

# Annual Report

2007



"We want to enhance people's lives, 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"

*Spirit of progress*

**Telefónica**

# Our Body

Strength

Leadership

Innovation

Scale

More than **228** million customer accesses

**169** million wireless telephony accesses

**42** million fixed telephony accesses

More than **10** million Broadband accesses

**1.7** million pay-TV accesses

Present in **24** countries

Over **56.4** billion euros in revenues

More than **63%** of revenues from outside Spain

Net profit of over **8.9** billion euros

**42%** shareholder return in 2007

Market cap of **106.1** billion euros

Annual Capex of **8** billion euros

Over **4.35** billion euros invested in R&D+i

Over **248,000** professionals

## TOTAL ACCESSES

Millions

■ Dec 2007  
■ Dec 2006

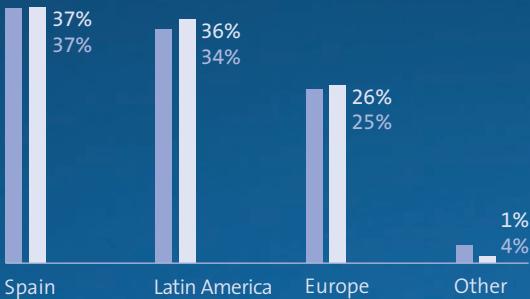
+12.5%  
203.2 228.5

2006 2007

## REVENUES BREAKDOWN BY BUSINESS UNIT

% of total

■ 2007  
■ 2006



### Geography

Services offered in 20 countries, with an indirect presence in another four

**Telefónica is present in 24 countries**

### Customers

Over 228 million customer accesses in 2007

**Telefónica is the world's largest integrated operator by customer accesses**

### Company Value

Market capitalization of 106.1 billion euros

**Returns to Telefónica shareholders in 2007 totalled 42%**

### Financial results

Improvement in the financial parametres

**Telefónica posted record net profit of 8.9 billion euros in 2007**

By region, Telefónica has the most balanced geographical profile of any telecommunications operator, with foreign operations contributing 63% of Group revenues.

In 2007, Telefónica rolled out its regional organisational model, structured into three large geographic regions: Spain, Latin America and Europe.

Telefónica has closed final year 2007 with over 228 million customer accesses, 12.5% more than in 2006, thanks to the Group's intense sales efforts.

The main increases in our customer bases were in Broadband, fixed and mobile telephony, and pay-TV services. By region, Latin America grew the fastest, at 16.9%.

In 2007, Telefónica Group strengthened its position as the fastest growing and profitable European integrated operator; it was also the fourth ranked global telecom operators by market cap.

Earnings per share jumped 43.5% in 2007 to 1.872 euros, notching up 14 straight quarters of growth.

Telefónica's shares rallied 37.8%, above the 14.6% gain by the European comparable index (DJ Stoxx Telecommunications), the 7.3% rise by the Ibex-35 and the 6.8% increase by the Eurostoxx-50.

The Company met its guidance again in 2007 and obtained the most net profit of any integrated operator in the world.

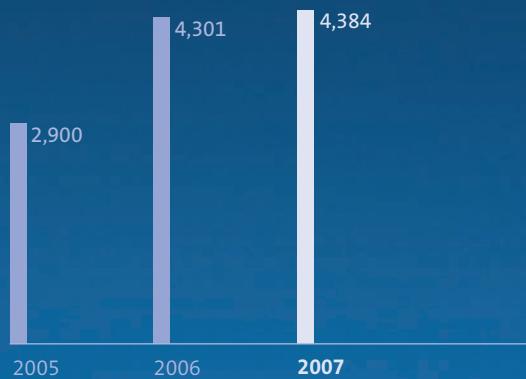
Revenue rose 6.7% in 2007 to 56,441 million euros.

OIBDA totalled 22,823 million euros, leaving an OIBDA margin of 40.4%.

Capex stood at 8,027 million euros. Meanwhile, operating cash flow soared 33% in 2007 to 14,797 million euros, while debt was cut by 6,861 million euros.

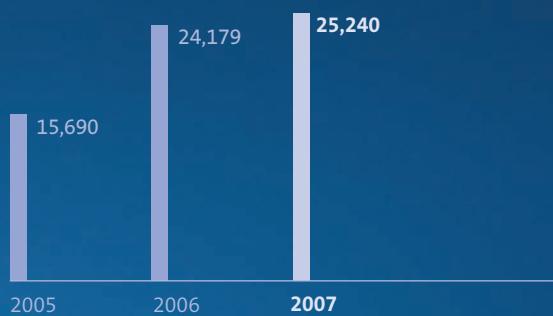
## TECHNOLOGICAL INNOVATION

Millions of euros



## PURCHASE VOLUME

Millions of euros



### Employees

The Group employees over a half a million people directly and indirectly

**Telefónica directly employs over 248,000 professionals**

By region, Latin America accounts for 66% of total headcount. Spain, at 22%, is the second most important region, while Europe accounts for 12%.

Atento, with a staff of over 123,000, is the largest employer among the Telefónica Group companies.



### Innovation

594 million euros invested in R&D

**Telefónica spent more than 4.4 billion euros in 2007 on technological innovation**

Last year, Telefónica ranked fourth among telecoms operators in R&D spend based on OECD criteria and spent the most of any Spanish company.

The Company established an open innovation network, with inputs from each of the Group companies and a corporate innovation program spearheaded by Telefónica I+D. In addition, it participated in 190 projects sponsored by Spanish and European public funds and collaborated with 920 institutions.

Last year the Company launched over 600 products and services worldwide.



### Infrastructure

Network transformation continued with fibre optic and 3G and 3.5G technologies

**Telefónica offers wireless services via 80,499 base stations**

Telefónica began the roll out of fibre to the home (FTTH) technology, the first to do so in Spain. In terms of wireless accesses, work continued on making 3G and 3.5G technology more broadly available across all operators to increase wireless data connection capacity. In 2007, the Group had 80,499 base stations.

In 2007, Telefónica continued the process of extending its fixed-to-mobile architectures to boost convergent services. The work in this field was concentrated in Spain, Argentina, Brazil, Chile, Colombia, Peru, UK, Germany and Czech Republic.



### Suppliers

Spain and Brazil, the most important markets in terms of purchasing volumes

**Telefónica awarded more than 25 billion euros to its suppliers**

In 2007 more than 28,000 suppliers were awarded business.

Most of its procurement came under the category of Services, which along with Market Products (including mobile handsets) and Network Infrastructure made up over 80% of total purchasing. The rest was split between IT systems, Advertising and Marketing and Content.

Telefónica E-sourced 84% of its Spanish and Latin American operators' purchases, with more than 33,000 transactions, including over 4,100 e-auctions.

## COMMUNITY INVESTMENT IN SOCIAL AND CULTURAL PROJECTS

Thousands of euros

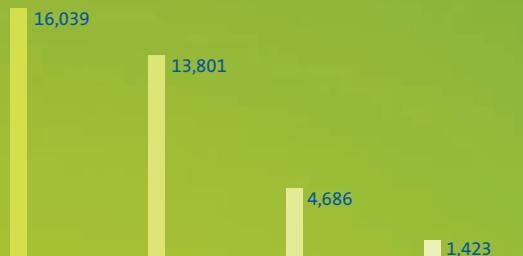


<sup>1</sup> Based on LBG methodology.

<sup>2</sup> All projects that have a positive impact on society, culture and art are considered social and cultural sponsorships in accordance with LBG.

## EMPLOYEES TRAINED ON BUSINESS PRINCIPLES

Telefonica Latin America  
 Telefonica O2 Europe  
 Telefonica Spain  
 Other business units



Note: It does not include Atento, as the Company has different training schemes for the business principles targeting teleoperators.



### Business Principles

More than 80% of employees will receive training in 2008

Over 36,000 Telefónica Group employees received training on Business Principles

In 2006 Telefónica approved its Business Principles. Throughout 2007, following approval by the Board of Directors, 81% of Group companies and subsidiaries ratified the Business Principles.

Based on its Vision and Business Principles, the Company is building a new corporate culture

In 2007, the Company approved the Corporate Guidelines for Extending these principles to the Supply Chain and Responsible Supplier Contracting Guidelines. An internal communications program was rolled out to support the implementation of these principles.



### Social and cultural action

Telefónica Foundation as the driving force

Telefónica spent almost 90 million euros on social and cultural initiatives in 2007

In order to measure and evaluate its social action, last year Telefónica adopted the LBG model, an internationally renown method to improve the management, evaluation and measurement of the company's community contributions.

