future imply an expenditure above that required at the starting date of each cycle if the price of the shares is above the corresponding price at the beginning of the cycle. If new shares are issued to award to the beneficiaries of the scheme, the ordinary shareholder would find the value of his shares diluted because there would be more shares in circulation.

With the aim of reducing the risk and having the necessary shares available at the close of the cycle begun in fiscal year 2006, Telefónica acquired an instrument from a financial body by means of which, at the end of the cycle, Telefónica will obtain a specific number of shares according to the same level of achievement established for the scheme. The maximum number of shares that Telefónica will be able to receive is 7,200,000. The cost of this instrument was 46 million euros, which, in unit

values comes to 6.43 euros for each maximum number of shares. Telefónica is also exposed to fluctuations in the prices of shares of its investee companies, especially to the extent that these are not integrated in its core business and may be subject to divestiture. In 2006, Telefónica sold its share in Telepizza and sold some of its shares in Sogecable, at the time that company was taken over.

## Liquidity Risk

Telefónica aims to adapt the maturity profile of its debt to its capacity to generate cash flows to pay it, maintaining a certain margin. In practice, that has meant following two criteria:

1. The average maturity of the Group's debt must be longer than the time required to pay the debt (assuming fulfilment of internal projections, and all the flows generated being allocated to payment of the debt, and not to dividends or acquisitions).
2. The Group must be able to pay off all its commitments in the coming 12 months, without having to resort to further loans or to the capital markets (but maintaining the credit lines already firmly committed by financing institutions), assuming budgetary fulfilment.

At December 31, 2006, the average maturity of the net financial debt – 52,145 million euros – was 6.5 years. The Group would need to generate around 8 billion euros per year in order to be able to repay the debt in this period of time if the entire cash flow were used to this end. The cash flow generated in 2006 easily exceeds this figure and, therefore, if the same volume of cash flow continues to be generated during the average term of the debt, the Group would repay the debt in its entirety in less than 6.5 years, if the entire cash flow were used to this end.

<sup>1</sup> Conforme al indicador EMBI elaborado por JP Morgan

Gross debt maturity in 2007 (8,381 million euros, including coverage) is less than the funds available calculated as a sum of:

- (ii) temporary financial investments and treasury at December 31, amounting to 5,472 million euros
- (ii) the annual cash-flow generation forecast for 2007 (which is expected to be more than the figure for 2006)
- (iii) the unused lines of credit committed by banks with an initial maturity term of more than a year (over 5,400 million euros, including the Cesky Telecom, Endemol B.V. and O2 Group lines)

The existing cushion means that it is possible for Telefónica to fulfil commitments acquired concerning payment of dividends and to purchase the number of company shares necessary to conclude the present own-share buyback scheme.

On October 31, 2005, Telefónica launched a public offer for the acquisition of 100% of the shares of the British company O2, for an amount of 17,887 million pounds sterling. To back the Public Acquisition Offer for O2, Telefónica, S.A. signed with a group of financial entities for a syndicated loan of 18,500 million pounds, a third of which with a maturity of 2 years, another third of 2 and a half years and the remaining third, of 3 years. The payment for the acquisition of 100% of the O2 shares took place on different dates over the first four months of 2006. The use of this loan to make the payment considerably increased debt maturities for the years 2007 and 2008, significantly reducing the average life of the debt to 3.75 years from the average of 5 years at December 31, 2005.

With the aim of restoring compliance with the two principles stated above that govern liquidity-risk management, the Group established a refinancing plan for the loan that was used for the acquisition of O2. Given that this refinancing is based mainly on

international bond markets, the Group established and announced a number of medium-term financial goals to be fulfilled with the aim of preserving their credit worthiness and guaranteeing access to capital markets. These goals are:

1. To establish a credit rating of BBB+/Baal as the minimum desirable rating, and
2. To maintain a net debt-assumable financial commitments ratio less or equal to 2.5 times the OIBDA (Operating Income Before Depreciation and Amortization) in the medium term

Telefónica's present credit rating is BBB+ by Standard and Poor's, Baal by Moody's and BBB+ by Fitch.

The financing operation has focused on international capital markets, mainly on the euro, pound and dollar markets. The main issues of bonds made during the year have been the following:

- In January, bonds were issued on the euro and pound sterling markets to a value of 4,000 million and 1,250 million, for periods of 5 and 10 years for the euro and 10 and 20 years for the pound respectively.
- In June, bonds were issued on the American market to a value of 5,250 million U.S. dollars for terms of 3, 5, 10, and 30 years
- In July, floating-rate notes were issued to a value of 1,250 million euros and for a period of 3 and a half years.
- In September, bonds were issued to a value of 500 million euros for a period of 5 and a half years.
- In October, bonds were issued to a value of 300 million euros for a period of 2 years.
- In December, bonds were issued to a value of 500 million pounds sterling for a period of 7 years and one month.

In the syndicated loans market, the Group carried out the following operations:

- In April, an agreement was made with a group of Spanish Savings Banks (Cajas de Ahorros) for a syndicated loan of 700 million euros with an average life of 10 years.
- In December, Telefónica signed a loan of 7,000 million pounds sterling to refinance the syndicated loan taken out to acquire O2, by means of requesting the banks participating in the syndicate a modification whereby the repayment period was extended until 2013 and the terms of the transaction were adjusted in line with Telefónica's loan operations already in existence in the market.

With this intense activity in the financial markets, Telefónica has, in 2006, completely refinanced the syndicated loan taken out for the acquisition of O2, substantially mitigating the refinancing risk it was facing after the acquisition of O2 in 2007 and 2008, whereby Telefónica was facing net debt maturities of more than 7,000 million euros and more than 19,000 million euros respectively, as at March 31. At December 31, the net debt maturities for those years, after the financing operations carried out, was 2,911 million euros in 2007 and 3,700 million euros in 2008, with a cumulative reduction of more than 20,000 million euros. Since most of the refinancing operations have been established as long term, the average life of the net debt has been extended from 3.75 years after the acquisition of O2, to 6.5 years at December 31.

## Country risk

The perception of sovereign risk for the Latin American region ended 2006 at 180 pbs, an all-time low; nevertheless, Ecuador was the exception, practically duplicating the country risk level in the month of December, due to political instability and plans announced by the new administration. The macroeconomic performance of the region continued to be very positive in 2006, with a 5.3% improvement in the GDP. Venezuela showed the most dynamic growth rate (10%) and Brazil (2.8%), the slowest growth rate. Thus, a steady path of four years of high growth can be observed – the last three years show a growth rate of over 4% - and an increasingly solid composition, based on the growth of domestic demand; in this sense, the dynamism of investment (10%) and the acceleration of consumption (6%) have been determining factors.

This positive economic climate has meant that the per capita income for the region has increased by 12% since the year 2002, the greatest consecutive increase since the seventies. Parallel to this, these results have occurred with inflation at a historic low (4.8%), except for Venezuela (15.8%) and Argentina (10%). Finally, growth in employment has favoured an improvement in social indicators for the region; the unemployment rate has dropped to 8.7% - the lowest since the beginning of the 90s – real salaries have grown more than 2% and the levels of deprivation and extreme poverty have continued to ease since the maximum level reached at the beginning of this decade.

## Standard & Poor's Credit Rating

	Rating	Change in notches Jan-06 - Feb-07	Outlook
Argentina	B+	+ 2	Stable
Brazil	BB	+ 1	Positive
Chile	A	=	Positive
Colombia	BB	=	Positive
Ecuador	CCC	- 1	Negative
Mexico	BBB	=	Stable
Peru	BB+	+ 1	Stable
Uruguay	B+	+ 1	Stable
Venezuela	BB-	+ 1	Stable

An analysis of credit rating in the region shows an improvement in 2006, as can be seen in the table below. This is due to the fact that, in general, the countries have taken advantage of the positive trend in the international economy – via prices of raw materials, dynamism in world trade and remittances from emigrants – to improve external vulnerability indicators, such as those related to foreign debt and the level of reserves. During 2006, 23,000 million dollars of foreign debt was cancelled and 38,600 million dollars was accumulated – the highest rate since 1990 – in international reserves in the Central Banks. The tax situation also improved considerably in 2006 with fiscal needs being reduced by more one percentage point as a percentage of the GDP, almost achieving budget balance.

Of special note are the operations of early repayment of debt or exchange for internal debt in very favourable conditions, carried out by Brazil and Peru. In both cases, this has allowed them to achieve the highest credit rating in their recent history. The case of Peru is particularly noteworthy, being one step away from achieving investment grade rating, taking into account the dynamics of medium term sustainability, although they are penalised for the high level of dollarisation which is still present in the economy and the deficient institutional framework.

Argentina and Uruguay improved their credit rating in 2006, returning to levels prior to default – the end of 2001 in the case of Argentina and the first half of 2003 in the case of Uruguay. Of particular note is the performance of the Argentinean government faced with an excessive supply of currencies. The early repayment of the whole of its IMF debt (\$9.5 billion) at the beginning of 2006, the normalisation with the Paris Club creditors (\$6.3 billion) and, despite this, an accumulation of reserves in the Central Bank of almost \$4 billion.

Chile and Mexico, the only countries in the region with investment grade rating, have not experienced a change in their credit rating over the last 2 years, although in Chile, the revision to positive outlook at the end of last year could lead the country to its highest rating in recent history. We must remember that Mexico, having consolidated its historic investment grade of 2002, made a substantial early repayment of foreign debt in 2006 (\$12.5 billion) which has made it possible to reduce their foreign debt by almost 5% of its GDP.

Colombia had very good economic and financial results in 2006 and regained the rating of positive outlook in February 2006, putting an end to the deterioration in credit rating experienced by this country after the sudden financial crisis at the end of 1999, which resulted in the loss of its long-held investment grade rating. The return to a positive climate has been reflected in a historic growth in business investment and great foreign support for the country in the extensive program of privatisation announced by the government.

Venezuela, the country in the region with most variation in credit rating in the last ten years – 14 rating changes – also regained a BB- rating in February 2006, for the first time since 1994. The positive impact of the rise in the price of oil on the public economy and foreign accounts played a decisive role. This foreign surplus (over 20% of the GDP) has permitted 2 restructuring procedures of external and internal debt to improve the profitability curve, which consisted of early payment for all the Brady bonds (\$4.4 billion), the purchase of sovereign debt of Argentina and Ecuador for over \$1 billion and lastly, the constitution of a foreign deposit of official funds for over \$18 billion. The capital control regime via the Currency Control Board (CADIVI) and the fixed exchange control system established in 2003, were maintained.

Finally, the exception to this trend of improvement is Ecuador, who was rated as grade CCC in January 2007, a category that has been maintained for practically the whole of the decade so far, due to the enormous political instability and financial problems that led the country to a restructuring of its debt. The fiscal surplus estimated at the close of 2006 will be historic (4.5% of the GDP), and may rise to almost 6.5% of the GDP excluding the financial burden.

In order to manage or mitigate country risk, Telefónica has adopted two main strategies (apart from the ordinary management of its business):

1. To partially compensate the assets with liabilities in the Latin American companies, not guaranteed by the parent company, to ensure that any loss in asset value would go hand in hand with a reduction of liabilities, and
2. To repatriate funds generated in Latin America which are not needed to take advantage of profitable business development opportunities in the region.

With regard to the first point, the Latin American companies have a net external debt volume unguaranteed by the Spanish companies amounting to 4,669 million euros, which constitutes 9% of the net financial debt of the Group.

With reference to the second point – the repatriation of funds – in 2006, 2,491 million euros were received from Latin America, mostly in dividends and the rest in loan interests and principal from loans to Latin American subsidiaries.

With regard to this, it is worth mentioning that, since February 2003, a regime of exchange-rate control has been in force in Venezuela. In order to administer this regime of exchange-rate control and to determine authorisations for the sale of currencies, the Commission for the Administration of Currency Control (CADIVI) was created. This organism has dictated various rulings (“providencias”) regulating the types of currency sale in Venezuela at the official exchange rate. The foreign businesses that are properly registered as foreign investors have the right to request from CADIVI, in accordance with ruling Number 029, Article 2, paragraph c), “Transfer of profits, earnings, income, interest and dividends from international investment.” In 2006, Telefónica Móviles Venezuela obtained approval for 137 million dollars in this way and is at present awaiting clearance of the last dividend requested, for 219 million dollars.



## Derivatives policy

At December 31, 2006, the nominal value of outstanding derivatives contracted with foreign counterparties amounted to 120,267 million euros. This amount constitutes an increase of 107% compared with the figures for 2005 and reflects the increased debt of the Group resulting from the acquisition of O2. This volume is so high because derivatives may be applied several times to the same debt for an amount equal to its nominal value; for instance, a debt in foreign currency may be converted into euros, at a floating rate, and then for each interest rate period, the rate may be fixed by using an FRA. Even adjusting the position downwards, it is necessary to exercise extreme caution when using derivatives so as to avoid problems due to errors or lack of knowledge of the real position and its risks.

1. Existence of a clearly identified underlying, on which the derivative is based.
2. Adjustment of the underlying to one side of the derivative.
3. Identity of the country contracting the derivative and the company that owns the underlying.
4. Capacity to measure the derivatives' market value, using the valuation systems available to the Group.
5. Sale of options only when there is an underlying exposure.
6. Hedge Accounting.

The guidelines for risk management are laid down by the General Directorate of Corporate Finance of Telefónica Group and implemented by the financial managers of the companies (ensuring they are in keeping with both the individual interests of the companies and those of the Group). The General Directorate of Corporate Finance may authorise deviations from this policy for justifiable reasons, normally when the market is too thin for the volume of transactions or for clearly limited, reduced risks. Likewise, companies joining the Group as a result of acquisitions or mergers may require time to adapt.



# our soul

## TELEFÓNICA IN 2006

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# Corporate Identity

## Telefónica's Vision delimits and defines the Group's brand strategy.

**For this reason, the Group's brand strategy pursues a double objective. On the one hand, to build its institutional profile in order to transfer the value of its brand, Telefónica, as a world leaders in telecommunications. And on the other hand, to configure our offering through our commercial brands (Movistar, O2, Terra) and a wide range of products (duo, trio, imagenio, speedy, superquince, etc.)**

In order to achieve these two objectives, Telefónica has created a system to link and express the portfolio of the group's brands: the brand "family system".

### The family system

The family system organizes the relationship of the binomial made up by the Telefónica brand (Master Brand) and by the Group's commercial brands (especially Movistar, O2 and Terra) to create a positive pairing. This system is characterized by:

- The definition of the brand roles.
- The definition of the commercial brand icons or symbols.
- The creation of a coexisting system or connecting device in graphic and image terms between the Master Brand and the commercial brands, and, finally, the organization of the brand portfolio by customer segments: people/mobility; homes, businesses.

### Telefónica's Role

The Telefónica Master Brand provides the binomial stature: financial solvency, management capacity, leadership, international projection, credibility, solidity and the know-how of one of the major telecommunication groups in the world.

Therefore:

- Telefónica is the primary brand for all the Group businesses
- The values and positioning of the Telefónica brand are the starting point for all Group relationships and communication
- Telefónica is the only valid speaker from an institutional standpoint, with its shareholders, society and the regulator
- No activity should work against the Telefónica brand, independently of the commercial benefit it may provide in the short term
- The entire organization must work pro-actively in the constant strengthening of the Telefónica brand

### The Role of the Commercial Brands

The commercial brands (Movistar, O2, Terra) provide the binomial with the role of "freshness": and closeness, humanity, a personal and privileged relationship and commitment. However, the products (duo, trio, imagenio, speedy, superquince, etc...), are not commercial brands, and therefore they are subordinated to the Master brand and have no identity, graphic image or strategy. Therefore, the commercial brands:

- Develop, communicate and sell the entire commercial strength of the Telefónica Group to customers.
- They are responsible for the arrival of new services, thus helping to expand the Telefónica brand.
- With simplicity and clarity to transfer the benefit and meaning of the commercial offering to customers.

## Trademark and Domain Portfolio, Telefónica S.A.<sup>1</sup>

Brands: Telefónica S.A. Ownership	10,664
Telefónica Móviles S.A. Ownership	9,454
Domains	2,925
Patents and Models	1,349
Intellectual property	1,811

(1) As of 31 December 2006

## Telefónica Fixed Line Brand Recognition<sup>1</sup>

Country	Top of Mind	Total References
Argentina	68	98
Chile**	21	75
Peru	98	100
Spain	59	95
Brazil*	56	90

Source: 2006 Brand Advertising and Health Tracking. Millward Brown  
Data from Telefónica (Compiled in 2006)

(\*) Data from Telefónica (Compiled from December 2006 – January 2007)

(\*\*) Data from Telefónica Chile, Telefónica Long Distance, Telefónica CTC

(1) As of 31 December 2006

## Telefónica Mobile Brand Recognition

Country	Top of Mind	Total References
Spain	49	95
Argentina	39	89
Peru	61	95
Chile	39	89
Mexico	25	88
Colombia	26	97
Venezuela	46	96
Guatemala	33	89
El Salvador	30	89
Uruguay	38	97
Panama	44	95
Nicaragua	44	97
Ecuador	31	98

Data from Telefónica Movistar (Compiled in 2006)

## Integration between the Telefónica and O2 Brand identities

After the acquisition of O2, a process began to associate and align the O2 brand with the aforementioned family system. For this work, two different situations were established:

### Historical O2 Markets (Germany, United Kingdom and Ireland).

From the first two weeks of October 2006, O2 incorporated the endorsement formula "A Telefónica company" in all communication with institutional groups of interest such as employees, investors, suppliers, corporations, etc. The expression "A Telefónica company" made it possible to exploit very relevant synergies within the institutional territory and above all, in manufacturing and support aspects.

With respect to commercial communication with customers, the O2 brand is being maintained for now.

### New European O2 Markets

(Czech Republic, Slovakia, and others in the future)

Telefónica family system is adapted to what is known in agreements as a "sophisticated family system". This adaptation of the family system is characterized by:

The Telefónica Master Brand, which provides "stature" value, appears in all communication with no exceptions (including commercial communication) and acts as support, height and presentation.

The coexistence system or connecting device in graphic and image terms between the Master Brand and the commercial brands follows the blue O2 "layout".

Therefore, while in the Czech Republic and Slovak markets, the Telefónica brand, through the "family system" assumes its role as the master brand, in the natural markets, it plays a role which is more like an institutional guarantee in relationships with non-commercial stakeholders.



## Telefónica sponsors 825 initiatives in 2006

**Telefónica, as an institution, takes part in a range of activities in society, generally speaking by sponsoring sporting, cultural and social events. In total, during 2006, the company sponsored some 825 initiatives.**

### Sponsorship policy

Telefónica's sponsorship policy includes:

- Support for events and activities that, due to their important repercussions in society, can help the companies promote their products and services. Highlights include sponsorship of sporting or musical events.
- Events and activities where the presence of Telefónica, as an institution, has repercussions in terms of associating its brands with cultural or social events that are valued by the general public.

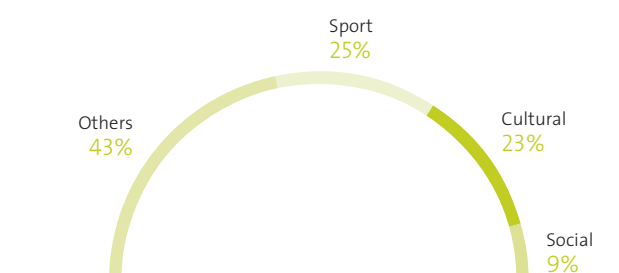
The Sponsorship Department in Spain is the only channel for receiving requests for sponsorship from institutions and companies with sponsorship proposals. Each month, Committees meet to present and debate sponsorship proposals for all of the Telefónica Group's lines of business. This sponsorship is approved by the lines of business and supported by the budget.

At Telefónica we sponsor sporting, cultural and technological events. In 2006, we received 3,138 requests for sponsorship from around the world, which were handled internally by Telefónica. We supported over 25% of all of these (825 sponsorships), of which 25% (208) were sports related, 23% (192) and cultural and 9% (73) were social activities.

### Sports

- We support football as sponsors and exclusive telecommunications suppliers for three important Spanish clubs: Real Madrid, FC Barcelona and Real Zaragoza.
- During 2006, we continued to support Spanish driver Fernando Alonso and the Renault F1 Team, who, for the second consecutive year, won the Formula 1 World Championship, both for drivers and manufacturers.
- We support the Movistar Cultures Cup and the Immigration and Solidarity World Cup, both of which are aimed at an important section of society, ie immigrants. This is aimed to use a sport that is as widely popular as football as a catalyst for integration.
- Alongside the important sponsorship initiatives mentioned above, we also look to establish close links with the societies in which we operate by supporting activities in the local communities, whether these be cultural or sporting events. Thus, in 2006, we continued to sponsor in Spain, the Madrid Marathon, the Tennis Master's Series in Madrid and other events of interest.

## Distribution of sponsorship by activity\*



(\*) Not including information for Telefónica O2 Europa.

## Sponsorship by country\*

Region/Country	N° of sponsorships
<b>Spain</b>	<b>371</b>
<b>Latin America</b>	<b>454</b>
Argentina	87
Brazil	72
Chile	20
Peru	68
Colombia	6
Ecuador	55
El Salvador	14
Guatemala	24
México	2
Nicaragua	9
Panama	24
Venezuela	73
<b>Total</b>	<b>825</b>

(\*) Not including information for Telefónica O2 Europa.

## Music and culture

- Telefónica Movistar continues to establish close links with the younger audience through music. Highlights include its participation as a sponsor of the concerts for the 40th anniversary of the radio station “40 principales”, a tour involving stars such as Shakira and Alejandro Sanz.
- We created the Espacio Movistar, a marquee offering a range of contents that is designed to be a pioneering centre and point of reference for technology, offering people the chance to get a closer look at the latest trends in technology, innovation, art, cinema and music. It is designed to act as a point of reference in Spain for these subjects.
- We have become exclusive sponsors for telecommunications at the International Expo Zaragoza 2008.
- Through Telefónica Móviles España, we launched an exclusive Cinema on Tuesdays promotion in 2006, offering our customers 2 tickets for the price of 1, to establish closer links with society through culture.
- In 2006, we signed a sponsorship agreement for the branding of the Telefónica Arena Madrid. Thus, we have joined the international trend to name spaces, ie to associate our brand with an emblematic place. In this case, we have associated our brand with the former Rockódromo de la Casa de Campo, now known as the Telefónica Arena Madrid.

## Society

- In 2006, we have continued to support projects to benefit society and offer our support to institutions that work in this area by collaborating with programmes to promote information technology. Highlights from this collaboration include work with the FAD (Foundation for Support against Drug Addiction), the Spanish Association Fighting Cancer, the Spanish Red Cross and other non-profit organisations.
- In Brazil, we supported the Guri project, which aimed to promote social integration amongst children and adolescents living in run-down areas through music.
- In Venezuela, we have taken part in two Health for All the Family Fairs organised by the Fundafarmacia (the social arm of the pharmaceutical industry).
- This social action is complemented by the work carried out by the Telefónica Foundation and its programmes, (Proniño, EducaRed, Voluntarios, etc).

Telefónica  
in 2006

02.2

## Business Principles

The principles will favour a homogeneous culture

Telefónica approved its Business Principles in 2006 for its employees in the whole world, after the unification of its ethical codes

**On the basis of these Principles, we have built our reputation, earned the confidence of our stakeholders and maximized long-term value for our shareholders and for society in general.**

### Telefónica's commitment

In our previous Corporate Responsibility Report, we undertook to unify the group's Ethical Code and to this end we have taken on board the concerns of our clients, employees, shop stewards, suppliers, shareholders and representatives of the local communities where we operate.

In December 2006, the Board of Directors of Telefónica S.A. approved our Business Principles as a result of the integration our Ethics Code with the Business Principles of O2. This process took account of the comments received from professionals in all the countries where the Telefónica Group has operations.

Our business principles stem from a series of general principles associated with honesty and reliability, respect for legality, personal integrity and respect for human rights.

In addition, specific principles are now in place with a view to ensuring the trust of our clients, professionals, shareholders, suppliers and society in general.

### More than words

One of the main challenges for those companies deciding to abide by an Ethical Code is that it should go beyond a mere statement of intent.

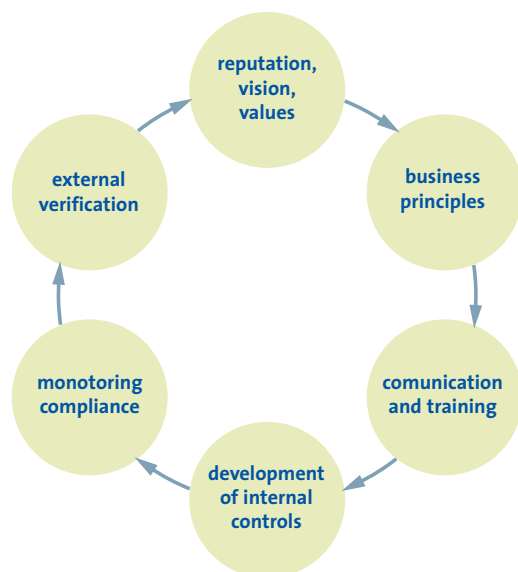
For this reason, at Telefónica, we are implementing policies in connection with each of these principles in order to improve how we act in all of the activities covered by this Code.

The major policies we are implementing in this sense include internal rules on accessibility, the responsible use of services, the protection of minors, the environment, responsible supply chain, ... among others.

These policies will continue to be adequately communicated to each of the areas responsible for their compliance, and this may later be audited through the corresponding internal audit and monitoring rules. Where necessary, compliance may be audited by the external auditors.



## Implementation program



## Responsibilities for complying with the Principles

All employees will be responsible for taking their own decisions in accordance with these company policies and for reporting any sign of non-compliance. In order to ensure full awareness and understanding of these issues, an on-line training programme must be taken and passed by all our professionals.

The Telefónica management is responsible for informing their teams about the Business Principles, setting an example in terms of compliance, helping their workers to resolve ethical dilemmas that may arise and correcting any possible deviations that may be detected.

Telefónica's workforce has the opportunity to ask questions and raise issues in absolute confidence through the help lines available on the Business Principles web site.

In addition, we have created a Business Principles Office to take charge of disseminating these ethical guidelines as well as reviewing processes, studying queries, complaints or allegations by employees, shareholders or suppliers and fostering the necessary policies for the adequate compliance of the principles.

# General Business Principles

## Honesty and trust

- We will be honest and trustworthy in all our dealings, and keep the commitments we make.
- We will protect the confidentiality of company, employee, shareholder, supplier and customer information.

## Respect for the law

- We will comply with all applicable national or international laws, rules and regulatory obligations, as well as our internal policies and procedures.
- We will compete fairly in our markets. We believe that consumers and society in general benefit from open and free markets.

## Bribery and anti-corruption

- We will never seek, offer or accept gifts, hospitality, bribes or other inducements to reward or encourage a decision.
- We will avoid or declare conflicts of interest that may lead to divided personal loyalties.
- We will behave with integrity and not seek gain for ourselves or for a third party by misusing our position or contacts within Telefónica. As a corporate entity, we will act with absolute political neutrality.
- We will abstain from any direct or indirect participation that could be interpreted as taking a position in favour of or against legitimate political parties. In particular, we will not make donations of any type, in support of political parties, organisations, factions, movements, or public or private entities whose activities are clearly linked with political activity.

## Human rights

- We will respect the principles of the UN Universal Declaration of Human Rights and the International Labour Organisation's declarations.
- We will foster equal opportunity and will treat everyone fairly, impartially and without prejudice, regardless of race, colour, nationality, ethnic or national origins, religion or religious affiliation, gender, gender status, sexual orientation, marital status, age, disability or caring responsibilities.

## Our Business Principles for our stakeholders

### Our clients can trust us

#### Products and services

- We will provide our customers with high-quality, innovative, reliable products and services at a fair price.
- We will verify and ensure that our products, and those that we distribute, comply with manufacturing standards on safety and quality. We will disclose and resolve any instances in which health risks are detected.

#### Communications and advertising

- We will always provide truthful, helpful and accurate information when marketing our products and services. We will make sure our products meet all advertised and required specifications.
- If our customers are dissatisfied with our products or services, we will provide them with the information and contact details necessary to make a complaint, should they wish to do so.

### Our employees can trust us

#### Professional development

- We will communicate our goals and strategies to our employees, to foster their commitment to and enthusiasm for achieving our vision.
- We will encourage the professional and personal growth of our employees, supporting the development of their skills and competences.
- We will ensure that policies on selecting, hiring, training and internally promoting employees are based on clear criteria relating to skills, competencies and merit
- We will inform employees how their work will be appraised and expect them to participate positively in appraisals in order to improve their work, initiative and dedication.

#### Compensation

- We will offer our employees fair and just compensation in the context of the labour markets where we operate.

#### Human rights

- We will not use any form of forced or child labour, nor will we tolerate any type of direct or indirect threat, coercion, abuse, violence or harassment in our working environment.
- We will respect our employees' right to join the labour union of their choice and will not tolerate any type of retaliatory or hostile action towards employees who take part in union activities.

#### Health and safety

- We will provide our employees and partners with a safe working environment. We will establish suitable mechanisms to avoid workplace accidents, injuries or diseases associated with our work activity through strict compliance with all relevant regulations and the preventive management of workplace hazards.

## Our shareholders can trust us

### Corporate governance

- We will manage the Company in accordance with the highest standards of corporate governance and best practice.

### Value creation and transparency

- We will manage the company with the aim of creating value for our shareholders.
- We undertake to provide all relevant information for their investment decisions. We will do this promptly in a non-discriminatory way.

### Internal controls and risks

- We will ensure that appropriate controls are in place to assess and manage the risks to our business, our people and our reputation.

- We will ensure that business, financial and accounting records are prepared accurately and reliably.
- We will cooperate with our internal and external auditors or any official inspection authority.

### Company assets

- We will preserve, safeguard and use our physical, financial and intellectual assets efficiently and for the business purposes for which they are made available.
- We will not tolerate any use of our computers that could damage Company assets or reduce workers' productivity; nor illicit, illegal, or fraudulent activities that could threaten our reputation.

## Our communities can trust us

### Development of society

- We will contribute to the social, technological and economic development of the countries where we operate. We will do this by investing in telecommunications infrastructure, generating employment opportunities, and developing products and services that contribute to the development of society.
- Through our skills, products and services, we will seek to work in partnership with civic, community and charitable groups and in public initiatives that aim to bridge social divides in the regions where we operate.

### Environment

- We will be committed to sustainable development and environmental protection by minimising the impact of our operations on the environment.

## Our suppliers can trust us

### Conflicts of interest

- We will establish controls in our procurement processes to manage situations in which a person with a material financial interest (whether through employment, investment, contract or otherwise) in a supplier or potential supplier is likely to be directly or indirectly involved in a procurement process or decision relating to that supplier.

### Fairness and transparency

- We will guarantee transparent and equal opportunities for our suppliers, fostering competition whenever it is possible.

- We will adhere to strict procurement procedures to ensure we receive services and products under the best possible conditions and will award business solely on merit.

### Responsibility in the supply chain

- We will require our suppliers to meet similar ethical standards in their businesses and to comply with existing legislation and regulations in each country where they operate.
- We will fulfil our payment commitments to our suppliers.

# Corporate Responsibility

A standard management model in all countries

## In 2006, Telefónica integrated Corporate Responsibility across its businesses

**Our leadership and corporate responsibility has been framed by three factors this year:**  
a report model verified by external auditors; the launch of Group-wide Business Principles;  
a continued presence in the DJSI.

### How do we view CR at Telefónica?

At Telefónica we understand that corporate responsibility is a way of managing the business in close contact with our stakeholders. If we are able to generate a positive impact through our activities, we are also able to ensure the sustainability of the company and its relations with stakeholders. In short, the achievement of economic and financial goals and targets is just as important to us as the methods by which they are obtained.

For Telefónica, managing corporate responsibility entails:

- Embracing the needs and concerns of all stakeholders.
- Maintaining close business ties and conducting our business activities as sensitively as we can.
- Ensuring sustainable development in the countries where we operate, providing resources for worthy social causes and seeking to establish profitable and long-lasting relationships with all our stakeholders.

### Our CR indicators

We have two overarching external indicators to assess the fulfilment of our strategic goal to be a committed and responsible company.

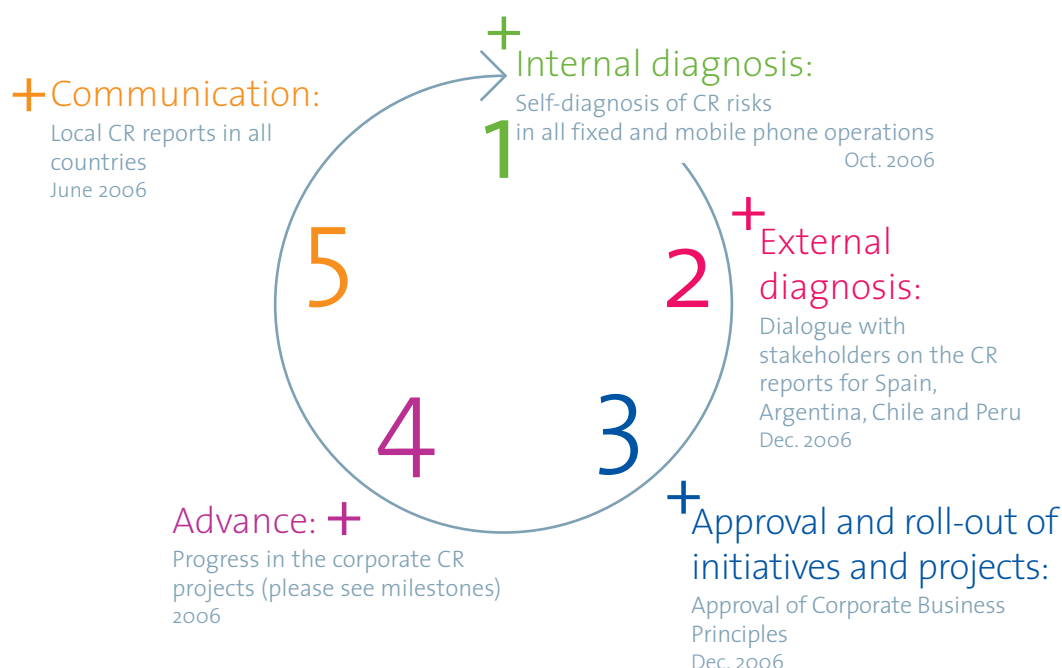
- We monitor the assessments of CR experts, analysts and observers. We believe their critiques of responsible performance represent a reliable indicator of the issues that we face. Among these analysts, a determining factor for Telefónica is the renewal of its inclusion on the Dow Jones Sustainability Index (DJSI), a worldwide reference for socially responsible investment.
- We carry out surveys into society's perception of Telefónica and other companies in accordance with the RepTrak® model produced by the Reputation Institute in collaboration with the Corporate Reputation Forum. Since 2005, 1,000 surveys a year have been conducted for each Telefonica company in Argentina, Brazil, Chile, Spain, Mexico and Peru. During the last quarter of 2006, we extended this methodology to Colombia and we plan to introduce it to Telefónica O2 Europe in 2007.

### Telefónica's reputation with society. RepTrak Pulse Index

Scale from 1 to 100

	2005	2006
Spain	64.3	67.7
Argentina	63.0	62.9
Brazil	54.6	53.5
Chile	55.1	49.9
Mexico	61.8	62.9
Peru	52.1	52.0

## How did we implement our management model?



## Our CR management model

CR management in Telefónica is the responsibility of all of the business units co-ordinated from Telefónica's Directorate for Reputation, Brand, and CSR, which is part of the General Technical Secretariat of the Presidency, and driven by the Human Resources and CR Committee of the Board of Directors of Telefónica S.A.

Telefónica's management of corporate responsibility is based on a process of continuous improvement. We conduct an initial diagnosis of the different risks we face and the expectations of our stakeholders.

On the basis of this, we then implement improvement targets, adapted to the unique conditions of each business sector and each country. By assessing our fulfilment of these targets, we set out a new improvement cycle, regularly repeating the process over time.

During the financial year, the model was presented internally at the Telefónica's first CR Forum, held in Madrid in July and attended by over 100 Telefonica professionals.

The first steps in the application of the model were taken over the course of 2006.

The model is developed through the different functions assigned to the corporation, regional co-ordination centres, and countries.

Lastly, the skills required of Telefónica's CR professionals were defined, establishing the groundwork for a possible professional career in this area.

## Integration of CR in Telefónica and O2

Telefónica's acquisition of O2 in January 2006 offered both companies the opportunity to identify synergies in the management of corporate responsibility.

In March 2006, only two months after the effective acquisition date, a joint work plan was submitted to our Integration Committee. This included:

- Unification of our Ethical Codes.
- Integration of O2 into Telefónica's CR Management Model.
- Sharing of reputation management tools.
- Integration of CR processes and communication tools that relate to different stakeholders.
- Encouragement of the exchange of expertise, best practice and policies between managers involved in CR.




In January 2007, we reviewed our integration carefully and systematically. This confirmed that both companies today have a more solid management model for corporate responsibility and we are able to share policies and experiences very effectively.

In the coming months, we will collaborate on the application of the management model in O2 and the integration of the information systems and the key performance indicators.



## Milestones and challenges in 2006

One of the most frequent demands among our stakeholders is to know what goals we are setting for the coming financial year. Telefónica wishes to abide by its transparency undertaking by publishing our targets for CR issues and, in particular, the degree of their fulfilment.

	TARGET FOR 2006	STATUS	EXPLANATION
CORPORATE RESPONSIBILITY	Co-ordinate the CR strategy with O2	Achieved 100% 	In 2006, a 10-point integration plan was agreed, all of which have been fulfilled during the 2006 financial year.
	Verify the CR Report to the AA1000/AS standard in the countries	Achieved 70% 	The Telefónica CR Report includes verification according to the AA1000/AS standard for Spain, Argentina, Chile, Colombia, Peru, United Kingdom, German and Ireland.
	Pilot projects for dialogue with stakeholders in Latin America	Achieved 100% 	Discussion panels were organized with stakeholders in Argentina, Chile and Peru (and were also repeated in Spain)
BUSINESS PRINCIPLES	Alignment with the Business Principles of O2	Achieved 100% 	In June 2006, after reviewing the status of the Telefónica Ethical Code and the Business Principles of O2, it was decided to combine both documents into one. The uniform Business Principles were approved by the Board of Directors in December.
	Implementation of an Ethical Code throughout the Telefónica Group	In progress 2007 	As a consequence of the acquisition of O2, the review of Telefónica's Ethical Code has altered the policy timeframe for implementation of the Principles. The Target has been pushed back to 2007.
CORPORATE REPUTATION	Implementation of a corporate model for managing reputation risk	Achieved 100% 	RepTrak, already applied in 7 Group countries, is used as the corporate tool for identifying reputation risks. The results are reviewed every three months and are exploited by many areas of the company
	Improvement of 5% in Telefónica's reputation in Lat-Am on its weakest dimensions	Not Achieved 	Telefónica's reputation in the region kept stable in 2006.
ENVIRONMENT	Implementation of the "minimum standards" in environmental management. One step in each company	Achieved 80% 	In 2006 we advanced the implementation of the environmental management: we reached ISO14001 certifications in Telefónica Móviles Ecuador and Peru.
	Improvement in the waste management systems in Lat-Am	In progress 2007 	During 2006 we encouraged countries to manage environmental issues. Target delayed until 2007.
	Internal rules for the management and monitoring of environmental aspects	Delayed 2007 	The approval of corporate policies has been delayed until 2007 to ensure alignment with the Business Principles.
	Establishment of Environmental Committees per country	Achieved 100% 	The environmental committees have been set up in Argentina, Brazil, Chile, Colombia, Peru and Spain.
	Publication of an Environmental Policy for the Telefónica Group	Delayed 2007 	The adoption of corporate policies has been delayed until 2007 to ensure alignment with the Business Principles.