Telefónica Foundation channelled 51.1 million euros into more than 700 projects, benefiting 39.8 million people. The most important programs are: Proniño (the company's initiative to eradicate child labour in Latin America), EducaRed (a program designed to enhance education standards through the application of new technologies), Telefónica Volunteers, Forum (concerned with knowledge creation under the umbrella of the information society), and Art & Technology.

ATAM also channeled over 13 million euros to integrate the disable within society.



### Corporate responsibility

Telefónica is included in the main indices: DJSI and FTSE4good

Telefónica published 14 corporate responsibility reports at 17 of its operations

In order to extend its Business Principles to the supply chain, Telefónica designed a self-assessment questionnaire for suppliers to evaluate their CR performance. Over 1,000 suppliers will be evaluated in 2008.

In 2007 the Company set up the Corporate Environmental Unit, as well as by Regional Committees to ensure implementation of the 2008-1012 Environmental Action Plan. In addition, Telefónica made 15,167 measurements of radio wave emissions and invested 5.2 million euros to minimise the visual impact of its infrastructure.

Telefónica launched a strategy to fight climate change, comprising internal initiatives and others related to the customer services on offer.



### Digital inclusion

To help bridge the digital divide

Telefónica invests in infrastructure and services designed for people on low incomes or with disabilities

Last year in Latin America, the company's net contribution to providing Universal Telecommunications Service coverage was 161 million euros.

At year-end 2007, over 81% of our 102 million mobile accesses in Latin America were using pre-pay services. In addition, the Company had over 6 million pre-pay fixed and controlled lines, accounting for 25.9% of fixed telephony accesses in Latin America.

Telefónica upgraded its Accessible Telefónica Standards, which set minimum accessibility criteria in 13 areas, and began to implement the policy internally and its application in areas of accessibility: web, handsets, Telefónica stores and customer service.

# Contribution to progress

SPAIN	ECONOMIC IMPACT				REVENUE/GDP	MAGNITUDES
SPAIN	Revenue Expense	7,413	3,711	2,635	2,381	20,806 2.0%
<b>LATIN AMERICA</b>						
ARGENTINA	Revenue Expense	905	413	470	289	2,368 1.3%
BRAZIL	Revenue Expense	4,117	936	3,519	1,087	8,139 0.9%
CENTRAL AMERICA	Revenue Expense	300	54	78	133	587 1.2%
CHILE	Revenue Expense	988	231	248	418	1,825 1.6%
COLOMBIA	Revenue Expense	836	128	302	360	1,585 1.3%
ECUADOR	Revenue Expense	173	24	48	60	281 0.9%
MEXICO	Revenue Expense	1,002	167	120	230	1,571 0.2%
PERU	Revenue Expense	834	309	378	281	1,506 2.0%
URUGUAY	Revenue Expense	94	7	0.3	15	111 0.7%
VENEZUELA	Revenue Expense	961	135	652	370	2,430 1.5%
<b>EUROPE</b>						
GERMANY	Revenue Expense	1,539	466	29	850	3,560 0.1%
IRELAND	Revenue Expense	365	108	114	117	966 0.5%
UK	Revenue Expense	5,280	780	597	832	7,792 0.4%
CZECH REPUBLIC Including Slovakia	Revenue Expense	373	255	438	281	2,233 1.8%
						

## Note:

Revenue, personnel expenses, payment of tax in the country, purchases and investment (capex) in millions of euros.

Revenue correspond to all Telefónica business units in the country.

Employees: direct employees of the Telefónica Group in the country (headcount at 31 December 2007).

Suppliers: suppliers awarded businesses in the country in 2007.

% in parentheses represents the % awarded to local suppliers (% awarded to suppliers domiciled in the country/total awards based on volume).

Accesses: number of fixed + mobile + ADSL + TV connections (thousand).

Revenue TEF/GDP: ratio between Telefónica revenue (contribution by the country to consolidated revenue of the Telefónica Group) and forecast GDP for the country (source: IMF).

# Our Soul

Vision

Values

Principles

Policies

**36,000** employees trained on our Business Principles, approved in 2006; in 2008 over 1,000 suppliers will be assessed under the corporate guidelines for extending these principles to the supply chain

Nearly **90** million euros on social and cultural projects, with more than **39.8** million people benefiting from initiatives in 2007

Some **19,000** employees are Telefónica Volunteers

More than **50,000** children saved from child labour and put in school in Latin America thanks to the Proniño program

A Customer Satisfaction Index of **6.84** (out of 10) at the end of 2007

Employment satisfaction at **65%**

More than **50%** of mobile companies environmentally certified according to ISO 14001

Annual Report 2007  
Telefónica S.A.



*Telefónica*

The logo consists of the word "Telefónica" in a stylized, italicized font, with a horizontal line underneath it. The background is a dark blue gradient with a subtle diagonal texture.



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## Letter from the Chairman

César Alierta  
Executive Chairman, Telefónica S.A.

Dear shareholder,

I am very pleased to give you this brief account of Telefónica's performance in 2007. This has been a record-breaking year, yet another year with results that highlight our company's distinct profile, its ability to deliver and its vision in such a high growth industry as telecommunications.

At the same time, I'd like to take this occasion to convey to you our ambition to keep on excelling, to maintain and even enhance Telefónica's leadership and discuss the huge opportunities that the new digital environment affords.

### The best results ever

2007 was an historic year for the company, in which its net profit climbed by 43% to a record 8,906 million euros. That figure means that Telefónica earned a higher net income than any other integrated operator in the world.

Similarly, earnings per share grew by 43.5% in 2007 to 1.872 euros, for an impressive track record of fourteen consecutive quarters of uninterrupted growth.

And that growth was reflected in each and every caption on the income statement. Revenues, operating income before depreciation and amortisation (OIBDA) and operating income (OI) all rose significantly in 2007 by 6.7%, 19.3% and 42.1%, respectively. In 2007 operating revenues amounted to 56,441 million euros, 37% of which was earned by Telefónica España, 36% by Telefónica Latinoamérica and 26% by Telefónica O2 Europe. At the same time, all the lines of business made a positive contribution to the company's organic revenue growth, which, excluding the effects of exchange rates and changes in the consolidation perimeter, came to 7.4%. Year-on-year organic revenue growth in Telefónica Latinomérica was 13.0%, in Telefónica España 4.6% and in Telefónica O2 Europe 4.5%.

This upward trend reflects on Telefónica's organic growth potential, the high value of its regional and business diversification and its efficient cost structure.

Moreover, progress in the integrated management of our businesses translated into synergies during the year worth over 1,600 million euros.

Similarly, good business performance in 2007 enabled us to raise operating cash flow (OIBDA-Capex) by 33%, to 14,797 million euros.

This high growth rate in terms of results is based especially on a very healthy 12.5% rise in our customer base to nearly 229 million accesses, driven by the mobile and Broadband businesses. At year-end 2007 we had 169.2 million mobile, 10.3 million retail Broadband and 1.7 million pay TV customers, with increases in 2007 of 16.6%, 28.9% and 64.3%, respectively.

In a word, these results go to show that ours is a growth company able to combine global scope with a regional and local focus, whose credibility rests on its consistent compliance with all its market commitments.

### We reinforce shareholder earnings

In financial year 2007 Telefónica completed its share buy-back programme for a total of 2,700 million euros, and has proposed to pay a dividend of 0.75 euros per share, up 25% from the preceding year.

In addition, thanks to the favourable performance of our businesses, we can reinforce our shareholder remuneration policy in 2008. As a result, in October 2007 we proposed to pay a dividend of 1.0 euro per share against financial year 2008, for a 33% increase over the preceding year. Proposals for the necessary corporate resolutions in this regard will be put forward in due time. With this measure, the commitment undertaken by the Company in May 2006 to double its 2005 dividend by 2009 will be met in advance.

Similarly, the new share buy-back programme announced on 27 February 2008 for 100 million shares, representing approximately 2.095% of the company's share capital, is now underway and will be in place throughout 2008 and the first half of 2009. This stands as further proof that at Telefónica we strive to continue to be the best investment option in the industry: the company best positioned to transform high organic growth into profitability and higher shareholder value.

#### **Telefónica, a global leader**

Our vision and the effectiveness of our performance have made us a telecommunications industry leader in terms of size, pace of growth and results, as well as upward market value and shareholder returns. Indeed, Telefónica:

- Is the world's largest integrated operator by number of customers, with 229 million.
- Is the world's second largest integrated operator by asset value, assessed at 151,351 million euros on 31 December 2007.
- Is an operator with higher organic revenue growth than any of its peers in Europe or the United States.
- Is the integrated operator that posted the highest earnings world-wide in 2007.

With a 37.8% rise in its share price, our company recorded a higher increase in market value than any of its peers in Europe or the USA, and more than doubled the annual growth of the world-wide benchmark Dow Jones Telco index. On the Spanish market, Telefónica accounted for 80% of IBEX 35 growth in 2007.

Finally, Telefónica earned a higher total return for its shareholders (TSR) than any of its peers in Europe or the USA in 2006-2007, with a TSR of 86.1%. But Telefónica's leadership stretches beyond the telecommunications industry, for in 2007 it was among the world's 50 largest companies by market capitalisation. Telefónica has progressively advanced in this respect over the last decade, rising from 198th position in 1995 to 72nd in 2000 and 37th at year-end 2007.

In such a scenario of leadership, we can face the future with an inherent advantage, renewed ambition and a clear goal: to continue to be leaders in the long term.

#### **Our challenge: to continue to be leaders in the long term**

In the years to come Telefónica, as industry leader, will enjoy huge growth opportunities.

Firstly, telecommunications is expanding and its customer base is growing. And Latin America, a region where Telefónica has a sound position, is the area where highest growth is expected in the near future.

Opportunities are also being created by ever increasing customer needs: there is a growing demand for personalised services and a desire to be "always connected", regardless of place or kind of device. And customers' greater involvement in content generation, distribution and promotion will fuel demand even further.

In a word, households and businesses are becoming more and more digital and connected, as is the time devoted to work, information or leisure; and the industry's extraordinary growth potential is driven by its customers.

We, at Telefónica, are technology and connectivity leaders, we have physical and commercial access to customers, and we are confident that technological advances in our fixed and mobile networks will enable us to satisfy our customers' expectations with standards of excellence and introduce them to the benefits of the new digital environment.

Telefónica is facing the possibility of capturing a major share of access growth, as well as the wide range of new services, applications, content and business models arising in the new stage on which the industry is embarking.

In this regard, our confidence in the future has enabled us to commit to a strong increase in our customer base, to 290 million by late 2010.

I can assure you that in the years to come we will continue to pursue our own transformation and turn the enormous opportunities afforded by industry dynamics into value for the company. To achieve this objective, in the next few years we are going to dedicate our resources to four major priorities:

- To provide our customers with the best service experience, transforming the company into an organisation where customers not only are, but are made to feel that they are, the centre of attention. This will be achieved by improving customer support and service, along with enhancing our understanding of customer expectations in order to meet their needs with segmented offerings that deliver added value.
- To encourage both in-house and third party innovation as the key to building our domain in the new digital environment, capitalising on the new growth opportunities afforded.
- To continue to transform our operating model as an indispensable tool to provide an integrated, excellent and efficient delivery.
- And to make Telefónica the best employer, able to attract and retain the best talent.

### **We have the opportunity to lead social progress**

In future, societies are going to experience unprecedented progress, and information and communications technologies (ICTs) will be the key to this brisk pace of development.

From our leadership position, at Telefónica we are faced with the opportunity and at the same time the responsibility to play a decisive role in the societies where we operate.

Our new generation networks and services will improve people's quality of life, companies' competitiveness and governments' efficiency. Telefónica, as a world leader engaging in a key industry for social development, assumes this social responsibility, which is written into the values by which the company is governed.

To sum up, ours is the best Telefónica in history, with a unique position and huge opportunities ahead which, I assure you, we will not miss. We are prepared to attain the next level of leadership: such is our ambition and our commitment.

I would like to take this opportunity, yet another year, to thank our shareholders for their support and confidence in facing a future ripe with opportunity, in which all our effort and our full attention will be focused on our customers.



**César Alierta**

Executive Chairman, Telefónica S.A.

## Group Description

The goal is to facilitate the integration of the fixed and mobile businesses and boost convergence



For more information:  
[www.telefonica.es/abouttelefonica](http://www.telefonica.es/abouttelefonica)

# The Telefónica Group's operations are structured into three geographic regions: Spain, Latin America and Europe

The rationale underpinning the Group's structure is to bring the company closer to its customers and to facilitate the exploitation of economies of scale to enhance its competitive positioning.

## Organisational profile

### Corporate Centre

Telefónica's Corporate Centre is responsible for defining overall strategy and corporate policy and managing the business units' shared functions.

### Telefónica España

Telefónica was founded in Spain in 1924; Spain remains its biggest market today. Telefónica España's main activity is the provision of fixed and mobile telephony and Broadband services in Spain; this division also includes operations in Morocco (through Meditel).

### Telefónica Latinoamérica

Telefónica Latinoamérica provides telecommunications services in thirteen countries under the Telefónica and Movistar brands: Argentina, Brazil, Chile, Colombia, Ecuador, El Salvador, Guatemala, Mexico, Nicaragua, Panama, Peru, Uruguay and Venezuela. Telefónica also engages in complementary activities in Puerto Rico and in the US.

### Telefónica O2 Europe

Its main activity is the provision of fixed and mobile telephony and Broadband services in Europe. This business unit operates in the UK, Ireland, Germany, the Czech Republic and Slovakia. Telefónica also has a foothold in China and Italy through its alliances with China Netcom and Telecom Italia.

### Other companies

Atento provides customer care services through contact centres or multichannel platforms. Atento has centres in Spain, Argentina, Brazil, Chile, Colombia, El Salvador, the US, Guatemala, Morocco, Mexico, Panama, Peru, Puerto Rico, the Czech Republic, Uruguay and Venezuela.

t-gestiona is engaged in the provision of management support services in the following areas: finance, administration, HR management, logistics and comprehensive building and service management. This company has operations in Spain, Argentina, Brazil, Chile and Peru.

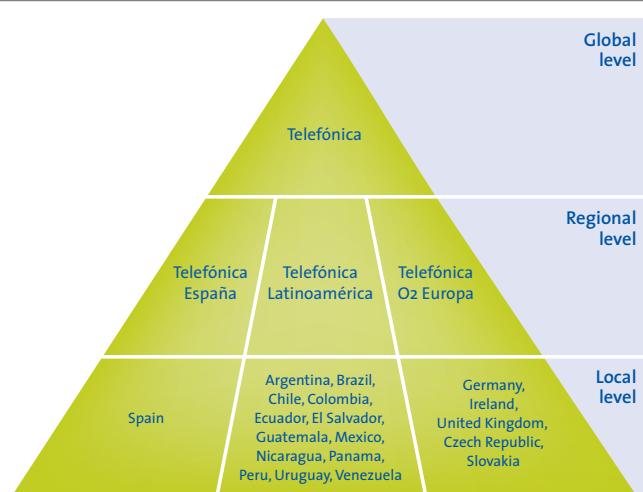
Telefónica I+D is the Group's R&D subsidiary, operating in Spain, Brazil and Mexico.

## New structure

Telefónica's new structure enables it to unlock value at global, regional and local levels:

- Locally, initiatives are implemented seeking the integration of services and technologies in each country with the overriding aim of enhancing customer service.
- Regionally, the new structure makes for optimal management of sales and technical resources.
- Globally, Telefónica's corporate structure enables it to better leverage the opportunities afforded by its international scale and diversity.

## NEW STRUCTURE



## Group Structure

The Telefónica Group's main shareholdings, broken down by business units



For more information:  
[www.telefonica.es/shareholdersandinvestors](http://www.telefonica.es/shareholdersandinvestors)

### TELEFÓNICA ESPAÑA GROUP

	% Part
Telefónica de España	100.00
Telefónica Móviles España	100.00
Telyco	100.00
Telefónica Telecomunic. Públicas	100.00
T. Soluciones de Informática y Comunicaciones de España	100.00
Iberbanda	51.00
Medi Telecom	32.18

### TELEFÓNICA O2 EUROPE

	% Part
O2 UK	100.00
O2 Alemania <sup>1</sup>	100.00
O2 Irlanda	100.00
Manx	100.00
Be	100.00
Group 3G (Germany) <sup>3</sup>	100.00
Telefónica O2 República Checa <sup>1</sup>	69.41
Telefónica O2 Eslovaquia <sup>2</sup>	100.00

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

<sup>2</sup> Company owned through Telefónica O2 Czech Republic.

<sup>3</sup> Company owned through O2 Germany.