	TARGET FOR 2006	STATUS		EXPLANATION
CUSTOMERS	Establishment of homogeneous metrics to measure the satisfaction of clients of Telefónica Móviles Lat-Am	Achieved 100%	😊	The model has been uniformly established with the measurement of satisfaction made for the Group and is currently applied in Telefónica.
	Client Ombudsman Service in Spain	Achieved 100%	😊	Service currently operating and covering clients of fix and mobile services.
	Progress in ISO 9001 certification	Achieved 100%	😊	More information in <a href="http://www.telefonica.es/rc2006/clientes">www.telefonica.es/rc2006/clientes</a>
	Implement Acceptable Use Policy for Internet Services	In progress 2007	😞	Delayed until 2007 to ensure alignment with our Business Principles.
	Implement rules for handling of Adult Contents	In progress 50%	😊	The approval of the rules set June 2008 as the compliance date.
	Manual for clients in Lat-Am to understand mobile telephony	Achieved 70%	😊	Leaflets for costumers in Argentina, Brazil and Peru.
	Regulations on management of gambling contents	In progress 2007	😞	The approval of corporate policies has been pushed back to 2007 in order to ensure their alignment with the Business Principles.
EMPLOYEES	To increase employee satisfaction by over 5%.	Achieved 100%	😊	The satisfaction was increased by 6.1% average.
	Individual development plan for all employees	Achieved 55%	😊	Actually, more than 70,000 Telefónica employees have individual training plans.
	Third and final phase of the work audit at Telefónica	Achieved 100%	😊	A new cycle of work audits begins at Telefónica companies in 2007.
	Homogenization of health and safety processes for the Group	Achieved 50%	😊	A working group has been created to combine CSR and HR in Spain and Latin America and some indicators have been homogenized.
	Development of the model for the corporate university	Achieved 100%	😊	The corporate university is now operational in the provisional campus.
	Homogenization of the Group's fringe benefits for managers	In progress 2007	😞	The project has been delayed due to another priority in HR.
	New ways of working: mobile work, flexibility	Achieved 65%	😊	Associated with the transfer of professionals in Spain to Distrito C (mobility, flexible working hours, tele-working, ...). There are currently 7000 professionals in Distrito C.
	Implementation of the 2006 Internal Communication Plan in Lat-Am	Achieved 100%	😊	The internal communication programmes are operating in Lat-Am, with integration of fixed and mobile telephony.
SUPPLIERS	Publication of a responsible purchasing policy for the Telefónica Group	In progress 2007	😞	The adoption of corporate policies has been delayed until 2007 to ensure alignment with the Business Principles.
	Purchasing Policy for social suppliers	In progress 2007	😞	The adoption of corporate policies has been delayed until 2007 to ensure alignment with the Business Principles.
	Participation in the GeSI Supply Chain Working Group	Achieved 100%	😊	The co-ordinator of the Working Group is the head of procurement at O2 UK.
SOCIETY	Encourage corporate volunteering projects	Achieved 100%	😊	Review of the strategy and team responsible for corporate volunteering at Telefónica Foundation.
	Telefónica Accessible projects (2 countries in Lat-Am)	Achieved 70%	😊	Launch of projects associated with Telefónica Accessible in Chile and Colombia (named differently than Telefónica Accessible)
	Encourage the "Digital Inclusion" project in Lat-Am	Achieved 100%	😊	Leadership of the "1st Latin-American Summit on ICT and MG". Strategic line for Telefónica International



## Our new challenges for 2007

Corporate Responsibility is characterized by two lines of work: on one hand, it involves all of the company's areas of management, and on the other, it represents a process of continuous improvement. Consequently, the Telefónica Group has set 21 new goals for 2007 and plans to complete six challenges started in 2006.

CORPORATE RESPONSIBILITY AND BUSINESS PRINCIPLES	<ul style="list-style-type: none"> <li>• Implementation of the Business Principles in all of the Group's companies (scheduled for 2006)</li> <li>• Perform the CR Diagnosis for Telefónica's companies</li> <li>• Establish key performance indicators linking CR diagnoses with compliance of the Business Principles</li> <li>• Publication of local CR reports in all the countries where operations are carried out</li> <li>• Extend dialogue projects to 3 countries of Latin America and 2 in Europe and consolidate dialogue in the rest of the countries</li> </ul>
ENVIRONMENT	<ul style="list-style-type: none"> <li>• Implementation of a uniform system of management throughout the group</li> <li>• Definition and implementation of a corporate strategy to fight climate change</li> <li>• Homogenization of operational control systems in Latin America</li> <li>• Progress with ISO 14001 certification for the Environmental Management Systems</li> <li>• Improvement in waste management systems in Latin America (scheduled for 2006)</li> </ul>



CUSTOMERS	<ul style="list-style-type: none"> <li>• “Client Experience” Project in all regions, with the aim of satisfying clients’ needs in their relations with Telefónica</li> <li>• Publish information for “a responsible use of ICT” on the company’s web pages and at sales outlets</li> <li>• Implement the Acceptable Use Policy for Internet Services (scheduled for 2006)</li> <li>• Implement Childhood Protection Policy, including the management of gambling (scheduled for 2006)</li> </ul>
EMPLOYEES	<ul style="list-style-type: none"> <li>• To increase employee satisfaction (target: reach the satisfaction of 65% of employees)</li> <li>• To encourage the ‘new ways of working’ project</li> <li>• Consolidation of the Model for the Corporate University and the launch of the virtual campus</li> <li>• Uniform the index the frequency of accidents at work</li> <li>• Development of the ‘employee promise’</li> </ul>
SUPPLIERS	<ul style="list-style-type: none"> <li>• Publication of a Responsible Purchasing Policy for the Telefónica Group (scheduled for 2006)</li> <li>• Implementation of the CR self-diagnosis for suppliers at risk</li> <li>• Implementation of the selective audit phase for suppliers at risk</li> <li>• Purchasing Policy for social suppliers (scheduled for 2006)</li> </ul>
SOCIETY	<ul style="list-style-type: none"> <li>• Definition of products aimed at fostering “Digital Inclusion” in Latin America</li> <li>• Approval of 5 policies associated with the Telefónica Accessible Project (realms of accessibility)</li> <li>• Fostering of corporate volunteering projects integrating the approaches of the Telefónica Foundation and Telefónica O2 Europe</li> <li>• Aligning the sponsorship policy towards favouring the social use of ICT</li> </ul>



With a significant increase in Latin America

## In 2006, average satisfaction ratings of Telefónica's customers was close to 7 out of 10

**At Telefónica we want to improve customer service. We have set ourselves a goal to improve customer satisfaction levels. To achieve it we have put in place initiatives such as the Customer Ombudsman Service in Spain. We are not only striving to improve our service but also to offer more innovative products than our competitors.**

### We want to improve

In 2006, we became the world's third-largest company by number of clients (203 million). Only two Chinese companies handle more accesses than Telefónica. We want our clients to be more and more satisfied. So much so that we want to turn them into our biggest fans.

It is no easy task to transform a company of the size and history of Telefónica, but we have set up a working party with 30 professionals to identify the demands of clients and change those aspects of our company that our clients do not like. We aim to do everything we can to improve the service they receive.

### What was customer satisfaction like in 2006?

The company's overall Customer Satisfaction Index (CSI) evolved stably throughout 2006. The fourth quarter achieved a satisfaction index score of 6.78.

Telefónica's clients in Spain have assessed the company in this respect with scores very similar to the group's overall result, a circumstance that is consistent with the weighting Spain has in the overall index.

In comparative terms, Europe is the region presenting the highest levels of satisfaction, a circumstance associated, at least in part, with the weighting of mobile telephony transactions, which generally present higher levels of satisfaction than fixed telephony.

The Customer Satisfaction Index for Latin America experienced a significant increase in the second quarter due to the incorporation of mobile transactions in the region into the index.

### Rates and billing

We offer competitive rates and we try to ensure no citizen is excluded from the advantages of telecommunications services for reasons of cost.

The invoice is of great importance for our clients and for us; it is a means of permanent contact with them. We strive to offer clarity and accuracy in these communications and to provide complementary information that may be of interest. We are very concerned that our clients should perceive their bills as a faithful reflection of the services they have contracted, and they should also find them easy to understand.

### Advertising

Advertising is the main vehicle we use to inform our clients about our services and products. If it was too aggressive, misleading or insufficiently respectful it might be counterproductive for the company, undermining our clients' trust and having negative repercussions on their future purchase decisions. For this reason, we adhere to our commitment to apply a clear, respectful and legal advertising policy.

To ensure legality, our advertising treatments go through a process of approval prior to their definitive use. Most of our campaigns have to be approved by the heads of the legal department in each of the companies, so as to ensure respect for regulations and for our competitors.

To ensure that advertising messages do not contain anything offensive for particular groups, we usually conduct a pre-launch test with different focus groups of individuals that are representative of society as a whole.

## Customer Satisfaction Index (CSI) evolution¹

Company and Regional Total

■ Dec 2006

■ Dec 2005

6.78 6.78

05 06

CSI Evolution  
Spain

6.85 6.78

05 06

CSI Evolution  
Latin America

5.92 6.36

05 06

CSI Evolution  
Europe

7.37 7.25

05 06

\* Index score (0-10)

## Awards

- Telecommunications company with less complaints (Oficina de Atención al Usuario de Telecomunicaciones)
- Telefónica de España, leader in quality-price (UCE)
- Telefónica's broad band, recommended as the best of Spain (Asociación Internautas)
- 1004, the best call center

## Customer Ombudsman Service at Telefónica España

In April, 2006, Telefónica pioneered the creation of an independent department in charge of protecting our customers' interests. In this way, we can respond to their needs and those requested by the market and the regulatory authorities.

Its main function is to provide a means for customers who have previously used the normal channels provided by Telefónica for submitting complaints and to obtain an independent review as a last resort. The actions of the Ombudsman Service will at all times be guided by the principles of objectivity and independence, with a view to defending and protecting the rights of clients.

This service is available to customers of Telefónica de España and Telefónica Móviles España. It is essential for customers to have addressed their complaints first to the 1004 or 609 services; they may appeal to the Ombudsman if they do not agree with the answer received or if no response is obtained within the maximum deadline of 30 days.

We have spent the first few months communicating the service to customers and other stakeholders, as well as handling the first complaints received.

At year end, out of around five hundred complaints received, 63% were deemed to be within the remit of the Ombudsman Service and were admitted for consideration.

Of all the cases involved, the customer received a favourable resolution 83% of the time.

These resolutions are binding on the company and, before handing down its findings, the Ombudsman Service investigates each of the complaints. The specific circumstances and factors affecting each case are also assessed.

The information obtained allows Telefónica to increase awareness of our customers' needs and to identify improvements in processes and actions undertaken by the group's companies. These improvements will be aimed at strengthening the customer-focus philosophy of the companies in their day-to-day activities. We aim to share the company's common goal of meeting the needs of our clients and to fulfil our quality commitments.



## Key quality of service data\*

	Spain	Latin America
<b>ADSL</b>		
Provision time	10.5 days	6.6 days
% malfunctions associated with provision	3.8%	10.8%
Malfunctions / 1000 lines	1.21	5.8
Billing complaints / 1000 invoices	5.09	28
Average line repair time	12.9 hours	33 hours
<b>Basic telephone service</b>		
Provision time	17.5 days	6.2 days
Malfunctions / 1000 lines	1.6	4.5
Billing complaints / 1000 invoices	3.48	28
Average line repair time	16.4 hours	48 hours
<b>Mobile services</b>		
Effectiveness of the GSM network	98.9%	>96%
Complaints / 1000 invoices	3.22	n.a.

(\*) Information about Telefónica O2 Europe not available

## Responsible use of technology

New technologies offer our clients countless possibilities to access all kinds of digital services and contents. This spread of networks on a global scale also makes it possible for users to suffer external attacks such as spam, intrusions, illegal downloading of intellectual property, inappropriate content, child pornography, fraud, phishing, insults, ...

At Telefónica we assume responsibility for collaborating with the public administrations, NGOs, parents, tutors, ... in order to foster the responsible use of technology.

### Spam

According to the data presented in March, 2007, 84% of all the e-mails transmitted in Spain contain spam, a percentage similar to that of other countries in the world. This traffic means that we have to invest in networks capable of transporting these mails, overloading the capacity available for useful and legal contents.

Spain is in fifth place on the world ranking for the generation of spam, with 5.8% of the total volume. One of the main causes is the lack of security on Spanish computers, due to the increased number of Trojans taking over domestic computers and turning them into spam servers at the command of criminals.

Telefónica's collaboration in the fight against junk mail includes advice to customers about how to use the Internet, channels for submitting complaints and the provision of tools and services designed to protect our clients' equipment.

Finally, in view of the spread of spam to mobile networks, Telefónica Móviles and O2 have signed the GSM Association's Voluntary Codes of Conduct on mobile spam.

Spam leads to the emergence of webs pretending to be banks and e-commerce sites (phishing). This is an international problem, with over 120 financial institutions attacked a day, on average.

### Data protection

The regulations and procedures in place at Telefónica companies to protect the personal details of clients stipulate that information will only be supplied to the registered subscribers of the telephone lines and requests for service will only be processed if they are authorised by them directly. Requests for information about clients made by third parties will only be handled if accompanied by a court order or authorized by the competent body in each country.

### Intellectual property

The development and protection of artistic creation makes it necessary to collaborate with the Public Authorities and the owners of intellectual property rights in the fight against the illicit use of electronic communication networks.

Telefónica believes that this is an essential factor for the balanced development of the Information Society, and to achieve this it is necessary to adopt measures for awareness-raising, prevention, dissuasion and, finally, repression against activities that infringe intellectual property rights on the Internet.

One of the initiatives promoted by Telefónica to foster legal access to the Internet is making legal contents available through its own services, such as Pixbox and Imagenio.

It is considered vital to promote initiatives for awareness-raising and education of citizens in order to progressively reduce and eliminate activities that infringe intellectual property rights.



However, Telefónica believes that this necessary fight must be compatible with strict respect of citizens' fundamental rights, the secrecy of telecommunications and the protection of personal data.

## Protection of minors

It is estimated that one in two Spanish children between 8 and 13 years of age has a cell phone. New technologies form a part of these young people's lives and they know more about them than their parents and tutors. They use these technologies mainly to stay in touch with each other and as a source of entertainment.

Through the global application of its regulations on "Adult Contents", Telefónica is promoting the responsible use of its services by minors. The goal of these regulations is to establish an appropriate mechanism for the provision of services with adult contents in all of Telefónica's lines of business, offering adequate guarantees for limiting access by minors to this kind of service.

To ensure responsible use, Telefónica supports the active role not only of the operators, but also parents and teachers as well as the national and regional administrations, NGOs and the content providers themselves.

In this sense, Telefónica intensified its commitment to the proper use of mobile telephony among minors by ratifying, in 2007, a framework agreement with the European Union to increase the protection measures applied to minors when they access contents through their cell phones.

## Mobile telephony for children

Children are getting their first mobile telephones at an ever-younger age. These devices, received from adults as gifts or hand-me-downs, have more and more possibilities and contents, some of which are inappropriate for minors.

This, together with an absence of training in phone use, may in many cases lead youngsters to make an incorrect use of phones, frightening many parents.

In view of this situation, in consultation with Imaginarium, Movistar España launched the Mo1 cell phone aimed at children from 6 years of age. Mo1 has been designed with an appropriate selection of functions, only those needed and encouraging the learning curve that will allow our youngest callers to use cell phones properly in future.

Thus, incoming and outgoing calls are limited to the contacts added to the phone book by parents through a restricted-access web site, and the text messages received can also be controlled to avoid any undesired external contact. Moreover, Mo1 includes a "hands-free" loudspeaker that operates automatically and a device location service, as well as a special panic button that is permanently enabled.

In addition, Mo1 has been recommended by "Protégeles", an organization founded in 2001 and devoted to the protection of childhood in Information and Communications Technologies.



We want to be 'the best place to work' in 2010

The satisfaction and the commitment of our employees was 62.1% in 2006, an increase on 2005 (58.3%)

**At Telefónica, we provide employment for close to 235,000 people world-wide. We are driving a new work culture, aimed at turning Telefónica into a company capable of attracting and retaining the best talent, and offering our employees the best place to work in all the countries where we are present. To accomplish this goal we are developing an 'employee promise', which is a commitment to all our employees. This will be the basis of Human Resources policies throughout 2007.**

## Commitment of our employees

The motivation of our employees and their commitment to the company are crucial. So we measure their satisfaction through the "Employee Satisfaction Index", part of the Working Climate survey. This indicator shows us the perceptions of our employees in connection with their colleagues, confidence in the management, customer focus, innovation, communication, their immediate bosses, personal and professional development as well as the image they have of Telefónica. For 2006, the goal set was to increase the Global Satisfaction Index by 5% and this has been exceeded, passing from 58.36% in 2005 to 62.10% for 2006.

At Telefónica O2 Europe, 89% of employees are proud to work for the company and 82% would recommend our company to friends or relatives. Furthermore, during 2007 work is progressing to include Telefónica O2 Europe in the next Working Climate survey.

## Professional development

As a leading company in the world-wide telecommunications sector, the goal of excellence is shared by us all: being the best professionals offering the best services to our clients. Training our professionals is therefore a strategic imperative. We are committed to enhancing and strengthening the development of our staff's professional personal skills.

During 2006, Telefónica devoted over 54 million euros to the training of our employees\*. Our professionals spent almost 11 million hours on training in 2006, an absolute increase of 16.40% compared to 2005\*. In addition, over 70,000 of our employees have their own individual training plans.

To retain the professionals with the greatest potential, 2006 saw the introduction of the Corporate University in Barcelona (Spain). The University is the meeting point for all of Telefónica's professionals throughout the world (Spain, Europe and Latin America). Here we share and study best practice, discuss

knowledge of the sector and apply ourselves to strategic opportunities for Telefónica's growth. It is planned that 1,200 of our high-flying staff and management professionals will attend the Corporate University this year.

In 2006, the implementation of the new Professional Development model was completed, based on a new corporate skill set shared by all of Telefónica's businesses and in line with the company's strategic repositioning. During the year, over 100,000 of our employees were assessed on the basis of their skills, without including Atento, implying an increase of 30.90% over 2005.

## Diversity and equal opportunities

We aim to treat everyone fairly and impartially, without discrimination associated with race, colour, nationality, ethnic origin, religion, gender, sexual orientation, civil status, age, disability or family ties. We believe that diversity is beneficial for the good progress of our business and that is why we want to make the most of the advantages it offers.

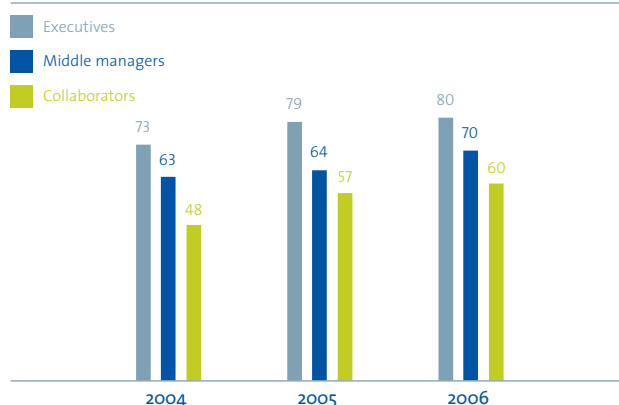
With respect to gender diversity, on average, 49.5% of the staff of the Telefónica Group are women. If we refer to management positions, our company has over 1,900 women in senior and middle management positions, a figure that represents 22.48% of the total.

As for the integration of people with disability in our company, there are currently close to 1,400 professionals with disability working at the Telefónica Group, representing 0.59% of its staff worldwide.

Figures do not include operations in the United Kingdom, Germany, Ireland and the Isle of Man.

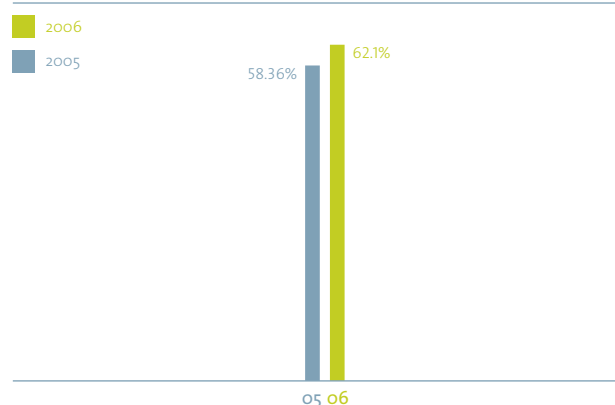
## Overall satisfaction

Data in %



## Overall satisfaction for Telefónica Group

Results – work environment index



## Social dialogue

Social dialogue and collective bargaining are irreplaceable instruments channelling labour relations as well as to communicate changes arising in the companies. Telefónica promotes social dialogue at both the international level, through the global framework agreement signed with Union Network International (UNI), and at the national level (e.g. in Spain, the agreement signed between the company and the most representative trade unions has turned out to be very effective).

At the Telefónica Group there are close to 50,000 employees who are members of trade unions\*, almost 16,000 of who are in Spain. On the other hand, at the close of 2006, more than 162,000 employees of Telefónica have their working conditions regulated by means of Collective Bargaining Agreements, versus 142,700 in 2005.

## Health and safety

Ensuring a safe workplace is one of the responsibilities we have as a company. One of our ethical principles stipulates that we will offer our employees a safe workplace and that we will establish appropriate mechanisms to avoid accidents, injuries and occupational illnesses associated with our professional activities.

During the last quarter of 2006, in order to standardize health and safety practices and metrics throughout the company, we set up a working group comprising the regions of Spain, Europe and Latin America, which is a difficult subject because of the different regulations in each country.

## Key Indicators for 2006:

Country	With Atento	Without Atento
<b>Total number of employees</b>	<b>234,900</b>	<b>128,476</b>
Spain	57,058	42,453
Europe	33,818	33,818
Latin America	142,983	52,205
Rest of the World	1,041	–
Employees with split-shift working <sup>1</sup>	6.75%	5.18%
<b>Job creation<sup>2</sup></b>		
Number of incorporations	130,989	13,025
Number of voluntary redundancies	60,226	5,944
Number of mandatory redundancies	59,635	6,470
External churn	52.77%	9.7%
<b>Professional development</b>		
Total expenditure on training (thous. €) <sup>3</sup>	54,728	49,793
Euros per employee on training (€) <sup>3</sup>	260	479
Hours of training <sup>3</sup>	10,881,938	3,538,693
% employees with skills assessment <sup>1</sup>	78.88%	83.04%
% employees with variable remuneration <sup>1</sup>	74.09%	59.08%
<b>Diversity</b>		
% women	49.46%	34.00%
% women in middle management and senior posts <sup>4</sup>	22.74%	22.05%
Nº of employees with a disability	1,388	952
<b>Health and safety</b>		
Accident rate <sup>5</sup>	–	11.91
Nº of employees with preventive medical examinations <sup>3</sup>	147,943	77,590

<sup>1</sup> Calculation excluding physical plant in Holland (Endemol) and Morocco (Atento).

<sup>2</sup> Sign-up/Cancellation data for Europe calculated based on equivalent staff

<sup>3</sup> Figures do not include UK, Germany, Ireland, Isle of Man, Holland

<sup>4</sup> Figures for Telefónica O2 only consider senior management

<sup>5</sup> Number of accidents per 1,000 employees. Indicator for Telefónica de España

\* Figures do not include operations in the United Kingdom, Germany, Ireland and the Isle of Man.





## A more open and flexible working culture

# Distrito C Telefónica's new headquarters, has begun new ways of working which will be introduced progressively throughout the Group

**More than 2,000 of our staff now have mobile workplaces. This change to 'hot-desking' requires management of space and technology to allow employees to work when and where necessary. It also gives them the flexibility to make their lives easier and more satisfying at work.**

**Here, we describe the changes and present our new headquarters Distrito C, a historic landmark for the company.**

## Encouraging flexibility, co-operation and focus

Distrito C's work ethic is a ground breaking project involving our people in new ways to work. It encourages mobility, diversity and collaborative team working where performance is measured on output and creative thinking rather than the time spent sitting behind a desk.

We are convinced that this goal-based ethos increases productivity. It is a way to encourage flexibility while at the same time bringing teams together to work collaboratively. It also allows us to encourage diversity in the workplace, with all the advantages that offers to our organisation.

Senior and middle management are charged to be the driving force behind this transformation, and are required to lead by example.

In this new culture, hierarchy becomes less relevant and relationships are built on shared goals and projects, which can stretch people beyond their own responsibilities. We believe this will offer more job satisfaction for all.

## New technologies are key

New technologies are at the centre of these changes. They allow us greater flexibility and creativity in our day-to-day work. Technology provides full connectivity, so our personnel can work whenever and wherever they need.

Over 2,000 employees in the Telefónica Group are working in mobile conditions already. The company's central offices in Madrid provide a clear example of this: the employees at Distrito C with an "advanced position" have no desk assigned to them in the office. They work with laptops, a PDA and a cell phone, along with their personal ID cards to access the various workspaces available throughout the building. The goal is to have 40% of the employees at Distrito C working in this way in 2008.

In addition, Distrito C is a "paperless office". So the use of available technologies provides environmental advantages too. In 2006, Telefónica in Spain consumed less than half the paper it had used in 2002.

Mobile working, the re-definition of relations between bosses and secretaries, the disappearance of paper and personal printers and the use of virtual "tele-meetings" instead of travel are just some examples of these eco- and people-friendly New Ways of Working.



**6,870** employees are already working at **Distrito C**



## Distrito C, A new space for a new age

Telefónica's central headquarters in Las Tablas (Madrid) has been designed to allow this change of culture. As a building used by the different companies in the group, it encourages new and easier ways to communicate, brings managers closer to their teams and allows everyone to work more closely and transparently.

Distrito C involves a host of innovations. Employees who moved into the new offices between 2006 and 2007 gained a steady flow of information about the changes, as well as the company's strategy, through new flat screens which project the latest news through the company Intranet.

To also make things easier for our employees, we use new 'RFID' (Radio Frequency Identification) cards that allow people entering the building and their laptops to be identified remotely by means of sensors. This system removes the time-consuming need to show ID cards or barcodes on computers every time people come into the building.

Finally, Distrito C is an example of Telefónica's commitment to corporate responsibility. The buildings blend in with their surroundings and are designed to minimize physical barriers between people. They also use 'sustainable architecture', including the generation of solar energy, efficient use of resources and appropriate waste treatment.

## Adaptation to the new headquarters

Employees who already work in this way have welcomed most of the changes. Nonetheless, some who have yet to be transferred can be reluctant to make the change. They feel that there are other priorities for the company, such as ease of access by road, public transport and places to eat.

At the close of this edition of the Annual Report (April 2007) the new metro station "Ronda de Comunicaciones" and the M-40 road access had been opened. Telefónica has invested 14 million euros in the new underground station.

We are confident that the reluctancies that still exist will soon pass and that the advantages of flexibility and professional development in the workplace will outweigh any residual negativity. We are convinced that in the medium term everyone will start to enjoy the benefits of this new and progressive working culture.



With initiatives for inclusion on geographical, economic and accessibility criteria

## Telefónica backs new technologies as a driver of social progress

**The Millennium Development Goals form a plan adopted by all of the world's nations to fight against poverty and reduce inequalities in economic and social matters. Goal 18 states that "In collaboration with the private sector, ensure that the benefits of new technologies can be exploited to the full, particularly in Information and Communications Technologies."**

**This goal entails the considerable challenge of adopting specific actions to close the gaps that exist in economy, geography, health and education and, in this way, become a fairer region with bigger opportunities for all its citizens. To do so, strategic alliances will be necessary in the public and private sectors, and with civil society supported by international bodies.**

### Economic inclusion

The growth in the basic telephone service in Latin America among the most disadvantaged segments of society is based on the development and provision of products that match consumers' needs and their economic potential.

For this reason, we offer prepayment and contract packages, as well as commercial packages allowing us to reach a wide range of budgets, seeking to help our clients optimize their telephone consumption.

Out of our 83 million clients of mobile services in Latin America, 81% use prepayment products. In addition, the deployment of GSM networks is allowing our clients to purchase cheaper handsets.

The more than 6.4 million consumption-capped prepaid fixed lines, together with the 536,000 public use telephones, already represent over 32% of our equipment in Latin America. If this percentage is compared with the revenue generated by lines and also with the revenue generated by the sale of prepayment cards, it can be seen that this kind of service is offering a real alternative for the strata of society with the least resources.

### Geographical inclusion

Telefónica Móviles has strengthened its position as the main operator in the region, extending its coverage in all the countries where it has operations.

In Latin America, the Telefónica companies collaborate with the different public initiatives of universalizing the service. During the 2006 financial year, the provisions for contributions to the universalization of service fund exceeded 350 million euros. (\*)

### Educational inclusion

Technological barriers are not the only ones that may lead to the digital divide. There are barriers due to knowledge and qualification that can be even greater than technological ones, particularly in emerging countries and among the elderly or disabled. Telefónica, in collaboration with its Foundation, has been carrying out programmes aimed at giving society the skills to use new technologies.

### Accessible Telefónica

'Accessible Telefónica' is a comprehensive project intended to make the Telefónica group fully accessible in all its processes and contributing actively to the full equality of opportunities for people with disabilities.

Since 2004 when we started working on this programme in collaboration with the Spanish Committee of Representatives of People with Disabilities (CERMI in its Spanish acronym), Telefónica's different companies and lines of business have adapted their activities in order to achieve the goals of this comprehensive plan:

- Improve the quality of life for people with disabilities and facilitate their inclusion in society.
- Ensure the full accessibility of the Telefónica Group and its products and services.
- Encourage collaboration between Telefónica, the public administrations and organizations representing the disabled.
- Promote better knowledge and awareness in society of the needs of the disabled.

'Accesible Telefónica' was presented on 2006 and the company announced an investment of 35 million euros.

\* This includes fixed telephony in Argentina, Brazil, Peru and Colombia; mobile telephony in Argentina, Brazil and Colombia.

[www.telefonica.es/accesible](http://www.telefonica.es/accesible)

Best Initiative to Bridge the Digital Divide on Internet Day 2006.

#### Population coverage in Latin America (%)

Argentina	86%
Brazil	90%
Chile	93%
Colombia	69%
Ecuador	n.a.
El Salvador	77%
Guatemala	71%
Mexico	81%
Nicaragua	64%
Panama	56%
Peru	68%
Uruguay	80%
Venezuela	94%

#### 1st Latin-American Meeting on “United Nations Millennium Goals” and Information and Communications Technologies.

In September, 2006, in Punta del Este (Uruguay) a meeting was held on the Millennium Goals and ICT. This meeting, organized by the Secretariat General for Latin America (SEGIB) and AHCET, included the participation of almost a hundred participants representing the public and private sectors. Some of their conclusions were:

It should be highlighted that Goal 18 of the Millennium Development Goals has acknowledged the ICTs as an important tool for their achievement. It is necessary to understand that investments in ITC drives economic growth and development in the medium and long term.

The key aspects in the development of ICTs in the region are the investment infrastructures and the promotion of efficient uses among citizens, companies and administrations. To foster the acceleration of economic growth through ICTs, it is essential to adopt a shared view of all the players, generate consistent long-term policies and a favourable investment climate.

In the face of this opportunity and in view of the efforts made by governments as well as the private sector and civil society, the challenge in Latin-American countries is aimed at the generation of a framework promoting ICTs and allowing the inclusion of all its citizens in the economic development of society.

The conclusions of this meeting were supported by the Latin-American Summit of Heads of State, held in 2006.

- ICTs can be a tool to alleviate the inequalities that exist between urban and rural areas, as well as between different regions and countries in Latin America, by contributing to attenuate demographic movements and improving the opportunities and quality of life in the least favoured areas.

- ICTs can contribute to reduce inequalities at the educational level by taking teaching into less favoured areas, encouraging equal opportunities for both genders, the inclusion of indigenous peoples and improving the level of qualification of the trainers.

- ICTs can be a tool for: (i) optimization in the management of the entire health system; (ii) reducing inequalities in access to health services; (iii) access by the citizenry to information and contents on disease prevention and good practices on health matters; and (iv) the integration of the disabled into society. All this has a positive repercussion on reducing inequalities and social exclusion.

- ICTs can generate positive impacts on economic activity, through improved access to markets, greater competitiveness of businesses and new business opportunities for developing countries.

- ICTs can improve the quality of institutions, bringing the State closer to citizens, and are a tool to make the public administration more democratic and foster transparency.

- ICTs can contribute to improving productivity in the various sectors of the economy, generating a favourable impact on the competitiveness of society as a whole, a key element to compete in a globalized world.



## Environmental committees have been formed in all the countries Telefónica introduced its regulations for the minimum environmental requirements in 2006

**Telefónica is determined to achieve an efficient balance between its activities and sustainability with a commitment to the environment. All of our activities are conducted in accordance with an environmental policy that will be adopted by all our operations throughout 2007.**

**The Telefónica Group signed the United National Global Compact in 2002 and thus undertook to take a preventive approach, encourage environmental responsibility and foster the development of environmentally-friendly technologies. In addition, we participate in various international initiatives aimed at promoting sustainable development such as the Global e-Sustainability Initiative (GeSI) and the sustainability group of the European Telecommunications Network Operators (ETNO).**

### Environmental management

To ensure compliance with this commitment, we have an internal standard of "Minimum Environmental Requirements" with the ultimate goal of environmental certification for all our operations. Through a common methodology we can ensure that all of the group's companies behave responsibly in this field. To facilitate compliance with the standard, we have established five stages in the process: commitment, requirements for application, improvement in behaviour, implementation of systems and certification.

Compliance with the standard is monitored through the Environmental Committees Argentina, Brazil, Chile, Colombia, Spain, Mexico and Peru. All of these committees regularly submit the results of their monitoring to the Reputation and Human Resources Committee.

One of the keys to ensure adequate management of environmental issues is to increase the training and awareness of our personnel. Over 8,000 professionals received activity-focused environmental training in the course of 2006.

One of the greatest challenges is to extend our environmental commitment to our suppliers and require them take it on board. As the first step in appropriate procurement contracts, specific clauses should be included on the environment, in accordance with the pertinent legislation applicable to the product or service supplied. During 2007, a standard operating procedure will be approved to ensure the monitoring of the suppliers' actions with the greatest environmental incidence.

In order to improve our behaviour we assess the aspects deriving from our environmental activity to establish a process for continuous improvement in those activities with the greatest relevance for the environment, and conduct monitoring.

To achieve correct environmental management, we integrate environmental aspects into our day-to-day activities. These aspects are related to electromagnetic emissions, visual impact or land occupation by our installations, the waste generated by what we do and the energy consumed.

#### Electromagnetic emissions

In recent years the general public has become interested in the potential negative effects of electromagnetic fields. This focus has exceeded the strictly scientific and medical view and has become a subject with a distorted perception of the risk.

Apart from establishing mechanisms to ensure strict compliance with legislation on exposure to electromagnetic fields, Telefónica has also set up a number of channels through which to respond to requests for information from people interested in these matters.

In addition, we carry out monitoring and metering of the electrical radiation at our installations. In 2006, we measured more than 12,000 sites. All of them complied strictly with the emission levels of all the international standards and recommendations.

#### Impact of the installations

The planning, building, maintenance and operation of these installations entail associated environmental aspects such as visual impact or land occupation. The assessment of these aspects, prior to installation, is contained in environmental impact studies. During 2005, 658 studies were carried out, either in compliance with legal requirements or voluntarily in protected areas or spaces considered to be of natural interest. Out of the total of the sites installed in 2006, about 60 correspond to protected areas or natural interest locations.

In order to minimize the impact of our installations we pay special attention to the "visual fragility of the landscape",

fitting aerials and equipment on pre-existing infrastructure rather than looking for a new site and we try to share sites with other operators. We may install new aerials on other pre-existing telecommunications infrastructures or use dual or tri-band aerials.

We also measure the noise generated by our installations, working on two fronts: firstly by adapting the air-conditioning equipment to the sites by the installation of metal screens, soundproofing systems, etc. In 2006, about 400 acoustic adaptations took place. Secondly, we monitor the installations by acoustic measurement to verify noise levels and compliance with legal limits. More than 1,000 installations were measured in 2006.

#### **Waste management**

The waste streams generated are one of the principal environmental issues for companies. Depending on the type of activity, they generate only office waste (paper, toner cartridges, office equipment, etc) or other specific type of waste such as electric or electronic. The latter represents the biggest amount that we generate. We manage appropriately the ones that could be dangerous for environment.

#### **Consumption of paper**

In 2003, Telefónica put in place a plan for the improvement of operational efficiency, mobility and environmental impact through a paper-saving campaign. Between 2003 and 2006, this plan has brought down paper consumption from 232 million to 109 million sheets, representing savings amounting to 56.2 million euros, direct savings of 18.6 million euros and indirect savings of 37.6 million.

In addition, this has avoided the felling of 46,879 trees, the consumption of 256 million litres of water and the consumption of 583,000 litres of oil.

#### **Energy consumption**

Telefónica has made considerable improvements in energy efficiency at its offices and networks. It has fostered the use of renewable energy at the new headquarters in Las Tablas as well as carrying out internal awareness campaigns encouraging its employees to conserve. These actions are also linked to reductions in CO<sub>2</sub> emissions.

### **The positive impact of telecommunications on the environment**

Telecommunications contribute to sustainability by acting as a means to convey data and ideas with a low environmental impact. Some of the services traditionally considered to have a positive environmental impact are tele-working, remote offices, conference calls and videoconferencing, tele-education, e-commerce, mobile services for consulting personalized information, network-based answering machines and caller ID. The impact of these services is greater when consideration is given to transport and distribution systems, energy efficiency in buildings, savings in paper through electronic catalogues and invoices, otherwise known as dematerialization.

On its web site, Telefónica publishes monthly articles analyzing the relation between the use of new technologies and sustainability, with a deeper analysis of the environmental impact of telecommunications.