### TELEFÓNICA LATINOAMÉRICA GROUP

	% Part
Telesp <sup>1</sup>	87.95
Telefónica del Perú	98.18
Telefónica de Argentina	98.04
TLD Puerto Rico	98.00
Telefónica de Chile	44.89
Telefónica Telecom	52.03
Telefónica USA	100.00
T. Intern. Wholesale Serv. (TIWS) <sup>2</sup>	100.00
Brasilcel <sup>3</sup>	50.00
T. Móviles Argentina	100.00
T. Móviles Perú	98.53
T. Móviles México	100.00
Telefónica Móviles Chile <sup>4</sup>	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	100.00
T. Móviles Uruguay	100.00
Telefónica Celular Nicaragua	100.00
T. Móviles Soluciones y Aplicac. (Chile)	100.00

### OTHER OWNERSHIPS

	% Part
3G Mobile AG (Switzerland)	100.00
Grupo Atento	100.00
Telefónica de Contenidos	100.00
Mobipay Internacional	50.00
Telco SpA (Italy) <sup>5</sup>	42.30
Tempos 21 <sup>1</sup>	43.69
IPSE 2000 (Italy) <sup>1</sup>	39.92
Lycos Europe	32.10
Sogecable <sup>2</sup>	16.79
Mobipay España <sup>1</sup>	13.36
Hispasat	13.23
Portugal Telecom <sup>3</sup>	8.21
China Netcom Group <sup>4</sup>	5.00
BBVA	0.97
Amper	6.10

<sup>1</sup> Companies owned, directly and indirectly, by Telefónica Móviles.

<sup>2</sup> Telefónica de Contenidos, S.A. holds 15.59% and Telefónica, S.A. holds 1.20%.

<sup>3</sup> Telefónica Group's effective participation. Telefónica Group's participation would be 8.32% if we exclude the minority interests. The percentage of voting rights of Telefónica Group would reach 9.16% if the shares owned by the Portuguese company without considering minority shareholders would be taken into account.

<sup>4</sup> Ownership held by Telefónica Latinoamérica.

<sup>5</sup> Telefónica owns an indirect share in the ordinary capital (with right to vote) of Telecom Italia through Telco of approximately a 10%. If we would take saving shares (azioni di risparmio) into account, which do not confer political rights, the indirect participation of Telefónica over Telecom Italia would be a 6.9%.

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

<sup>2</sup> Telefónica, S.A. owns 92.51% and Telefónica DataCorp owns 7.49%.

<sup>3</sup> Joint Venture that consolidates, through a share in Vivo Participações, S.A. the subsidiary Vivo, S.A. by the full integration method.

<sup>4</sup> Telefónica Móviles Chile enlarged its capital in May. This turned it in the only shareholder of Telefónica Móviles de Chile, which was dissolved the July 1st, 2007.

## Board of Directors

In March 2008, Telefónica's Board consisted of 17 directors

# Telefónica's Board of Directors is guided by six steering committees to guarantee good corporate governance

Telefónica's Consultative or Control Committees are mandated with the analysis or monitoring of a specific area of special significance to the company's corporate governance, or the evaluation of a topic of singular importance.

Under its Regulations, the Board of Directors is mandated with the supervision and control of the Company's operations. The Board delegates the day-to-day management of the business to the executive bodies and management team.

The Board of Directors retains exclusive competence for certain matters that cannot be delegated over certain matters, such as: general corporate strategy and policy, evaluation of the performance of the Board, its Committees and its Chairman, appointment of senior management and director and senior management compensation, and strategic investments.

## COMPOSITION OF THE BOARD OF DIRECTORS AND ITS COMMITTEES

	Type of Director	Executive Committee	Audit and Control Committee	Nominating, Compensation, and Corporate Governance Committee	Human Resources, Reputation Corporate Responsibility	Regulation	Quality of Service, Commercial Service	International Affairs
César Alierta Izuel (Executive Chairman)	■	■						
Isidro Fainé Casas (Vice Chairman)	■	■						
Vitalino Manuel Nafría Aznar (Vice Chairman)	■		■	■	■	■		■
Julio Linares López (Chief Operating Officer)	■	■						
José María Abril Pérez	■	■						■
José Fernando de Almansa Moreno-Barreda	■				■			■
José María Álvarez-Pallete López	■							
David Arculus	■				■			■
Maria Eva Castillo Sanz	■							
Carlos Colomer Casellas	■	■		■			■	
Peter Erskine	■	■		■				
Alfonso Ferrari Herrero	■	■	■	■	■	■		■
Luiz Fernando Furlán	■							■
Gonzalo Hinojosa Fernández de Angulo	■	■	■	■	■	■	■	■
Pablo Isla Álvarez de Tejera	■		■	■	■	■	■	
Antonio Massanell Lavilla	■		■		■		■	
Francisco Javier de Paz Mancho	■	■		■	■	■		■

## NON DIRECTOR SECRETARY

Ramiro Sánchez de Lerín García-Ovies

## NON DIRECTOR VICE SECRETARY

Maria Luz Medrano Aranguren

Note: Data at March 31st, 2008

■ Executive

■ Proprietary Director

■ Independent

■ Other external directors



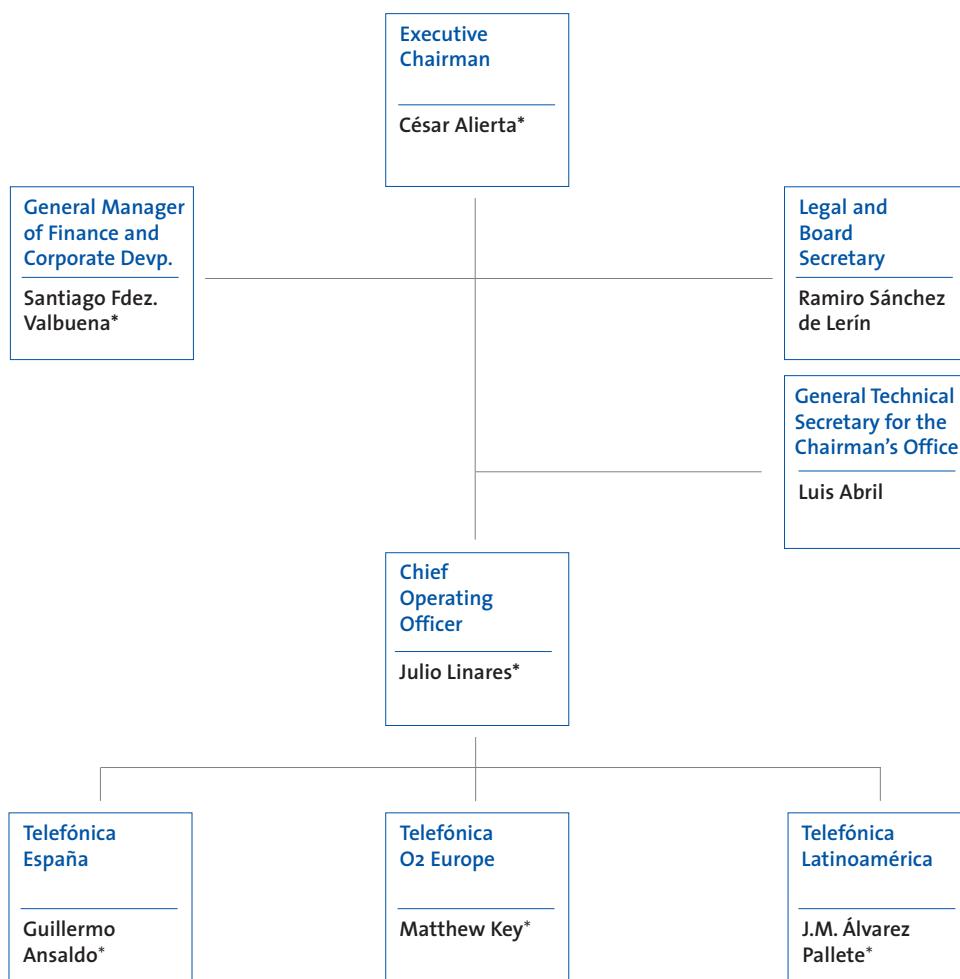
With the goal of exploiting economies of scale and focusing more on customers

## Telefónica approved a new organisational structure in December 2007

The newly defined structure entails single heads for the fixed and mobile businesses who in turn set strategy for each of the three regional business divisions.

The Telefónica Group's organisational structure includes three regional business divisions (Telefónica España, Telefónica O2 Europe and Telefónica América Latina), which report directly to the Company's COO. He in turn reports to the Executive Chairman of Telefónica.