We have measured the levels of electromagnetic emissions at more than 12,000 sites worldwide

## Telefónica reaffirms compliance with all the power limits and regulations in each country

**Over the last few years, the alleged potential effects of electromagnetic fields (EMF) have exceeded scientific and medical opinion and has become a subject of public interest with a distorted perception of the risk. In many cases, this situation has hindered the deployment of the infrastructures necessary to ensure quality of service. Telefónica provides information for customers and everyone interested in this subject.**

### What is mobile telephony and how does it work?

Mobile telephony allows users to make and receive voice or data communications within the coverage area of the aerial to which the cellular handset has made contact when turned on.

In order to be able to provide this service and meet the needs of users, we have to be able to deploy a network of base stations providing coverage of appropriate quality. Mobile telephony systems require the existence of basic elements such as the cell phone itself, Base Stations, Transmission Media and switching centres.

All of the base stations are installed in accordance with a design drawn up by a technician ensuring compliance with all applicable rules regarding safety and protection.

### Electromagnetic emissions

In order to convey sound, mobile telephony uses radio waves that are in fact electromagnetic emissions of the same type as light rays. Similarly, there is a multitude of applications for these emissions such as television, radio broadcasting, microwave ovens or radar to cite just a few examples. The only difference between them is the frequency and power used in each case.

In addition to the artificial sources necessary for the applications described above, there are natural sources of electromagnetic fields. Nature can provide us with many examples of electrical and magnetic changes: lightning bolts are merely electrical discharges triggered by strong electrical fields formed during storms; the earth generates magnetic fields by itself due to the currents created by the movement of masses. A practical application of magnetic fields is the use of compasses (which measure these fields) to determine the cardinal points.

An electromagnetic wave is characterized by its frequency. Frequency is a measure of the number of times that an electromagnetic wave oscillates per second and the unit of its measurement is called a "Hertz".

### Waves

Throughout the world, mobile telephony uses radio waves at frequencies between 900 and 2000 MHz (million Hertz). Mobile services currently use the following frequency bands. The so-called Global System for Mobile Communications (GSM) uses digital technology and operates in the 900 MHz frequency band. An extension of this system, the European Digital Cordless System (DCS-1800), is very similar to GSM but operates in the 1800 MHz band. The Universal Mobile Telecommunications System (UMTS-2000) technology operates in the 2000 MHz band.

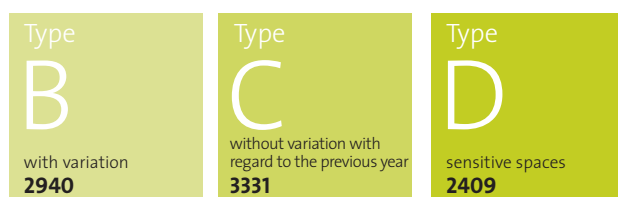
### Regulations on electromagnetic fields

The safety of mobile telephony infrastructures is based on the rigorous observation of the limits for exposure to emissions of electrical radiation established by the international reference bodies and by the regulations of each country.

These limits incorporate wide safety margins that are well within the levels at which there could be a risk to health. Both the calculations prior to installation of an antenna and the measurements made constantly through the inspection and monitoring programmes show that mobile telephony antennas generally produce emissions hundreds and even thousands of times lower than the limits established in the international regulations.

The current regulations distinguish two types of limits in electromagnetic fields. On the one hand, they limit the maximum power of a mobile telephony base station and, on the

## Sites certifications



other, the maximum electromagnetic fields to which a person may be exposed.

These limits are based on the different conclusions of international bodies such as CENELEC (European Committee for Electrotechnical Standardization) or ICNIRP (International Commission on Non-Ionizing Radiation Protection), but mainly on the Recommendation of the Council of the European Union dated July 12th, 1999. These are the same as have been established in nearby countries such as Germany, Greece, the United Kingdom, Ireland, Finland, Denmark, Sweden, etc. It is very important to stress that the exposure limits incorporate some additional precautions.

In addition, research has allowed competent institutions and organizations such as the World Health Organization (WHO), the International Commission on Non-Ionizing Radiation Protection (ICNIRP), the European Committee for Electrotechnical Standardization (CENELEC), the American National Standards Institute (ANSI), the Council of European Union Health Ministers or expert committees of the United Kingdom, France and Spain to establish regulations and issue reports concluding that “exposure to the emissions of electromagnetic waves generated by mobile telephony, within the limits established, has no adverse effects on health”.

Some countries, including Spain, have drawn up complete regulations as shown in Royal Decree 1066/2001 reflecting the Recommendation of the Council of the European Union dated July 12th, 1999. These add planning criteria for new networks, thus ensuring compliance with the limits on exposure to radiofrequencies.

In Spain, 100% of the base stations comply with the limits stipulated in the legislation. During 2006, external agents certified 8,680 sites.

## What we do and how we provide information

We not only comply strictly with the regulations currently in force on exposure to electromagnetic fields, but also, in response to requests for information from the general population, Telefónica companies are able to use different channels to convey the most relevant information to everyone interested in the subject.

Through its web page, Telefónica Móviles España provides a great deal of information on these issues. It also works together constantly with the Administration and with other bodies to harmonize network deployments and ensure the best and widest distribution of information.

The company has also signed several collaborative agreements with town councils, the Spanish Federation of Towns and Provinces, and with consumer associations.

Similarly, we work to organize informative meetings for both citizens and administrations. This enables us to help deal with occasions of social alarm caused by the deployment of the infrastructures needed for mobile telephony services requested by the population.





Contracting over 18,000 million euros

## Telefónica collaborates with over 19,000 suppliers throughout the world

**Through its supply chain, Telefónica has begun to spread ethical and responsible business practices throughout the world. In this sense, the new e-mail tools increase transparency and equality of opportunity.**

**We strive to have a positive influence on the entire supply chain so that our suppliers incorporate more and more corporate responsibility criteria into their actions. To this end, we are implementing certain requirements that will allow us, on occasions, to go beyond mere compliance with the law.**

### Telefónica's suppliers

The volume of purchases awarded and paid for out of the 2006 budget amounted to over 18,000 million euros<sup>(\*)</sup> (13,000 in 2005). The distribution of these contracts by countries puts Spain at the top of the procurement ranking with Brazil in second place.

This volume of purchases was awarded to 19,079 suppliers throughout the world (18,834 in 2005). The top ten suppliers to the Telefónica Group in the world were: Alcatel, Brightstar, Ericsson, Huawei, LG, Motorola, Nokia, Samsung, Siemens and Sony Ericsson.

Telefónica classifies its purchases in six product lines. The largest item is usually for the category of Market Products (including mobile handsets) which, together with Network Infrastructure and Works & Services, represents over 80% of purchases. The remainder is distributed between Information Systems, Marketing & Advertising, and Contents.

In order to ensure compliance with our principles on equal opportunities and transparency, Telefónica's procurement model is structured around the Purchasing Boards. At the meetings of these boards, all areas involved take part in the presentations on potential purchases and award decisions are adopted unanimously.

### E-commerce increases transparency and competition

We are constantly innovating in our supplier-relation systems. Negotiating and formalizing business commitments electronically, together with the transmission and reception of orders, delivery notes and electronic invoices over the Internet, are common practices at Telefónica to make the process more efficient. All of these actions are based on a global e-commerce platform managed by Adquira.

E-commerce increases transparency as all of the transactions are recorded on the system and it is the suppliers who add their tenders to the tool. In addition, any information related to the process can be accessed simultaneously by all the participating suppliers.

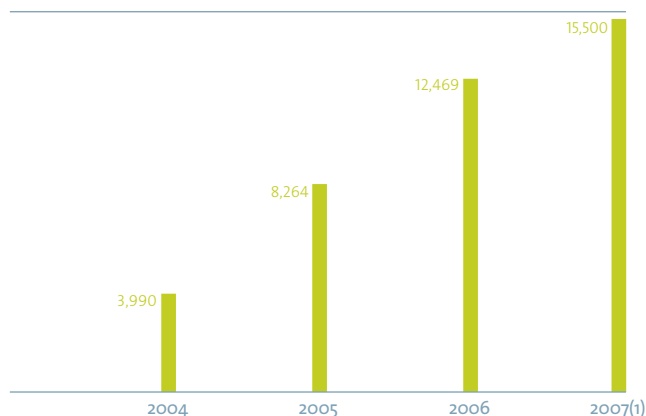
In 2006, e-commerce tools were deployed in nine countries, including Colombia, El Salvador, Guatemala, Nicaragua, Panama. During this year there has been a significant boom in the number of contracts negotiated and formalized electronically:

- Over 12,500 million euros awarded electronically. Of these, approximately 1,366 million were awarded using the auction system
- More than 2,400 auctions, up by 61% over 2005
- Over 82,000 electronic formalizations (contracts, letters of award and orders)

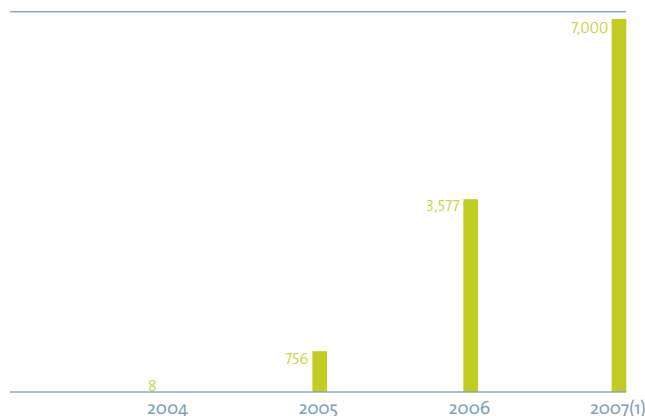
(\*)Data including Spain, Latin America and Czech Republic.  
Not included UK, Germany and Ireland.



**Procurement Volumes  
Negotiated electronically**  
Amount in millions of euros



**Procurement Volumes  
Formalized electronically**  
Amount in millions of euros



(1) Telefónica's Target 2007

In 2006 we incorporated new functions into the electronic billing process, thus closing the electronic process cycle with suppliers, as they are able to issue their invoices on the basis of a prior electronic or conventional order.

All these electronic processes also mean advantages for our suppliers:

- Greater operational efficiency
- Contributes to equal opportunities
- Facilitates objectivity in contract awards
- Greater flexibility and security in data exchange
- Accessibility and connectivity to other potential clients (clients of Adquiria Marketplace)
- Delays in the agreed payment terms are avoided or reduced (electronic invoice)

## Ethical standards in the supply chain

Telefónica interacts with its suppliers in an ethical and responsible manner to promote working standards and environmental protection throughout the supply chain. In our General Terms and Conditions for the Supply of Goods, we require the fulfilment by our suppliers of all pertinent legislation on working conditions, health and safety in the workplace and environmental impact.

Among these requirements, the ones we are going to demand most firmly from our suppliers are: No use of child labour or forced labour, no acceptance of working conditions representing a risk for the lives of workers and no tolerance of inhumane treatment in the workplace and we demand strict compliance with the legislation on environmental matters.

During the 2006 financial year, we performed a risk analysis with regard to these matters in connection with all our supply chain.

The criteria applied were visibility of the product for the client, association with the brand, visibility for the media, country where the activities were carried out and the nature of the supply.

The risk analysis concluded that the handsets and telecommunications equipment, installation and network maintenance services, merchandising products or telemarketing activities are the supplies that we must pay greater attention to.

For 2007, our approach on these matters includes:

- Awareness through information to our purchasers about the critical aspects of CR in our purchases.
- Implementation of the supply chain Responsibility Regulations based on international standards such as the Universal Declaration of Human Rights from the United Nations and the Conventions of the International Labour Organization (ILO).
- Performing audits on CR matters among some of our suppliers.
- Encouraging our suppliers to apply similar measures in their respective supply chains.

Telefónica is not facing this challenge of responsibility in the supply chain alone, as it forms part of a sectorial initiative on the supply chain through the GeSI. In this initiative, different companies are collaborating to promote good business practices in this sense; developing or promoting tools, management practices, processes and systems allowing each participant to control the CR risks associated with their supply chain.



## Philanthropy

### In 2006, Telefónica allocated more than 50 million euros to Philanthropy

**The Telefónica Foundation is the group's principal driving force for social action. In 2006, it allocated more than 33 million euros, 6% more than in 2005, to 673 social initiatives that directly benefited more than 30 million people. Also, 13 million euros were allocated to encourage the integration of people with disabilities through ATAM.**

At Telefónica we are firmly committed to society. We are convinced that our activity benefits the countries in which we operate, enhancing economic, technological and social development. However, we believe that in addition to the performance of our activity, we should add other social and cultural activities where we operate.

In 2006, more than 50 million euros were devoted to social action through investment by Fundación Telefónica, O2, contributions by ATAM and social sponsorships.

The most significant part of these resources (33 million euros) was invested by Fundación Telefónica<sup>1</sup>, the group's leading social action channel. Since 2006, the foundation has reoriented its strategy towards education, the social integration of children in Latin America, the promotion of the information society and the management of corporate volunteer programmes, as will be explained in this chapter

#### ATAM

ATAM is the association of the group for the disabled, through which the employees and the company have sought to improve the quality of life of these people through prevention and full social integration over the past 34 years.

It is largely funded by voluntary contributions of approximately 61,000 employees from 22 companies of the Telefónica Group. The workers contribute 2 per thousand of their basic salaries and the company doubles this contribution.

The contributions made to ATAM by all the companies of the Telefónica Group in 2006 reached 13.6 million euros, directly benefiting 3,981 people.

Through this non-profit project, the beneficiaries and their families are offered extensive social protection

throughout life in the event of situations of disability or dependence. Therefore, in addition to contributing to solidarity action in exchange for a small payment, members and their families enjoy a present and future guarantee which responds to any of their needs.

#### Social Sponsorships

The third main axis of Telefónica's social action is social sponsorships. The company participates in activities in the countries in which it operates. During 2006, there were 73 social sponsorships, representing 9% of the company's total sponsorships. We continue to support charitable projects and back institutions working in these fields through participation in programmes to promote information technology. Particularly noteworthy is our involvement with: Fundación de Ayuda contra la Drogadicción (Foundation against Drug Addiction), Asociación Española Contra el Cáncer (Spanish Cancer Association), the Spanish Red Cross and other non-profit organizations.

### Telefónica's Investment in Philanthropy

Data in thousands of euros

	2005	2006
Fundación Telefónica <sup>1</sup>	28,999	33,015
ATAM <sup>2</sup>	13,605	13,658
Social Sponsorships <sup>3</sup>	2,571	2,930
O2 <sup>4</sup>	0	2,493
<b>Total</b>	<b>45,175</b>	<b>52,096</b>

<sup>1</sup> TF Budget.

<sup>2</sup> Contributions to ATAM by Telefónica and its employees.

<sup>3</sup> Includes social and non-cultural sponsorships.

The real amount was 2.9 millions euros but we took away some sponsorships of Proniño from Colombia Foundation.

<sup>4</sup> Data applicable from 2006.

<sup>1</sup> Includes Colombia Foundation, legally created in 2007

## Total number of participants/beneficiaries directly affected by Telefónica Foundation activity in 2006 \*

Area	Number of people
Educared	25,076,321
Proniño	25,339
Telefónica Volunteers	12,595
Forum	13,570
Art and Technology	7,302,272
Other programs	1,090,179
<b>Total</b>	<b>33,520,276</b>

\* Including direct and internet beneficiaries

## Telefónica Foundation

### What is the Telefónica Foundation?

Telefónica Foundation is the expression of the Telefónica Group's commitment to the societies of the countries where it is present. Since 1998, it has been the Group's social and cultural action tool, the strategy of which is focused on Education through Information and Communication Technologies (ICT).

The main mission is to contribute to building the future of the regions where the Telefónica Group operates and drive social development through Education, using its strength and technology capability, its territorial presence and extensive customer and employee base for this.

95% of the people that have had a direct relationship with the Foundation in 2006 accessed content, services, and information over the Internet, reflecting the role played by technology as a motor for social development.

#### Main Programs

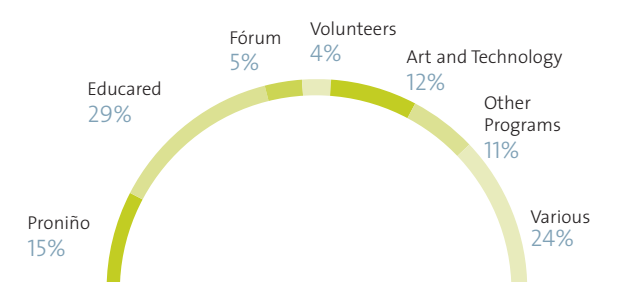
- **Proniño**
- **EducaRed**
- **Forum**
- **Telefónica Volunteers**
- **Art and Technology**

### Where is the Telefónica Foundation present?

The Telefónica Foundation carries out its work in Argentina, Brazil, Chile, Colombia, Spain, Mexico, Peru and Venezuela. Acting with a global focus, all eight foundations share the same goals and work methods, albeit each according to the social reality in its own country. Also, the foundation's social and cultural actions through the Proniño programme extends to other Latin American countries such as Nicaragua, Guatemala, El Salvador, Panama, Ecuador, and Uruguay.

### The Magnitude of the Telefónica Foundation

Distribution of resources dedicated to projects and initiatives carried out by Telefónica Foundation in 2006 per activity area.



### Budget per country

Argentina	7%
Brazil	10%
Chile	3%
Colombia	4%
Spain	65%
Mexico	2%
Peru	5%
Venezuela	3%

More than **25,000** boys, girls and schooled adolescents

More than **92,000** indirect beneficiaries

**646** schools and education centers participate in Proniño



## Proniño

The Telefónica Group, through its Foundation, manages Proniño, a Philanthropy program which hopes to significantly assist achieve the regional goals of eradicating the worst forms of child labor in Latin America before 2015. It is an Integrated Care Program, which through quality schooling, ensures educational achievements and knowledge of Information and Communication Technologies. Moreover, it incorporates specific activities to empower institutions and social agents linked to childcare and the promotion of children's rights in order to sustain the eradication of child labor in the long term.

Proniño is committed to educational quality, improving the infrastructures at the centers and providing new educational and pedagogical focuses adapted to each social situation, which favor not only the direct beneficiaries of Proniño, but also the entire educational environment in places it intervenes.

As of December 31, 2006, Proniño directly benefited 25,339 boys, girls and adolescents (\*) from thirteen countries (Argentina, Brazil, Chile, Colombia, El Salvador, Ecuador, Guatemala, Mexico, Nicaragua, Panama, Peru, Venezuela and Uruguay), and 92,115 indirectly at 656 education centers and schools.

The basic pillars of Proniño are the 35 NGO of recognized international prestige with which it directly works, as well as the schools, public and private institutions along with the collaboration of the communities in the countries where Proniño works.

In this scheme, Telefónica Volunteers play a fundamental role in the program, participating in different activities and contributing their time and talent.

## Percentage of boys, girls and adolescents that work<sup>1</sup>

Country	Working (in thousands)	Work rate
Belize	9	11%
Bolivia	656	28%
Brazil	5,071	12%
Colombia	1,568	15%
Costa Rica	114	10%
Chile	196	5%
Ecuador	779	21%
El Salvador	288	15%
Guatemala	938	23%
Honduras	356	15%
Jamaica	16	2%
Nicaragua	253	14%
Panama	46	6%
Paraguay	322	10%
Peru	1,987	26%
Dominican Rep.	436	18%

<sup>1</sup> Source: International Labour Organization 2006 "Eliminating child labour: a goal within our reach"

In 2006, EducaRed on-line received more than **40** million visitors, with a total of **220** million pages viewed on its five portals.

It is the leading educational program in Spain and Latin America



## Educared

This is a program which was created by Telefónica Foundation in 1998 in accordance with the 16 top organizations in the Spanish educational community. It attempts to contribute to improving the quality of Education in order to promote equal opportunities through the application of Information and Communication Technologies in the education and learning processes.

EducaRed began in Spain and is a transnational program which includes local portals in Argentina, Brazil, Chile, Peru and very soon in Colombia and Mexico. In Spain alone there are 11,846 schools registered in the program, which represents more than 372,000 teachers and 4.4 million students.

There are two major lines of activity in EducaRed:

- **EducaRed on line.**
- **EducaRed face to face.**

## Lines of Action

### Educared on line

- **The best didactic content in software and educational webs:**  
The EducaRed Navigator
- **The most advanced tools in the EducaRed Navigator:**  
Software and educational webs
- **Online training for teachers and students:**  
Innovative Teachers  
Learn with the Internet
- **Interactive contests and activities:**  
Navigating  
Check Mate
- **Virtual communities:**  
EducaRed 2.0  
Tam-Tam  
Coisas Bôas 2007

### EducaRed face to face

- **Training and innovation for the education community:**  
EducaRed Innovates  
Mobile Classroom
- **Network of model centers**
- **Science and technology exhibits:**  
Divulga Biotec
- **Integrated educational programs:**  
EducaRed Integra
- **Education dynamization activities:**  
International Conventions  
Ibero-American Conventions  
EducaRed Day  
EducaParty

Telefónica Foundation has become a benchmark in research and knowledge of the social impact of Information and Communication Technologies

**12,595** employees of the Telefónica Group in **14** countries participated in 2006 in Corporate Volunteer initiatives on which they dedicated more than **55,200** hours

## Forum

Fórum is an area of Telefónica Foundation which was conceived as a unit for creation, debate and skill sharing in order to be a reference for the development of the Information Society, build and use the necessary structures for the generation and circulation of knowledge and support innovative projects.

Through this program, Telefónica Foundation plans activities to promote and facilitate advanced research, analysis and knowledge of the Information and Communication Technologies and their social impact mainly in Spain and Latin America.

## Strategic lines

- **Research and analysis.** Drive research and trend studies on subjects related to the Information Society.
- **Debates and exchanges.** Seminars, conferences and debate forums, whether face-to-face or on the net, on the topics researched as well as other current topics and trends.
- **Knowledge sharing.** The creation of the Telefónica Foundation Collection. Publications on the results of the research, studies, debates and relevant topics related to the society of knowledge.
- Furthermore, **Fórum on the Net** stands out as a specific section on Telefónica Foundation's web page where the program's principal lines of action as well as the magazine Telos, which covers the studies on communication in Spanish, are updated.

## Telefónica Volunteers

The Telefónica Group Corporate Volunteer program seeks to motivate and strengthen the social volunteer activities among employees, by providing and developing the necessary resources so that said volunteerism is effective and permanent.

Conceived as a transnational initiative, its objective is to organize and strengthen the development of a humanitarian network made up of Telefónica Group active employees, early retirees and retirees who wish to work in a proactive way to benefit the community and its most underprivileged groups.

The Corporate Volunteer Program managed by Telefónica Foundation develops three major lines of work:

- Promote employee participation in volunteer activities by identifying possible ways to collaborate in Telefónica Foundation social action programs like Proniño or through agreements with NGOs.
- Provide technical and financial support for implementation of humanitarian programs involving groups of employees.
- Strengthen the volunteer leadership capacity through training which provides knowledge of the social world and resources to improve the impact of their actions and capacity to work with social organizations, as well as offer the practical tools for the formulation, implementation and evaluation of projects.

**7.3** million people have participated in the various art and culture activities carried out by the Foundation in Spain and Latin America in 2006

## Art and Technology

### Art and Culture

From the beginning, Telefónica Foundation has been working intensively to spread contemporary culture and art, seeking to link the value of the artistic avant-garde and technological innovation that has always characterized the development of telecommunications, with very special, recent attention to the creation of digital art and its access and distribution through the Net.

In this sense, Telefónica Foundation's primary task as far as Art and Technology is the management of the Group's artistic patrimony, fundamentally made up of the following collections:

- **Historical Collection of Spanish Contemporary Art.** Value by critics as one of the most relevant examples of corporate art collection, this one includes 84 pieces of work by Spanish artists of great international prestige: Pablo Picasso, Luis Fernández, Eduardo Chillida and Antoni Tàpies.
- **Cubist Collection.** A total of 41 cubist paintings from 1912-1933, pertaining to 18 authors (Gleizes, Lhote, Marcoussis, Metzinger, Barradas, María Blanchard, Torres García, Xul Solar, etc.) and grouped around an exceptional collection of 11 works of art by Juan Gris.
- **Contemporary Photography Collection.** 78 works (276 pieces) by 48 international authors (Bernd and Hilda Becher, Thomas Ruff, Thomas Struth, Vik Muniz, Helena Almeida, etc.) which reflect the change of paradigm which has occurred in visual culture since the 60's until now.

- **Telefónica's Historical-Photographic Archive.** One of the most important groups of documentary photography from XX century Spain, with around 12,000 images and some twenty films from 1924-1931, by the most important Spanish graphic reporters of the time: Alfonso, Luis Ramón Marín, etc.
- **"Telos" Collection.** 418 works by a total of 43 artists: Antonio Saura, Luis Feito, Eduardo Úrculo, etc. The Collection came about in 1985 from the originals which were expressly commissioned to be published as illustrations in the magazine Telos, which is published by the Foundation.

The Foundation also manages Telefónica's Historical Technology Collection and the corresponding Telecommunications Museum, one of the most important in the world in this field.

Telefónica Foundation also develops an intense program of temporary art exhibits (with its own halls in Madrid, Santiago de Chile, Buenos Aires and Lima) which were visited by 388,994 visitors in 2006.

### Ars Virtual

A virtual museum dedicated to cultural heritage and which enables an interactive visit and in 3D of almost 50 monuments (National Heritage, Cathedrals, churches and monasteries, Natural Parks, etc.) from Spain, Latin America and Morocco. In 2006, this Internet portal received more than 3 million direct and indirect visits.

## Corporate Governance

This chapter provides a summary of the Annual Report on Corporate Governance of Telefónica S.A. for financial year 2006.

**This Report, which complies with the requirements established in Circular 1/2004, of March 17, of the Comisión Nacional del Mercado de Valores (Spanish Stock Exchange Commission), is published on an annual basis and can be accessed through the Shareholders and Investors section of the corporate website.**

### Ownership

Telefónica's fully subscribed and paid-up capital amounts to 4,921,130,397 euros, and is divided into 4,921,130,397 ordinary shares, of a single class and series, with a nominal value of one euro each, represented by book entries.

In accordance with the information available to the Company, there is currently no natural or legal person who exercises, or may exercise control directly or indirectly, individually or jointly, over Telefónica. There are, however, two shareholders with significant stakes, directly and indirectly, as is shown in the following table: Caja de Ahorros y Pensiones de Barcelona (La Caixa), and Banco Bilbao Vizcaya Argentaria, S.A. (BBVA), with 5.08% and 6.43% of the share capital, respectively.

### Shareholders with significant stakes

Name or corporate name of shareholder	% total share capital
BBVA	6.43%
La Caixa	5.08%



## Corporate Governance at Telefónica Group

### Principles of Corporate Governance

The basic Corporate Governance regulations of Telefónica are set out in the Company By-laws, in the Regulations of the General Shareholders Meeting and in the Regulations of the Board of Directors. The Regulations of the General Shareholders' Meeting establish its principles of organisation and operation, offering shareholders a framework that guarantees and enables the exercise of their rights with regard to the General Shareholders' Meeting, as the governing body of the Company. The Regulations of the Board of Directors, as the founding rules of corporate governance for the Company, determine the principles guiding the actions of the Board of Directors, regulate its organisation and operation and establish the rules of conduct for its members.

In accordance with the above, the Regulations of the Board of Directors of the Company, as the basis of Telefónica's governance structure, determine the fundamental principles that guide the actions of the Board of Directors:

**With respect to corporate interest.** The Board of Directors carries out its duties in accordance with corporate interest, understood as the Company's interest, and, in this respect, acts to guarantee the long term viability of the Company and to maximise its value, whilst taking into account the range of public or private legitimate interests that converge in the operation of all business activities.

**With respect to its shareholders.** The Board of Directors, as the liaison between the shareholders and the management, is responsible for setting up the necessary information channels regarding proposals put forward by shareholders with regard to the management of the Company. The Board of Directors

also undertakes to guarantee equal treatment in its relations with shareholders.

Likewise, the Company makes all information of interest to shareholders available through its website.

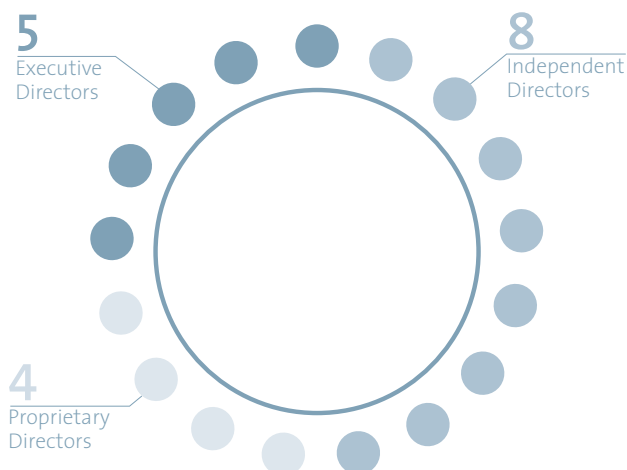
**With respect to the market.** The Board undertakes to carry out any actions and adopt any measures necessary to ensure the Company's transparency in financial markets and to promote the correct formation of the Company's share prices, specifically preventing manipulation and abuse of privileged information.

### The Board of Directors

The Regulations of the Board of Directors establish it as a supervisory body controlling the Company's activity, while entrusting the day-to-day management of the business to the executive bodies and the management team. In addition, and in accordance with the provisions contained in these Regulations, those powers that are legally or statutorily reserved for the Board of Directors may not be delegated, nor may any others necessary for the responsible performance of its basic supervisory and control duties. Accordingly, and within the scope of its duties of supervision and control, the Board of Directors (i) establishes the strategies and guidelines for Company management, (ii) establishes the basis for corporate organisation to ensure its maximum efficiency, (iii) implements and oversees the establishment and compliance with suitable information procedures to report Company information to shareholders and markets in general, (iv) makes decisions regarding business and financial transactions of particular importance to the Company, and (v) approves the bases of its own organisation and operation to ensure optimal compliance with these duties.

## Composition of the Board of Directors

April 2007



The Company By-laws of Telefónica establish that the Board of Directors must comprise a minimum of five and a maximum of twenty Board Members. In April 2007, the Board of Directors was comprised of 17 Directors: 5 Executive Directors, 4 Proprietary Directors and 8 Independent Directors.

### The Board of Directors Executive Commission

Subject to the legislation in force, the Board of Directors has expressly delegated all its powers and competencies, except those that may not be legally or statutorily delegated, to an Executive Commission, with general decision-making powers. The relationship between the Board of Directors and its Executive Commission is based on the principle of transparency, such that the Board is always fully aware of the decisions made by this Commission. Thus, the Board of Directors is informed at each of its sessions of all the resolutions adopted by the Executive Commission, and proceeds to ratify any of the resolutions that so require it. In addition, the election of the members of the Board of Directors to the Executive Commission must have the backing of, at least, two thirds of the Board of Directors.

### The Board of Directors' Consultative or Control Committees

The Board of Directors of Telefónica has several consultative or control Committees –precisely six– which it entrusts with the ongoing analysis and monitoring of areas of special relevance for the Company's good governance, or with monographic analyses of certain aspects or issues whose significance or degree of importance so require. These Committees are not Corporate bodies, but rather instruments that serve the Board of Directors, which receives the conclusions reached regarding the matters and issues the Committees are instructed to study.

### The main Consultative or Control Committees are:

**The Audit and Control Committee**, established in 1997, is regulated by the Company By-laws and the Board Regulations, and chaired by an Independent Director.

Its main duties are: (i) to know the financial information process and evaluate the accounting verification system, (ii) to safeguard the independence of the external auditor, supervising their work and serving as a liaison between the Board of Directors and the external auditor; (iii) to supervise the internal auditing services and (iv) to supervise compliance and integrity of the internal control systems for financial information.

**The Nominating, Compensation and Corporate Governance Committee**, regulated by the Board Regulations and comprised entirely by Independent Directors, has the following main duties (i) to report the proposals for the appointment of Directors and other high-ranking officers of the Company and its subsidiaries, (ii) to approve the remuneration bands for high-ranking officers of the Company, (iii) to approve the standard contracts for high-ranking officers, (iv) to determine the remuneration scheme for the Chairman, (v) to report and propose to the Board the remuneration schemes for Directors and to review them periodically, (vi) to inform of the incentive plans, (vii) to perform an annual analysis of the remuneration policy for Directors and high-ranking officers, (viii) to inform with regard to proposals for the appointment of members to the Board Committees, (ix) to prepare and keep a register of the status of Directors and high-ranking officers of the Company, (x) to prepare the Annual Corporate Governance Report and (xi) to exercise any other competencies assigned to this Committee by the Board of Directors.

In addition, the Board of Directors has four other consultative Committees for the analysis and study of aspects that the company deems especially relevant for the management of the

## Telefónica's Board of Directors Committees

Board Director's Committee	External Directors	Executive Directors	Nº of sessions 2006
Executive Commission	4	4	19
Audit and Control	4	0	11
Nominating, Compensation and Corporate Governance	4	0	11
Regulation	3	1	11
Human Resources and Corporate Reputation	4	0	5
Service Quality and Customer Services	3	0	4
International Affairs	5	0	3

business, such as regulation, corporate responsibility, quality and customer satisfaction. These Committees, made up mostly by external Director, are the following: the Human Resources and Corporate Reputation Committee; the Regulation Committee, the Service Quality and Customer Service Committee and the International Affairs Committee.

### Directors

#### Appointment

In accordance with the Ley de Sociedades Anónimas (Spanish Corporations Act), the appointment of Directors is submitted for decision and approval by the General Shareholders' Meeting and, in accordance with the Regulations of the Board of Directors of the Company, the proposals for appointment are preceded by a relevant favourable report, and, if applicable, a proposal, from the Nominating, Compensation and Corporate Governance Committee.

#### Rights and Obligations

The Regulations of the Board of Directors describe in detail the rights and obligations of the Board Members, explaining the duties arising from the obligations of diligence, fidelity and loyalty of Directors, and, in particular, addresses possible situations of conflict of interest, the duty of confidentiality, the exploitation of business opportunities and the use of company assets. In addition, the Regulations of the Board of Directors includes the right of Directors to obtain the information and advice necessary to perform their duties, as well as the establishment of suitable channels for the exercise of such rights. In this respect, the Company has adopted the measures required to ensure that Directors are furnished in a timely manner with sufficient information specially drawn up to this effect, geared to preparing for the sessions of the Board and its Committees. In accordance with the Regulations of the Board of Directors, the latter performs an annual evaluation of its performance and quality of its work on the occasion of the approval of the Annual Report on Corporate Governance.

#### Remuneration Policy

As regards the remuneration policy for Directors, this policy is proposed, evaluated and reviewed by the Nominating, Compensation and Corporate Governance Committee, ensuring that it is in-keeping with market practice in companies with a similar size and activity. Currently Telefónica does not have a remuneration system linked to the market price of the company shares or that involves handing over shares or stock options to external Directors. On an annual basis, the Company provides information regarding the remuneration received by the Members of the Board of Directors, both in its Annual Report and in the Report on Corporate Governance, in accordance with the criteria established for each of these documents, detailing individual remuneration for each of the positions on the Board of Directors and its Committees. All the information regarding Corporate Governance structure of the Company is available in the Shareholders and Investors section of Telefónica's website.

## Transparency of the Information for Shareholders

### Regulations for Reporting to Markets

In 2003, the Board of Directors of Telefónica approved the “Regulations on Communication of Information to the Markets”, which include the legal requirements that affect Telefónica derived both from Spanish law and from international laws applicable to the Company due to its shares being listed on other stock markets. In accordance with these regulations, the Company disseminates immediately and simultaneously to the markets where it is present all the information that could be considered relevant, and, therefore, must be communicated to the market. Likewise, these communications are published on the Company website.

### External Auditor

One of the main competencies of the Audit and Control Committee is to propose to the Board of Directors, for submittal to the General Shareholders’ Meeting, the appointment of the Accounts Auditor, as well as the terms and conditions of contract, the scope of the auditor’s professional mandate and the renewal or not of their appointment. The External Auditor has direct access to the Audit and Control Committee, and takes part in its meetings, without the presence of the management team, if necessary. In accordance with the internal Regulations of the Company, and in keeping with the legal requirements established by Spanish and American regulations, the contracting of any service from the External Auditor Company must always be previously approved by the Audit and Control Committee. This contracting of services other than those related with Spanish accounts auditing is carried out in strict compliance with the Auditing Act and the Sarbanes –Oxley Act, and its regulations. In this sense, the amount corresponding to work other than auditing with regard to the total amount invoiced by the auditing firm was 2.2% in financial year 2006.

## Composition of the Board of Directors of Telefónica, S.A. and its Committees<sup>1</sup>

	Type of Director	Executive Commission	Audit and Control	Nominating Compensation and Corporate Governance	Human Resources and Corporate Reputation	Regulation	Quality of Service and Customer Service	International Affairs
<b>César Alierta Izuel</b> (Chairman)	●	●						
Isidro Fainé Casas (Vice Chairman)	●	○						
Gregorio Villalabeitia Galarra (Vice Chairman)	●	○	○			○		○
Fernando de Almansa Moreno-Barreda	○					○		●
José María Álvarez-Pallete	●							
David Arculus	○							
Maximino Carpio García	○	○	●	○				
Carlos Colomer Casellas	○	○					○	
Peter Erskine	●	○						
Alfonso Ferrari Herrero	○			●	○			○
Gonzalo Hinojosa Fernández de Angulo	○		○	○			●	○
Pablo Isla Álvarez de Tejera	○			○	●			
Julio Linares López	●	○				○		
Antonio Massanell Lavilla	●		○		○		○	
Vitalino Manuel Nafria Aznar	●							
Enrique Used Aznar	○				○	●		○
Antonio Viana-Baptista	●	○						

### Secretary non Director

Ramiro Sánchez de Lerín García-Ovies								
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### Vice Secretary non Director

Antonio Hornedo Muguiro								
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● Executive    ● Proprietary    ○ Independent    ● Chairman    ○ Director

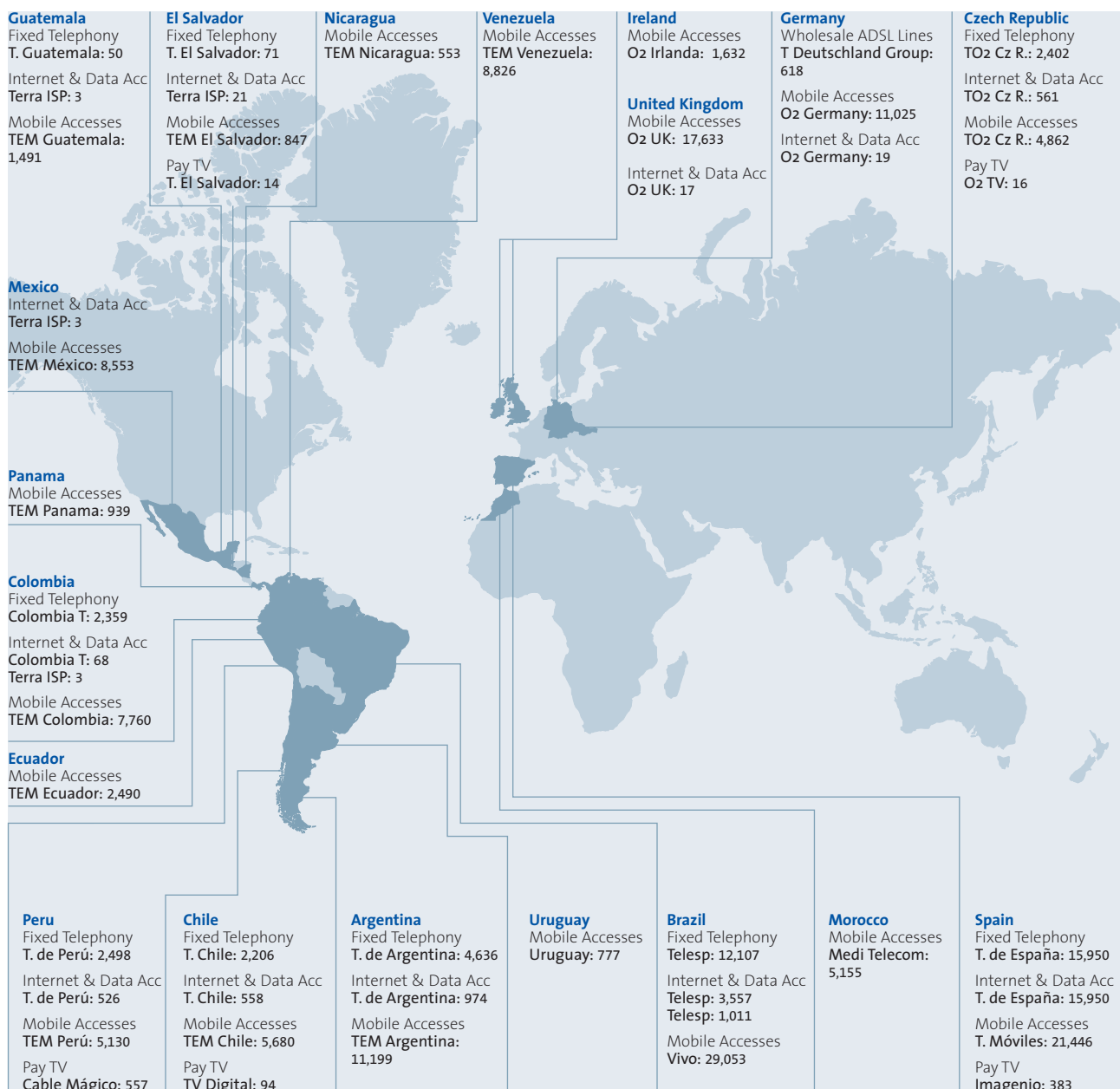
<sup>1</sup> April 2007

Telefónica  
in 2006

# Quarterly results January to December 2006

## Telefónica Group: Market size

Data in thousands



## Telefónica Group accesses

Unaudited figures (Thousands)

January - December

	2006	2005	% Chg
<b>Final Clients Accesses</b>	<b>200,700.7</b>	<b>151,669.6</b>	<b>32.3</b>
Fixed telephony accesses <sup>1</sup>	42,340.7	40,859.9	3.6
Internet and data accesses	12,170.9	11,002.6	10.6
Narrowband	3,997.7	5,166.9	(22.6)
Broadband <sup>2</sup>	7,974.8	5,653.0	41.1
Other <sup>3</sup>	198.4	182.7	8.6
Cellular accesses	145,125.1	99,124.0	46.4
Pay TV	1,064.0	683.2	55.7
<b>Wholesale Accesses</b>	<b>2,479.4</b>	<b>1,827.4</b>	<b>35.7</b>
Unbundled loops	962.2	441.7	117.8
Shared UL	527.7	279.0	89.1
Full UL	434.5	162.7	167.1
Wholesale ADSL <sup>4</sup>	1,288.6	1,330.1	(3.1)
Other <sup>5</sup>	228.6	55.6	n.s.
<b>Total Accesses</b>	<b>203,180.2</b>	<b>153,497.0</b>	<b>32.4</b>

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

<sup>2</sup> ADSL, satellite, optical fibre, modem cable and broadband circuits.

<sup>3</sup> Remaining non-broadband final client circuits.

<sup>4</sup> Includes T. Deutschland connections resold on a retail basis.

<sup>5</sup> Circuits for other operators.

Note: Cellular accesses, Fixed telephony accesses and Broadband accesses include MANX customers and Telefónica Telecom.

## Financial Highlights

The most relevant facts of Telefónica Group results for the January-December 2006 period are the following:

- Telefónica Group strengthens the best combination of growth and returns in the European industry:
  - Revenues posted 41.5% year-on-year growth to 52,901 million euros. In the fourth quarter the year-on-year growth stood at 37.4%.
  - Basic earnings per share increased 42.9% year-on-year to 1.304 €/share.
- Net income reached an historic record figure of 6,233 million euros compared to 4,446 million euros in 2005 (+40.2%).
- The higher Telefónica Group top line growth is sustained by the solid increase in the customer base, thanks to the strong commercial activity developed during the year and especially in the fourth quarter:
  - Total accesses stood at 203.2 millions, 32.4% more than in December 2005.
  - Telefónica Group's Double Play and Triple Play Offers exceeded 3 million at the end of the year.
- Only in the fourth quarter, total accesses net additions surpassed 7.3 millions, of which more than 6.6 million corresponded to cellular accesses, close to 0.7 million to retail internet broadband and nearly 200,000 to Pay TV.
- The organic growth<sup>1</sup> of revenues reached 7.8%, at the top of the peer Group.
- The ongoing efficiency in the integrated management of operations, cost optimisation and tangible synergies achieved flows to:
  - Increased OIBDA by 27.0% with respect to January-December 2005.
  - Operating free cash flow (OIBDA-CapEx) which rose 12.3% vs. 2005 and totalled 11,122 million euros, despite the higher investment effort.
- Telefónica Group achieved and even surpassed the financial targets<sup>2</sup> set for 2006 in terms of revenues, OIBDA and OI:
  - Revenue<sup>2</sup> increased year-on-year 38.8%, confirming the guidance of "higher than 37%" upgraded from the initial range of +34%/+37%.
  - OIBDA<sup>3</sup> increased year-on-year 28.9%, in the high end of the communicated range (+26%/+29%).
  - OI growth<sup>3</sup> stood at 29.2%, in line with the range of +26%/+30% announced.

<sup>1</sup> Assuming constant exchange rates and including the consolidation of Telefónica O2 Czech Republic in January -December 2005 and O2 Group in February-December 2005. Excluding the consolidation of Telefónica Telecom (formerly Colombia Telecom) in May-December 2006 and Iberbanda in July-December 2006.

<sup>2</sup> 2006 guidance assumes constant exchange rates as of 2005. Base reported numbers include six months of Telefónica O2 Czech Republic (consolidated since July 2005) and include TPI as a discontinued operation. All figures exclude changes in consolidation, other than O2 (Feb-Dec 06 included). In terms of guidance calculation, OIBDA and OI exclude other exceptional revenues/expenses not foreseeable in 2006. Personnel Restructuring and Real Estate Programs are included as operating revenues/expenses. For comparison, the equivalent other exceptional revenues/expenses registered in 2005 are also deducted from reported figures. The assignment of O2's goodwill is not included in OI guidance calculation.

- After the fast integration of acquired assets, the Company presented a higher geographic diversification:
  - Latin America and Europe represent 61.2% of total sales and a 55.6% of the total OIBDA.
  - Spain reduced its contribution to the consolidated revenues to 37.9% and to the consolidated OIBDA to 43.8%.
- More attractive shareholder remuneration policy:
  - An interim dividend of 0.3 euros per share has been paid the 10th of November 2006. An additional 0.3 euros per share to be paid in the first semester of 2007.
  - Share buy-back program to be completed until the end of 2007 by an amount of 2,700 million euros (treasury stock as of 31st January 2006 stood at 1.5% of the current share capital).

3 2006 guidance assumes constant exchange rates as of 2005. Base reported numbers include six months of Telefónica O2 Czech Republic (consolidated since July 2005) and include TPI as a discontinued operation. All figures exclude changes in consolidation, other than O2 (Feb-Dec 06 included). In terms of guidance calculation, OIBDA and OI exclude other exceptional revenues/expenses not foreseeable in 2006. Personnel Restructuring and Real Estate Programs are included as operating revenues/expenses. For comparison, the equivalent other exceptional revenues/expenses registered in 2005 are also deducted from reported figures. The assignment of O2's goodwill is not included in OI guidance calculation.



## Consolidated Results

The results obtained by Telefónica Group and the management report included in this report are based on the actions carried out by the various business units in the Group and which constitute the units over which management of these businesses is conducted. This implies a presentation of results based on the actual management of the various businesses in which Telefónica Group is present, instead of adhering to the legal structure observed by the participating companies.

In this sense, income statements are presented by businesses, which basically implies that each business line participate in the companies that the Group holds in the corresponding business, independently of the legal structure.

It should be emphasized that this presentation by businesses in no case alters the total results obtained by Telefónica Group. These results are incorporated from the date of effective acquisition of the holding.

From the first quarter of 2007 and according to the new regional and integrated management model approved on the 26th July 2006 by the Board of Directors of the Company, the consolidated results for the Telefónica Group will be presented with information segmented into three Regional Business Units: Telefónica Spain, Telefónica Europe and Telefónica Latin America. In this document addenda, the 2006 results are published under this new model.

The results of the Telefónica de España Group and the Telefónica Latinoamérica Group include the results from Terra Networks operations as of 1st January 2005. Hence, Terra España, Azeler and Maptel results are included in the Telefónica de España Group, whereas the Terra results in Latin America are included in the Telefónica Latinoamérica Group.

As of 1st February 2006, the results of the O2 Group are consolidated into Telefónica O2 Europe business line. This business line is integrated by the assets of O2 Group, Telefónica O2 Czech Republic (during the July-December 2005 period it was an independent business line) and Telefónica Deutschland (in 2005 it was included in Other companies of the Telefónica Group).

As of 1st May 2006, the results of Colombia Telecom (renamed Telefónica Telecom in November 2006) are consolidated into Telefónica Latinoamérica Group.

As of 1st July 2006, the results of Iberbanda are consolidated into Telefónica de España Group.

In the last quarter of 2006 the results of Telefónica O2 Slovakia are included into Telefónica O2 Europe.

Due to Telefónica's sale of TPI, the Telefónica Group's 2005 and 2006 results include the Directories Business as a discontinued operation, in line with International Financial Reporting Standards (IFRS).

2006 results strengthen the Telefónica Group as the incumbent European operator that offers the best combination of growth and returns in the industry.

Growth differential takes place in all items of P&L, from revenues, which grew by 41.5% with respect to the previous year, to basic earnings per share, which rose 42.9% (1.304 euros per share). Thus, in 2006 the Telefónica Group obtained a historic record figure of net profit (6,233 million euros), 40.2% above the 2005 figure.

2006 was also characterised by the rapid and successful integration of recent acquisitions, the O2 Group and Telefónica Telecom amongst others. Thus, the efficiency in integrated management, the optimisation of costs and synergies already achieved delivered a OIBDA growth of 27.0% year-on-year and an operating free cash flow (OIBDA-CapEx) of 12.3% totalling 11,122 million euros. This has been achieved despite important commercial expenses, which allowed the total accesses to rise to 203.2 million at the end of the year.

The evolution of the results has allowed the Telefónica Group to achieve and surpass its guidance<sup>1</sup> for 2006. Thus, the growth in revenues stands at 38.8%, confirming the growth guided of over 37%; the growth in operating income before depreciation and amortization (OIBDA) stands at 28.9%, in line with the objective set at the high end of the announced range (+26%/+29%); Operating Income (OI) increased 29.2%, also at the high end of the range (+26%/+30%).

In 2006, a new and more attractive and competitive long-term shareholder remuneration policy was announced, which has as a strategic target for the year 2009 to double both the earnings

per share and dividend per share from the 0.91 euros and 0.5 euros per share reported for 2005. In this sense, an interim dividend of 0.3 euros per share has been paid on the 10th of November 2006 from 2006 profits. This payment will be followed by an additional 0.3 euros per share to be paid in the first semester of 2007. The share buyback programme for an amount of 2,700 million euros will be completed before the end of 2007 and these shares will be cancelled. As of 31st of December, the Company's treasury stock represented 1.5% of the current share capital, equivalent to 75,632,559 shares.

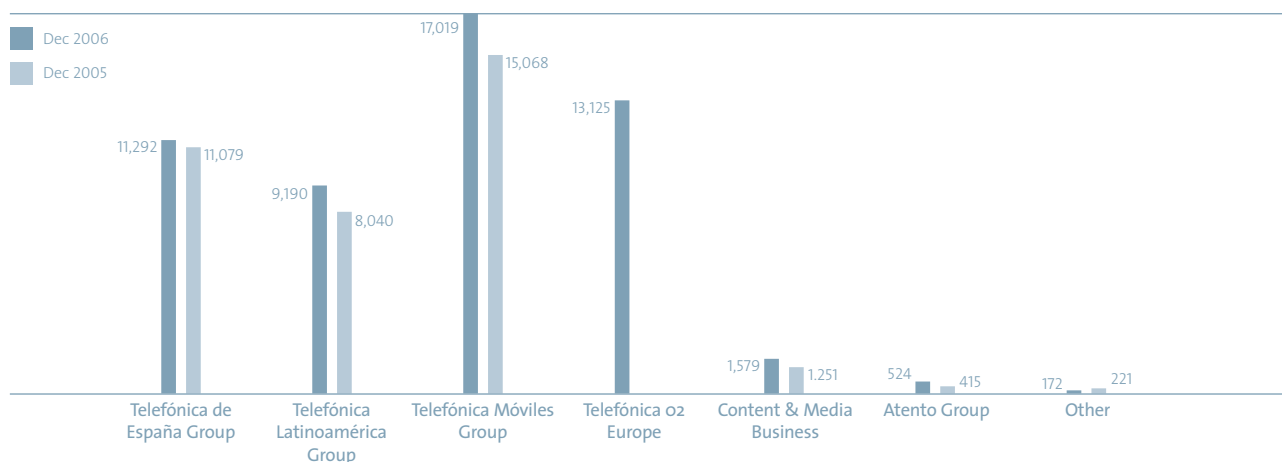
Telefónica Group's total accesses rose to 203.2 million by the end of 2006 (+32.4% year-on-year) as much as a consequence of the strong commercial activity and the dynamism of the markets of operations, which allowed us to maintain our strong competitive position. It is worth mentioning the Christmas campaigns in the fourth quarter, especially with regards to broadband, mobile telephony and the extension of bundles offers for voice, ADSL and TV. Geographically, accesses in Spain reached 44.2 million (41.8 million in 2005), 114.7 million in Latin America (98.8 million at December 2005) and 39.2 million in Europe (8.8 million by the end of 2005).

By the end of December 2006, cellular access managed by the Telefónica Group stood at 145.1 million (99.1 million in 2005 and 138.4 in September 2006), reflecting the good quality of acquisition and retention of value customers carried out by the different operators. In Spain, after registering in the fourth quarter net adds of 426,000 and 1.6 million since the beginning of the year, the total customer base reached 21.4 million. In Latin America the customer base reached 83.3 million, with net adds of 4.5 million in the fourth quarter and 12.8 million since the beginning of the year. In Europe, quarterly

<sup>1</sup> 2006 guidance assumes constant exchange rates as of 2005. Base reported numbers include six months of Telefónica O2 Czech Republic (consolidated since July 2005) and include TPI as a discontinued operation. All figures exclude changes in consolidation, other than O2 (Feb-Dec 06 included). In terms of guidance calculation, OIBDA and OI exclude other exceptional revenues/expenses not foreseeable in 2006. Personnel Restructuring and Real Estate Programs are included as operating revenues/expenses. For comparison, the equivalent other exceptional revenues/expenses registered in 2005 are also deducted from reported figures. The assignment of O2's goodwill is not included in OI guidance calculation.

## External sales by business lines

Data in million euros



net adds surpassed 824,000, totalling 35.2 million. Lastly, in Morocco the total customer base grew by 28.1%, with respect to the previous year, to reach 5.2 million.

At the end of the year, the Telefónica Group recorded 8.0 million retail broadband internet connections, a year-on-year increase of 41.1% and 9.5% with respect to September 2006. The bundle offers of voice, ADSL and TV continues to have a significant influence in Spain and Latin America on the previously mentioned growth and serves as an instrument of customer loyalty. In Spain, 3.7 million connections (3.4 million in September 2006 and 2.7 million in December 2005) led to an estimated broadband market share of 56%. Latin America recorded 3.8 million, 40.0% more than in December 2005 and 8.1% more than in September 2006.

In 2006 revenues for the Telefónica Group amounted 52,901 million euros, 41.5% higher than that registered in 2005. Of this growth, the incorporation of the O2 Group, Telefónica O2 Czech Republic, Telefónica Telecom and Iberbanda contributed with 32.1 percentage points, (+32.4 percentage points in January-September 2006) and the positive impact of exchange rates, despite showing a downwards trend throughout the year, contributed with 1.6 percentage points (+3.2 percentage points in January-September 2006). Organic growth<sup>2</sup> reached 7.8% (0.3 percentage points up on those obtained in the first nine months of the year), based on the positive contribution of all business, standing out Móviles Latinoamérica and the O2 Group, jointly with the solid performance in the fixed line business, due to the higher contribution of broadband.

Telefónica Móviles Group, with revenues of 18,403 million euros, registered a year-on-year growth of 11.4% (+11.2% in constant euros). Telefónica Móviles Spain closed the year with a 4.1% year-

on-year sales increase, mainly due to the good performance of service revenues (+4.5%) and higher customer revenues (+6.5%), which grew in line with the customer base (+7.8%). In the fourth quarter, revenues for Telefónica Móviles Spain accelerated (+5.4%) with respect to the third quarter (+5.1%), due to the higher sales of handsets during the Christmas campaign. Revenues for Telefónica Móviles Latinoamérica grew 19.9% with respect to 2005 (+19.4% excluding exchange rates), standing out the contributions of Venezuela (+45.7% in local currency), Argentina (+32.5% in local currency) and Mexico (+28.2% in local currency).

Telefónica O2 Europe, constituted by the O2 Group since the 1st of February 2006 and Telefónica O2 Czech Republic and Telefónica Deutschland from the 1st of January 2006, contributed to the consolidated revenues for 2006 with 13,159 million euros. In a dynamic and demanding competitive environment, service revenues in O2 UK continued to show strong growth (+14.7% in local currency) sustained by the increase in the customer base and ARPU, meanwhile O2 Germany recorded a year-on-year increase of 6.7%. Revenues for Telefónica O2 Czech Republic increased 0.4% in local currency (including other recurrent revenues) from 2005 thanks to growth in mobile telephony (+6.1% in local currency).

Revenues for the Telefónica de España Group rose to 11,964 million euros in the period from January-December 2006 and grew 1.8% with respect to the same period the previous year. Higher revenues from Internet and broadband (+26.2%), Data (+4.4%) and Information Technology (+19.9%) more than compensated the fall in traditional access (-2.1%) and traditional voice services (-5.7%).

<sup>2</sup> Assuming constant exchange rates and including the consolidation of Telefónica O2 Czech Republic in January–December 2005 and O2 Group in February–December 2005. Excluding the consolidation of Telefónica Telecom in May–December 2006 and Iberbanda in July–December 2006.

Revenues for the Telefónica Latinoamérica Group amounted to 9,537 million euros in 2006, 14.2% more than in 2005 in current euros, showing a downwards trend with respect to January-September 2006 (+17.5%) due primarily to the lower positive effect of exchange rates (+6.0 percentage points up to December in comparison to +10.2 percentage points up to September). In constant euros and excluding revenues from Telefónica Telecom from the 1st of May 2006 (398 million euros), year-on-year revenue growth reached 2.1%. TASA, with a 13.6% growth in local currency is the operator who has contributed the most to the growth followed by Telesp (+1.5% despite showing a slowdown in growth compared to September: +2.1%), Telefónica Peru (+2.6% in local currency) and Telefónica Chile (+0.2% in local currency). Revenues from operators were based on the higher contribution of the Internet and broad band, which has permitted, partially, to offset the lower revenues from traditional business.

Apart from the business revenue diversification highlighted, geographic diversity is also worth mentioning. By the end of December 2006, Spain represented 37.9% of consolidated revenues (13.6 percentage points less than in 2005), Latin America 34.7% (-6.9 percentage points with respect to the previous year) and Europe 26.5% (20.9 percentage points more than twelve months ago following the incorporation of the O2 Group in February). Brazil's contribution over total sales fell to 14.4% (18.4% in December 2005); meanwhile the UK contributed 12.8% (0.5% in the previous year) and Germany 6.4% (1.0% twelve months ago).

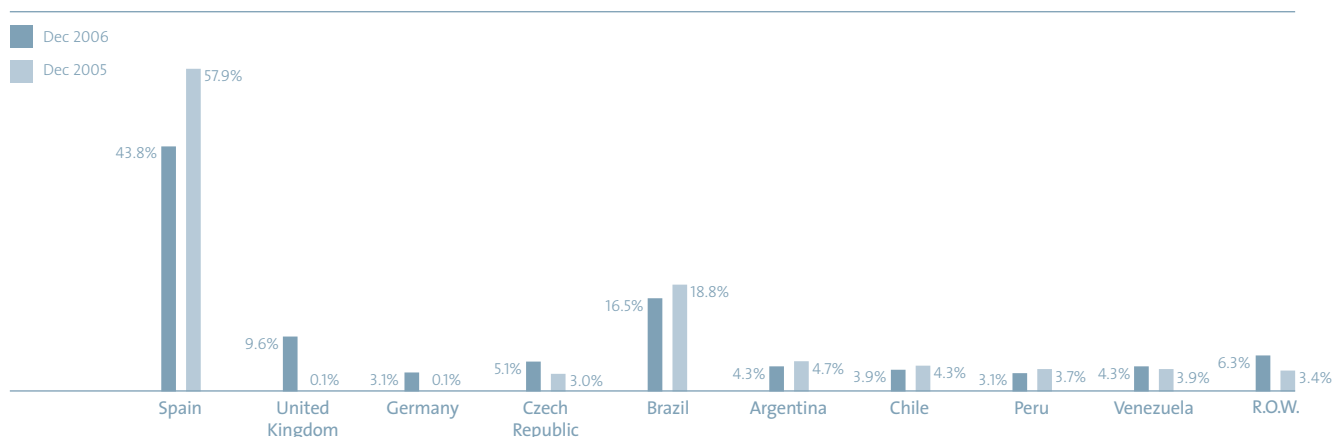
Operating expenses for the Telefónica Group rose to 34,386 million euros in 2006, a year-on-year increase of 49.7% and slightly higher than in January-September (+47.8%) period. The higher level of costs, with respect to the previous year, is due to

the incorporation of new companies to the perimeter of consolidation and the higher commercial efforts in the markets of operations, mainly in mobile telephony, in a context of continued effort to achieve maximum efficiency in the cost structure.

Supplies expenses for the financial the year rose 66.3% with respect to 2005 (+65.0% excluding the effects of exchange rates) totalling 16,629 million euros. This variation is explained by changes in the perimeter of consolidation, principally the O2 Group, by Telefónica Móviles Latin America for the higher handsets purchases, and by Telefónica Latin America for the higher interconnection costs. With respect to January-September the growth dropped 1.6 percentage points in constant currency of 2005.

In the period January-December 2006 personnel expenses amounted to 7,622 million euros, presenting a year-on-year growth of 37.8% (+36.6% in constant euros). The average workforce increased by 36,752 employees to 227,137 employees due to the incorporation of the O2 Group and the Atento Group (+20.1% excluding Atento Group up to 127,364). Additionally, it is important to highlight that the provision with respect to the Telefónica de España Group's redundancy plan rose to 982 million euros. Of this figure, 479 million euros corresponds to the provision of 1,542 employees initially forecast for 2006 and 503 million euros because of bringing forward to September 21st 2006 the period for joining the E.R.E 2007 that resulted in 1,762 employees signing earlier. During the last quarter of the year, personnel costs accelerated growth (+72.2% vs. +26.1% up to September) mainly due to two reasons: 1) workforce restructuring expenses related to bringing forward the period for joining the E.R.E. 2007 that resulted in 1,762 employees signing

## OIBDA by countries



earlier 2) New management pension scheme in the Telefónica Group that records 21 million euros of costs related to 2006 and 113 million euros of extraordinary costs.

External services accumulated in 2006 (9,230 million euros) increased 38.6% year-on-year (+36.9% in constant euros), mainly due to the incorporation of the O2 Group (where there is a strong commercial effort), to Telefónica Móviles Latin America (higher commercial, advertising and network costs) and to Telefónica Móviles España (customer management costs). With regard to the first nine months of the year (+33.3% excluding the effects of exchange rates) there was an acceleration of costs due to the higher commercial activity in the Telefónica de España Group and the Telefónica Móviles España, together with higher costs for O2 Germany and Telefónica O2 Czech Republic (costs relative to the launch of operations of O2 Slovakia and the rebranding).

With respect to the sale of fixed assets, it amounted to 236 million euros in January-December 2006, compared to 250 million euros accrued the previous year. The figure for 2006 corresponds mainly to the sale of shares of Sogecable (6.6% of capital share) after the takeover bid launched by the Prisa Group and the capital gain of real state in the Telefónica de España Group.

The Telefónica Group consolidated OIBDA for January-December 2006 totalled 19,126 million euros, 27.0% up on that obtained during the same period in 2005. The positive effects of exchange rates contributed 1.8 percentage points to the growth (+3.3 percentage points cumulative to September). Organic<sup>3</sup> variation would stand at 2.8%. If we exclude the provision related to bringing forward to September 21st 2006, the period for joining

to the E.R.E 2007, that resulted in 1,762 employees and the new management pension scheme, OIBDA organic growth would reach 6.4%. In terms of the OIBDA margin, this stood at 36.2% at the end of the year, presenting a year-on-year fall of 4.1 percentage points, impacted mainly by the incorporation of the O2 Group since the month of February, with lower margin. The Telefónica Móviles Group represented 33.7% of the total OIBDA and reached 6,443 million euros over the year, an increase of 10.8% than the same period in 2005 (+10.7% in constant euros). Despite the high commercial activity carried out, OIBDA for Telefónica Móviles España (4,128 million euros) was practically in line with the previous year. The OIBDA margin reached 44.9% compared with 46.7% in 2005. Telefónica Móviles Latin America amounted an OIBDA of 2,429 million euros registering a strong year-on-year growth of 38.5% (+38.3% eliminating the effect of exchange rates) mainly due to the lower losses of Telefónica Móviles Mexico (-10 million euros in 2006 vs. -159 million euros in 2005) and the higher efficiency in regional management. However, Telefónica Móviles Latin America still registered an improvement year-on-year of OIBDA margin of 3.5 percentage points, reaching 26.3% (24.7% up to September).

OIBDA for the Telefónica de España Group (23.9% of the consolidated OIBDA) stood at 4,572 million euros recording a year-on-year fall of 4.4%, after registering in the fourth quarter a year-on-year drop of 37.3%, as a result of the provision accounted for the workforce reduction program. Thus, the OIBDA margin reached 38.2%. Excluding the effect of the redundancy plan in both periods the margin would reach 46.4%, 0.6 percentage points higher than the previous year.

<sup>3</sup> Assuming constant exchange rates and including the consolidation of Telefónica O2 Czech Republic in January–December 2005 and O2 Group in February–December 2005. Excluding the consolidation of Telefónica Telecom in May–December 2006, Iberbanda in July–December 2006 and Telefónica O2 Slovakia in October–December 2006.

OIBDA for the Telefónica Latinoamérica Group represented 22.0% of the total OIBDA, and reached 4,209 million euros in 2006, (+11.7% compared to 2005). Excluding the positive effects of exchange rates (+6.1 percentage points compared to +10.4 percentage points cumulative to September) and of Telefónica Telecom (203 million euros), growth declined to 0.3% (+3.3% eliminating the results of the disposal of fixed assets in both periods). The OIBDA margin, without taking Telefónica Telecom into account and the results of the disposal of fixed assets, is 42.0% compared with 43.8% in 2005.

Telefónica O2 Europe contributed 3,708 million euros to the consolidated OIBDA, which represents 19.4% of the consolidated OIBDA. The O2 Group contributed 2,773 million euros to the OIBDA in the first 11 months of the year. For O2 UK, the margin over revenues fell 0.9 percentage points from February-December 2005 to 28.4%, reflecting the high growth of customers. OIBDA margin for O2 Germany reached 20.7%, 1 percentage points lower to the one registered in February-December 2005. OIBDA for Telefónica O2 Czech Republic totalled 985 million euros during the year 2006 and the OIBDA margin stood at 45.8%.

At the end of 2006, the geographical split of OIBDA also reflected a higher diversification than the previous year. Spain's contribution to the consolidated OIBDA was reduced to 43.8%, 14.1 percentage points lower than in 2005, increasing Europe's contribution to 20.0% (6.1% in January-December 2005) and Latin America's weight remaining practically stable (35.6% in 2006 vs. 36.6% in 2005).

Depreciation and amortization totalled 9,704 million euros in 2006, presenting a year-on-year growth of 45.0%. This increase is explained by the consolidation of the O2 Group since the month of February 2006 and the O2 Group Purchase Price Allocation (861 million euros February-December 2006) and Telefónica O2 Czech Republic (155 million euros in January-December 2006). Organic<sup>4</sup> growth of depreciation and amortization would stand at 8.1% (+9.1% in the first nine months of the year).

Operating income grew 12.7% with respect to the period January-December 2005 reaching 9,421 million euros. In organic<sup>4</sup> terms, the operating income presented a fall of 2.0% (+6.2% cumulative to September), although excluding the provision related to bringing forward to September 21st 2006, the period for joining to the E.R.E 2007, that resulted in 1,762 employees and the new management pension scheme, the growth would stand at 4.8%.

Results of associated companies stood at 77 million euros in 2006, changing the trend with respect to 2005 (-128 million euros). In the fourth quarter 2005 was accrued the write-down of the remaining value of the UMTS licence of IPSE. The positive results for 2006 were produced mainly by the higher contribution of Portugal Telecom.

Net financial result for 2006 amounted to 2,734 million euros, 68% above those of 2005. Excluding FX results, net financial debt figures would be 2,795 million euros for 2006 and 1,792 million euros for 2005. This would imply a 55.9% increase in the adjusted net financial result in the period 05-06. This variation arises from two different effects. On one hand, an increase of 1,372 million euros as the result of a 83.9% rise in average total net debt (54,315 million euros as of December 31, 2006, including

<sup>4</sup> Assuming constant exchange rates and including the consolidation of Telefónica O2 Czech Republic in January-December 2005 and O2 Group in February-December 2005. Excluding the consolidation of Telefónica Telecom in May-December 2006, Iberbanda in July-December 2006 and Telefónica O2 Slovakia in October-December 2006.

pre-retirement plan commitments). On the other hand, a decrease of 369 million euros due to a reduction of 47 million euros in the cost associated to marked-to-market positions together with 109 b.p reduction (2006 vs. 2005) in the average cost of debt for the Telefónica Group. Both these facts have allowed for savings of 322 million euros the reason being average interest rate at which the increase in debt was held during 2006 was lower than the average rate for 2005. The average cost calculated on average total net debt for 2006 is 5.0% and 5.1% when excluding FX results.

The net free cash flow after CapEx generated by the Telefónica Group in 2006 totalled 8,916 million euros of which 2,401 were assigned to Telefónica's share buyback program, 2,627 million euros to dividend payments and 830 million euros to commitment cancellations derived mainly from the pre-retirement plans. Financial Investment for the period amounted to 21,550 million euros (net of real state divestment and net of cash from O2, Colombia Telecom and TPI at the time of acquisition/disposal) due fundamentally to O2 take-over (which had been initiated in 2005 through the purchase of shares in the stock market). This fact has caused the need to increase net financial debt in 18,492 million euros plus another 3,586 million euros due to changes in the perimeter of consolidation (fundamentally due to the incorporation of O2's gross debt and Telefónica Telecom), other effects on financial accounts and to the depreciation in debt caused by FX results. As a result, starting from a net financial debt of 30,067 million euros in 2005 plus a debt variation of 22,078 million euros during 2006, we get to a closing net financial debt of 52,145 million euros in 2006.

The tax provision accrued in the year 2006 amounted to 1,781 million euros, which implies a tax rate of 26.3% in the period, although the cash outflow for the Telefónica Group will be further reduced as negative tax bases generated in past years are compensated.

The tax rate in the year 2006 has been affected by several issues with opposite effects. On one hand, the partial modification of the Corporate Tax Law in Spain, that translated into a reduction of the current tax rate (35%), establishing a fixed rate for the fiscal years finishing after the 1st of January 2007 of 32.5%, and for the fiscal years finishing after the 1st of January 2008 of 30%, will suppose in the future lower taxable positive results for Spanish companies, although similarly will involve a reduction of the amount to recover from the losses of previous years. This reduction meant in the 2006 fiscal year a tax expenses of 355 million euros. On the other hand, Corporate Tax Law has been reduced due to the allowances of export activities (910 million euros) that were generated in the last buyout operations made by the Group.

The result from discontinued operations amounted to 1,596 in 2006 after registering in the third quarter of the year the net capital gain corresponding to the sale of Telefónica's participation in TPI for 1,564 million euros.

The results attributed to minority interests during the period January-December 2006 subtract 346 million euros from the net income, 9.2% less than in the same period in 2005 (-381 million euros). This variation is due mainly to the sale of TPI, the change in the participation of Telefónica Móviles and the consolidation of Telefónica Telecom since May 2006, that compensated

partially, among others, the higher net income registered by Telesp and Endemol (IPO in November 2005).

As a result of the performance of the aforementioned items, the consolidated net income rose to 6,233 million euros in 2006, 40.2% higher than that obtained in 2005. In the fourth quarter net income reached 1,047 million euros, 12.2% lower than the one registered over the same period of the previous year.

The consolidated CapEx cumulative to December 2006 amounted to 8,003 million euros, representing an increase of 55.3% with respect to 2005. In organic<sup>5</sup> terms, growth is reduced to 7.7% explained mainly by the investment in broadband networks in Spain and Latin America and also by the faster roll out of third and second generation networks in Europe, mainly Germany. Regarding the CapEx<sup>6</sup> announced for 2006 (approximately 7,200 million euros) the company ended the year with 7,749 million euros due to the acceleration in the investments in fixed and wireless broadband as well as the acceleration in the rollout of third generation networks, mainly in Germany and bringing forward investments in second generation networks, mainly in GSM in Latin America.

<sup>5</sup> Assuming constant exchange rates and including the consolidation of Telefónica O2 Czech Republic in January–December 2005 and O2 Group in February–December 2005. Excluding the consolidation of Telefónica Telecom in May–December 2006, Iberbanda in July–December 2006 and Telefónica O2 Slovakia in October–December 2006.

<sup>6</sup> Assuming constant 2005 exchange rates and excluding changes to the perimeter of consolidation with the exception of O2 Group (included in February–December 2006).



# Financial Data

## Telefónica Group Selected financial data

Unaudited figures (Euros in millions)

	January - December		
	2006	2005	% Chg
Revenues	52,901	37,383	41.5
Operating income before D&A (OIBDA)	19,126	15,056	27.0
Operating income (OI)	9,421	8,363	12.7
Income before taxes	6,764	6,607	2.4
Net income	6,233	4,446	40.2
Basic earnings per share	1,304	0,913	42.9
<b>Weighted average number of ordinary shares outstanding during the period (millions)</b>	<b>4,779.0</b>	<b>4,870.9</b>	<b>(1.9)</b>

Note: For the basic earnings per share calculation purposes, the weighted average number of ordinary shares outstanding during the period have been obtained applying IFRS rule 33 "Earnings per share". Thereby, there are not taking into account as outstanding shares the weighted average number of shares held as treasury stock during the period nor the shares assigned to the stock options plans for employees. Furthermore, in line with IFRS rule 33, the weighted average number of shares outstanding during every period, has been adjusted for these operations that had implied a difference in the number of outstanding shares, without a variation associated in the equity, as if those have taken place at the beginning of the first period presented. It consists on the distribution of the paid-in capital reserve by means of delivery of shares in the proportion of 1 share to every 25 shares, approved by the AGM as of May 31, 2005.

## Telefónica Group Results by companies

Unaudited figures (Euros in millions)

	Revenues			OIBDA			Operating income		
	January - December			January - December			January - December		
	2006	2005	% Chg	2006	2005	% Chg	2006	2005	% Chg
Telefónica de España Group <sup>1</sup>	11,964	11,755	1.8	4,572	4,784	(4.4)	2,706	2,645	2.3
Telefónica Latinoamérica Group <sup>1</sup>	9,537	8,352	14.2	4,209	3,766	11.7	2,251	1,967	14.4
Telefónica Móviles Group	18,403	16,514	11.4	6,443	5,817	10.8	4,012	3,443	16.5
Telefónica O2 Europe <sup>2</sup>	13,159	1,316	n.c.	3,708	454	n.c.	309	146	n.c.
Atento Group	1,027	856	19.9	142	116	21.8	113	88	8.2
Content & Media Business	1,608	1,269	26.7	362	269	34.4	336	240	39.6
Other companies <sup>3</sup>	826	595	38.9	(316)	(186)	70.4	(383)	(236)	62.1
Eliminations	(3,623)	(3,274)	10.6	(40)	36	c.s.	29	69	(58.6)
<b>Total Group</b>	<b>52,901</b>	<b>37,383</b>	<b>41.5</b>	<b>19,126</b>	<b>15,056</b>	<b>27.0</b>	<b>9,421</b>	<b>8,363</b>	<b>12.7</b>

<sup>1</sup> Telefónica de España Group and Telefónica Latinoamérica Group results consolidates the results from Terra Networks operations from 1 January 2005.

<sup>2</sup> Telefónica O2 Europe includes in 2006 O2 Group (February-December), Telefónica O2 Czech Republic and T. Deutschland. In 2005 Telefónica O2 Europe includes Telefónica O2 Czech Republic since July and T. Deutschland since January.

<sup>3</sup> OIBDA and Operating Income exclude the variation in investment valuation allowances and the capital gain obtained for the sale of TPI accounted for by Telefónica S.A. parent company and that are eliminated in consolidation.