In addition to the COO, also reporting directly to the Executive President, are the General Manager for Finance and Corporate Development, the two General Secretariats: the Legal and Board Secretary, and the Secretary to the Chairman's Office.



\*Members of the Executive Committee



## Our Body

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## Countries

Offers services in 20 countries and has an indirect presence in a further 4

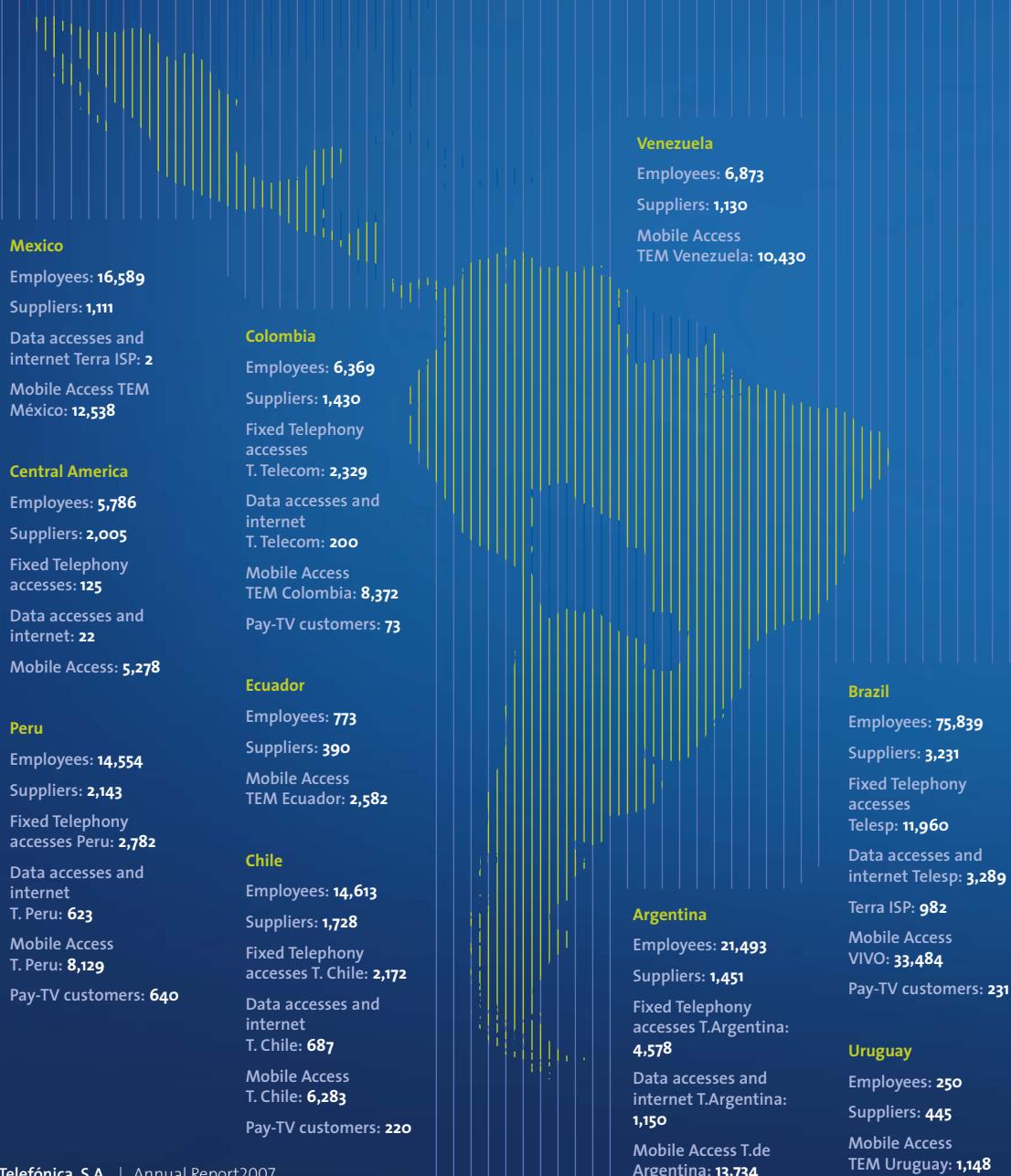


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[www.telefonica.es/shareholdersandinvestors](http://www.telefonica.es/shareholdersandinvestors)

## Telefónica is present in 24 countries\*

Telefónica has achieved the most geographically balanced profile of all telecommunication operators, with foreign countries contributing 63% of consolidated revenue.

In 2007, Telefónica put in practice its model of regional organisation, focused on three main geographical regions: Spain, Latin America and Europe.



**Present in  
24 countries**

**169 million  
mobile telephony  
acceses**

**42 million  
fixed telephony  
acceses**

**More than  
10 million  
Broadband  
acceses**

**More than  
228 million  
customer acceses**

**Revenues of more than  
56.4 billion  
euros**

**42%  
of shareholder return in  
2007**

**1.7 million  
pay-TV acceses**

**63%**  
**of revenues come  
from outside Spain**

**More than  
4.35 billion  
euros invested  
in R&D&i**

**More than  
248,000  
professionals**

**106.1 billion  
euros market cap.**

#### **United Kingdom**

Employees: **13,221**

Suppliers: **7,240**

Data accesses and  
internet O2 United  
Kingdom: **71**

Mobile Access O2  
United Kingdom: **18,382**

#### **Ireland**

Employees: **1,617**

Suppliers: **824**

Mobile Access O2  
Ireland: **1,646**

#### **Spain**

Employees: **53,300**

Suppliers: **4,065**

Fixed Telephony  
acceses: **15,898**

Data accesses and  
internet: **5,279**

Mobile Access: **22,827**

Pay-TV customers: **511**

#### **Portugal**

8.32% Ownership of  
Portugal Telecom

#### **Germany**

Employees: **5,101**

Suppliers: **2,179**

O2 Germany Internet  
and data acceses: **75**

O2 Germany mobile  
acceses: **12,472**

#### **Slovakia**

Employees: **354**

Suppliers: **90**

TO2 Slovakia Mobile  
Accesses: **565**

#### **Italy**

Indirect participation of  
Telefónica and a 9.98%  
voting right of Telecom  
Italia, S.p.A.

#### **Morocco**

Employees: **1,646**

Suppliers: **442**

Mobile Accesses  
Morocco: **6,153**

#### **China\*\***

Participation of 5% in  
China Netcom Group.

\* Data at 31 of December of 2007.

\*\* Telefónica, S.A., through its TELEFÓNICA INTERNACIONAL, S.A.U. subsidiary, reached an agreement for the acquisition of an additional part on CHINA NETCOM (CNC). After this acquisition, Telefónica Group's participation in CNC became approximately 7.22%.

## Customers

The company added 25 million new customer accesses in 2007



For more information:  
[www.telefonica.es/abouttelefonica](http://www.telefonica.es/abouttelefonica)  
[www.telefonica.es/shareholdersandinvestors](http://www.telefonica.es/shareholdersandinvestors)

# Telefónica is the world's biggest integrated operator by customer accesses

Telefónica ended 2007 with over 228 million customer accesses, 12.5% more than in 2006 thanks to the Group's intense sales efforts.

Wireless and Broadband were the main drivers of this performance. By region, Latin America grew the fastest, at 16.9%.

## Fixed telephony

The telecoms markets has been changing in recent years, giving customers new communications alternatives to traditional fixed accesses.

Telefónica ended 2007 with close to 42 million fixed lines, 0.9% fewer than the year before, in a mature market

In Spain, Telefónica held fixed-line losses to just 0.3%, with a total cumulative reduction in 2007 of 51,901 lines, the smallest annual reduction since 2001. Market share was unchanged at near 81%.

Latin America had 23.9 million fixed telephony accesses, in line with 2006. The big rise in Peru's accesses (+11.3%) offset a fall in the number of lines in service elsewhere, such as Argentina, Brazil, Chile and Colombia, with declines of between 1.2% and 1.5%.

In the Czech Republic total wireline accesses ended the year at 2.1 million, a 14% drop on the previous year as a result of fixed-mobile substitution.

## Broadband

Telefónica is solidly placed to seize opportunities in the new digital environment.

By the end of 2007, retail Broadband accesses totalled over 10.2 million.