## Telefónica Group

### CapEx by business lines

Unaudited figures (Euros in millions)

	January - December		
	2006	2005	% Chg
Telefónica de España Group <sup>1</sup>	1,555	1,401	11.0
Telefónica Latinoamérica Group <sup>1</sup>	1,285	989	29.9
Telefónica Móviles Group	2,275	2,227	2.2
Telefónica O2 Europe <sup>2</sup>	2,553	162	n.c.
Atento Group	35	40	(12.3)
Content & Media Business	33	25	30.9
Other companies & Eliminations	266	308	(13.6)
<b>Total Group</b>	<b>8,003</b>	<b>5,153</b>	<b>55.3</b>

Note: Group CapEx in 2006 at cumulative average exchange rate. For comparative purposes, 2005 Capex has been recalculated at the cumulative average exchange rate for the corresponding period.

<sup>1</sup> Telefónica de España Group and Telefónica Latinoamérica Group results consolidates the results from Terra Networks operations from 1 January 2005.

<sup>2</sup> Telefónica O2 Europe includes in 2006 O2 Group (February-December), Telefónica O2 Czech Republic (including Slovakia) y T. Deutschland. In 2005 Telefónica O2 Europe only includes Telefónica O2 Czech Republic since July and T. Deutschland since January .

## Telefónica Group

### Consolidated income statement

Unaudited figures (Euros in millions)

	January - December			October - December		
	2006	2005	% Chg	2006	2005	% Chg
Revenues	52,901	37,383	41.5	14,196	10,329	37.4
Internal exp capitalized in fixed assets <sup>1</sup>	719	601	19.6	195	263	(25.9)
Operating expenses	(34,386)	(22,968)	49.7	(9,867)	(6,378)	54.7
Supplies	(16,629)	(9,999)	66.3	(4,645)	(2,926)	58.7
Personnel expenses	(7,622)	(5,532)	37.8	(2,421)	(1,406)	72.2
Subcontracts	(9,230)	(6,657)	38.6	(2,578)	(1,795)	43.7
Taxes	(905)	(781)	15.9	(224)	(251)	(10.9)
Other net operating income (expense)	(263)	(186)	41.3	2	(1)	n.m.
Gain (loss) on sale of fixed assets	236	250	(5.5)	12	72	(82.7)
Impairment of goodwill and other assets	(81)	(23)	n.s.	(66)	(11)	n.m.
<b>Operating income before D&amp;A (OIBDA)</b>	<b>19,126</b>	<b>15,056</b>	<b>27.0</b>	<b>4,472</b>	<b>4,274</b>	<b>4.6</b>
Depreciation and amortization	(9,704)	(6,694)	45.0	(2,495)	(1,891)	31.9
<b>Operating income (OI)</b>	<b>9,421</b>	<b>8,363</b>	<b>12.7</b>	<b>1,977</b>	<b>2,383</b>	<b>(17.0)</b>
Profit from associated companies	77	(128)	c.s.	16	(138)	(111.5)
Net financial income (expense)	(2,734)	(1,628)	68.0	(805)	(503)	60.1
<b>Income before taxes</b>	<b>6,764</b>	<b>6,607</b>	<b>2.4</b>	<b>1,187</b>	<b>1,742</b>	<b>(31.8)</b>
Income taxes	(1,781)	(1,904)	(6.5)	(67)	(495)	(86.5)
<b>Income from continuing operations</b>	<b>4,983</b>	<b>4,703</b>	<b>6.0</b>	<b>1,120</b>	<b>1,247</b>	<b>(10.2)</b>
Income (Loss) from discontinued ops.	1,596	124	n.s.	0	70	n.m.
Minority interest	(346)	(381)	(9.2)	(73)	(125)	(41.5)
<b>Net income</b>	<b>6,233</b>	<b>4,446</b>	<b>40.2</b>	<b>1,047</b>	<b>1,193</b>	<b>(12.2)</b>
<b>Weighted average number of ordinary shares outstanding during the period (millions)</b>	<b>4,779.0</b>	<b>4,870.9</b>	<b>(1.9)</b>	<b>4,853.6</b>	<b>4,813.1</b>	<b>0.8</b>
<b>Basic earnings per share</b>	<b>1.304</b>	<b>0.913</b>	<b>42.9</b>	<b>0.216</b>	<b>0.248</b>	<b>(12.9)</b>

<sup>1</sup> Including work in process.

Note: For the basic earnings per share calculation purposes, the weighted average number of ordinary shares outstanding during the period have been obtained applying IFRS rule 33 "Earnings per share". Thereby, there are not taking into account as outstanding shares the weighted average number of shares held as treasury stock during the period nor the shares assigned to the stock options plans for employees. Furthermore, in line with IFRS rule 33, the weighted average number of shares outstanding during every period, has been adjusted for these operations that had implied a difference in the number of outstanding shares, without a variation associated in the equity, as if those have taken place at the beginning of the first period presented. It consists on the distribution of the paid-in capital reserve by means of delivery of shares in the proportion of 1 share to every 25 shares, approved by the AGM as of May 31, 2005.

## Telefónica Group

### Consolidated balance sheet

Unaudited figures (Euros in millions)

	January - December		
	2006	2005	% Chg
Non-current assets	91,269	59,545	53.3
Intangible assets	20,758	7,877	163.5
Goodwill	21,739	8,910	144.0
Property, plant and equipment and Investment property	33,888	28,027	20.9
Long-term financial assets and other non-current assets	6,183	6,346	(2.6)
Deferred tax assets	8,702	8,385	3.8
Current assets	17,713	13,629	30.0
Inventories	1,012	920	10.0
Trade and other receivables	9,666	7,516	28.6
Current tax receivable	1,555	1,448	7.4
Short-term financial investments	1,679	1,518	10.7
Cash and cash equivalents	3,792	2,213	71.3
Non-current assets classified as held for sale	9	14	(38.2)
<b>Total Assets = Total Equity and Liabilities</b>	<b>108,982</b>	<b>73,174</b>	<b>48.9</b>
Equity	20,001	16,158	23.8
Equity attributable to equity holders of the parent	17,178	12,733	34.9
Minority interest	2,823	3,425	(17.6)
Non-current liabilities	62,644	35,126	78.3
Long-term financial debt	50,675	25,168	101.4
Deferred tax liabilities	4,700	2,477	89.7
Long-term provisions	6,287	6,353	(1.0)
Other long-term liabilities	982	1,128	(12.9)
Current liabilities	26,337	21,889	20.3
Short-term financial debt	8,382	9,236	(9.2)
Trade and other payables	8,533	6,933	23.1
Current tax payable	2,841	2,192	29.7
Short-term provisions and other liabilities	6,580	3,528	86.5
Liabilities associate with non-current assets classified "held for sale"	0	0	n.m.
<b>Financial Data</b>			
Net Financial Debt <sup>1</sup>	<b>52,145</b>	<b>30,067</b>	<b>73.4</b>

<sup>1</sup> Net Financial Debt = Long term financial debt + Other long term liabilities + Short term financial debt - Short term financial investments - Cash and cash equivalents - Long term financial assets and other non-current assets.

## Telefónica Group

### Free cash flow and change in debt

Unaudited figures (Euros in millions)

		January - December		
		2006	2005	% Chg
<b>I</b>	<b>Cash flows from operations</b>	<b>18,824</b>	<b>13,854</b>	<b>35.9</b>
II	Net interest payment <sup>1</sup>	(2,296)	(1,449)	
III	Payment for income tax	(1,100)	(1,233)	
<b>A=I+II+III</b>	<b>Net cash provided by operating activities</b>	<b>15,428</b>	<b>11,172</b>	<b>38.1</b>
B	Payment for investment in fixed and intangible assets	(6,828)	(4,410)	
<b>C=A+B</b>	<b>Net free cash flow after CAPEX 8,600</b>	<b>8,600</b>	<b>6,762</b>	<b>27.2</b>
D	Net Cash received from sale of Real Estate	24	100	
E	Net payment for financial investment	(21,574)	(5,940)	
F	Net payment for dividends and treasury stock <sup>2</sup>	(5,542)	(4,823)	
<b>G=C+D+E+F</b>	<b>Free cash flow after dividends</b>	<b>(18,492)</b>	<b>(3,901)</b>	
H	Effects of exchange rate changes on net financial debt	(511)	1,396	
I	Effects on net financial debt of changes in consolid. and others	4,097	1,076	
J	Net financial debt at beginning of period	30,067	23,694	
<b>K=J-G+H+I</b>	<b>Net financial debt at end of period</b>	<b>52,145</b>	<b>30,067</b>	

<sup>1</sup> Including cash received from dividends paid by subsidiaries that are not under full consolidation method.

<sup>2</sup> Dividends paid by Telefónica S.A. and dividend payments to minorities from subsidiaries that are under full consolidation method and treasury stock.

## Telefónica Group

### Reconciliations of cashflow and OIBDA minux CAPEX

Unaudited figures (Euros in millions)

		January - December		
		2006	2005	% Chg
<b>OIBDA</b>		<b>19,126</b>	<b>15,276</b>	<b>25.2</b>
-	CapEx accrued during the period <sup>1</sup>	(8,003)	(5,359)	
-	Payments related to commitments	(830)	(894)	
-	Net interest payment	(2,296)	(1,449)	
-	Payment for income tax	(1,100)	(1,233)	
-	Results from the sale of fixed assets	(236)	(249)	
-	Invest. in working cap. and other deferred income and exp	1,939	670	
<b>= Net Free Cash Flow after CapEx</b>		<b>8,600</b>	<b>6,762</b>	<b>27.2</b>
+	Net Cash received from sale of Real Estate	24	100	
-	Net payment for financial investment	(21,574)	(5,940)	
-	Net payment for dividends and treasury stock	(5,542)	(4,823)	
<b>= Free Cash Flow after dividends</b>		<b>(18,492)</b>	<b>(3,901)</b>	<b>n.m.</b>

<sup>1</sup> The CapEx in 2005 calculated using EoP exchange rates.

Note: At the Investor Conference held in October 2003, the concept expected "Free Cash Flow" 2003-2006 was introduced to reflect the amount of cash flow available to remunerate Telefónica S.A. Shareholders, to protect solvency levels (financial debt and commitments), and to accommodate strategic flexibility. The differences with the caption "Net Free Cash Flow after CapEx" included in the table presented above, are related to "Free Cash Flow" being calculated before payments related to commitments (workforce reductions and guarantees) and after dividend payments to minorities, due to cash recirculation within the Group.

	Jan-Dec 2006	Jan-Dec 2005
Net Free Cash Flow after CapEx	8,600	6,762
+ Payments related to cancellation of commitments	830	693
- Ordinary dividends payment to minorities	(514)	(347)
<b>= Free Cash Flow</b>	<b>8,916</b>	<b>7,108</b>

## Telefónica Group

### Net financial debt and commitments

Unaudited figures (Euros in millions)

December 2006

	Long-term debt	51,163
	Short term debt including current maturities	8,249
	Cash and Banks	(3,792)
	Short and Long-term financial investments <sup>1</sup>	(3,474)
<b>A</b>	<b>Net Financial Debt</b>	<b>52,145</b>
	Guarantees to IPSE 2000	365
<b>B</b>	<b>Commitments related to guarantees</b>	<b>365</b>
	Gross commitments related to workforce reduction <sup>2</sup>	5,447
	Value of associated Long-term assets <sup>3</sup>	(734)
	Taxes receivable <sup>4</sup>	(1,624)
<b>C</b>	<b>Net commitments related to workforce reduction</b>	<b>3,089</b>
<b>A + B + C</b>	<b>Total Debt + Commitments</b>	<b>55,599</b>
	<b>Net Financial Debt / OIBDA<sup>5</sup></b>	<b>2.67€</b>
	<b>Total Debt + Commitments/ OIBDA<sup>5</sup></b>	<b>2.85€</b>

<sup>1</sup> Short term investments and certain investments in financial assets with a maturity profile longer than one year, whose amount is included in the caption "Investment" of the Balance Sheet.

<sup>2</sup> Mainly in Spain. This amount is detailed in the caption "Provisions for Contingencies and Expenses" of the Balance Sheet, and is the result of adding the following items: "Provision for Pre-retirement, Social Security Expenses and Voluntary Severance", "Group Insurance", "Technical Reserves", and "Provisions for Pension Funds of Other Companies".

<sup>3</sup> Amount included in the caption "Investment" of the Balance Sheet, section "Other Loans". Mostly related to investments in fixed income securities and long-term deposits that cover the materialization of technical reserves of the Group insurance companies.

<sup>4</sup> Net present value of tax benefits arising from the future payments related to workforce reduction commitments.

<sup>5</sup> Calculation based on 12 months accumulated OIBDA, including Telefónica O2 Czech Republic, O2 and Telefónica Telecom.

## Telefónica Group

### Exchanges rates applied

	P&L and CapEx <sup>1</sup>		Balance Sheet <sup>2</sup>	
	Jan - Dec 2006	Jan -Dec 2005	December 2006	December 2005
USA (US Dollar/Euro)	1.255	1.242	1.317	1.180
United Kingdom (Sterling/Euro)	0.682	-	0.672	0.685
Argentina (Argentinean Peso/Euro)	3.857	3.631	4.033	3.577
Brazil (Brazilian Real/Euro)	2.728	3.002	2.816	2.761
Czech Republic (Czech Crown/Euro)	28.338	29.780	27.495	29.005
Chile (Chilean Peso/Euro)	665.336	694.444	701.262	606.061
Colombia (Colombian Peso/Euro)	2,949.853	2,881.844	2,949.853	2,695.418
El Salvador (Colon/Euro)	10.977	10.870	11.524	10.322
Guatemala (Quetzal/Euro)	9.548	9.496	10.004	8.974
Mexico (Mexican Peso/Euro)	13.664	13.517	14.330	12.715
Nicaragua (Cordoba/Euro)	22.031	20.799	23.703	20.222
Peru (Peruvian Nuevo Sol/Euro)	4.108	4.096	4.205	4.051
Uruguay (Uruguayan Peso/Euro)	30.183	30.331	32.201	28.490
Venezuela (Bolivar/Euro)	2,695.418	2,624.672	2,832.861	2,538.071

<sup>1</sup> These exchange rates are used to convert the P&L and CapEx accounts of the Group foreign subsidiaries from local currency to euros.

<sup>2</sup> Exchange rates as of 31/12/06 y 31/12/05.

## Results by business lines

### Fixed line Business

#### Telefónica de España Group

The 2006 results for Telefónica de España Group fully met guidance announced at the start of the year, which was upgraded following the publication of the third quarter results. In a year of strong commercial activity in which the company reinforced its competitive position in the market, revenues grew by 1.8% (target +0.5% / +2%) and OIBDA adjusted for comparison with the financial guidance communicated increased by 6.4% (growth target of over 5%).

With excellent operative and financial results, the Internet and Broadband business played a leading role in this performance, in a growth environment that reached historic heights for the broadband market in Spain. Along these lines, Telefónica de España recorded a net gain of over one million new broadband retail subscriptions in 2006, over 20% up on that obtained in 2005.

The offers of Dúo and Trío product bundles have already exceeded the 2.8 million mark in terms of units sold. The success of these packages, together with that of other measures launched, led to a containment in the loss of fixed telephone lines, which in 2006 fell by 1.2%, with a yearly net loss 7% lower than in 2005. Line lost in 2006 represented 1.2% of the lines at 2005 year end.

It is also important to note the global ARPU of our customers, which increased to total 63.8 euros as a result of the continued efforts of Telefónica de España to increase the value of its customers.

During last quarter of 2006, in merit of settlements met with workers representatives, it was agreed to bring forward, to September 21st 2006, the period for joining Telefónica de

España's E.R.E. for 2007, as already anticipated during 2006 third quarter results conference call. This has resulted in an uplift of 2006 redundancies from the 1,542 initially expected, to total 3,304 in the year. Following, the corresponding provision was increased by additional 503 million euros to stand at 980 million euros for 2006, resulting on a reduction in OIBDA growth of 10.5 p.p. in 2006.

Analysing the latest commercial launches in detail, the following must be underlined:

- “ADSL 3 Mbps / 320 Kbps”. The product is offered independently or in double or triple play offers for just one additional euro on top of the 1 Mbps ADSL price.
- “UNO PROFESIONAL” (Professional ONE), the first commercial offer in conjunction with Telefónica Móviles España for SMEs and Professionals (SoHo). This product enables customers to make free calls between their own fixed and mobile lines. The offer can also be extended to certain external destinations.

In terms of regulatory matters, a 2.0% increase in the PSTN line monthly fee came into force as of January 1st, 2007. A 3.7% increase in domestic telephone traffic tariffs not related to packages/bundles has also been indicated, which is to come into force as of March 1st, 2007.

At the start of the year, the CMT also lowered the wholesale price of indirect broadband access as a cautionary measure. This drop ranges between 22% and 54% - depending on the modality - for the GigADSL service and between 24% and 61% for the ADSL-IP service. Thus, the CMT has replaced the “retail minus” methodology applied to date, by the new “cost plus” methodology.

Revenues of Telefónica de España Group amounted to 11,964 million euros over 2006, a year-on-year growth of 1.8%. Revenues amounted to 3,070 million euros during the fourth quarter of the year, a 2.0% increase that, as in previous quarters, was lowered by the change in accounting criterion for traffic-cards revenues. The growth in revenues for 2006 without this effect would have stood at 2.4%.

Telefónica de España Parent Company recorded revenues of 11,508 million euros over the year, a 2.3% year-on-year increase, which amounted to 1.7% in the fourth quarter.

Below is a detailed analysis of the Telefónica de España Parent Company's revenues:

- Traditional access revenues, amounting to 2,768 million euros, fell by 2.1% in relation to those obtained during the previous year, due to the reduction in the number of fixed telephone lines and the freezing of the PSTN line monthly fee in 2006. This reduction amounted to 2.1% during the fourth quarter.

The fixed telephony market in Spain increased its estimated growth in 2006 to stand at 2.3%, compared with the 0.9% growth rate recorded in 2005. In terms of fixed telephony lines, Telefónica de España recorded a net reduction of 185,696 over the year, slightly less than the loss of 199,243 lines in 2005. The estimated market share for Telefónica de España stood at 82.5%, almost 2.5 percentage points down on 2005.

The total number of Telefónica de España accesses where, along with fixed telephony accesses, data and Internet accesses were accounted for, as well as pay television and wholesale accesses, increased by 3.7% to stand at 22.7 million.

- Revenues from traditional voice services amounted to 4,868 million euros in 2006, with a year-on-year reduction of 5.7%. Without taking the change in accounting criterion for traffic-cards into account, this reduction would have been 4.3%.

Revenues from outgoing voice traffic dropped by 7.7% over the year to stand at 3,014 million euros, with this decrease being mainly attributable to the fall in the average price per minute, specially on national voice traffic.

This fall in revenues does not reflect the better performance of outgoing voice traffic seen as a result of the Dúo and Trío offers, dropping by only 1.3% in 2006 to reach 43,369 million minutes, compared with 7.2% fall in 2005.

This effect can also be seen in the performance of the fixed voice market in Spain as a whole that fell by a 0.7% in 2006 compared with the 3.1% drop of the previous year. The estimated market share of Telefónica de España remained relatively stable throughout the year at around 66%.

In 2006, domestic voice traffic fell slightly by 1.3% in comparison with the previous year, with a total of 33,087 million minutes. The systematic, significant 11.7% growth of "interprovincial" traffic (DLD) is worth noting, doubtlessly the most positively affected by the new rate schemes. The acceleration of international traffic (2,094 million minutes) is also significant, with a year-on-year growth of 6.4% in 2006 and 12.8% over the quarter. Fixed-to-mobile traffic continued to drop by 4.4% (5,431 million minutes).

With regard to service packages, the total number of combined plans and flat rates amounted to 4,638,661, 11.6% up on that of September 2006.

Moreover, by December 2006, there were 1,906,519 pre-selected lines, a drop of 118,851 over the fourth quarter, with the accumulated reduction over the year amounting to 378,071 lines.

- According to our estimates, the fixed broadband Internet access market in Spain amounted to around 6.7 million accesses by the end of the year, recording a historic maximum net quarterly gain over the last months of the year of 550,000 accesses, an estimate year-on-year growth of 10%. Telefónica's ADSL connections as a whole (wholesale plus retail, including accesses providing only the Imagenio service) accounted for 4,385,804 connections in 2006.

Revenues from Internet and Broadband services, which totalled 2,403 million euros over the year, 26.2% up on the previous year, more than offset the reduction in revenues from the traditional access and voice businesses. During the fourth quarter of the year, the growth in these revenues stood at 23.9%.

Within this section, broadband revenues from both Internet access and pay television grew 32.6% over the year to reach 2,260 million euros, of which 84% are from the retail business.

Telefónica's client base of retail Internet broadband accesses (ADSL, optical fiber and other technologies, excluding accesses only providing the Imagenio service) recorded a net gain of 331,330 connections over the fourth quarter, representing an estimated 60% of the total net gain of broadband accesses over the quarter. With this, the total number of Telefónica Internet broadband retail accesses stood at 3,742,652 by the end of 2006. The company has strengthened its leadership in this market with an estimated broadband share of 56%.

The new packages of products have led to a year-on-year reduction in the ADSL connectivity ARPU of 8.4% that, partially offset by the growth of almost 19.4% in the value added services ARPU, led to an overall 4.8% drop in broadband ARPU.

It must be highlighted that over 70% of Telefónica de España retail broadband accesses have the Internet connectivity service within some kind of double or triple-play bundle.

The evolution of unbundled loops has maintained significant drive over the year. The net gain amounted to 164,201 loops during the fourth quarter of 2006. A high percentage of the net gain of loops (60% over the year and 52% in the last quarter) corresponds to migrations from Telefónica de España wholesale ADSL service. By year end, the total number of unbundled loops stood at 939,006 to represent, according to our estimates, 14% of the total number of fixed broadband accesses on the Spanish market and 17.6% of ADSL lines. Of this total, 56% were shared access loops, which remained stable over the last quarters.

The wholesale ADSL service was affected by the migration to unbundled loops and, therefore, recorded a loss of 135,522 accesses over the year to leave its total plant in 586,418, 18.8% down on that recorded at the end of 2005.

Value-added services (VAS) provided over Telefónica de España broadband accesses remained a fundamental factor in the service portfolio of the Company. The number of operative services amounted to 3.1 million. ADSL Solutions is noteworthy among these services, a total of 356,986 solutions being operational by the end of 2006 to give a 8.5% increase in relation to the previous quarter.

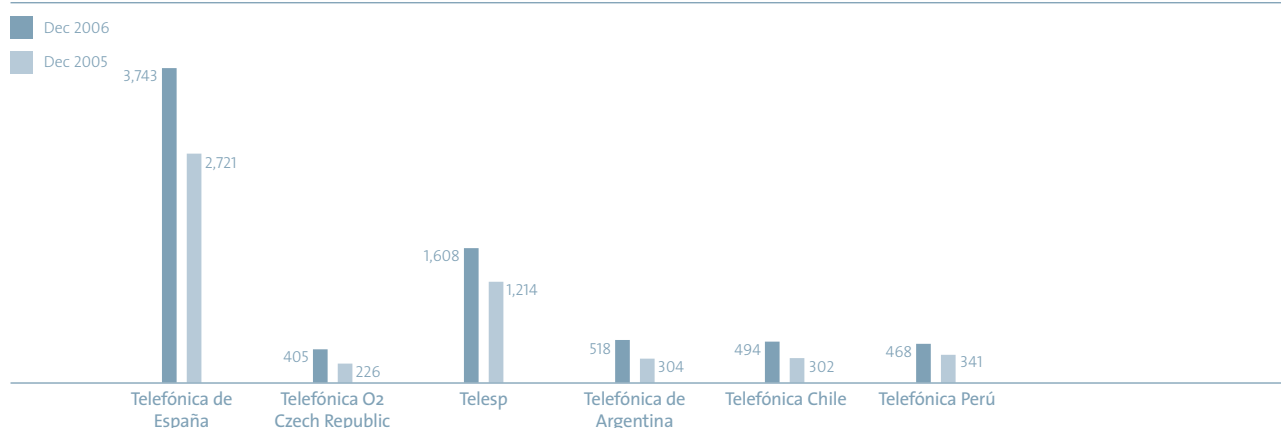
The net increase in Imagenio customers during the fourth quarter of the year stood at 78,674, representing 43% of the total estimated net gain for the pay TV market in Spain and 45% of the net growth of Imagenio customers over the year. The total number of pay TV customers stood at 383,027, with a market share of 10% (+4 percentage points compared with 2005).

- Revenues from data services grew by 4.4% over the year to reach 1,076 million euros, with wholesale data revenue accounting for the yearly growth, 19% for the accumulate of the year.



## Retail internet broadband accesses

Data in thousands



- Lastly, information technology services contributed towards Telefónica de España revenues with a total of 392 million euros, a 19.9% increase year on year. Growth stood at 25.4% over the fourth quarter.

Telefónica de España Group operating expenses recorded a year-on-year growth of 5.1% to stand at 7,582 million euros, while this growth totalled 30.5% over the fourth quarter. These figures were significantly affected by the workforce restructuring provisions, with a total of 3,304 redundancies and a provision of 980 million euros for 2006. This amount is divided into the 477 million euros corresponding to 1,542 employees joining the Redundancy Programme initially planned for 2006, plus 503 million euros associated to the bringing forward the period for joining the E.R.E. corresponding to 1,762 employees. Excluding the effect of the E.R.E. provisions, 2006 operating expenses would have dropped by 0.2% backing up the result of the cost containment policy.

- Personnel expenses grew by 14.7% in relation to the same period of the previous year to reach 3,105 million euros. Growth stood at 86.4% over the fourth quarter.

Excluding the effect of the workforce restructuring provisions for 2005 (595 million euros including actuarial reviews) and 2006, personnel expenses would have grown by 0.7%.

The Telefónica de España Parent Company workforce at the end of the year totalled 32,397 employees, with a net reduction of 1,147 employees since the start of the year. The average Telefónica de España Parent Company workforce in 2006 stood at 34,533 employees, a 4.2% reduction in comparison with the average workforce in 2005.

- Supplies expenses fell by 1.1% over the year to stand at 2,971 million euros. Over the fourth quarter, however, there was a 0.8% growth due to the increased activity of Telyco over this last three months of the year.
- External services expenses recorded a 5.9% increase over the fourth quarter, due to the commercial expenses of this last

part of the year. These expenses fell by 0.4% over the year to reach 1,302 million euros. Without taking the change in accounting criterion for traffic-cards into account, external services expenses would have grown by 5.5%.

The Telefónica de España OIBDA amounted to 4,572 million euros in 2006, a 4.4% drop over the year and 37.3% over the quarter. The aforementioned impact of the workforce restructuring provisions must be taken into account to explain this behaviour.

For comparison purposes with the announced financial guidance, exceptional revenues/expenses not foreseen in years 2005 and 2006 must be excluded from OIBDA; for year 2006 this includes the 503 million euro provision associated to the bringing forward of the period for joining the E.R.E. of 2007. Once this adjustment has been made, the growth in OIBDA would stand at 6.4%, in line with the target announced (above 5%).

If specific effects such as those arising from the Redundancy Programme, the Real Estate programme or subsidies mainly are excluded, underlying OIBDA would have grown by 3.7%.

The OIBDA margin stood at 38.2% in 2006, 2.5 percentage points under that recorded the previous year. Excluding the effect of Redundancy Plan provision and the actuarial review for both years, the margin would have increased by 0.7 percentage points year on year to reach 46.4%.

OIBDA for Telefónica de España parent company amounted to 4,593 million euros, down 2.6% year on year.

Lastly, CapEx for Telefónica de España Group totalled 1,555 million euros, a significant increase of 11.0% in comparison with the previous year, having anticipated investments to meet increasing demand in the broadband market.

## Telefónica de España Group accesses

Unaudited figures (Thousands)

	2005	2006				
	December	March	June	September	December	%Chg
<b>Final Clients Accesses</b>	<b>20,742.7</b>	<b>20,901.7</b>	<b>20,821.7</b>	<b>20,931.3</b>	<b>21,174.9</b>	<b>2.1</b>
Fixed telephony accesses <sup>1</sup>	16,135.6	16,108.5	16,019.7	15,978.1	15,949.9	(1.2)
Internet and data accesses	4,400.6	4,542.9	4,534.6	4,648.8	4,842.0	10.0
Narrowband	1,614.9	1,437.4	1,254.0	1,177.7	1,040.5	(35.6)
Broadband <sup>2</sup>	2,720.8	3,042.7	3,220.1	3,411.3	3,742.7	37.6
Other <sup>3</sup>	64.9	62.8	60.4	59.8	58.8	(9.4)
Pay TV	206.6	250.3	267.5	304.4	383.0	85.4
<b>Wholesale Accesses</b>	<b>1,164.1</b>	<b>1,260.4</b>	<b>1,369.3</b>	<b>1,406.5</b>	<b>1,531.8</b>	<b>31.6</b>
Unbundled loops	434.8	546.7	678.3	774.8	939.0	116.0
Shared UL	279.0	320.3	386.0	438.5	527.7	89.1
Full UL	155.7	226.4	292.3	336.3	411.3	164.1
Wholesale ADSL	721.9	706.4	684.4	625.2	586.4	(18.8)
Other <sup>4</sup>	7.4	7.3	6.6	6.5	6.4	(14.0)
<b>Total Accesses</b>	<b>21,906.8</b>	<b>22,162.1</b>	<b>22,191.0</b>	<b>22,337.7</b>	<b>22,706.7</b>	<b>3.7</b>

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

<sup>2</sup> ADSL, satellite, optical fiber and broadband circuits. Includes Terra.

<sup>3</sup> Leased lines.

<sup>4</sup> Wholesale circuits.

## Telefónica de España parent company

### Operating revenues

Unaudited figures (Euros in millions)

	January - December			October - December		
	2006	2005	% Chg	2006	2005	% Chg
<b>Traditional Access<sup>1</sup></b>	<b>2,768</b>	<b>2,826</b>	<b>(2.1)</b>	<b>689</b>	<b>704</b>	<b>(2.1)</b>
<b>Traditional Voice Services</b>	<b>4,868</b>	<b>5,162</b>	<b>(5.7)</b>	<b>1,203</b>	<b>1,298</b>	<b>(7.4)</b>
Domestic Traffic <sup>2</sup>	1,211	1,331	(9.0)	308	335	(8.0)
Fixed to Mobile Traffic	1,105	1,152	(4.1)	269	282	(4.4)
International Traffic	500	474	5.3	130	120	8.2
Intel. Network, other cons. and bonus <sup>3</sup>	199	310	(35.8)	33	87	(62.8)
Interconnection <sup>4</sup>	907	944	(4.0)	211	227	(7.3)
Handsets sales and others <sup>5</sup>	947	951	(0.4)	252	47	2.1
<b>Internet Broadband Services</b>	<b>2,403</b>	<b>1,905</b>	<b>26.2</b>	<b>640</b>	<b>517</b>	<b>23.9</b>
Narrowband	143	201	(28.7)	26	48	(46.1)
Broadband	2,260	1,704	32.6	615	469	31.1
Retail <sup>6</sup>	1,901	1,298	46.4	532	359	48.2
Wholesale <sup>7</sup>	359	406	(11.5)	83	110	(24.8)
<b>Data Services</b>	<b>1,076</b>	<b>1,031</b>	<b>4.4</b>	<b>270</b>	<b>262</b>	<b>3.2</b>
VPN, Leased Circuits and Broadcasting	643	667	(3.6)	165	169	(2.7)
Wholesale	433	364	19.0	106	93	13.7
<b>IT Services</b>	<b>392</b>	<b>327</b>	<b>19.9</b>	<b>136</b>	<b>108</b>	<b>25.4</b>
<b>Total operating revenues</b>	<b>11,508</b>	<b>11,251</b>	<b>2.3</b>	<b>2,939</b>	<b>2,890</b>	<b>1.7</b>

<sup>1</sup> Monthly and connection fees (PSTN, Public Use Telephony, ISDN and Corporate Services) and Telephone booths surcharges.

<sup>2</sup> Local and domestic long distance (provincial and interprovincial) traffic.

<sup>3</sup> Intelligent Network Services, Special Valued Services, Information Services (118xy), bonuses and others.

<sup>4</sup> Includes revenues from fixed to fixed incoming traffic, fixed to mobile incoming traffic, and transit and carrier traffic.

<sup>5</sup> Managed Voice Services and other businesses revenues.

<sup>6</sup> Retail ADSL services and other Internet Services.

<sup>7</sup> Includes Megabase, Megavia, GigADSL, and local loop unbundling.

Note: On 1st July 2006, Terra España merged with Telefónica de España, S.A., retroactively to 1st January 2006.

## Telefónica de España Group

### Consolidated income statement

Unaudited figures (Euros in millions)

	January - December			October - December		
	2006	2005	% Chg	2006	2005	% Chg
Revenues	11,964	11,755	1.8	3,070	3,011	2.0
Internal exp capitalized in fixed assets <sup>1</sup>	142	162	(12.1)	44	54	(18.7)
Operating expenses	(7,582)	(7,213)	5.1	(2,321)	(1,779)	30.5
Other net operating income (expense)	(15)	18	c.s.	19	(12)	c.s.
Gain (loss) on sale of fixed assets	80	71	12.6	(3)	11	c.s.
Impairment of goodwill and other assets	(17)	(10)	66.0	(5)	(4)	25.9
<b>Operating income before D&amp;A (OIBDA)</b>	<b>4,572</b>	<b>4,784</b>	<b>(4.4)</b>	<b>803</b>	<b>1,281</b>	<b>(37.3)</b>
Depreciation and amortization	(1,866)	(2,138)	(12.7)	(453)	(511)	(11.4)
<b>Operating income (OI)</b>	<b>2,706</b>	<b>2,645</b>	<b>2.3</b>	<b>350</b>	<b>770</b>	<b>(54.5)</b>

<sup>1</sup> Including work in process.

Note: Telefónica de España Group incorporates the results of Terra Networks operations from 1 January 2005.

### Telefónica Latinoamérica Group

From January 1st 2006, Telefónica Latinoamérica Group's fixed telephony operator accounts include the Telefónica Empresas businesses in their respective countries. The 2005 results are shown on comparable terms. On the other hand, to facilitate year-on-year comparisons, the Telefónica Latinoamérica Group figures include the results of the Terra subsidiaries in Latin America since January 1st 2005.

Since 1st May, the results of the Telefónica Latinoamérica Group include the results of Colombia Telecom, that changed its name to Telefónica Telecom in November. In November Telefónica Telecom merged with Telefónica Empresas Colombia, thus Telefónica Latinoamérica Group's stake in the new company increased to 52.03%. In these eight months, Telefónica Telecom has recorded 398 million euros of revenues and 203 million euros at the OIBDA level (without considering Telefonica Empresas business). In 2006, the currencies of the countries in which the Telefónica Latinoamérica Group operates have remained relatively stable over the year in relation to the dollar. Despite the appreciation of the euro in relation to the dollar exchange rates posted a positive impact over the year, with a 6.0 percentage point increase in revenues (10.2 percentage points to September) and a 6.1 percentage point growth in OIBDA (10.4 percentage points to September).

Over the year, the Telefónica Latinoamérica Group recorded revenues of 9,537 million euros, 14.2% up on that of the same period of the previous year in current euros. Excluding the positive exchange rate effect and revenues from Telefónica Telecom, the Telefónica Latinoamérica Group recorded a 3.5% growth in revenues. This increase is compared with the target announced<sup>1</sup>, which considered an estimated growth in revenues around the lower level of the target range announced (4%-6%),

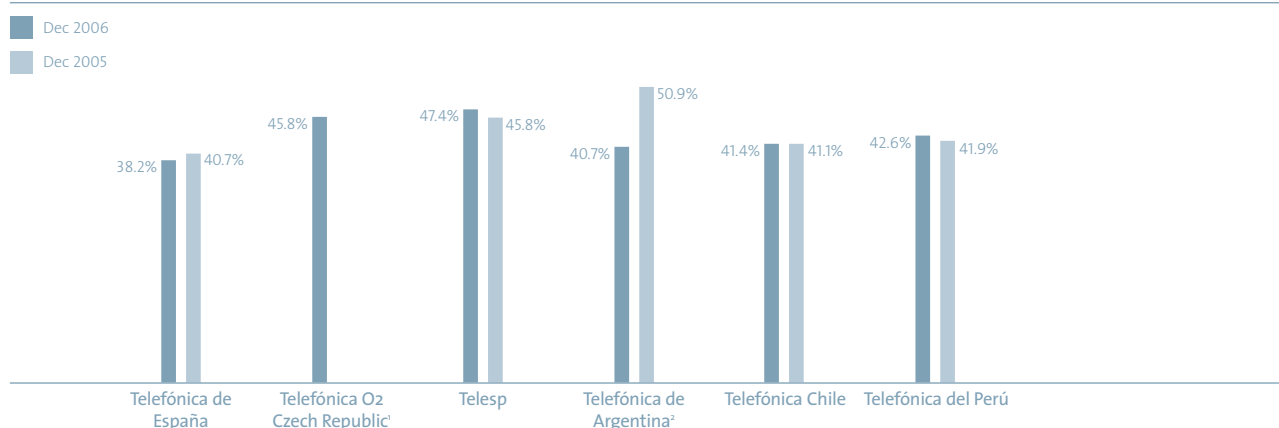
including the reclassification of international termination rates in Brazil, Argentina and Peru and the public telephony commissions in Brazil, now under operating expenses (previously as a minor revenue) as of 1st January 2006, which finally contributed 0.6 percentage points to the growth in revenues for the year as a whole (compared with the initially estimated 0.7 percentage points).

The growth in revenues for the Telefónica Latinoamérica Group is mainly due to the growth of all operators in broadband, leading to a growth in revenues from the Internet business (narrowband + broadband + pay TV) of 17.3% in constant euros, representing 14.9% of revenues (13.3% in 2005). Brazil's revenues increased by 1.5% in local currency due to the 15.3% local currency increase in revenues from the Internet business (narrowband + broadband), as the traditional business remained almost stable as a result of the slight decrease in the number of lines and the downwards trend in traffic that the company is trying to offset through the sale of packages. Argentina recorded a 13.6% growth in revenues in local currency thanks to the growth of traditional business (+10.9% in local currency), primarily due to the minutes packages and the wholesale business, as well as the progress of the Internet business (+34.4% in local currency). Revenues from Peru grew by 2.6% in local currency as a result of the good progress of broadband and TV (cable and satellite) revenues that increased by a total 24.4% in local currency, offsetting the 2.0% drop in local currency in revenues from traditional business due to the productivity factor (CPI-10.07%) and lower public telephony revenues due primarily to the fixed-mobile substitution. In Chile, in an environment of intense competition and with a high mobile substitution effect, Telefónica was able to keep revenues stable (+0.2% in local currency) thanks to the 36.5% increase in local currency in Internet business (narrowband + broadband + television) revenues that offset the lower revenues from

<sup>1</sup> 2006 guidance assumes constant exchange rates as of 2005 and excludes changes in the consolidation perimeter, namely Telefónica Telecom.

**OIBDA Margin - Fixed Telephony**

Data in million euros



traditional business (-3.0%). On the other hand, Terra recorded 299 million euros in revenues, 3.5% more than in 2005 in constant euros.