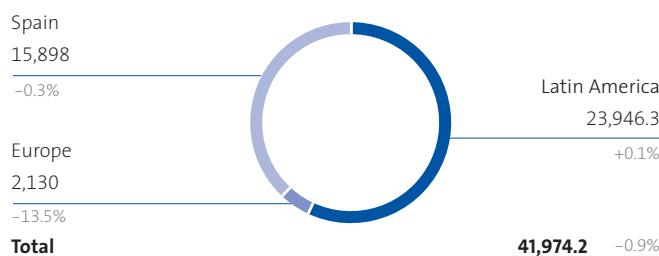
In Spain, Telefónica competed strongly in the Broadband market, maintaining its estimated market share at above 56%. At the end of December, it had 4.6 million Broadband retail accesses.

Retail internet accesses in Latin America numbered over 5 million with numbers again growing strongly from the year before (+33.2%), thanks to strong commercial activity by all operators.

In Europe, at the end of 2007 Telefónica had over 670,000 Broadband accesses, mostly in the Czech Republic. The Broadband offer in the UK also met with an excellent reception, scoring highest of any ISP in a survey carried out just two months after the service was first launched.

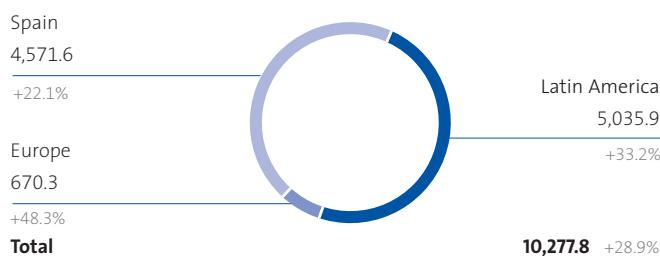
### FIXED TELEPHONY ACCESSES

Data in thousands of accesses / % Chg 2007/2006



### MINORITY BROAD BAND ACCESSES

Data in thousands of accesses / 06-07 Evolution



## TELEFÓNICA GROUP CUSTOMER ACCESSES

Unaudited figures (thousands)	2007	2006	Geographical breakdown		
			Spain	Latin America	Europe
<b>Final customer accesses</b>	<b>225,910.3</b>	<b>200,700.7</b>	<b>44,514.9</b>	<b>134,041.8</b>	<b>41,201.2</b>
Fixed telephony accesses <sup>1</sup>	41,974.2	42,340.7	15,898	23,946.3	2,130
Internet and data accesses	12,968.4	12,170.9	5,279.3	6,95.8	734.2
Narrowband	2,532.9	3,997.7	660.8	1,815.6	56.6
Broadband <sup>2</sup>	10,277.8	7,974.8	4,571.6	5,035.9	670.3
Others <sup>3</sup>	157.7	198.4	47	103.4	7.3
Mobile accesses	169,219.7	145,125.1	22,826.6	101,976.9	38,263.8
Pay-TV	1,748.1	1,064.0	511.1	1,163.8	73.2
Wholesale accesses <sup>4,5</sup>	2,628.0	2,479.4	1,859.2	62.6	706.2
<b>Total accesses</b>	<b>228,538.3</b>	<b>203,180.2</b>	<b>46,374.2</b>	<b>134,104.4</b>	<b>41,907.3</b>

Note: mobile accesses, fixed telephony accesses and internet and data accesses include MANX's customers. The breakdown by geographical regions does not include Morocco.

<sup>1</sup> RTB (including TUP) x1; RDSI x1 basic access; RDSI primary access; 2/6 x30 Digital Accesses. Includes self-consumption.

<sup>2</sup> ADSL, satellite, optic fibre, modem wire and broad band circuits.

<sup>3</sup> Rest of retail circuits that are not broad band.

<sup>4</sup> Includes rented loops by Telefónica Deutschland.

<sup>5</sup> Includes circuits whose final customer is operators.

## Pay-TV

Content distribution is one of the value-added services around which Telefónica plans to build its integrated value solution for the customer.

In Spain, the *imagenio* service, available through all Broadband lines, had an estimated market share of under 13% at end-2007, with over half a million accesses.

In Latin America, Telefónica had 1.2 million pay-TV customers via cable or satellite with operations in Peru, Chile, Colombia and, from 3Q 2007, in Brazil.

In the Czech Republic, following the launch of new bundled products, the total of O2 TV customers rose to 73,000 at end-2007.

## Wireless telephony

Wireless is a core driver of Telefónica's growth.

The Company, which operates in mobile telephony through the Movistar and O2 brands, ended 2007 with net adds of 24 million accesses, and an internal growth of 16.6%.

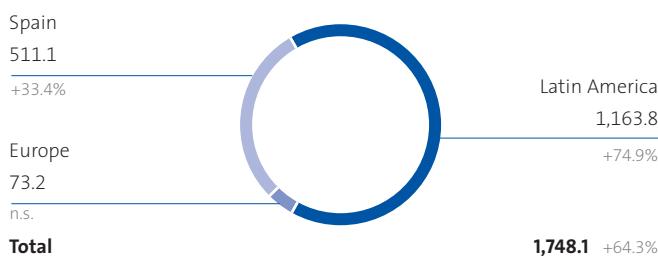
In the highly competitive Spanish market, Telefónica achieved more than 22.8 million mobile lines, with more than 50.7 million customers and penetration of 111%. The year saw strong growth in the contract base (+12.4%) to nearly 60% of all wireless customers.

In Latin America, mobile accesses were nearly 102 million (+22.4% vs. 2006) with strong growth in nearly all countries. Highlights were Mexico (+46.6%), Argentina (+22.6%) and Peru (+58.5%).

In Europe, the iPhone was a big success in the UK, becoming the fastest-ever selling handset in the country and commanding a 30% higher ARPU than the average contract user. In March 2008 the iPhone was launched in Ireland.

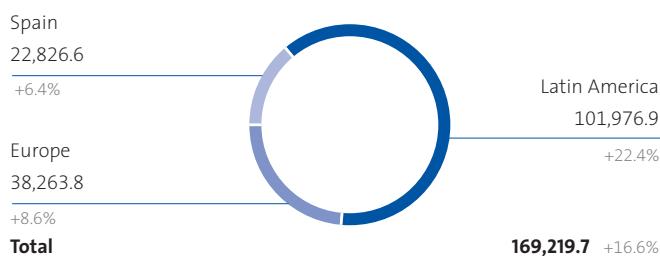
## PAY-TV TV ACCESSES

Data in thousands of accesses / 06–07 Evolution



## MOBILE TELEPHONY ACCESSES

Data in thousands of accesses / 06–07 Evolution



## Share Value

Telefónica's market capitalisation at year-end 2007 stood at 106.1 billion euros, ranking it the fourth largest telecommunications operator by this measure



For more information:  
[www.telefonica.es/abouttelefonica](http://www.telefonica.es/abouttelefonica)  
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## In 2007, total returns to Telefónica shareholders amounted to 41.9%

In 2007, the Telefónica Group strengthened its position as the fastest growing European incumbent operator and the player who created the most value for shareholders.

Earnings per share jumped 43.5% in 2007 to 1,872 euros.

## Shareholder remuneration

In 2007, the Company spent 5.2 billion euros on shareholder remuneration, including dividends and share repurchases; it concluded the announced 2.7 billion euro share buyback programme.

On 17 May 2007, Telefónica paid a gross final dividend against 2006 earnings of 0.30 euros per share, on top of the interim dividend of 0.30 euros per share paid on 10th November 2006.

On 14 November 2007 the Company paid an interim dividend of 0.35 euros per share against 2007 earnings. In addition, on 27 February 2008 the Board of Directors agreed to propose at the General Shareholders' Meeting scheduled for April 2008 payment of a final dividend of 0.40 euros per share, gross, against 2007 earnings, payable on 13 May 2008. If ratified this would raise the total dividend against 2007 earnings to 0.75 euros per share.

At the VI Investor Conference, held in London on 11th October 2007, the Company announced it would pay a gross dividend of 1 euro per share against 2008 earnings, up 33% on that paid against 2007 earnings. This dividend will be paid in two instalments, one in 2Ho8 and one in 1Ho9.

In addition, in February 2008, Telefónica announced a new share buyback programme. Under the new plan, the Company will buy back 100 million shares during 2008 and 1Ho9, as a function of the share price performance and cash flow generation. On 17 March 2008, Telefónica held 83,313,468 treasury shares, accounting for 1.745% of total outstanding shares. Accordingly, the Company plans to ask its shareholders to ratify the cancellation of 68,500,000 treasury shares at the next scheduled general meeting.

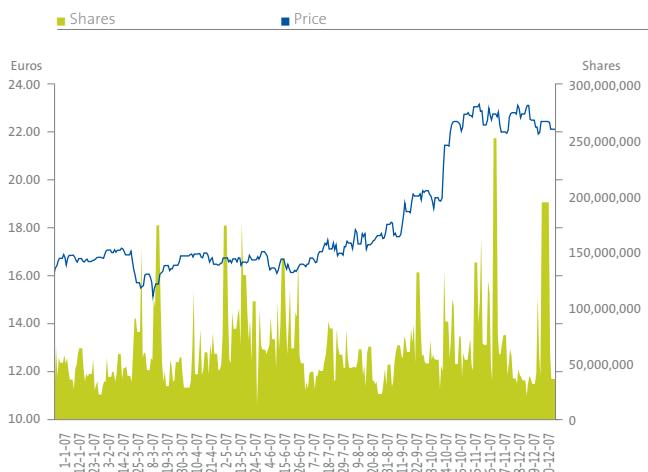
## SHARE PROFITABILITY IN 2007

Share profitability in 2007

	Number of shares	Gross amount euros
Value of 100 shares on 1st of January of 2007	100	1,612
Dividend in cash (17th of May 2007)	100	30
Dividend in cash (14th of November 2007)	100	35
Value of 100 shares on 1st of January of 2008	100	2,222
Total value of the portfolio made up by 100 shares		2,287
<b>Profitability</b>		<b>41.9%</b>

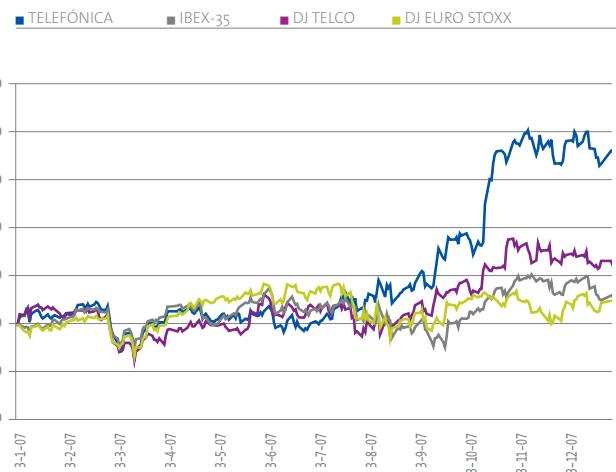
## PRICE / VOLUME

Source: Bloomberg



## 2007 STOCK MARKET EVOLUTION

Source: Bloomberg



## Share price performance

The equity markets performed well in 2007. Specifically, Telefónica's shares rallied 37.8% to 22.2 euros per share, outperforming the European comparable index (the DJ Stoxx Telecommunications) which rose 14.6%, the Ibex-35, up 7.3% and the Eurostoxx-50 which closed 6.8% higher. Telefónica also outperformed its closest peers in Europe (Vodafone rallied 32.7%, France Telecom, 17.5% and Deutsche Telecom, 8.5% while BT shed 9.5% and Telecom Italia lost 7.2%).

Telefónica's strong share price performance was underpinned by the company's higher organic growth relative to its peers (on customers, revenues, profitability and cash flow generation), the upwards revision to 2007 guidance provided, greater asset diversification and increasingly attractive shareholder remuneration. These competitive advantages came to the fore on 11 October at the Telefónica Investor Conference, where it unveiled its strategy and guidance for 2007-2010.

Telefónica's market capitalisation at year-end 2007 stood at 106.1 billion euros, ranking it the fourth largest telecommunications operator by this measure

Average daily trading volume in Telefónica shares in 2007 in the Spanish continuous market was 61.8 million shares, compared to 53.4 million in 2006.

## Earnings per share growth

In 2007, Telefónica posted record earnings once again. Earnings per share jumped 43.5% to 1.872 euros per share (from 1.304 euros per share in 2006), the fourteenth consecutive quarter of growth.

## Other data of interest

### Exchanges

Telefónica trades on the Spanish continuous market (within the benchmark Ibex-35 index), on the four Spanish stock exchanges (Madrid, Barcelona, Bilbao and Valencia), the LSE, the Tokyo Stock Exchange, the NYSE and the stock exchanges of Buenos Aires, Lima and São Paulo. In October 2007, Telefónica, S.A. began the process of delisting its shares from the Paris and Frankfurt stock exchanges, effective from 1Q08.

### Share capital

4,773,496,485 euros, following the cancellation of a number of treasury shares in June 2007 (in the amount of 147,633,912 euros). The nominal value of all shares outstanding is 1 euro.

### Number of shareholders

The Company had 1.5 million shareholders at 29 February 2008, according to itemised investor registries and based on Iberclear (the Spanish securities registration, clearing and settlement system) data.

### Significant shareholdings

At year-end 2007, La Caixa held a 5.5% interest while BBVA held a 6.3% stake.

## Results

Revenues, OIBDA and operating income driven higher by scale, diversification and integrated management



For more information:  
[www.telefonica.es/shareholdersandinvestors](http://www.telefonica.es/shareholdersandinvestors)

# Telefónica posted record net profit of 8.9 billion euros in 2007

The OIBDA margin stood at 40.4%.

FCF generation soared 33% in 2007 to 14.797 billion euros

Debt was cut by 6.9 billion euros in 2007 to 45.3 billion euros.

## Revenue\*

Revenue rose 6.7% in 2007 to 56.4 billion euros, driven by the growth in the Group's customer base.

Organic growth<sup>1</sup> in revenue was 7.4%, with increases across all businesses. Telefónica Latinoamérica posted a 13% increase, Telefónica España a 4.6% improvement and Telefónica O2 Europe a 4.5% increase. By business, the biggest growth drivers were the mobile and Broadband businesses.

By unit, Spain accounted for 36.6% of total revenues, Latin America for 35.6% and Europe, 25.6%. This diversification profile is the most balanced in the telecommunications industry.

## Profitability\*

Group OIBDA<sup>2</sup> rose 19.3% to 22.8 billion euros. The OIBDA margin stood at 40.4% (or 35.7% stripping out capital gains from Airwave and Endemol vs. 36.2% in 2006).

By unit, Telefónica España contributed 46.9% of total OIBDA, Telefónica Latinoamérica 35.3% and Telefónica O2 Europe, 18.3%. These figures exclude capital gains generated on the sale of Airwave and Endemol. Meanwhile, OIBDA was reduced by Telefónica's ongoing redundancy programmes, which will translate into higher profitability in the future.

## TELEFÓNICA GROUP RESULTS BY BUSINESS UNITS

Unaudited figures (million euros)

January-December

	BUSINESS FIGURE NET AMOUNT			OIBDA			OPERATING INCOME		
	2007	2006	% Chg	2007	2006	% Chg	2007	2006	% Chg
Telefónica España	20,683	19,750	4.7	9,448	8,647	9.3	7,067	6,113	15.6
Telefónica Latinoamérica	20,078	18,089	11.0	7,121	6,571	8.4	3,562	2,900	22.8
Telefónica O2 Europa <sup>1</sup>	14,458	13,159	9.9	4,977	3,708	34.2	1,591	309	n.s.
Other companies and eliminations <sup>2</sup>	1,221	1,903	(35.8)	1,278	200	n.s.	1,168	99	n.s.
<b>Total Group</b>	<b>56,441</b>	<b>52,901</b>	<b>6.7</b>	<b>22,825</b>	<b>19,126</b>	<b>19.3</b>	<b>13,388</b>	<b>9,421</b>	<b>42.1</b>

Note: Figures of 2006 are presented considering the Purchase Price Allocation of O2 as of February 2006.

Note: OIBDA for wireline operations in Latin America is presented after management fees.

<sup>1</sup> Telefónica Europe includes in 2006 Telefónica O2 Czech Republic (January-December), T. Deutschland (January-December), O2 Group (February-December) and O2 Germany (February-December). OIBDA figures exclude brand fee.

<sup>2</sup> OIBDA and Operating Income exclude the variation in investment valuation allowances accounted by Telefónica, S.A.

\* For a detailed analysis of the Group's financial performance please refer to the audited consolidated financial statements and accompanying notes.