Operating expenses for the Telefónica Latinoamérica Group stood at 5,351 million euros, with a year-on-year growth of 17.9% in current euros. Excluding the contribution of Telefónica Telecom and the exchange rate effect, operating expenses recorded a 7.6% growth in constant euros. This growth in expenses was affected over the year by workforce restructuring expenses in Brazil, Argentina and Chile. Higher tax expenses were recorded in Telesp due to the new concession contract. Also an increase in payroll expenses in Argentina and higher commercial expenses, especially regarding customer service, were recorded.

As a result, Telefónica Latinoamérica recorded operating income before depreciation and amortization (OIBDA) of 4,209 million euros, 11.7% higher year-on-year. Excluding the contribution of Telefónica Telecom and the positive contribution of exchange rates, OIBDA recorded a 0.3% increase in constant euros. These year-on-year variations were affected by the sale of Infonet and Telinver in Argentina in 2005 and the sale of TUMSAC in Peru in 2006. Excluding the gain on sales of fixed assets, the growth in OIBDA stood at 15.1% (+3.3% excluding the exchange rate effect and Telefónica Telecom). With regards to the financial objectives for the year as a whole<sup>2</sup>, the growth in OIBDA was expected to stand at the top end of the 3%-5% range announced at the beginning of the year, having ended at 3.7% affected by the inclusion of the expenses associated with the Pension Plan for Management at the year end, without which growth would have stood at 4.6%.

Telefónica Latinoamérica Group's CapEx in 2006 amounted to 1,285 million euros, a year-on-year growth of 29.9% (+10.2% in constant terms and excluding the investment of Telefónica Telecom), primarily used for the expansion of broadband and new businesses. The CapEx recorded for the Telefónica Latinoamérica Group comparable with the target<sup>3</sup> announced at the start of the year amounted to 1,090 million euros, compared with the initially announced target of around 1,200 million euros. Telefónica Latinoamérica Group's operating free cash flow (OIBDA-CapEx) over the year amounted to 2,924 million euros, a 5.3% growth (+0.7% in constant euros and excluding the contribution of Telefónica Telecom and the gain on sales of fixed assets).

By the year end, Telefónica Latinoamérica Group managed 31.2 million accesses, 10.9% up on 2005 following the incorporation of Telefónica Telecom with almost 2.4 million fixed telephone accesses and 68,004 Internet retail broadband accesses. The Group's retail broadband Internet connections upheld the strong growth rate of previous quarters, reaching a total of almost 3.8 million (+40.0% year-on-year), thanks to the commercial effort of all operators. Fixed telephone lines amounted to 23.8 million, 10.0% up on 2005 following the incorporation of Telefónica Telecom and thanks also to the high growth rate of Telefónica del Perú and TASA, which offset the lower plant in service of Telesp and Telefónica Chile. Telefónica Latinoamérica Group already has 651,392 pay TV clients in Peru and Chile.

<sup>2</sup> 2006 guidance assumes constant exchange rates as of 2005 and excludes changes in the consolidation perimeter, namely Telefónica Telecom Operating income before D&A excludes other exceptional revenues/expenses not foreseeable in 2006. For comparison purposes, the equivalent other exceptional revenues/expenses registered in 2005 are also deducted from the reported figures.

<sup>3</sup> 2006 guidance assumes constant exchange rates as of 2005 and excludes changes in the consolidation perimeter, namely Telefónica Telecom.

## TELESP accesses

Unaudited figures (Thousands)

	2005	2006				
	December	March	June	September	December	%Chg
<b>Final Clients Accesses</b>	<b>15,606.8</b>	<b>15,618.7</b>	<b>15,704.4</b>	<b>15,759.0</b>	<b>15,663.9</b>	<b>0.4</b>
Fixed telephony accesses <sup>1</sup>	12,340.3	12,370.4	12,336.1	12,295.1	12,107.1	(1.9)
Internet and data accesses	3,266.5	3,248.2	3,368.3	3,463.9	3,556.8	8.9
Narrowband	1,986.7	1,876.1	1,891.4	1,884.5	1,856.6	(6.5)
Broadband <sup>2</sup>	1,213.8	1,307.3	1,382.4	1,485.2	1,608.2	32.5
Other	66.0	64.8	94.5	94.2	92.0	39.3
<b>Wholesale Accesses</b>	<b>32.6</b>	<b>32.7</b>	<b>46.3</b>	<b>46.4</b>	<b>38.4</b>	<b>17.6</b>
<b>Total Accesses</b>	<b>15,639.4</b>	<b>15,651.3</b>	<b>15,750.8</b>	<b>15,805.4</b>	<b>15,702.2</b>	<b>0.4</b>

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

<sup>2</sup> Includes ADSL and broadband circuits.

## TELESP

By the end of December, Telesp had 15.7 million accesses, a year-on-year growth of 0.4% thanks to the strong growth in the number of Internet retail broadband accesses that stood at 1.6 million (+32.5% year-on-year), following a net gain over the year of almost 400,000 accesses. Fixed telephony accesses stood at 12.1 million (-1.9% year-on-year), of which around 19% were prepaid lines or lines with a consumption limit.

Voice traffic recorded a 3.9% year-on-year decrease standing at 69,737 million minutes as a result of the drop in local traffic (-3.1%), mainly due to lower consumption per line and lower average plant, which the operator is trying to offset with the sale of minutes packages. Long distance traffic, mostly inter-state, also dropped as a result of the squeeze of this market due to the growth of the cellular business.

Revenues recorded a year-on-year growth of 1.5% in local currency to stand at 5,565 million euros, compared with a 2.1% growth up to September. This lower growth rate is due to the slowing down of traditional business (+0.1% compared with +0.6% over the first nine months of the year), mostly as a result of the reduced average billable fixed telephony plant and the drop in traffic per line. The growth in the broadband business (+27.1% in local currency) also contributed positively, thanks to the increased plant that enabled Internet business revenues (narrowband + broadband) to contribute with 8.5% to Telesp revenues (7.5% in the same period of 2005). To a lesser extent, the growth in the data and information technology business also contributed positively (+6.2% and +14.7% in local currency, respectively), providing a combined 3.9% of the company revenues.

Operating expenses recorded a 4.8% year-on-year growth in local currency, primarily due to higher tax expenses (+72.7% in local currency) mainly due to the tax established in the new concession contract, and higher personnel expenses (+9.6% in

local currency) following the extraordinary charge associated with the workforce restructuring programme undertaken during year that is, however, beginning to bear fruit. Excluding this extraordinary charge, personnel expenses would increase by 0.7% and operating expenses would limit their growth rate to 3.7% in local currency. Furthermore, supplies expenses increased by only 0.7% in local currency due to the slowing down of interconnections as a result of lower revenues from traffic to mobiles. Subcontracting expenses recorded a growth rate of 2.5% in local currency, reflecting the cost containment efforts of the operator.

Telesp's Operating income before depreciation and amortisation (OIBDA) to December stood at 2,637 million euros, 5.1% more in local currency than the same period of the previous year and positively affected by the recovery of old taxes (PIS/Cofins) following the favourable judgement issued in September. The OIBDA margin was 47.4%, 1.6 percentage points higher than that recorded in the same period of 2005.

CapEx accumulated to December amounted to 639 million euros, 1.3% lower than in the same period of 2005 in local currency and despite higher investments in broadband and new businesses. Thus, the operating free cash flow (OIBDA – CapEx) amounted to 1,998 million euros (+7.3% year-on-year in local currency). From a regulatory viewpoint, the new regulation for pulse-to-minute migration was finally approved in December, which is to start as of 1st March. In line with this, two migration plans will co-exist: the basic which, in short, transfers the current intervals to minutes, and the PASOO (Alternative Compulsory Offer Plan).

## Telefónica de Argentina

Results in Argentina had progressed well by the end of the year, supported by the strong increase in revenues due to the growth of different commercial initiatives, despite the lack of tariff indexation since 2001.

## Telefónica de Argentina accesses

Unaudited figures (Thousands)

	2005	2006				
	December	March	June	September	December	%Chg
<b>Final Clients Accesses</b>	<b>5,417.3</b>	<b>5,465.4</b>	<b>5,548.3</b>	<b>5,611.3</b>	<b>5,609.9</b>	<b>3.6</b>
Fixed telephony accesses <sup>1</sup>	4,532.2	4,553.1	4,586.7	4,612.4	4,636.3	2.3
Internet and data accesses	885.1	912.3	961.6	998.9	973.7	10.0
Narrowband	564.0	548.9	536.1	504.1	439.2	(22.1)
Broadband <sup>2</sup>	304.3	346.5	408.7	477.9	517.7	70.1
Other	16.8	16.8	16.8	16.8	16.8	0.0
<b>Wholesale Accesses</b>	<b>6.9</b>	<b>7.3</b>	<b>7.2</b>	<b>7.2</b>	<b>7.3</b>	<b>5.4</b>
<b>Total Accesses</b>	<b>5,424.2</b>	<b>5,472.7</b>	<b>5,555.5</b>	<b>5,618.4</b>	<b>5,617.2</b>	<b>3.6</b>

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

<sup>2</sup> Includes ADSL, optical fiber, broadband circuits and ISP in the North part of the country.

By the end of the year, TASA managed 5.6 million accesses (+3.6% compared with the same period in 2005), thanks to the year-on-year increase in fixed telephony accesses (+2.3%) to stand at 4.6 million and the strong growth in the number of Internet retail broadband accesses (+70.1%), enabling the company to maintain its position as leader of the broadband market in its influence area with 517,666 accesses.

Total voice traffic remained stable compared with 2005 levels, in line with the performance of local traffic that remained unvaried thanks to the sale of DUOS (local traffic + broadband). The growth in long distance traffic (+2.1%), as well as an increase in interconnection traffic (+1.0%) and Intelligent Network traffic (+23.9%), offset the drop in public telephony traffic due to expansion of the cellular business.

Revenues totalled 989 million euros, a year-on-year increase of 13.6% in local currency due to the change in the accounting criteria for international termination costs that, as of September, are accounted as operating expenses and no longer netted the line of revenues as of 1st January 2006. Eliminating this effect, revenues would have grown by 10.6% in local currency compared with 10.0% to September. Traditional business increased by 7.4% in local currency (+10.9% including the international termination costs effect), mainly due to the growth in interconnection and local traffic revenues and the progress of minutes packages, as well as lower commercial discounts and a higher average plant in service (+3.5%). The wholesale business and value added services also performed well, offsetting lower revenues from the public telephony business following the growth in mobile telephony. The Internet business maintained its strong growth rate (+34.4% in relation to the previous year in local currency), increasing its contribution to total revenues by 1.7 percentage points to stand at 11.2%, due to the explosive growth in broadband (whose revenues increased by 55.4% in local currency) offsetting the squeeze in the narrowband business. High growth rates were also

maintained in the data and information technology businesses (+16.5% jointly in local currency) as a result of higher sales to companies, primarily of VPN's and turnkey projects.

Operating expenses grew by 19.2% (without taking the reclassification of international termination costs into account) in local currency compared with 2005. This was mainly due to personnel expenses (+26.5% in local currency) affected by payroll increases agreed in late 2005 and the impact of workforce restructuring expenses. Supplies expenses increased by 17.8% (excluding the reclassification of international termination costs), due to the increase in interconnection traffic with other operators and the cost of equipment (associated to higher revenues). Subcontracted services increased by 14.8% in local currency, primarily due to the growth in service contracts that were also affected by salary increases and higher commercial and customer service activity.

The ratio of bad debt provision to revenues remained below 1% thanks to good recovery management and to the larger volume of pre-paid and consumption control infrastructure, which remained at around 30% of the total plant.

TASA recorded an operating income before depreciation and amortization (OIBDA) of 473 million euros, 8.9% down in local currency on that obtained in 2005 due to the sale of Telinver during the last quarter of 2005 and the workforce restructuring expenses recorded in 2006. Excluding the effect of the sale of Telinver, TASA's OIBDA remained practically stable (-0.2% in local currency).

CapEx stood at 140 million euros, 21.5% higher than in 2005 in local currency, of which around half was accounted for by broadband and new businesses. Thus, Argentina's operating free cash flow (OIBDA-CapEx) amounted to 333 million euros, 7.2% down on that generated in 2005, excluding the sale of Telinver.

## Telefónica Chile accesses

Unaudited figures (Thousands)

	2005	2006				%Chg
	December	March	June	September	December	
<b>Final Clients Accesses</b>	<b>2,876.0</b>	<b>2,873.8</b>	<b>2,853.4</b>	<b>2,817.1</b>	<b>2,858.2</b>	<b>(0.6)</b>
Fixed telephony accesses <sup>1</sup>	2,429.1	2,407.0	2,328.0	2,225.9	2,206.2	(9.2)
Internet and data accesses	446.9	466.7	514.9	538.9	557.7	24.8
Narrowband	130.5	110.7	95.6	72.8	53.3	(59.2)
Broadband <sup>2</sup>	302.0	345.4	409.0	456.0	494.5	63.8
Other	14.5	10.6	10.3	10.1	10.0	(31.0)
Pay TV	0.0	0.0	10.4	52.4	94.2	n.s.
<b>Wholesale Accesses</b>	<b>25.9</b>	<b>23.9</b>	<b>22.8</b>	<b>21.9</b>	<b>19.9</b>	<b>(23.4)</b>
<b>Total Accesses</b>	<b>2,902.0</b>	<b>2,897.7</b>	<b>2,876.1</b>	<b>2,839.1</b>	<b>2,878.0</b>	<b>(0.8)</b>

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

<sup>2</sup> Includes ADSL, optical fiber and broadband circuits.

### Telefónica Chile

The total number of accesses managed by Telefónica Chile dropped slightly (-0.8%) by the end of 2006 to stand at 2.9 million. Extraordinary cancellations were made in the telephony plant due to adjustments in the inactive prepaid plant (137,000 lines) and the review of criteria to cancel these lines. These extraordinary cancellations led to no additional expense or drop in company revenues, as the lines were inactive. Thus, the number of telephony accesses amounted to 2.2 million by the end of the year (-9.2% year-on-year). During the fourth quarter of the year, the company continued even further with the triple play strategy, supporting new sales of DUO and TRIO products that combine the basic telephone service, broadband Internet and digital TV (DTH). As a result of this strategy, Telefónica Chile ended 2006 at the forefront of the broadband market with 494,469 accesses (+63.8% year-on-year) and an estimated share of 49%.

In June 2006, the new satellite digital TV (DTH) services were launched. After seven months of operations, Telefónica Chile totalled 94,209 digital TV clients, strengthening its position as the second operator in terms of number of clients in the Chilean market.

Voice traffic carried by the networks remained affected by the substitution effects of mobile telephony and Internet, and by higher market competition. In 2006, a total of about 14,300 million voice minutes were processed, an 11.6% drop in relation to the previous year.

Despite the heavy competition in all markets, Telefónica Chile was able to increase its revenues slightly in 2006, amounting to 1,006 million euros (+0.2% year-on-year in local currency). Over the year, revenues from new businesses gained weight from traditional business revenues that fell by 3.0% in local currency compared with 2005 due to strong competition. Internet revenues (narrowband + broadband + TV) revenues increased significantly (+36.5% in local currency) to account for 10.7% of company

turnover, thanks to the progress of the broadband business and the launch of satellite TV. Revenues from data and information technologies suffered from the strong competitive pressure in the business segment, falling by a joint 0.6% in local currency compared with the previous year.

Thanks to the cost containment measures taken after the second quarter, the growth of operating expenses slowed to 5.2% in local currency due to the higher fall in personnel expenses (without taking workforce restructuring expenses into account), to 5.8%, and the lower growth in supplies (+7.3% in local currency) due to higher fixed-to-fixed interconnection costs and the necessary costs for the TV service. Subcontracting services grew moderately (+3.0% in local currency) given the increase in activities to improve service quality, the launch of new products and the increased number of broadband accesses.

Higher efforts were made over the year to improve collection parameters, which were reflected by an improvement in bad debt ratios. By year end, the provision of bad debts in relation to revenues amounted to 2.7%, a 0.3 percentage point improvement on the previous year.

Hence, the accumulated operating income before depreciation and amortization (OIBDA) for 2006 amounted to 417 million euros, a year-on-year increase of 1.0%. Without taking the costs arising from workforce restructuring during the first quarter of the year into account, OIBDA would have grown by 3.7% in relation to 2005.

Accumulated investment to December (CapEx) stood at 163 million euros. This figure grew 43.5% in local currency year-on-year, primarily due to the launch of digital TV, the growth of broadband, improved network capacity and new information systems. Hence, the accumulated operating free cash flow (OIBDA – CapEx) generated amounted to 254 million euros, 15.2% down year-on-year in local currency.



## Telefónica del Perú accesses

Unaudited figures (Thousands)

	2005	2006				%Chg
	December	March	June	September	December	
<b>Final Clients Accesses</b>	<b>3,211.0</b>	<b>3,277.9</b>	<b>3,374.2</b>	<b>3,469.9</b>	<b>3,581.2</b>	<b>11.5</b>
Fixed telephony accesses <sup>1</sup>	2,347.6	2,388.2	2,434.0	2,468.2	2,498.5	6.4
Internet and data accesses	401.2	414.9	449.8	494.2	525.5	31.0
Narrowband	52.5	47.6	52.0	49.6	47.8	(9.0)
Broadband <sup>2</sup>	341.1	359.8	389.3	435.7	468.5	37.3
Other	7.6	7.5	8.4	8.9	9.2	21.7
Pay TV	462.2	474.7	490.4	507.5	557.2	20.5
<b>Wholesale Accesses</b>	<b>0.5</b>	<b>0.6</b>	<b>0.5</b>	<b>0.5</b>	<b>0.4</b>	<b>(17.0)</b>
<b>Total Accesses</b>	<b>3,211.6</b>	<b>3,278.5</b>	<b>3,374.7</b>	<b>3,470.4</b>	<b>3,581.6</b>	<b>11.5</b>

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

<sup>2</sup> Includes ADSL, optical fiber, cable modem and broadband circuits.

### Telefónica del Perú

At the end of December, Telefónica del Perú reached an agreement with the Peruvian Government to promote the development of public telecommunications services in the country. The main agreements are as follows: (i) 22% reduction in the tariffs of different plans, benefiting 1.5 million homes, (ii) creation of a per second billing plan without set-up call charge, (iii) extension of the expiry period for prepaid cards, (iv) start of a long-distance market deregulation process, (v) reduction in public telephony tariffs, (vi) expansion plan for 685,000 new residential lines, aimed at segments of the population with less resources, (vii) agreement by the Telefónica Group to invest 1,000 million dollars in the country over the next 4 years (2006-2009).

At the end of the year, Telefónica del Perú recorded a total of 3.6 million accesses, 11.5% up on the previous year thanks to the commercial campaigns and assistance developed over the year. The progress of traditional business (2.5 million accesses, +6.4% year-on-year) and the broadband business (468,488 Internet retail broadband accesses, +37.3% year-on-year) is worth noting. Furthermore, the launch of satellite TV in July encouraged the growth of the television business to give a total of 557,166 clients by year end (+20.5% year-on-year).

Voice traffic increased by 1.1% in relation to 2005 due to higher fixed-to-mobile, long distance and interconnection (mainly mobile-to-fixed) traffic, which offset the drop in public telephony traffic over the year following higher competition and the growth of the cellular business.

Revenues stood at 1,097 million euros, 2.6% up in local currency on the 2005 revenues. Internet revenues (narrowband + broadband + television) recorded a 21.4% increase in local currency as a result of the progress of broadband revenues (+30.5% in local currency) and TV (+16.3% in local currency), both due to strong commercial activity over the year and the launch of satellite TV, notably expanding TV service coverage in Peru. Internet revenues continued to gain relevance in relation to total revenues,

accounting for 20.2% over the year (17.0% in 2005). Furthermore, data and information technology revenues increased by 6.5% and 13.7% respectively in local currency thanks to general and municipal election projects with the National Electoral Process Office (ONPE). However, revenues from traditional business recorded a negative trend (-2.0% in local currency), primarily due to the application of the productivity factor (CPI-10.07%) and the drop in public telephony revenues (-8.7% in local currency), heavily affected by the replacement of fixed traffic for mobile traffic.

Operating expenses for the year grew by 2.9% in local currency. The growth in personnel expenses (+5.4% in local currency) slowed down due to the sale of TUMSAC, which employed 1,220 workers. Supplies increased by 2.6% in local currency due to higher activity, whereas subcontracted services increased by 4.7% in local currency as a result of higher plant maintenance expenses and strong commercial activity, leading to an increased gross adds in traditional, broadband and television accesses.

The substantial weight of the prepaid and consumption control infrastructure on the telephony plant (around 60%) favoured low bad debt and, therefore, the bad debt provision as a percentage of revenues stood at below 1% for the year.

Operating income before depreciation and amortization (OIBDA) grew by 4.3% in local currency to stand at 467 million euros thanks to the good progress of revenues that offset the growth in expenses and to lower extraordinary contingencies, primarily relating to labour and tax issues and capital gains from the sale of TUMSAC during the third quarter. The OIBDA margin was 42.6%, 0.7 percentage points higher than that recorded in 2005.

In relation to CapEx for 2006, 132 million euros were invested, 7.8% higher year-on-year in local currency. Thus, the operating free cash flow (OIBDA – CapEx) generated amounted to 335 million euros (+3.0% year-on-year in local currency) as a result of the growth in OIBDA that offsets higher yearly investment.

## Telefónica Latinoamérica Group accesses

Unaudited figures (Thousands)

	2005	2006				%Chg
	December	March	June	September	December	
<b>Final Clients Accesses</b>	<b>28,086.8</b>	<b>28,231.4</b>	<b>30,713.0</b>	<b>31,064.6</b>	<b>31,160.0</b>	<b>10.9</b>
Fixed telephony accesses <sup>1</sup>	21,649.1	21,718.8	23,895.5	23,964.2	23,807.5	10.0
Internet and data accesses	5,975.4	6,037.9	6,316.6	6,540.5	6,701.1	12.1
Narrowband <sup>2</sup>	3,185.1	3,030.6	3,005.7	2,931.2	2,813.5	(11.7)
Broadband <sup>3,4</sup>	2,685.4	2,907.5	3,180.9	3,479.3	3,759.6	40.0
Other	105.0	99.8	130.0	130.0	128.0	22.0
Pay TV	462.2	474.7	500.9	559.9	651.4	40.9
<b>Wholesale Accesses</b>	<b>66.0</b>	<b>64.5</b>	<b>76.8</b>	<b>76.0</b>	<b>65.9</b>	<b>(0.1)</b>
<b>Total Accesses</b>	<b>28,152.7</b>	<b>28,295.9</b>	<b>30,789.8</b>	<b>31,140.6</b>	<b>31,225.9</b>	<b>10.9</b>

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

<sup>2</sup> Includes narrowband ISP of Terra Brasil and Terra Colombia.

<sup>3</sup> Includes broadband ISP of Terra Brasil, Telefónica de Argentina, Terra Guatemala y Terra México.

<sup>4</sup> Includes ADSL, optical fiber, cable modem, broadband circuits and ISP in the North part of the country.

Note: Fixed telephony and Internet and Data accesses from Telefónica Telecom (formerly known as Colombia Telecom) are included as of December 2006.

### Telefónica International Wholesale Services (TIWS)

Telefónica Internacional Wholesale Services (TIWS) ended the last quarter of the year with a significant growth in revenues, in line with previous quarters. Accumulated to December, revenues stood at 232 million euros that, in constant terms, is a 24.1% increase in relation to 2005. By business lines, all company business increased significantly, particularly revenues from satellite services (+57.9%), bandwidth capacity sales (+27.6%, in line with the progress of the entire Group in terms of broadband), International VPNs (+20.0%) and International IP (+18.0%), the latter accounting for 52% of company sales.

Operating Income before Depreciation and Amortization (OIBDA) accumulated to December amounted to 79 million euros, a 35.8% increase the previous year in constant currency, due to the increase in revenues.

Accumulated investment (CapEx) amounted to 45 million euros. This was a significant increase on the previous year (+65.9%), due to the necessary SAM1 expansions required to extend its cover in Colombia, Ecuador and Peru.

## Telefónica Latinoamérica Group

### Selected operating data

Unaudited figures (Thousands)

		January - December			
		2006	2005	% Chg	% Chg Local Cur
<b>Telesp</b>	Revenues	5,565	4,980	11.7	1.5
	OIBDA	2,637	2,281	15.6	5.1
	OIBDA margin	47.4%	45.8%	1.6 p.p.	
<b>Telefónica de Argentina</b>	Revenues	989	925	6.9	13.6
	OIBDA	473	552	(14.3)	(8.9)
	OIBDA margin <sup>1</sup>	40.7%	50.9%	(10.2 p.p.)	
<b>Telefónica Chile</b>	Revenues	1,006	962	4.6	0.2
	OIBDA	417	396	5.4	1.0
	OIBDA margin	41.4%	41.1%	0.3 p.p.	
<b>Telefónica del Perú</b>	Revenues	1,097	1,072	2.3	2.6
	OIBDA	467	449	4.0	4.3
	OIBDA margin	42.6%	41.9%	0.7 p.p.	
<b>Telefónica Telecom<sup>2</sup></b>	Revenues	397	–	n.c.	n.c.
	OIBDA	203	–	n.c.	n.c.
	OIBDA margin	50.9%	–	n.c.	n.c.
<b>TIWS</b>	Revenues	232	188	23.4	24.1
	OIBDA	79	58	35.8	35.8
	OIBDA margin	34.1%	31.0%	3.1 p.p.	

Note: From January 1st 2006, Telefónica Latinoamérica Group's fixed telephony operator accounts include the Telefónica Empresas businesses in their respective countries. The 2005 results are shown on comparable terms.

OIBDA is presented before management fees. Data for Telefónica de Argentina include the ISP business of Advance, while those of Telefónica del Perú includes CableMágico.

<sup>1</sup> Margin over revenues includes fixed to mobile interconnection.

<sup>2</sup> Data for Telefónica Telecom (formerly Colombia Telecom) only include results for May-December 2006 period.

## Grupo Telefónica Latinoamérica

### Consolidated income statement

Unaudited figures (Euros in millions)

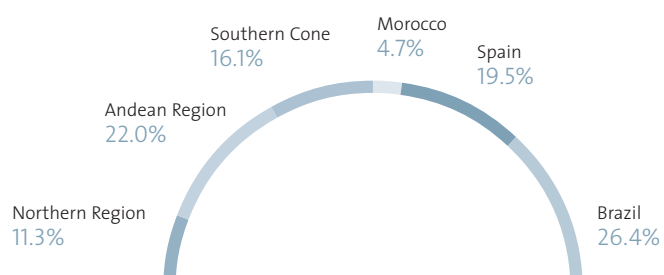
	January-December			October-December		
	2006	2005	%Chg	2006	2005	%Chg
Revenues	9,537	8,352	14.2	2,487	2,351	5.8
Internal exp capitalized in fixed assets <sup>1</sup>	48	47	1.8	13	16	(18.8)
Operating expenses	(5,351)	(4,539)	17.9	(1,452)	(1,282)	13.3
Other net operating income (expense)	(21)	(207)	(90.0)	(34)	(41)	(17.8)
Gain (loss) on sale of fixed assets	(2)	107	c.s.	(2)	29	c.s.
Impairment of goodwill and other assets	(2)	6	c.s.	(1)	(0)	192.5
<b>Operating income before D&amp;A (OIBDA)</b>	<b>4,209</b>	<b>3,766</b>	<b>11.7</b>	<b>1,011</b>	<b>1,073</b>	<b>(5.8)</b>
Depreciation and amortization	(1,957)	(1,799)	8.8	(497)	(484)	2.6
<b>Operating income (OI)</b>	<b>2,251</b>	<b>1,967</b>	<b>14.4</b>	<b>514</b>	<b>589</b>	<b>(12.8)</b>

<sup>1</sup> Including work in process.

Note: Telefónica Latinoamérica Group incorporates the results of Terra Networks operations from 1 January 2005.

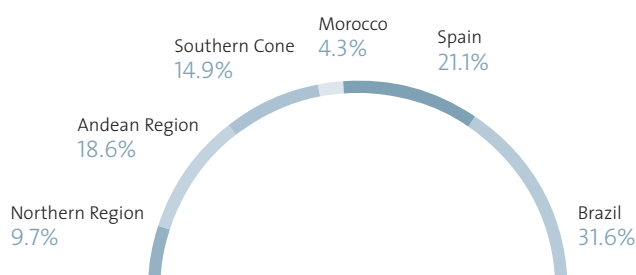
**Total customers: 109,899,704**

December 2006



**Total customers: 94,447,943**

December 2005



## Telefónica Móviles Group

The Telefónica Móviles Group has reached at the end of 2006 a total managed customer base close to 110 millions, with a year-over-year increase of 16.4%. The main characteristic for the year was the high level of commercial activity in every region where the Group has presence, driving a strong growth in its main operations markets.

Net adds in the fourth quarter of 2006 reached 5.9 million, mounting total net adds for the year to 15.5 million of new customers. Latin American contributed 83% to customer base growth, reaching 83.3 million clients as of December 2006 (+18.1% vs. December of 2005).

Telefónica Móviles España accelerated its customer base growth this quarter, recording net adds of 426,000 clients (+65.8% vs. fourth quarter 2005), and bringing the customer base at the end of the year to 21.5 million clients (+7.8% vs. December of 2005).

Consolidated revenues reached 18,403 million euros by December, with year-over-year growth of 11.4% in the twelve months of 2006, contributing the exchange rates 0.2 percentage points to this growth. By those means, the revenues growth reached the top end of the range established as financial target<sup>1</sup> (+9%/+12%). In the fourth quarter, the revenue stood at 4,866 million euros, showing an improvement of 9.0% over the fourth quarter of 2005.

By geographic regions, the revenues are splitted equally at the end of the year between Telefónica Móviles España (9,199 million euros, +4.1 vs 2005) and those coming from the consolidated

Latin American operators (9,240 million euros, +19.9% vs 2005). In the twelve months through December the exchange rates reduced their impact to 0.5 percentage points. The better performance from Latin America is supported one more quarter by Venezuela, Peru, Argentina and Mexico.

Consolidated OIBDA reached 6,443 million euros in December 2006, up 10.8% in the year vs. 2005. The exchange rates has no material impact in the consolidated OIBDA, that would register, excluding that effect, a year-over-year growth of 10.7% compared with the twelve months of 2005, accomplishing the financial target<sup>1</sup> for the year (+9%/+12%). In the fourth quarter of 2006 the OIBDA totaled 1,743 million euros, 9.6% more than in the same period of the previous year.

The strong commercial activity for the Christmas Campaign drives the consolidated OIBDA margin in the fourth quarter of 2006 to 35.8%. The higher operational efficiency allows an improvement of 0.2 percentage points compared to the fourth quarter of 2005, and to reach 35.0% in the accumulated for 2006 (-0.2 percentage points compared to 2005).

OIBDA for Telefónica Móviles Spain showed no changes in 2006, up to 4.128 million euros as of December, despite the increased competence and higher commercial costs. In the fourth quarter OIBDA reached 1,002 million euros, with year-over-year decrease of 3.4%. In the twelve months to December, the margin stands at 44.9%, 1.9 percentage points below the margin obtained a year ago.

Latin America is therefore, the region that, with a consolidated OIBDA growth of 38.5% in euros in 2006 (+38.3% excluding the impact of exchange rates), fully contributes to the OIBDA Group

<sup>1</sup> 2006 guidance assumes constant exchange rates as of 2005, and excludes changes in consolidation perimeter. Operating Income before D&A exclude other exceptional revenues/expenses not foreseeable in 2006. For comparison, the equivalent other exceptional revenues/expenses registered in 2005 are also deducted from reported figures.

## Telefónica Móviles Group

## Total customers

Unaudited figures (Euros in millions)

December

	2006	2005	% Chg
<b>Spain and Morocco</b>	<b>26,601.3</b>	<b>23,913.2</b>	<b>11.2</b>
Prepaid	14,321.3	13,059.8	9.7
Contract	12,278.3	10,853.4	13.1
Fixed Wireless	1.7	0.0	n.s.
<b>Latin America</b>	<b>83,298.4</b>	<b>70,534.7</b>	<b>18.1</b>
Prepaid	67,329.9	56,459.9	19.3
Contract	14,705.4	13,066.3	12.5
Fixed Wireless	1,263.1	1,008.5	25.2
<b>Total</b>	<b>109,899.7</b>	<b>94,447.9</b>	<b>16.4</b>

increase. The region totaled 2,429 million euros in 2006, with a figure for the fourth quarter of 775 million euros (+40.1% vs the same period in 2005 in euros). Likewise, consolidated Latin America subsidiaries contributed 37.1% to consolidated OIBDA<sup>2</sup> (+7.1 percentage points vs. the previous year). The positive trend for the region is supported both in the bigger scale of GSM customer base and the lower unit acquisition costs, and specially in the significant contribution from Mexico, Venezuela and Argentina. That leads to a 6.0 percentage points progress in the margin compared to the fourth quarter of 2005, up to the 30.5%, and 3.5 percentage points compared with the twelve months of 2005, up to the 26.3%.

The operating cash flow (OIBDA-CapEx) obtained in Latin America region as of December 2006 reached 904 million euros, with a year-over-year growth of 250%.

## Spain

The results obtained by Telefónica Móviles España in 2006 reflect the success of the company's commercial strategy with a clear focus on loyalty, enabling to increase its yearly net adds by 70%, compared with an 18% growth in gross adds. Hence, net adds for 2006 amounted to 1.6 million new clients (93% in the postpay segment), highlighting the low 1.0% churn in the contract segment.

Thus, Telefónica Móviles España has strengthened its competitive position by driving the market and ending the year with an estimated market share of over 45%.

The growth in the total number of clients, initiatives to promote consumption and commercial efficiency have led to a 4.1% increase in total revenues (+3%/+6% target), supported by the good performance of customer revenues (+6.5%), reversing the downwards trend of absolute OIBDA and reaching an OIBDA margin of 45%.

In 2006, the mobile telecommunication sector in Spain was marked by increased competitive intensity throughout the year and, more specifically, in the fourth quarter, with aggressive Christmas campaigns and the entry of three new players. The market therefore exceeded 47 million clients by the end of December 2006, an estimated 104% penetration (+7.7 percentage points vs. 2005).

In this context, the commercial strategy of Telefónica Móviles España has provided very positive results, with net adds of over 426,000 clients in the fourth quarter (+66% year on year) to gain 1.6 million lines in the yearly accumulate. The estimated net gain share of the company amounted to over 39% for the year (+16 percentage points vs. 2005). The good performance of the net gain led to a total of 21.4 million clients by the end of 2006, 7.8% up on 2005. The performance of Telefónica Móviles España contract customer base is worth noting, which grew by 13.4% year on year to stand at 57%, 2.8 percentage points up on that recorded one year ago.

Good commercial performance during the fourth quarter was supported by the successful Christmas campaign (100x1 promotion until 31st December and weekends free until April 2007), joined by 1.2 million clients. Together with the special loyalty campaign launched last October, this led to over 3.1 million commercial actions during the fourth quarter of 2006, 17% more than in the last quarter of 2005. In the yearly accumulate commercial actions amounted to 11.6 million (+8.3% vs. 2005).

This progress in terms of commercial actions was supported by the gross adds performance, which exceeded 1.5 million in the last quarter of 2006 (up 21% year on year) and totalled 5.9 million in the yearly accumulate (+18% year on year). The significant growth in contract gross adds in the year is also worth highlighting, up 10.1% compared with 2005, to confirm Telefónica Móviles España's focus on value customers.

<sup>2</sup> Consolidated data before rest and intragroup eliminations.

## Telefónica Móviles España

### Selected operating data

Unaudited figures	2005	2006				%Chg
	December	March	June	September	December	
<b>Cellular customer (thousands)</b>	<b>19,889.9</b>	<b>20,276.8</b>	<b>20,655.0</b>	<b>21,019.7</b>	<b>21,446.0</b>	<b>7.8</b>
Prepaid	9,186.4	9,231.9	9,261.2	9,290.7	9,303.0	1.3
Contract	10,703.5	11,044.9	11,393.8	11,729.0	12,142.9	13.4
	4Q	1Q	2Q	3Q	4Q	% Chg
<b>MOU (minutes)</b>	<b>152</b>	<b>153</b>	<b>156</b>	<b>158</b>	<b>157</b>	<b>3.6</b>
Prepaid	67	66	64	71	66	(0.7)
Contract	226	227	231	228	228	0.8
<b>ARPU (EUR)</b>	<b>33.2</b>	<b>31.8</b>	<b>33.0</b>	<b>33.9</b>	<b>33.0</b>	<b>(0.8)</b>
Prepaid	16.7	15.7	16.4	17.6	15.9	(4.9)
Contract	47.7	45.5	46.6	46.9	45.7	(4.0)
<b>Data ARPU</b>	<b>4.7</b>	<b>4.4</b>	<b>4.2</b>	<b>4.6</b>	<b>5.0</b>	<b>5.2</b>
%non-P2PSMS over data revenues	41.1%	43.6%	42.5%	43.9%	45.3%	4.1 p.p.

Note: MOU and ARPU calculated as monthly quarterly average.

## Telefónica Móviles España

### Selected financial data

Unaudited figures (Euros in millions)	January - December			October - December		
	2006	2005	% Chg	2006	2005	% Chg
Revenues	9,199	8,834	4.1	2,333	2,213	5.4
OIBDA	4,128	4,128	(0.0)	1,002	1,038	(3.4)
OIBDA margin	44.9%	46.7%	(1.9 p.p.)	43.0%	46.9%	(3.9 p.p.)

## Telefónica Móviles España

### Revenues

Unaudited figures	December	
	2006	2005
Customer revenues	69.1%	67.5%
Interconnection	16.3%	17.3%
Handset sales	11.5%	11.8%
Roaming - In	2.7%	3.0%
Other	0.4%	0.4%

Portability over the fourth quarter of 2006 continued to show good results with a net gain of 61,500 lines, almost six times the one obtained in the same quarter of 2005 to give an accumulated 174,700 lines (-116,000 in 2005). The excellent performance of the contract segment must be underlined, with 103,100 net adds in the fourth quarter and over 278,000 over the year as a whole, as a result of the company's emphasis on clients with greater consumption.

Churn played a key role in the solid commercial results of Telefónica Móviles España. This stood at 1.74% during the fourth quarter, following on with the downwards trend of the other three quarters of the year and almost in line with that obtained during the fourth quarter of 2005. Accumulated churn amounted to 1.74%, slightly below that obtained in 2005. The behaviour of contract churn is worth noting, which fell to 0.9% in the last quarter (-0.2 percentage points year on year) to give a yearly accumulate of 1.0% (-0.1 percentage points vs. 2005). Handset upgrades through the loyalty programme contributed towards the good evolution of churn.

In terms of consumption, the minutes managed by the network during the last quarter of the year grew by 11.2% in relation to the same period of 2005 to post over 56,800 million minutes for the year as a whole (+11.4% vs. 2005). On-net traffic recorded a 13.5% growth over the year compared with 2005. Hence, the MoU in the fourth quarter of 2006 amounted to 157 minutes (+3.6% on the same quarter in 2005). Accumulated MoU grew by 4.4% to total 156 minutes.

Despite the fall in interconnection tariffs in October (-6.9%), voice ARPU amounted to 28 euros in the fourth quarter, a 1.8% drop year on year, to limit the year's accumulated decrease to 1.2% to stand at 28.4 euros. Accumulated outgoing voice ARPU for 2006 increased by 0.8% in comparison with 2005.

Data ARPU in the fourth quarter of the year grew by 5.2% compared with the same period of 2005 to stand at 5.0 euros, 4.6 euros for the year as a whole and a 2.9% increase in annual terms compared with 2005. This progress is due to the 24% growth in non-SMS interpersonal data revenues. The company already has over 1.1 million 3G clients and over 100,000 clients subscribed to semi-flat rate data packages such as the 5Gb, 1Gb and 30Mb plans, which contributed towards the progress of data ARPU.

Hence, total ARPU amounted to 33.0 euros for the fourth quarter and 32.9 euros for the year as a whole, a slight 0.8% drop compared with the fourth quarter of 2005 and 0.7% compared with 2005 as a whole.

The following must be noted with regards to the financial results for the last quarter and year end 2006:

- Company revenues for 2006 as a whole amounted to 9,199 million euros, a 4.1% increase compared with 2005, as a result of the evolution of service revenues (+4.5%) supported by the good performance of customer revenues (+6.5%).

During the last quarter, total revenues amounted to 2,333 million euros, up 5.4% year on year. This performance is due to increased service revenues (+4.2%) and the progress of handset sale revenues (+15.7%) compared with the fourth quarter of 2005, a result of the successful Christmas commercial campaign that had a higher weight on 3G handsets.

The positive performance of service revenues in the fourth quarter of 2006 was especially supported by the evolution of customer revenues, which were up 4.7% up on the fourth quarter of 2005, with roaming and interconnection revenues remaining almost stable compared with the same quarter of the previous year (0.8%).

## Morocco

## Selected operating data: cellular customers

Unaudited figures (Thousands)

	2005	2006				%Chg
	December	March	June	September	December	
<b>Medi Telecom</b>	<b>4,023.3</b>	<b>4,185.6</b>	<b>4,167.9</b>	<b>4,245.6</b>	<b>5,155.3</b>	<b>28.1</b>
Prepaid	3,873.4	4,040.5	4,029.8	4,111.0	5,018.3	29.6
Contract	149.9	145.1	137.7	133.3	135.4	(9.7)
Fixed Wireless	0.0	0.0	0.4	1.2	1.7	n.m.

- Accumulated OIBDA for 2006 amounted to 4,128 million euros, in line with that obtained in 2005 despite greater commercial activity during 2006 (+8.3%) to reverse the fall recorded the previous year. Thus, the OIBDA margin for 2006 as a whole stood at 44.9%, 1.9 percentage points lower than 2005 due to greater commercial activity and higher network and customer management expenses.

The increase in the number of commercial actions in the fourth quarter of 2006, which were up 17% year on year, affected OIBDA for the fourth quarter causing it to fall slightly (-3.4%) compared with the same period of 2005 with the OIBDA margin standing at 43.0% (46.9% in the fourth quarter of 2005).

- Accumulated investment in 2006 reached 750 million euros, a 3% increase on investments in 2005. Telefónica Móviles España continued to deploy its UMTS network with over 1,000 base stations during 2006 to give a total of over 6,000.
- Thus, the operating cash flow (OIBDA-CAPEX) accumulated over the year amounted to 3,378 million euros, maintaining a similar level to 2005.

## Morocco

At the end of 2006 Médi Telecom customer base stood at 5.2 million, posting a 28.1% growth vs. December 2005.

Regarding results, revenues in 2006 reach 425 million euros (+7.2% vs. 2005 in local currency).

OIBDA to December 2006 increases by 7.9% in local currency to reach 167 million euros, standing the margin for the year at 39.2%, in line with the obtained in 2005.



## Brazil

## Selected operating data: cellular customers

Unaudited figures (Thousands)

	2005				2006	
	December	March	June	September	December	%Chg
<b>Vivo</b>	<b>29,804.6</b>	<b>30,137.7</b>	<b>28,524.7</b>	<b>28,725.7</b>	<b>29,053.1</b>	<b>(2.5)</b>
Prepaid	24,060.8	24,377.2	23,256.5	23,481.5	23,543.4	(2.2)
Contract	5,743.8	5,760.5	5,268.1	5,244.1	5,509.6	(4.1)

At the close of 1H06, an adjustment of 1.8 million inactive lines in Brazil was made.

## Latin America

## Brazil

Vivo's results for the fourth quarter maintained the growth trend from the third quarter, based on a better operational performance, as a consequence of the market's good perception of the company's commercial offer. On top of that, the initiatives established in its action plan also remained positive, with a 95% reduction of phone cloning fraud cases and due to the integration of billing systems and prepay platforms.

At the end of the last quarter of 2006, Vivo's customer base totalled 29.1 million clients in a market with a 55% penetration, 6 percentage points higher than the third quarter of 2005, and maintaining the deceleration trend of previous quarters. Quarterly net adds stood at 327,000 clients, of which 266,000 are in the contract segment, that reflects the improvement in the churn rate resulting from the implementation of initiatives for recovering corporate clients.

Consumption and traffic indicators reaped the positive effects of the new commercial strategy. In October, Vivo launched new contract plans "Vivo Escolha", delivering more flexibility to its clients. At the end of the year, they counted for 10% of customer base and had a mix of plans that, in 60% of the cases led to increased monthly consumption compromises. In addition, Vivo has maintained its campaigns designed to increase prepay traffic ("Promoção Natal 2006 Mil Reais") with on-net traffic promotions variable according to top-ups. The MOU in the fourth quarter of 2006 was 82 minutes, showing a 10.6% increase in relation to the same period last year, and impacting positive on the ARPU, up to 31.2 Brazilian reais (+6.8% vs. last quarter 2005).

Total revenues for 2006 stood at 2,005 million euros (-3.5% in local currency vs. the previous year). Service revenues in local currency dropped by 0.6% vs. 2005, whilst this same figure for the fourth quarter of 2006 increased by 2.0% in relation to the

same period last year, due to greater revenues from interconnection (+20.5%), which was the consequence of the removal of the Bill & Keep rule. Without taking into account the impact of Bill & Keep, income would drop 9.3% in relation to 2005.

It is important to highlight the good results in the prepay segment, resulting from well received promotions designed to promote traffic, presenting a 15.2% increase in outgoing revenues in relation to the same quarter in 2005 (+6.1% for the whole year). The new commercial strategy, as well as a better operational efficiency and cost reduction, allowed the company to reach a 103 million euros OIBDA in the fourth quarter (-5.7% in local currency). Regarding the most relevant commercial costs, it is worth mentioning the drop in commissions, as a consequence of the higher percentage of joining clients at Vivo shops and the lower unit subsidy, due to the change in the mix of handsets. This OIBDA was affected by the extraordinary impact of 51 million euros write down in network equipment, for the 50% of Vivo. For the year OIBDA amounted to 438 million euros, down 19.8% in local currency, and down 11.4% excluding both the effect of Bill & Keep and network write down. The OIBDA margin stood at 21.9%, and would be 24.1% if this impact were excluded. The margin stood at 19.9% in the fourth quarter. The positive impact of Bill & Keep added around 5.5 million euros to the company's annual OIBDA.

Finally, it is worth mentioning that the implementation of the GSM network is almost finished, and will be launched fully commercially by the end of the first quarter. The expected investment for the network implementation has remained in line with guidance, with a 65% of the 1,080 Brazilian reais budget already executed as of December.

## Northern Region

### Mexico

During the last quarter of 2006, Telefónica Móviles Mexico's commercial activity rose significantly. This was mainly due to its well received Christmas campaign and the improvement of its commercial network, customer service processes and network quality.

As of December 2006, the estimated penetration in the Mexican market reached 53% (+9 percentage points vs. December 2005). Telefónica Móviles Mexico's customer base exceeded 8.5 million clients, which represents a 34.3% growth with respect to 2005. This good performance in total numbers is based on December's offers, which allowed to surpass 1.8 million adds in the last quarter of 2006, 30% higher than the figure recorded in the same period last year. The improvement in the quality of new clients allowed the company to maintain the levels of churn stable, in spite of higher add rates. In this context, net adds in the fourth quarter rose to 1.1 million clients leading to churn rate improvements, reaching a yearly rate of 3.5%. In 2006 Telefónica Móviles Mexico's net adds reached 2.2 million clients, of which over 210,000 are in the contract segment. Churn rate reduction in this segment to 2.0% mark (-3.5 p.p. vs. 2005) and higher numbers of new clients, allowed the company to exceed 530,000 contract clients.

At operational level it is worth mentioning the strong traffic growth, especially for outgoing traffic and in contract segments. Thus, MOU in the last quarter of 2006 amounted to 104 minutes, more than doubling consumption from the fourth quarter 2005. This improvement is reflected on the ARPU, reaching 21.6% increase up to 136.3 Mexican pesos. For the year, the MOU stood at 80 minutes (+55.8% vs. 2005) and the ARPU at 121.5 pesos (+12.1% vs. 2005).

As a result of the good commercial performance of the company ("Fixed Rate per Call" or "Fixed Rate Plan") revenues for 2006

reached 988 million euros and showed a 28.2% growth in local currency with respect to 2005. Service revenues maintained the positive trend of previous quarters (+34.3% year-on-year), reflecting the average customer base growth, and the better quality and consumption by clients. This good performance of service revenues is based on the outgoing traffic revenues (+45.0% in local currency), helped by on-net traffic increase. Although incoming traffic revenues (+16.6% in local currency) still reflected the reduction of interconnection fees from the start of the year, in this quarter they showed signs of recovery due to the launch – on the 4th of November - of the "El que llama paga nacional" (National CPP service), which is the result of an agreement dated the 11th of October, signed by the operators Telcel, Telmex, Iusacell, Unefon and Movistar. During the fourth quarter of the year, service revenues presented a 57.9% growth in relation to the fourth quarter 2005.

OIBDA in the last quarter reflected the good development of revenues and improvements in efficiency. The Christmas campaign intense commercial activity did not prevent the OIBDA reaching 22 million euros in the fourth quarter, reducing OIBDA losses in 2006 to 10 million euros, in comparison to negative OIBDA of 159 million euros in 2005.

The positive trend of OIBDA was reflected in the operating cash flow, which in 2006 reduced its losses in local currency by 53% compared to the previous year, standing at -190 million euros.

## Northern Region

### Selected operating data: cellular customers

Unaudited figures (Thousands)

	2005				2006	
	December	March	June	September	December	%Chg
<b>TEM México</b>	<b>6,368.1</b>	<b>6,559.4</b>	<b>6,865.6</b>	<b>7,443.3</b>	<b>8,553.2</b>	<b>34.3</b>
Prepaid	6,047.7	6,189.1	6,439.0	6,950.7	8,017.8	32.6
Contract	319.9	369.3	425.3	490.9	533.4	66.8
Fixed Wireless	0.6	0.9	1.2	1.6	2.0	n.s.
<b>TEM Guatemala</b>	<b>1,040.7</b>	<b>1,149.1</b>	<b>1,281.4</b>	<b>1,385.6</b>	<b>1,490.6</b>	<b>43.2</b>
Prepaid	864.4	965.8	1,078.8	1,175.8	1,264.5	46.3
Contract	69.9	71.2	82.1	88.9	100.6	43.9
Fixed Wireless	106.3	112.1	120.6	120.9	125.5	18.0
<b>TEM Panamá</b>	<b>849.4</b>	<b>904.8</b>	<b>889.4</b>	<b>948.7</b>	<b>939.2</b>	<b>10.6</b>
Prepaid	781.5	836.2	815.9	872.1	859.8	10.0
Contract	67.9	68.5	73.5	76.7	79.4	17.0
<b>TEM El Salvador</b>	<b>537.8</b>	<b>626.4</b>	<b>693.9</b>	<b>743.6</b>	<b>846.9</b>	<b>57.5</b>
Prepaid	435.3	513.6	568.8	607.3	691.1	58.8
Contract	79.0	79.9	82.5	86.2	92.0	16.4
Fixed Wireless	23.5	32.9	42.6	50.0	63.7	171.2
<b>TEM Nicaragua</b>	<b>371.6</b>	<b>414.7</b>	<b>458.7</b>	<b>486.9</b>	<b>552.8</b>	<b>48.8</b>
Prepaid	310.4	354.6	397.2	423.7	487.6	57.1
Contract 45	45.3	43.4	43.2	43.2	43.5	(4.0)
Fixed Wireless	15.9	16.7	18.3	20.0	21.7	36.6
<b>Total Accesses</b>	<b>9,167.6</b>	<b>9,654.3</b>	<b>10,188.9</b>	<b>11,008.1</b>	<b>12,382.8</b>	<b>35.1</b>

## Mexico

### Selected financial data

Unaudited figures (Euros in millions)

	January - December				October - December		
	2006	2005	% Chg	% Chg Local	2006	2005	% Chg
Revenues	988	779	26.8	28.2	299	216	38.7
OIBDA	(10)	(159)	(93.7)	(93.7)	22	(29)	c.s.
OIBDA margin	(1.0%)	(20.4%)	19.4 p.p.		7.5%	(13.2%)	20.7 p.p.

## Mexico

### Selected operating data: cellular customers

Unaudited figures (Thousands)

	2005				2006	
	December	March	June	September	December	%Chg
<b>TEM México</b>	<b>6,368.1</b>	<b>6,559.4</b>	<b>6,865.6</b>	<b>7,443.3</b>	<b>8,553.2</b>	<b>34.3</b>
Prepaid	6,047.7	6,189.1	6,439.0	6,950.7	8,017.8	32.6
Contract	319.9	369.3	425.3	490.9	533.4	66.8
Fixed Wireless	0.6	0.9	1.2	1.6	2.0	n.m.

## Venezuela

### Selected financial data

Unaudited figures (Euros in millions)

	January - December				October - December		
	2006	2005	% Chg	% Chg Local	2006	2005	% Chg
Revenues	2,040	1,438	41.9	45.7	590	445	32.8
OIBDA	815	585	39.2	42.9	236	178	32.7
OIBDA margin	39.9%	40.7%	(0.8 p.p.)		39.9%	39.9%	(0.0 p.p.)

## Venezuela

### Selected operating data: cellular customers

Unaudited figures (Thousands)

	2006				2006	%Chg
	December	March	June	September	December	
<b>TEM Venezuela</b>	<b>6,160.3</b>	<b>6,683.3</b>	<b>7,820.6</b>	<b>8,025.9</b>	<b>8,826.2</b>	<b>43.3</b>
Prepaid	5,203.7	5,659.0	6,665.7	6,813.6	7,520.2	44.5
Contract	347.8	371.7	399.2	431.6	469.4	35.0
Fixed Wireless	608.8	652.7	755.7	780.7	836.6	37.4

## Andean Region

### Venezuela

In the last quarter of 2006, there was a rise in market growth in Venezuela, reaching approximately 70% penetration, presenting a more than 20 percentage points improvement on the previous year. In December 2006, Telefónica Móviles Venezuela's customer base surpassed 8.8 million clients (+43.3% in relation to December 2005), registering 2.7 million net adds in the twelve months of the year (+45.4% vs. 2005). The last quarter showed a record in the number of new clients, which, in addition to good churn rates, led the company to reach net adds of 800,000 clients in the period.

In terms of operational development, it is worth mentioning the accumulated ARPU year-on-year improvement (+6.8%), highlighting data revenues that improved 25% in relation to the previous quarter. This, and the customer base increase, allowed service revenues to rise 46.1%, in line with the client base.

Thus, accumulated annual revenues reached 2,040 million euros (+45.7% vs. 2005 in local currency), which in the fourth quarter reached 590 million euros (+41.6% vs. the last quarter of 2005 in local currency).

Operating income before depreciation and amortization (OIBDA) amounted to 815 million euros in 2006, up 42.9% in comparison with 2005 in local currency. Growth deceleration in the fourth quarter vs. the previous period (+41.5% in local currency vs. +60.4% in the third quarter of 2006) was mainly due to greater commercial activity registered in November and December. Margin for 2006 year remained at 39.9%, which translated into a limited decrease of 0.8 percentage points, given that the higher commercial costs were compensated by the good performance of service revenues. In the fourth quarter, the margin stood at 39.9% (in line with the one obtained in the same period 2005).

Finally, it is worth mentioning that the company has started the implementation of the GSM network, with a commercial launch in the last weeks of January 2007.

### Colombia

The Colombian cellular market reached 27.7 million customers, with a 67% penetration (+20 percentage points vs. December 2005). In comparison to the third quarter of 2006, total market figures were reduced by 1.5 million clients, after regulatory criteria change, which established a smaller client base (-2.3 millions) for Comcel and Millicom.

Commercial activity slowed down in the last quarter of 2006. Lower commercial aggressiveness, as well as the increase in churn rates related to the intense competitiveness of previous quarters campaigns, was translated into net gains of 73,000 lines during the period (-91.6% vs the last quarter of 2005). In accumulated terms, the figure rose to 1.7 million in 2006, 36.9% less in comparison to 2006 figure. At the end of the year the customer base reached 7.8 million clients (+28.6% year-on-year), with 60% of clients on GSM (+5.0 percentage points vs. third quarter 2006).

Revenues reached 779 million euros at the end of the year, reflecting a 6.4% growth in local currency, which referred to the fourth quarter, turns to a 1.2% decrease in relation to the same period the previous year. Service revenues presented a 0.4% growth with respect to last quarter of 2005 and a 4.4% growth accumulated year-on-year, affected by reductions in interconnection rates and accelerated client base growth.

Last months' strict control of costs and commercial spending, allowed the company to reach 138 million euros OIBDA, reflecting a 28.2% increase in accumulated terms and in local currency, and a 12.3% increase in the fourth quarter in relation to the last quarter of 2005. Margin registered a 3.0 percentage points increase in relation to 2005, reaching 17.7% in the year (27.4% in the last quarter of 2006).

## Andean Region

## Selected operating data: cellular customers

Unaudited figures (Thousands)

	2005				2006	
	December	March	June	September	December	%Chg
<b>TEM Venezuela</b>	<b>6,160.3</b>	<b>6,683.3</b>	<b>7,820.6</b>	<b>8,025.9</b>	<b>8,826.2</b>	<b>43.3</b>
Prepaid	5,203.7	5,659.0	6,665.7	6,813.6	7,520.2	44.5
Contract	347.8	371.7	399.2	431.6	469.4	35.0
Fixed Wireless	608.8	652.7	755.7	780.7	836.6	37.4
<b>TEM Colombia</b>	<b>6,033.0</b>	<b>6,817.8</b>	<b>7,474.0</b>	<b>7,687.0</b>	<b>7,759.7</b>	<b>28.6</b>
Prepaid	4,657.9	5,283.6	5,721.4	5,883.5	5,960.5	28.0
Contract	1,375.1	1,534.1	1,752.7	1,803.5	1,799.2	30.8
<b>TEM Perú</b>	<b>3,455.0</b>	<b>3,680.9</b>	<b>4,048.9</b>	<b>4,513.8</b>	<b>5,129.8</b>	<b>48.5</b>
Prepaid	2,804.3	3,007.6	3,331.1	3,749.7	4,353.3	55.2
Contract	579.5	603.3	648.1	691.9	705.2	21.7
Fixed Wireless	71.1	70.1	69.8	72.2	71.3	0.2
<b>TEM Ecuador</b>	<b>1,884.6</b>	<b>2,328.4</b>	<b>2,554.7</b>	<b>2,393.1</b>	<b>2,490.0</b>	<b>32.1</b>
Prepaid	1,517.5	1,948.3	2,161.7	1,984.0	2,133.0	40.6
Contract	364.7	377.7	390.6	406.9	355.3	(2.6)
Fixed Wireless	2.4	2.4	2.3	2.2	1.7	(29.4)
<b>Total Accesses</b>	<b>17,532.8</b>	<b>19,510.5</b>	<b>21,898.2</b>	<b>22,619.8</b>	<b>24,205.6</b>	<b>38.1</b>

## Colombia

## Selected financial data

Unaudited figures (Euros in millions)

	January - December				October - December		
	2006	2005	% Chg	% Chg Local	2006	2005	% Chg
Revenues	779	750	4.0	6.4	195	213	(8.5)
OIBDA	138	110	25.3	28.2	53	50	7.0
OIBDA margin	17.7%	14.7%	3.0 p.p.		27.3%	23.4%	4.0 p.p.

## Colombia

## Selected operating data: cellular customers

Unaudited figures (Thousands)

	2005				2006	
	December	March	June	September	December	%Chg
<b>TEM Colombia</b>	<b>6,033.0</b>	<b>6,817.8</b>	<b>7,474.0</b>	<b>7,687.0</b>	<b>7,759.7</b>	<b>28.6</b>
Prepaid	4,657.9	5,283.6	5,721.4	5,883.5	5,960.5	28.0
Contract	1,375.1	1,534.1	1,752.7	1,803.5	1,799.2	30.8

## Peru

## Selected financial data

Unaudited figures (Euros in millions)

	January - December				October - December		
	2006	2005	% Chg	% Chg Local	2006	2005	% Chg
Revenues	447	367	21.9	22.2	129	103	24.6
OIBDA	129	118	9.8	10.1	38	33	14.7
OIBDA margin	28.9%	32.1%	(3.2 p.p.)		29.3%	31.9%	(2.5 p.p.)

## Peru

## Selected operating data: cellular customers

Unaudited figures (Thousands)

	2005				2006		%Chg
	December	March	June	September	December		
<b>TEM Perú</b>	<b>3,455.0</b>	<b>3,680.9</b>	<b>4,048.9</b>	<b>4,513.8</b>	<b>5,129.8</b>		<b>48.5</b>
Prepaid	2,804.3	3,007.6	3,331.1	3,749.7	4,353.3		55.2
Contract	579.5	603.3	648.1	691.9	705.2		21.7
Fixed Wireless	71.1	70.1	69.8	72.2	71.3		0.2

## Peru

The Peruvian cellular market maintained the strong dynamism shown from the start of the year. Thus, penetration rate showed an increase of over 12 percentage points in relation to December 2005, reaching 32%. The company's more intense commercial stance was reflected in the positive development of customer base, especially during the Christmas campaign with a great variety of GSM handsets, traffic promotions of up to 3 times the price of equipment, SMS gifts and the possibility to select a phone number with unlimited traffic for a month. This led to a significant increase in the company's net adds, reaching 616,000 clients this quarter (+140.7% vs. the same quarter in 2005). Telefónica Móviles Peru customer base exceeded 5.1 million clients (+48.5% in relation to December 2005), with 42% of clients on GSM.

As well as aggressive commercial competitiveness, it is also worth mentioning good consumption trends, especially in prepay plans, associated with the success of promotional campaigns based on the duplication or triplication of top-ups. This was therefore reflected in a 36% prepay MOU growth in the fourth quarter compared to the same period the previous year. Revenues reached 447 million euros, rising 27.8% in relation to the fourth quarter of the previous year and 22.2% in accumulated terms, both in local currency. The good performance of service revenues is worth emphasising, as it maintained its growth trend (+33.5% with respect to the fourth quarter the previous year and 21.4% in accumulated terms). This growth is supported by the positive behaviour of prepay outgoing revenues, which more than double in comparison to the previous year, mainly due to the flexibility provided by traffic promotions mentioned above.

Despite greater commercial activity, revenues growth and improved operational efficiency led to 17.6% higher OIBDA in comparison to the fourth quarter of the previous year and 10.1% higher in accumulated terms, both in local currency. Fourth quarter margin reached 29.4% and stood at 28.9% for the cumulative year (-3.2 percentage points to that registered in 2005).

## Southern Cone Region

## Argentina

During the last quarter of 2006, the Argentinean mobile market showed a strong growth trend, reaching 78% penetration, which means more than 8 percentage points growth in the last quarter, around 23 percentage points higher than December 2005 figures. It is worth mentioning that the fourth quarter is the quarter with greater commercial activity in Argentina, due to Mothers' Days celebrations in October and Christmas campaign.

Net adds for the last quarter of 2006 rose to more than 1.0 million new clients, based on a 12.5% increase in commercial activity in comparison to the same quarter in 2005 and the good evolution of churn. The company closed the year with 2.9 million new clients, which meant a 34.4% growth in the company's customer base, reaching 11.2 million clients. GSM weight reached 73% of the customer base (+22 percentage points with respect to 2005).

Revenues maintained the solid growth registered in previous quarters, up 29.2% in the last quarter of 2006 in local currency vs. the same period in 2005. In accumulated terms the company reached 1,260 million euros, up 32.5% in local currency over the previous year. Service revenues grew to a rate of 30.5% in local currency in the last quarter of 2006 in comparison to the same period in 2005, driven once more by the good performance of outgoing revenues, and especially prepay revenues. Cumulative service revenues showed 32.3% growth. Data revenues maintained the growth trend of previous quarters, doubling 2005 figure at the end of the year, reaching 260 million euros.

Strong revenues growth and lower commercial unit costs allowed a 137.9% OIBDA growth for the year in local currency, which meant reaching 339 million euros in the cumulative year of 2006. OIBDA margin stood at 26.9% at the end of the year, improving 11.9 percentage points in relation to the previous year.

## Southern Cone

### Selected operating data: cellular customers

Unaudited figures (Thousands)

	2005				2006	
	December	March	June	September	December	%Chg
<b>TEM Argentina</b>	<b>8,335.0</b>	<b>8,914.4</b>	<b>9,486.1</b>	<b>10,150.2</b>	<b>11,199.4</b>	<b>34.4</b>
Prepaid	5,035.8	5,535.2	5,951.4	6,498.1	7,315.8	45.3
Contract <sup>1</sup>	3,119.2	3,210.0	3,373.8	3,499.4	3,742.9	20.0
Fixed Wireless	179.9	169.2	160.8	152.7	140.7	(21.8)
<b>TEM Chile</b>	<b>5,275.8</b>	<b>5,335.0</b>	<b>5,515.1</b>	<b>5,618.1</b>	<b>5,680.2</b>	<b>7.7</b>
Prepaid	4,384.1	4,396.0	4,501.9	4,491.6	4,507.6	2.8
Contract	891.7	938.9	1,013.2	1,126.5	1,172.7	31.5
<b>TEM Uruguay</b>	<b>418.9</b>	<b>500.4</b>	<b>584.4</b>	<b>655.4</b>	<b>777.3</b>	<b>85.6</b>
Prepaid	356.5	434.7	511.9	569.8	675.3	89.4
Contract	62.4	65.6	72.5	85.6	102.0	63.5
<b>Total Accesses</b>	<b>14,029.7</b>	<b>14,749.8</b>	<b>15,585.6</b>	<b>16,423.8</b>	<b>17,657.0</b>	<b>25.9</b>

<sup>1</sup> Includes customers with an "Ahorro" contract, who prepay a monthly fee.

## Argentina

### Selected financial data

Unaudited figures (Euros in millions)

	January - December				October - December		
	2006	2005	% Chg	% Chg Local	2006	2005	% Chg
Revenues	1,260	1,010	24.8	32.5	354	303	16.5
OIBDA	339	151	123.9	137.9	121	44	175.7
OIBDA margin	26.9%	15.0%	11.9 p.p.		34.3%	14.5%	19.8 p.p.

## Argentina

### Selected operating data: cellular customers

Unaudited figures (Thousands)

	2005				2006	
	December	March	June	September	December	%Chg
<b>TEM Argentina</b>	<b>8,335.0</b>	<b>8,914.4</b>	<b>9,486.1</b>	<b>10,150.2</b>	<b>11,199.4</b>	<b>34.4</b>
Prepaid	5,035.8	5,535.2	5,951.4	6,498.1	7,315.8	45.3
Contract <sup>1</sup>	3,119.2	3,210.0	3,373.8	3,499.4	3,742.9	20.0
Fixed Wireless	179.9	169.2	160.8	152.7	140.7	(21.8)

<sup>1</sup> Includes customers with an "Ahorro" contract, who prepay a monthly fee.

## Chile

## Selected financial data

Unaudited figures (Euros in millions)

	January - December				October - December		
	2006	2005	% Chg	% Chg Local	2006	2005	% Chg
Revenues	796	661	20.3	15.3	215	202	6.4
OIBDA	294	235	24.9	19.7	107	86	24.2
OIBDA margin	36.9%	35.5%	1.4 p.p.		49.6%	42.5%	7.1 p.p.

## Chile

## Selected operating data: cellular customers

Unaudited figures (Thousands)

	2005				2006		% Chg
	December	March	June	September	December		
<b>TEM Chile</b>	<b>5,275.8</b>	<b>5,335.0</b>	<b>5,515.1</b>	<b>5,618.1</b>	<b>5,680.2</b>		<b>7.7</b>
Prepaid	4,384.1	4,396.0	4,501.9	4,491.6	4,507.6		2.8
Contract	891.7	938.9	1,013.2	1,126.5	1,172.7		31.5

## Chile

In Chile, the high level of market competence has accelerated its growth, reaching an estimated penetration of 82% by December 2006, presenting a 10 percentage points improvement on the previous year.

Customer base for Telefónica Móviles Chile, that kept the market leadership, reached 5.7 million clients at the end of 2006, driven by new GSM clients, with 73% of the total base already using this technology. Contract clients (1.2 million, +31.5% vs. 2005) pushed an accumulated 7.7% growth in the company's customer base, reflecting net adds in the last quarter of 2006 of 62,000 new clients, (+36.1% vs. same period in 2005). Greater commercial activity in Christmas campaign and lower churn led to an accumulated net adds of 404,000 clients.

Revenues showed a 15.3% annual growth in local currency, reaching 796 million euros. Service revenues grew to a rate of 18.5% in local currency in 2006 in comparison to 2005 (+12.4% in the fourth quarter of 2006 vs. the fourth quarter of 2005), mainly driven by outgoing revenues growth, significantly higher than customer base expansion. This behaviour reflects the ARPU positive evolution (+11.8% in relation to 2005), based on the higher weight of contract clients, resulting both from new clients and the proactive prepay-contract migration policy, plan upgrades and minute packages and VAS sales.

OIBDA at the end of the year, with accumulated growth of 19.7% in local currency, reached 294 million euros, due to the revenues good performance and cost control. The last quarter of 2006 showed a 28.7% growth in local currency in relation to the same period in 2005. The cumulative OIBDA margin reached 36.9%, 1.4 percentage points over the 2005 figure, thanks to better efficiency and despite increased commercial efforts taken due to initiatives arising from technological migration. In the last quarter the OIBDA margin amounted to 49.6%, improving 7.1 percentage points in relation to the same period the previous year.

## Rest of countries

Apart from the above mentioned operations, Telefónica Latin America Group is present in Central America (Salvador, Guatemala, Panama and Nicaragua), in Ecuador and Uruguay cellular markets. All together, those operations had as of December 2006 more than 7 millions customers (+39% vs. 2005), revenues that amounted 923 million euros (+14% vs. 2005) and OIBDA that reached 287 million euros (+31.9% vs. 2005).



## Telefónica Móviles Group

### Selected financial data

Unaudited figures (Euros in millions)

		January - December		
		2006	2005	% Chg
<b>Spain</b>	Revenues	9,199	8,834	4.1
	OIBDA	4,128	4,128	(0.0)
	OIBDA margin	44.9%	46.7%	(1.9 p.p.)
<b>Latin America</b>	Revenues	9,240	7,705	19.9
	OIBDA	2,429	1,755	38.5
	OIBDA margin	26.3%	22.8%	3.5 p.p.
<b>Brazil</b>	Revenues	2,005	1,889	6.1
	OIBDA	438	496	(11.7)
	OIBDA margin	21.9%	26.3%	(4.4 p.p.)
<b>Northern Region</b>	Revenues	1,544	1,264	22.2
	OIBDA	195	(1)	c.s.
	OIBDA margin	12.6%	(0.1%)	12.7 p.p.
<b>Andean Region</b>	Revenues	3,557	2,837	25.4
	OIBDA	1,146	866	32.3
	OIBDA margin	32.2%	30.5%	1.7 p.p.
<b>Southern Cone</b>	Revenues	2,133	1,714	24.4
	OIBDA	650	393	65.5
	OIBDA margin	30.5%	22.9%	7.6 p.p.
<b>Rest and intragroup</b>	Revenues	(36)	(25)	44.2
	OIBDA	(114)	(65)	74.1
	OIBDA margin	n.m.	n.m.	n.c.
<b>Total</b>	<b>Revenues</b>	<b>18,403</b>	<b>16,514</b>	<b>11.4</b>
	<b>OIBDA</b>	<b>6,443</b>	<b>5,817</b>	<b>10.8</b>
	<b>OIBDA margin</b>	<b>35.0%</b>	<b>35.2%</b>	<b>(0.2 p.p.)</b>

## Telefónica Móviles Group

### Capex by geographic regions

Unaudited figures (Euros in Millions)

		January - December		
		2006	2005	% Chg Local
<b>Spain</b>		<b>750</b>	<b>727</b>	<b>3.0</b>
<b>Latin America</b>		<b>1,525</b>	<b>1,499</b>	<b>1.8</b>
Brazil		389	367	5.9
Northern Region		288	331	(12.9)
Mexico		180	245	(26.6)
Guatemala		38	25	49.5
El Salvador		28	18	51.7
Panama		32	26	22.1
Nicaragua		11	16	(31.3)
Andean Region		556	494	12.7
Venezuela		232	141	65.0
Colombia		192	254	(24.3)
Peru		84	48	75.7
Ecuador		48	51	(6.0)
Southern Cone		291	307	(5.0)
Argentina		102	130	(21.6)
Chile		176	154	14.2
Uruguay		13	22	(40.7)
<b>Rest of the World</b>		<b>1</b>	<b>1</b>	<b>(32.8)</b>
<b>TOTAL</b>		<b>2,275</b>	<b>2,227</b>	<b>2.2</b>

Group Capex in 2006 at cumulative exchange rate. For comparative purposes, 2005 Capex has been recalculated at the cumulative average exchange rate for the corresponding period.

## Telefónica Móviles Group

### Consolidated income statement

Unaudited figures (Euros in millions)

	January - December			October - December		
	2006	2005	% Chg	2006	2005	% Chg
Revenues	18,403	16,514	11.4	4,866	4,463	9.0
Internal exp capitalized in fixed assets <sup>1</sup>	124	124	0.6	37	38	(3.4)
Operating expenses	(11,849)	(10,634)	11.4	(3,110)	(2,849)	9.2
Other net operating income (expense)	(199)	(175)	14.1	(14)	(52)	(72.3)
Gain (loss) on sale of fixed assets	15	0	n.s.	16	1	n.s.
Impairment of goodwill and other assets	(51)	(11)	n.s.	(51)	(11)	n.s.
<b>Operating income before D&amp;A (OIBDA)</b>	<b>6,443</b>	<b>5,817</b>	<b>10.8</b>	<b>1,743</b>	<b>1,590</b>	<b>9.6</b>
Depreciation and amortization	(2,432)	(2,374)	2.4	(606)	(694)	(12.6)
<b>Operating income (OI)</b>	<b>4,012</b>	<b>3,443</b>	<b>16.5</b>	<b>1,136</b>	<b>896</b>	<b>26.8</b>

(1) Including work in process.

## Telefónica O2 Europa

The results of O2 Europe for the period ended 31 December 2006 comprise the results of the O2 Group for the 11 month period ended 31 December 2006 and the results of Telefónica O2 Czech Republic and Telefónica Deutschland for the 12 month period ended December 2006. O2 Group also includes the results of be\* from 1 July 2006, Decision Focus from 1 August 2006 and The Link from mid September 2006. At the end of December 2006, the contribution of Telefónica O2 Europe to Telefónica Group revenues was 13,159 million euros, and operating income before depreciation and amortization (OIBDA) reached 3,708 million euros.

Telefónica O2 Europe CapEx for the period ended December 2006 amounted to 2,553 million euros. For the period Feb-Dec 06, O2 Group CapEx, excluding acquisitions, totaled 2,238 million euros, in line with the guidance for the period provided by the Company (2,000-2,300 million euros).

Among the latest actions taken in the quarter, we should highlight:

- The launch of Telefónica O2 Slovakia's commercial service on 2 February 2007. In the first 12 days over 110,000 active customers were acquired. The initial offer, called "O2 Jednotky", includes prepaid on-net calls for SKK 2 and SKK 8.50 for calls to all other networks, and the Czech Republic, at anytime of the day. From 2 February until 31 March all customers will receive a 100% credit bonus when they top up for the first time. Top up vouchers are available with a value of SKK 250 and 350 (valid for 3 months), as well as SKK 550 and 950 (valid for 6 months). Vouchers will be sold through a broad distribution network of more than two thousand points of sale located across Slovakia.

- O2 launched its DSL service and refreshed its successful Genion Homezone tariffs, enabling the company to offer integrated mobile, DSL landline telephony and broadband Internet access services. The DSL packages, O2 DSL S/M/L, are priced from 40 euros to 55 euros a month and comprise a DSL connection of 4 to 16 megabits per second with flat rate Internet access, plus fixed line calls charged either at flat rate or per minute. O2 DSL customers who are also O2 mobile contract customers receive a discount of 5 euros per month.

The refreshed Genion tariffs - S/M/L - are closely integrated with the new DSL offering. The new tariffs simplify and reduce prices for making calls from both within and outside the Homezone. The Genion S tariff is a postpay tariff without a fixed contract term and no basic monthly fee. Genion M offers a flat rate tariff for calls from the Homezone, while the Genion L tariff introduces a Germany-wide flat rate for a monthly fee of 25 euros.

- Be\* continued its network rollout in the UK, with over 500 exchanges across the UK unbundled by February 2007, enabling it to provide broadband services to more than one third of the UK population. Be\* operates one of the most innovative and technically-advanced UK broadband networks, using ADSL 2+ technology which offers download speeds of up to 24 Mbps.

Be\* also launched "Upload Plus" during the quarter, a service which allows business broadband customers to send data at much faster speeds of up to 2.5Mbps, more than double the nearest competitor. Be\* is the first UK ISP to offer this service, with a rollout to consumers planned for the second quarter. Plans to offer an integrated mobile and broadband service from O2 in mid 2007 are progressing well, driven by three aims: to make customers' lives easier; to offer the best service quality and customer service in the market; and to give straightforward value for money.

## Telefónica O2 Europe Consolidated income statement

Unaudited figures (Euros in millions)

January - December

2006

Revenues	13,159
Internal expenditure capitalized in fixed assets <sup>1</sup>	219
Operating expenses	(9,570)
Other net operating income (expense)	(83)
Gain (loss) on sale of fixed assets	(8)
Impairment of goodwill and other assets	(9)
<b>Operating income before D&amp;A (OIBDA)</b>	<b>3,708</b>
Depreciation and amortization	(3,399)
<b>Operating income (OI)</b>	<b>309</b>

<sup>1</sup> Including work in process.

Note: Telefónica O2 Europe includes O2 Group (February-December), Telefónica O2 Czech Republic and T. Deutschland (January-December).

## Telefónica O2 Europe Accesses

Unaudited figures (Thousands)

2005

2006

	December	March	June	September	December	%Chg
<b>Final Clients Accesses</b>	<b>35,730.1</b>	<b>36,361.9</b>	<b>37,055.8</b>	<b>37,566.3</b>	<b>38,311.1</b>	<b>7.2</b>
Fixed telephony accesses <sup>1</sup>	3,021.6	2,971.4	2,894.9	2,598.3	2,462.9	(18.5)
Internet and data accesses	613.5	596.5	572.7	564.6	607.1	(1.0)
Narrowband	366.9	292.4	224.3	178.6	143.7	(60.8)
Broadband	233.7	291.5	335.9	373.9	451.9	93.4
Other	12.8	12.6	12.5	12.1	11.6	(9.7)
Cellular accesses	32,095.0	32,794.0	33,588.2	34,400.7	35,225.4	9.8
Pay TV	0.0	0.0	0.0	2.8	15.6	n.m.
<b>Wholesale Accesses<sup>2</sup></b>	<b>597.3</b>	<b>573.0</b>	<b>527.2</b>	<b>620.0</b>	<b>881.7</b>	<b>47.6</b>
<b>Total Accesses</b>	<b>36,327.4</b>	<b>36,934.8</b>	<b>37,583.0</b>	<b>38,186.3</b>	<b>39,192.8</b>	<b>7.9</b>

<sup>1</sup> PSTN (including Public Use Telephony) x1; ISDN Basic access x1; ISDN Primary access; 2/6 Access x30. Company's accesses for internal use included.<sup>2</sup> Includes T. Deutschland connections resold on a retail basis.

Note: Cellular accesses, Fixed telephony accesses and Broadband accesses include MANX customers.

## O2 Group

### Consolidated income statement

Unaudited figures (Euros in millions)

February - December

	2006
Revenues	10,733
Internal expenditure capitalized in fixed assets <sup>1</sup>	187
Operating expenses	(8,069)
Other net operating income (expense)	(67)
Gain (loss) on sale of fixed assets	(10)
Impairment of goodwill and other assets	0
<b>Operating income before D&amp;A (OIBDA)</b>	<b>2,773</b>
Depreciation and amortization	(1,770)
<b>Operating income (OI)</b>	<b>1,003</b>

<sup>1</sup> Including work in process.

- During the quarter O2 UK finished the re-branding of 96 Link stores, bringing the total number of O2 Retail stores to around 400. This expansion is part of an ongoing shift in the UK market towards increased direct distribution by network operators. As the focus moves to retention and loyalty in an increasingly mature market O2 is well placed to improve the customer experience through its award winning retail chain.
- In December O2 Ireland announced a joint venture with Tesco in Ireland, Tesco Mobile, to offer exclusively Tesco branded mobile services in Tesco Ireland stores nationwide. The MVNO service will use the O2 network and is expected to launch in summer 2007.

In October O2 Ireland and Arqiva jointly announced the first consumer trial of broadcast mobile TV in Ireland, featuring all the main Irish TV channels plus content from Sky and other channels. 350 O2 customers in the Greater Dublin area will be able to access broadcast TV on their mobile phone during the trial, using the Nokia N92 DVB-H handset. O2 has already conducted initial demonstrations of broadcast mobile TV at the 2006 Ryder Cup, with content from RTE 1, RTE 2, TV3, TG4 and Sky. The trial will commence in early March.

- Following on from the announcement in December 2006, JPMorgan Cazenove has been instructed to conduct a strategic review of Airwave, including a possible sale of the business. Since that date JPMorgan Cazenove has been working with all stakeholders involved, including the UK government, to review options and produce an Information Memorandum, which is expected to be released in early Spring.

With the conclusion of the Welsh Ambulance contract, Airwave has now contracted with all the blue light emergency services in the UK and continues to pursue other opportunities, such as winning new contracts and providing additional services to existing customers, as demonstrated by recent announcements regarding contracts with London Underground and Channel Tunnel Rail and the launch of new data services.

## O2 UK

### Selected operating data

Unaudited figures

	2005				2006	
	December	March	June	September	December	%Chg
<b>Cellular customer (thousands)</b>	<b>15,980.9</b>	<b>16,340.6</b>	<b>16,814.3</b>	<b>17,337.7</b>	<b>17,633.2</b>	<b>10.3</b>
Prepaid	10,479.2	10,654.4	10,940.5	11,255.8	11,415.1	8.9
Contract	5,501.6	5,686.2	5,873.8	6,081.9	6,218.1	13.0
	4Q	1Q	2Q	3Q	4Q	% Chg
<b>MOU (minutes)</b>	<b>165</b>	<b>162</b>	<b>169</b>	<b>175</b>	<b>180</b>	<b>9.1</b>
<b>ARPU (EUR)</b>	<b>33.3</b>	<b>32.3</b>	<b>33.1</b>	<b>34.0</b>	<b>34.1</b>	<b>2.5</b>
Prepaid	17.2	16.8	17.3	17.9	18.2	5.7
Contract	63.7	61.6	62.7	63.9	63.5	(0.4)
<b>Data ARPU</b>	<b>10.0</b>	<b>9.8</b>	<b>10.0</b>	<b>10.6</b>	<b>10.7</b>	<b>6.7</b>
%non-P2PSMS over data revenues	12.2%	12.5%	13.3%	13.1%	12.5%	0.3 p.p.

Note: MOU and ARPU calculated as monthly quarterly average.

## O2 Group

### O2 UK

Fourth quarter net service revenue grew by 13.7% year on year and for the eleven months to 31 December reached a total of 3,885 million pounds, an increase of 14.7% compared to the same period last year, in line with the guidance provided for 2006 (14%-15% range). This growth has been driven by continued strong customer and ARPU growth.

OIBDA margin for the eleven months to 31 December 2006 was 28.4% compared to 29.3% for the same period last year, reflecting the high level of customer growth, with O2 UK adding 1.65 million customers in the calendar year. The drop in OIBDA margin reported for the 11 month period until December is fully aligned with the last guidance provided by the Company (-1 p.p.) OIBDA for the eleven months to December 2006 was 1,211 million pounds, showing an increase of 10.2% vs. the same period last year.

The quarter again saw tough competition in the market, but the business continued to perform well with broadly stable gross additions quarter on quarter, although year on year gross additions were down around 5% due to the increasingly mature nature of the UK market. A total of 295,500 net new customers were added in the quarter, taking the base to 17.6 million, 10.3% higher than at the same time last year (excluding the Tesco Mobile customer base).

A total of 136,200 net new contract customers were added in the quarter and at the end of the period contract customers made up 35.3% of the total base, compared to 34.4% in the same period last year. 12 month rolling contract ARPU of 513 pounds was down 2 pounds quarter on quarter, and 4 pounds lower than the fourth quarter last year, as a result of new customer propositions and an increasingly competitive market. 12-month rolling contract churn was 23%, compared to 27% for the same period last year,

the sixth consecutive quarter of decline, reflecting the ongoing strategy of rewarding customer loyalty.

A total of 159,300 net new pre-pay customers were added in the quarter, and 12 month rolling pre-pay ARPU of 143 pounds was 7 pounds higher than the fourth quarter last year and 1 pound higher than the previous quarter, driven by promotions such as O2 Long Weekends.

12 month rolling data ARPU of 84 pounds was 7 pounds higher than the same period last year and 1 pound higher than the previous quarter, driven primarily by growth in text message volumes, up 30% year on year in the fourth quarter, as well as increasing usage of a range of non-SMS services such as the user generated content service "Look at Me".

O2 UK's blended 12 month rolling ARPU of 273 pounds was 6 pounds higher than the fourth quarter last year, and 1 pound higher than the previous quarter, reflecting the continued growth in data ARPU coupled with broadly stable voice ARPU.

Quarterly monthly minutes of use were up 9.1% year on year to 180 minutes a month, driven by propositions such as 50% extra minutes on 18 month contracts, Treats and Long Weekends.

O2 UK's own channels accounted for around 60% of gross connections in the quarter. O2 UK also completed the re-branding of 96 Link stores to expand its O2 Retail network to around 400 stores. Blended customer acquisition costs (SAC) on an annual basis fell by around 9% year on year.

CapEx in the eleven months to December (excluding CapEx related to the acquisition of be\* and The Link) was 518 million pounds, with continued expenditure on rolling out coverage of the 3G network as well as investment in the existing 2G network to ensure a high level of service.

## O2 Germany

### Selected operating data

Unaudited figures

	2005				2006	
	December	March	June	September	December	%Chg
<b>Cellular customer (thousands)</b>	<b>9,768.8</b>	<b>10,099.0</b>	<b>10,335.3</b>	<b>10,628.9</b>	<b>11,024.8</b>	<b>12.9</b>
Prepaid	4,798.9	4,986.9	5,143.3	5,340.7	5,544.1	15.5
Contract	4,970.0	5,112.1	5,192.1	5,288.0	5,480.7	10.3
	4Q	1Q	2Q	3Q	4Q	% Chg
<b>MOU (minutes)</b>	<b>124</b>	<b>127</b>	<b>128</b>	<b>124</b>	<b>129</b>	<b>4.0</b>
<b>ARPU (EUR)</b>	<b>26.5</b>	<b>24.1</b>	<b>24.2</b>	<b>25.3</b>	<b>23.7</b>	<b>(10.6)</b>
Prepaid	10.4	9.2	8.9	9.0	8.3	(20.5)
Contract	41.4	38.6	39.1	41.7	39.2	(5.3)
<b>Data ARPU</b>	<b>6.1</b>	<b>5.9</b>	<b>5.4</b>	<b>5.8</b>	<b>5.9</b>	<b>(3.6)</b>
%non-P2PSMS over data revenues	21.7%	23.0%	21.5%	21.4%	22.6%	0.9 p.p.

Note: MOU and ARPU calculated as monthly quarterly average.

O2 UK promoted a number of products and services during the quarter, aimed at acquisition and retention of customers and revenue growth. These included:

- O2 Long Weekends, offering free on net calls from Saturday to Monday for new and existing O2 Pay and Go customers who top up 15 pounds a month and free calls to any network in the UK for new Pay Monthly and upgrading customers;
- O2 Treats, offering customers bundles of free texts, voice minutes or value added services after 6 months as an O2 customer to reward loyalty;
- O2 Rewards, offering prepaid customers 10% of top-ups back every 3 months;
- Bluebook, which enables customers to store contact information, text messages, pictures and video clips to a free web-accessible personal account. The converged service is a first for any UK mobile operator;
- The Xda Orbit, the latest model in the successful Xda range, a stylish, ultra slim, lightweight device with inbuilt Global Positioning System (GPS). The Xda Orbit features Microsoft® Windows® Mobile 5.0, with direct push email giving real time access to Microsoft® Outlook® Inbox, Calendar, Contacts and Tasks. The Xda Orbit also has an FM radio, an MP3 player, a 2.0 megapixel camera and a quad band mobile phone.

### O2 Germany

Service revenue grew by 3.3% in the fourth quarter, and for the eleven months to December reached a total of 2,808 million euros, an increase of 6.7% compared to the same period last year vs. the guidance of High Single Digit growth provided by the Company for the period. This growth has been driven by the continued expansion of the customer base, which partly offset ARPU weakness in the German market. Fourth quarter service revenue was reduced by almost 5 p.p. due to the termination rate cuts in December 2005 and November 2006.

OIBDA margin for the eleven months to December was 20.7%, 1 percentage point lower than the same period last year. OIBDA for the eleven months to December 2006 was 631 million euros, broadly flat compared to the same period last year. OIBDA and consequently the OIBDA margin were negatively impacted by the inclusion of a charge related to a rebalancing of the workforce towards customer-facing areas. O2 Germany plans to increase the number of employees in areas such as customer service and to reduce positions in non-customer facing areas. Excluding this charge, the OIBDA margin for the eleven months to December 2006 is 21.8%, stable in comparison to the same period last year and in line with the full year guidance.

In this competitive environment, O2 Germany continued to trade well. Roughly 396,000 net new customers were added in the quarter, taking the base to 11.0 million, 12.9% higher than at the same time last year. The Tchibo Mobile customer base grew by 55,000 to 827,000 by the end of the quarter.

O2 Germany added a total of 192,700 net new contract customers in the quarter, its highest level since the fourth quarter last year. 12 month rolling contract ARPU of 475 euros was 6 euros lower than the previous quarter, and 33 euros lower than the same quarter last year. This reflected the impact of the termination rate cuts in both December 2005 and November 2006, as well as increasing competition in the German market and the introduction of new customer offers.

A total of 203,400 net new pre-pay customers were added in the quarter. 12 month rolling pre-pay ARPU of 105 euros was 6 euros lower than the previous quarter and 25 euros lower than the fourth quarter last year, reflecting the impact of the termination rate cuts, increasing competition, higher market penetration the growth in multiple SIM ownership and lower minutes of use.

12 month rolling data ARPU was 69 euros, 1 euro less than the previous quarter and 8 euros lower than the same period last year due to the higher number of lower spending pre-pay users in the base and a shift from SMS to voice usage. Non-SMS data users grew 12% compared to the same period last year.

Blended 12 month rolling ARPU remains the highest in the German market at 290 euros, down from 299 euros in the previous quarter and 332 euros in the same quarter last year. This trend reflects the ongoing impact of the termination rate cuts, the rapid growth in the pre-pay customer base over the past 12 months, which now makes up over 50% of the total base, and the increasingly competitive market environment. Termination rate cuts reduced 12 month rolling ARPU in the quarter by approximately 13 euros. Blended customer acquisition costs (SAC) on an annual basis fell by around 8% year on year.

Quarterly monthly minutes of use grew by 4% year on year, to 129 minutes, driven by new propositions such as Genion flat rate. O2 Germany now has a total of 3.9 million Genion customers (71% of the post-pay base), with 51% of all new post-pay customers opting for Genion.

CapEx in the eleven months to December was 1,139 million euros, with continued expenditure on both the 3G and 2G networks.

Germany launched a number of new products and services during the quarter, including:

- LOOP S/M/L, a new prepaid tariff to reward larger top ups. For a 30 euros top up the customer receives a 20 euro bonus;
- O2 Business flat, a nationwide flat rate tariff for on-net and fixed net calls. The flat rate is available for 25 euros per month SIM only and 35 euros with a handset. Off-net calls cost 15 cent/min. The Genion-Option for O2 Business and O2 Business Profi tariffs were also reduced, with local and long distance calls now charged at 2.5 cent/min;
- The Xda Orbit, also launched in UK;
- AOL Mobile. AOL Germany launched a mobile service during the quarter in co-operation with O2 Germany. The basic tariff costs 19 cent/min for calls to all networks, with SMS priced at 16 cents. Three additional options can be added to this basic tariff: Plus Family (4.99 euros/month) gives free calls between up to five numbers and an AOL phone; AOL Plus Friends (2.99 euros) enables national community calls for 5 cent/min; Plus Web offers 20 MB of WAP and Web browsing for 4.99 euros.
- Launch of HSDPA on 1 December 2006. Data download speeds of up to 1.8 Mbit/s are available in Hamburg, Berlin, Cologne, Düsseldorf, Frankfurt and Munich. There is no HSDPA surcharge on existing UMTS tariffs.

## O2 Ireland

### Selected operating data

Unaudited figures

	2005	2006				%Chg
	December	March	June	September	December	
<b>Cellular customer (thousands)</b>	<b>1,601.8</b>	<b>1,593.0</b>	<b>1,598.6</b>	<b>1,603.0</b>	<b>1,632.0</b>	<b>1.9</b>
Prepaid	1,173.2	1,154.0	1,146.9	1,134.9	1,146.9	(2.2)
Contract	428.6	439.0	451.7	468.1	485.1	13.2
	4Q	1Q	2Q	3Q	4Q	% Chg
<b>MOU (minutes)</b>	<b>224</b>	<b>220</b>	<b>237</b>	<b>241</b>	<b>246</b>	<b>9.8</b>
<b>ARPU (EUR)</b>	<b>46.1</b>	<b>44.6</b>	<b>45.8</b>	<b>45.2</b>	<b>45.0</b>	<b>(2.4)</b>
Prepaid	30.5	28.9	29.4	29.8	29.6	(3.0)
Contract	88.1	87.1	88.2	83.5	81.4	(7.6)
<b>Data ARPU</b>	<b>9.6</b>	<b>9.5</b>	<b>9.5</b>	<b>9.9</b>	<b>10.0</b>	<b>4.2</b>
%non-P2PSMS over data revenues	11.8%	13.8%	15.6%	18.4%	19.6%	7.8 p.p.

Note: MOU and ARPU calculated as monthly quarterly average.

#### O2 Ireland

Service revenue fell by 1.5% in the fourth quarter due to termination rate regulation, increasing competition and the introduction of new customer offers. The termination rate cut of RPI minus 11% in January 2006 impacted fourth quarter service revenue growth by approximately 2%. For the eleven months to December service revenue reached a total of 824 million euros, an increase of 1.1% compared to the same period last year, driven by a higher customer base.

In a competitive market O2 Ireland traded well, with gross and net connections at a broadly similar level to the fourth quarter last year. 29,000 net new customers were added in total during the quarter, taking the total base to 1.6 million customers, 1.9% higher than at the same time last year.

O2 Ireland added a total of 17,000 net new contract customers in the quarter. 12 month rolling ARPU of 1,020 euros was 53 euros lower than the fourth quarter last year and 20 euros lower than the previous quarter, reflecting the impact of the termination rate regulation.

A total of 12,000 pre-pay customers were added in the quarter, and 12 month rolling ARPU was 353 euros, down 7 euros on the same period a year ago and 3 euros compared to the previous quarter.

12 month rolling data ARPU was 117 euros, 4 euros higher than the fourth quarter last year and 1 euro higher than the previous quarter. Non-SMS data users grew by 53% year on year.

Blended ARPU of 542 euros was reduced by approximately 7 euros due to the termination rate cuts, and was 8 euros lower than the same quarter last year and down 3 euros quarter on quarter.

Quarterly monthly minutes of use increased by 9.8% year on year to 246 minutes, mainly due to the ongoing success of usage stimulation promotions such as 1 cent weekends on pre-pay.

In addition O2 Ireland launched a number of pricing initiatives and services during the quarter. These included:

- Extension of a new device repair programme called Swap Out Service (SOS). From an initial trial in six O2 stores, the programme has been extended to all O2 Retail stores. Under the new service, customers are given an immediate replacement handset if they have a faulty device which is within its warranty period.
- The launch of Napster Mobile in Europe on O2 Ireland 3G i-mode handsets. Napster Mobile allows O2 Ireland customers to search, browse, preview and purchase content from Napster's immense music catalogue of over two million songs.

O2 Ireland also continued to promote the following offers:

- 1 cent calls and texts at weekends for prepay customers, extended until 25 February 2007.
- "My Europe" roaming tariff, offering holidaymakers a reduced flat-rate voice roaming rate across the European Union. Using the free opt-in service, O2 customers are charged a flat rate of 59 cent per minute to make or receive a call within the EU, regardless of the mobile network used, at any time



### O2 Airwave

After the period end, Airwave announced the Welsh Ambulance Service had signed a 10 year contract worth 32 million pounds to use its service, as well as a contract with London Underground Limited valued at 115 million pounds to provide Airwave coverage for the emergency services throughout London's underground network. Airwave has now contracted with all the "blue light" emergency services in the UK to supply a secure digital communications system.

In December a 10 year contract was signed with Lancashire Constabulary to provide a managed mobile data solution based around the Airwave Mobile Applications Gateway (MAG) Service and the Airwave network. This groundbreaking development means that Lancashire Constabulary will become the first UK police force to deploy a multi-bearer force-wide mobile data solution.

During the quarter Airwave also launched the "Locator" service, a new location based service aimed at all Public Safety organisations, including police, that need to know the whereabouts of their people and assets. A 2.8 million pounds contract was also signed with Channel Tunnel Rail Limited to provide Airwave communications to their UK tunnels and stations. Airwave continues to improve its offering to customers with the development of voicemail and call forwarding adding new functionality to Airwave's telephony features.

### Telefónica O2 Czech Republic

Telefonica O2 Czech Republic contribution to Telefonica Group revenues in 2006 amounted to 2,148 million euros. In local currency, and taking into account other recurring revenues, this represents an increase of 0.4% year-on-year (+0.1% year-on-year in the fourth quarter alone), in line with the guidance of flat revenues set for 2006. Mobile business was the key driver of this growth, although the rate of decline of revenues from the fixed business slowed during the year.

Consolidated operating expenses showed an increase in local currency of 2.8% year-on-year in 2006, up by 13.2% in the fourth quarter alone mainly due to re-branding costs and costs related to the launching of the Slovak project (operations actually began on February 2nd 2007), fully reflected in the year-on-year 12.4% year-on-year increase, in local currency, of costs from external services. Supplies expenses (+2.2% year-on-year in local currency) also contributed to the increase in consolidated expenses due to higher activity in carrier transit and growth in mobile off-net traffic from Telefónica O2 Czech Republic customers. Personnel expenses showed a decrease in local currency of 9.4% as a result of one-off items recorded in 2005 and 6.4% headcount reduction (total number of employees at 31 December 2006 is 9,416).

The Group's operating income before depreciation and amortization (OIBDA) amounted to 985 million euros, a year-on-year increase of 2.4% in local currency, including Slovak operations and accomplishing guidance for the full year which was upgraded during third quarter' results. As a result, OIBDA margin was 45.8% in 2006, 0.9 p.p. higher than in 2005, showing the ongoing path on cost efficiencies on the one hand, and the higher impairment charge registered in 2005, on the other.

Total CapEx for Telefonica O2 Czech Republic Group in 2006 amounted to 229 million euros, an increase of 7.0% year-on-year in local currency. While CapEx in the fixed segment increased by 40.0% year-on-year in local currency and largely spent on

## Telefónica O2 Czech Republic

### Selected operating data cellular business

Unaudited figures

	2005				2006	
	December	March	June	September	December	%Chg
<b>Cellular customer (thousands)</b>	<b>4,676.0</b>	<b>4,695.0</b>	<b>4,770.2</b>	<b>4,759.7</b>	<b>4,864.5</b>	<b>4.0</b>
Prepaid	3,130.4	3,051.8	3,043.1	2,978.3	2,989.7	(4.5)
Contract	1,545.6	1,643.2	1,727.1	1,781.3	1,874.8	21.3
	4Q	1Q	2Q	3Q	4Q	% Chg
<b>MOU (minutes)</b>	<b>97</b>	<b>96</b>	<b>102</b>	<b>102</b>	<b>109</b>	<b>12.4</b>
<b>ARPU (EUR)</b>	<b>17.5</b>	<b>17.1</b>	<b>17.9</b>	<b>18.3</b>	<b>18.8</b>	<b>7.6</b>
Prepaid	8.3	7.9	8.4	8.6	8.8	6.5
Contract	36.8	34.8	34.8	34.9	35.0	(4.9)
<b>Data ARPU</b>	<b>3.8</b>	<b>3.7</b>	<b>3.7</b>	<b>3.8</b>	<b>4.0</b>	<b>6.0</b>
%non-P2PSMS over data revenues	40.2%	39.1%	38.7%	43.0%	40.0%	(0.2 p.p.)

Note: MOU and ARPU calculated as monthly quarterly average.

1 13 month active customer base.

broadband rollout and IPTV, investments in the mobile segment decreased by 16.9% year-on-year in local currency, mainly due to the significant investment in mobile broadband networks deployment made in the same period of last year. CapEx over revenues reached 10.6% in 2006.

Cumulative operating free cash flow (OIBDA-CapEx) to December 2006 stood at 755 million euros, 1.1% year-on-year higher in local currency than in the same period last year.

#### Fixed Line Business<sup>1</sup>

Revenues in the fixed line business amounted to 1,057 million euros for the full year, showing a decrease of 5.1% year-on-year in local currency, driven by the shift from traditional voice services which has not been fully compensated by the increase in revenues from broadband Internet, data and value added services. On the positive side, it is worth mentioning the turn around seen in the Internet revenues (Narrowband&Broadband) through the year and the significant improvement in revenues from IT services.

Revenues from traditional access fell by 6.5% year-on-year in local currency, primarily due to the 17.4% decline in the number of fixed telephony accesses to reach 2.4 million accesses at the end of 2006, reflecting a strong fixed to mobile substitution effect, as well as the exclusion of "incoming only lines" from calculation, already reported in September. The increase of residential monthly fees from 1st May has impacted positively on this revenue item, showing rates of decline of around 2% in the third and fourth quarter, respectively, compared to a decline of 7.9% in the second quarter.

Revenues from traditional voice services (voice traffic and interconnection) declined by 9.6% year-on-year in local currency. Revenues from voice traffic declined by 16.2% year-on-year in local currency, as a result of lower voice traffic generated by end customers, which decreased by 7.0% year-on-year. The unification of local and long distance rates effective as of 1st April helped long distance traffic to remain in 2006 in the same level as the previous year. Interconnection revenues were flat year-on-year in local currency in 2006, mainly due to the decrease in interconnection charges and lower incoming traffic, being offset by the growth in revenues from international operators, as a result of higher international transit traffic.

Revenues from Internet and Broadband services registered a year-on-year increase of 9.7% in local currency and by 17.9% in the fourth quarter alone, reflecting the turn around already seen from the first quarter, as Narrowband Internet represents a decreasing proportion of Internet revenues with limited downside potential.

The total number of retail Internet broadband accesses at the end of December, 2006 amounted to 405,000 (which represents 86.2% of the total ADSL base), showing a net adds in the year of 179,299 accesses.

It is also important to mention that "O2 TV" customers at the end of 2006 amounted to 15,600 since the launching of the service, based on the Imagenio IPTV platform, in the beginning of September 2006.

After the merger of Cesky Telecom and Eurotel into Telefónica O2 Czech Republic as of 1st July, 2006 all inter-company transactions between fixed and mobile became intra-company. As a result, the financial results of the fixed and mobile segments for 2006, as well as the comparable results from 2005 are disclosed excluding inter-segment revenues and costs. However, mobile ARPU calculation includes the full amount of revenues (including revenues from fixed line business).

## Telefónica O2 Czech Republic

### Selected financial data

Unaudited figures (Euros in millions)

	January - December			October - December		
	2006	2005	% Chg	2006	2005	% Chg
Revenues	2,148	1,035	n.c.	555	526	5.6
Resultado operativo antes de amort. (OIBDA)	985	457	n.c.	206	204	0.9
OIBDA margin	45.8%	44.1%	1.7 p.p.	37.1%	38.8%	(1.7 p.p.)

Note: In 2005 Telefónica O2 Czech Republic includes the results from July. In 2006 costs from start up operations in Slovakia are included.

Revenues from data services showed a 4.1% year-on-year decrease in local currency as the decrease in revenues from leased lines (-10.9%) was partially offset by the increase in revenues from virtual private networks based on broadband IP connectivity solutions (+6.2%).

#### Mobile Business

Revenues for the full year 2006 in the mobile segment increased by 6.1% year-on-year in local currency to reach 1,091 million euros.

In the Czech mobile market, while SIM card penetration reached almost 121% at 2006 year end, total number of cellular accesses managed by Telefónica O2 Czech Republic increased by 4.0% year-on-year to reach 4.9 million at the end of December 2006. Net additions for the full year amounted to 188,000, with strong performance in the fourth quarter alone (93,000 net additions on contract and 11,000 on prepaid). Further migration of prepaid customers to contract, has led to a 21.3% year-on-year increase in the number of contract customers who at the end of December totaled 1.9 million, or 38.5% of the total customer base compared with 33.1% at the end of 2005. The blended monthly average churn rate stood at 1.5% for the full year, up from the 1.3% registered in 2005.

Revenues from voice services (monthly fees, customer and interconnection traffic) increased in the full year by 4.4% in local currency, with the increase in revenues from monthly fees (+9.0% year-on-year), driven by the larger contract customer base, and helped by the 1.4% year-on-year increase in traffic revenues as a result of traffic stimulation activities. Total mobile traffic grew by 21.0% year-on-year, reflecting an increased average MOU per subscriber and the increase of incoming traffic (MOU per customer blended resulted in 102 minutes in 2006, up from 92 minutes in the last year).

In the fourth quarter of 2006, blended ARPU registered a 2.7% year-on-year increase in local currency to reach 19 euros on the back of continuing customer migration from the prepaid to the contract segment.

Revenues from Value Added services (SMS, MMS and Content) increased by 8.5% in local currency, with the non-SMS blended data ARPU as a percentage of data ARPU reaching 41.0%, compared with 39.0% for the same period last year.

The number of customers using the Data Express service (CDMA-based broadband internet access service) reached 94,000, up by 34.3% year-on-year. This, together with the 10.4% increase in the number of customers using the Data Nonstop service (GPRS-based internet access service), which stood at 74,000 at the end of December, led to a year-on-year increase in revenues from Internet and Data of 24.5% in local currency.

Revenues from equipment (including connection fees) showed a 0.6% year-on-year decrease in local currency, partially because lower connection fees charged to new contract customers.

## Telefónica Deutschland Selected financial data

Unaudited figures (Euros in millions)

	January - December			October - December		
	2006	2005	% Chg	2006	2005	% Chg
Revenues	297	281	5.4	76	73	4.8
Operating income before D&A (OIBDA)	(50)	(3)	n.m.	(25)	(4)	n.m.
OIBDA margin	(16.8%)	(1.1%)	(15.7 p.p.)	(32.1%)	(5.7%)	(26.4 p.p.)

### Telefónica Deutschland

Telefónica Deutschland revenues in the fourth quarter amounted to 76 million euros, 4.8% higher than in the same period last year, and reached a total of 297 million euros for the 12 months to December 2006, a year-on-year increase of 5.4%.

This was primarily due to a significant increase in revenues from voice services that offset the decline in revenues from the Internet narrowband wholesale business. Voice revenues in the twelve months of 2006 amounted to 93 million euros, an increase of 82% compared to full year 2005, representing 5.4 billion minutes carried by the Telefónica Deutschland IP network and maintaining the company's lead in the German VoIP wholesale market. Fourth quarter voice revenues were 23 million euros, an increase of 28% on the same period last year, representing 1.6 billion minutes.

Although competition in the German broadband access retail market remained intense, the total number of equivalent ADSL lines in service increased to about 618,000 at the end of full year 2006. Revenues from Internet broadband access based on Telefónica Deutschland's own LLU infrastructure amounted to 25 million euros for full year 2006, compared to 0.2 million euros in 2005. Fourth quarter LLU revenues were 14 million euros. Telefónica Deutschland continues to provide services to nearly all the major ISPs in Germany, maintaining its strong market position.

Telefónica Deutschland registered a negative operating income before depreciation and amortization (OIBDA) of 50 million euros in the 12 months to December 2006, compared to negative OIBDA of 3 million in the 12 months to December 2005, mainly due to start up losses relating to its nationwide ULL rollout. By the end of 2006 42% of households were covered, with a target of 60% by the end of august 2007. The fourth quarter of 2006 resulted in a negative OIBDA of 25 million euros, compared to a negative OIBDA of 4 million euros in the fourth quarter of 2005.

## Atento Group

### Consolidated income statement

Unaudited figures (Euros in millions)

	January - December			October - December		
	2006	2005	% Chg	2006	2005	% Chg
Revenues	1,027	856	19.9	269	248	8.3
Internal expenditure capitalized in fixed assets <sup>1</sup>	0	0	n.m.	0	0	n.m.
Operating expenses	(882)	(742)	18.9	(228)	(214)	6.6
Other net operating income (expense)	(3)	1	c.s.	(2)	(1)	n.m.
Gain (loss) on sale of fixed assets	(0)	0	c.s.	0	0	34.3
Impairment of goodwill and other assets	0	0	n.m.	0	0	n.m.
<b>Operating income before D&amp;A (OIBDA)</b>	<b>142</b>	<b>116</b>	<b>21.8</b>	<b>39</b>	<b>34</b>	<b>16.5</b>
Depreciation and amortization	(28)	(28)	1.4	(7)	(7)	(0.2)
<b>Operating income (OI)</b>	<b>113</b>	<b>88</b>	<b>28.2</b>	<b>32</b>	<b>27</b>	<b>21.1</b>

<sup>1</sup> Including work in process.

## Other Businesses

### Atento Group

Atento Group net turnover reached 1,027 million euros by the end of 2006, a 19.9% growth year on year. The evolution of Group revenues was motivated by the increased activity of its main clients, as well as the addition of new clients in all countries, primarily Brazil, Mexico, Venezuela, Chile and Spain.

The ratio of revenues generated by clients outside the Telefónica Group increased year on year by 2.2 percentage points to stand at 47.0% as of the end of December 2006. The main clients to have contributed to this growth are:

- In Brazil: Increased activity primarily in the financial sector with Banco IBI, Badresco, Itaú and the addition of new clients such as Santander and Aon.
- In Mexico: Growth in sales with BBVA, particularly in the Telcobranza Hipotecaria, Seguros Zodiaco and Finanzia services
- In Venezuela: Growth in revenues due to new clients in the financial sector, such as: Banco de Venezuela, Banpro and Sicobank and increased management with Grupo CANTV and Movilnet.
- In Chile: Increased activity with the client VTR Interamericana.
- In Spain: Growth in revenues in Servicios 012 Cataluña, Repsol, Agencia Estatal de Administración Tributaria and BBVA.

In terms of the geographic distribution of revenues, Brazil accounts for 38.7% of the total and Spain for 29.1%, as a whole representing 1.8 percentage points less than in December 2005. Atento México continued with its significant growth rate to stand at 10.2% of revenues compared with 8.7% the previous year. Chile represented 6.3% compared with 6% twelve months ago and Venezuela totalled 3.9% in comparison with 2.5% in December 2005.

Operating costs grew 18.9% year on year to 882 million euros, mostly due to increased personnel expenses (+19.6% year on year) as a result of the Group's activity growth.

The OIBDA of the Atento Group totalled 142 million euros, equivalent to a 21.8% year-on-year growth generated by increased activity and by savings in structural costs. In terms of profitability, the OIBDA margin stood at 13.8% to improve the margin recorded the previous year by 0.2 percentage points. Atento Brasil contributed to OIBDA with 62 million euros, representing 44.0%. The remaining operations contributing the most to the Consolidated OIBDA were Mexico with 13.5% (19 million euros), Chile with 9.8% (14 million euros), Spain with 9.2% (13 million euros), Venezuela with 8.3% (12 million euros) and Peru with 6.5% (9 million euros).

The operating result to December amounted to 113 million euros to give a year-on-year growth of 28.2%.

Capex at December 2006 stood at 35 million euros compared with 40 million euros the previous year, primarily centred on Brazil, Mexico, Venezuela and Spain.

Operating free cash flow (OIBDA – Capex) improved substantially in relation to the figure accumulated to December 2005 to stand at 106 million euros, a 39.9% increase as a result of improved management and lower investments.

In terms of operations, the Atento Group had 46,847 positions in place at 31st December 2006, 18.0% more than one year ago. The average number of occupied positions for 2006 stood at 35,343. Financial productivity stood at 77.6%, a 2.2 percentage point drop in comparison with December 2005.

## Content and Media Business

### Consolidated income statement

Unaudited figures (Euros in millions)

	January - December			October - December		
	2006	2005	% Chg	2006	2005	% Chg
Revenues	1,608	1,269	26.7	483	390	23.8
Internal expenditure capitalized in fixed assets <sup>1</sup>	0	0	n.s.	(0)	0	n.s.
Operating expenses	(1,411)	(1,052)	34.1	(404)	(325)	24.5
Other net operating income (expense)	24	6	n.s.	15	(3)	c.s.
Gain (loss) on sale of fixed assets	143	47	n.s.	(0)	40	c.s.
Impairment of goodwill and other assets	(2)	(1)	159.0	(2)	(1)	169.1
<b>Operating income before D&amp;A (OIBDA)</b>	<b>362</b>	<b>269</b>	<b>34.4</b>	<b>92</b>	<b>102</b>	<b>(10.1)</b>
Depreciation and amortization	(26)	(29)	(9.2)	(5)	(8)	(40.4)
<b>Operating income (OI)</b>	<b>336</b>	<b>240</b>	<b>39.6</b>	<b>87</b>	<b>94</b>	<b>(7.4)</b>

<sup>1</sup> Including work in process.

### Content and media business

The Contents and Media business ended the last quarter of 2006 with a net turnover (revenues) of 1,608 million euros, 26.7% up from the figure reached in the same period of the previous year. This increase is due to the positive evolution of results from the main lines of business.

Operating income before depreciation and amortization (OIBDA) in the January-December period amounted to 362 million euros, compared with the 269 million euros obtained in the same period of 2005. This significant growth in 2006 was primarily due to the revenues obtained from the sale of part of the Sogecable stake by the Telefónica Group in the take-over bid launched by the Prisa Group.

#### ENDEMOL NV

Endemol enjoyed a strong overall performance in the full year 2006, recording a 24.1% growth in turnover, reaching a level of EUR 1,117 million. The company experienced turnover growth in all genres, compared to last year. Growth in Non-scripted came in at 22.2% and Scripted grew by 8.5%. Digital Media registered a very strong performance as well, growing by 65.3%. Both Non-scripted and Digital Media were strongly fuelled by the hit format Deal or No Deal.

Organic growth accounted for the vast majority of total growth, with a remarkably high 20.9% out of the 24.1%, in line with the guidance provided to grow over 15% in organic terms. This organic development is mainly due to the strong performance of Endemol's operating companies in the UK, the US and Italy. While Big Brother remained the top format with very sound ratings across the globe, the performance of Deal or no Deal was especially remarkable, triggering an increasing appetite for game shows, one of the core elements of Endemol's product portfolio. This higher demand was leveraged by closing a number of deals in various territories on other game shows

such as 1 vs 100, Show me the Money and Set For Life.

EBITDA in 2006 reached a level of EUR 177 million, a +15.9% increase compared to last year, when it amounted to EUR 153 million. In terms of EBITDA margin, Endemol has moved from 17.0% of turnover in 2005 to 15.9% in 2006, almost in the middle of the guide EBITDA range (15-17%).

#### ATCO

The advertising market in Argentina (Capital and Gran Buenos Aires regions) grew by 10.8% over the year with respect to the previous year. This figure differs from the 20.7% increase recorded in the same period of 2005, which reflected the market recovery recorded over 2004 and 2005.

In this market context, Telefé maintained its leadership in terms of audience over the last quarter, ending 2006 as the leader in audience share that reached 38.8% compared with the 30.3% obtained by Canal 13, its main competitor. The market share accumulated by Telefé to December 2006 end stood at 41.6%, slightly up from that reached in the same period of 2005 and, once again, followed by Canal 13 with 38.1%.

**Telefónica, S.A.**  
Annual Report 2006

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