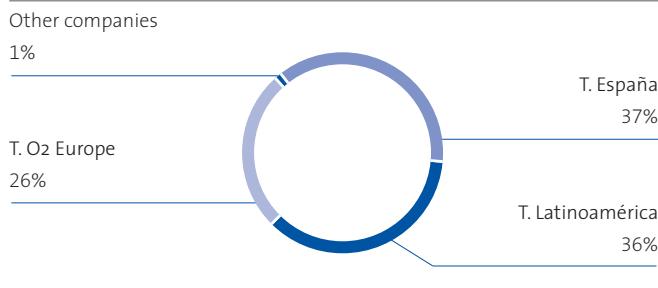
<sup>1</sup> Assuming constant exchange rates and factoring in the consolidation of O2, Telefónica Telecom and Iberbanda for all of FY06.

Telefónica O2 Slovakia is excluded from the scope of consolidation for FY07 and TVA is stripped out from October-December 2007.

Airwave is excluded from April-December 2007 and Endemol from July-December 2006.

<sup>2</sup> Includes 1.296 million euros of capital gains from the sale of Airwave and 1.368 billion euros from the sale of Endemol.

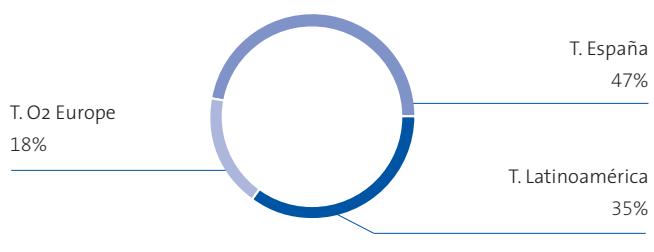
## DISTRIBUTION OF INCOME BY BUSINESS



Note: Data reported to the "Comisión Nacional del Mercado de Valores"

\*\*The consolidated OIBDA of Telefónica Group from January to December of 2007 excludes the capital gains of 1,296 million euros and 1,368 million euros from the disposals of Airwave and Endemol respectively.

## DISTRIBUTION OF OIBDA BY BUSINESS\*\*



## Cash Flow Generation\*

Operating Cash Flow<sup>3</sup> jumped 33% in 2007 to 14.8 billion euros, driven by synergies, cost rationalisation and diversification. This increase was recorded despite capex in the year (8.1 billion euros).

Free cash flow generation in the year totalled 8.8 billion euros, of which Telefónica, S.A. spent 2.1 billion euros on repurchasing shares and 3.1 on dividends, while 781 million euros went to cancelling Group commitments, mainly related to workforce reduction plans.

Disposals of investments in the year, mainly the sales of Airwave and Endemol and the stake acquired in TELCO, amounted to 2.512 billion euros, helped drive a 5.389 billion euros reduction in financial debt.

Changes in exchange rates and consolidation scope plus other impacts on the financial statements led to a further 1.5 billion euro reduction in debt. Combined, the total consolidated debt reduction in the year was 6.9 billion euros, from 52.1 billion euros to 45.3 billion euros.

## Shareholder Remuneration\*

Last year, Telefónica generated the most net profit of any integrated operator in the world.

Telefónica's consolidated net profit rose 42.9% in 2007 to 8.9 billion euros. This reinforced the Group's position as the fastest growing European incumbent operator and the player creating the most value for shareholders.

Basic EPS jumped 43.5% to 1.872 euros per share (2006: 1.304 euros per share), marking the fourteenth consecutive quarter of growth.

Shareholder returns stood at 41.9%, well above 19.3% return on the DJ Eurostoxx Telecommunications index.

<sup>3</sup> OIBDA-CapEx.



## Telefónica announced a dividend of 1 euro per share against 2008 earnings

The excellent performance of the business and the disciplined use of free cash flow has allowed Telefónica to revise upward its previous commitments. Cash flow will be allocated as generated to the following priorities:

Shareholder remuneration: dividend per share in 2008 of 1 euro\*

Debt reduction: net debt + cash commitments of between 2x and 2.5x OIBDA.

Selective acquisitions to boost growth in existing markets.

### A track record of promises kept

In recent years Telefónica has made a habit of sharing its earnings forecasts with the analyst and investor communities. Despite the level of uncertainty inherent in such a dynamic sector, and in contrast to its peers, Telefónica has consistently beaten the earnings guidance provided. Its credibility is underpinned by ongoing and systematic delivery of the promises made to the markets.



### Opportunities for organic growth

Based on the criteria used to set its 2008 financial targets, the Telefónica Group's forecasts at the consolidated level are as follows:

Forecast revenue growth in 2008 in the range of 6-8%.

■ Telefónica España: 2-3.5%.

■ Telefónica Latinoamérica: 11-14.0%.

■ Telefónica O2 Europe: 4-7%.

The guidance for OIBDA in 2008 is for growth in the range of 7.5-11%.

■ Telefónica España: 6-8%.

■ Telefónica Latinoamérica: 12-16%.

■ Telefónica O2 Europe: 2-6%.

The guidance for operating income (OI) in 2008 is for growth in the range of 13-19%.

Budgeted Capex for 2008 is approximately 8.6 billion euros.

\*Against 2008 earnings, payable in 2H08 and 1H09.

## TELEFÓNICA GROUP

Data Unaudited figures (million euros)

	2007	2007 (Ajust.) <sup>1</sup>	CAGR06-10E <sup>2</sup>
Income	56,441	55,550	5% / 8%
OIBDA	22,825	20,863	7% / 11%
OI	13,388	11,467	16% / 20%
Capex	8,027	7,975	Acum. 07-10E < 33,000 mill.€

<sup>1</sup> 2007 adjusted figures exclude Airwave and Endemol, include 3 months of consolidation of TVA. 2007 T. España revenues are adjusted for new public voice telephony services business model. Group revenues are also adjusted accordingly. 2008 figures includes TVA, Deltax and Telemig (from April 2008). Telefónica's CapEx excludes Real Estate Efficiency Programme. Guidance growths assume 2007 constant FX. In terms of guidance calculation OIBDA and OI exclude other exceptional revenues/expenses not foreseeable in 2007.

<sup>2</sup> Base 2006 reported numbers include eleven months of O2 Group (consolidated since February 2006), eight months of Telefónica Telecom (consolidated since May 2006), six months of Iberbanda (consolidated since July 2006), three months of start-up losses in Slovakia, and exclude Endemol and Airwave results. 2007 guidance assumes constant exchange rates as of 2006 and excludes changes in consolidation (TVA). In terms of guidance calculation, OIBDA and OI exclude other exceptional revenues/expenses not foreseeable in 2007. Personnel Restructuring and Real Estate Programmes are included as operating revenues/expenses, with the exception of the ones decided after the guidance communication at the beginning of the year. For comparison purposes the equivalent other exceptional revenues/expenses registered in 2006 are also deducted from reported figures. CapEx excludes investments related to Real Estate Efficiency Plan.

## Cashing in on growth

The guidance provided by Telefónica in October 2007 points to strong organic growth with bottom line growth outpacing the topline.

- Accesses are expected to grow at an annual compound rate (CAGR) of above 9%.
- CAGR revenue growth in 2006-2010E is expected to range between 5% and 8%.
- OIBDA is expected to grow at a CAGR of between 7% and 11% over the same period.
- Operating income is forecast to grow at a CAGR of between 16% and 20% between 2006 and 2010E.

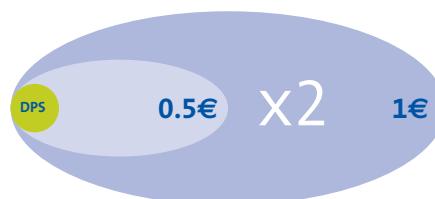
The scope to achieve organic growth, coupled with disciplined financial management, should drive an increase in profits and free cash flow.

- Earnings per share (EPS), which was ?1.304 in 2006 is expected to be one full euro higher by 2010 (?2.304).
- Free cash flow per share (FCFS)<sup>2</sup> is also expected to rise by one euro between 2006 and 2010, to ?2.87 per share (from ?1.87 per share in 2006).

## Shareholder remuneration policy

Telefónica is bringing forward the commitment announced in May 2006 to double the dividend by 2009. In fact, Telefónica will pay 1 euro per share dividend against 2008 earnings.

Payment will be made in two instalments: one in 2H08 and the other in 1H09. In addition to the dividend increase announced last October, on 27 February 2008, the Company announced a new share buyback programme under which it will repurchase 100 million shares, around 2.095% of the total outstanding, during 2008 and 1H09.



## TELEFÓNICA GROUP

	2006	2010
EPS (?) <sup>1</sup>	1,304	2,304
FCF per share <sup>2</sup>	1.87	2.87

<sup>1</sup> Reported EPS.

<sup>2</sup> "Free Cash Flow" reflects 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.

### DISCLAIMER:

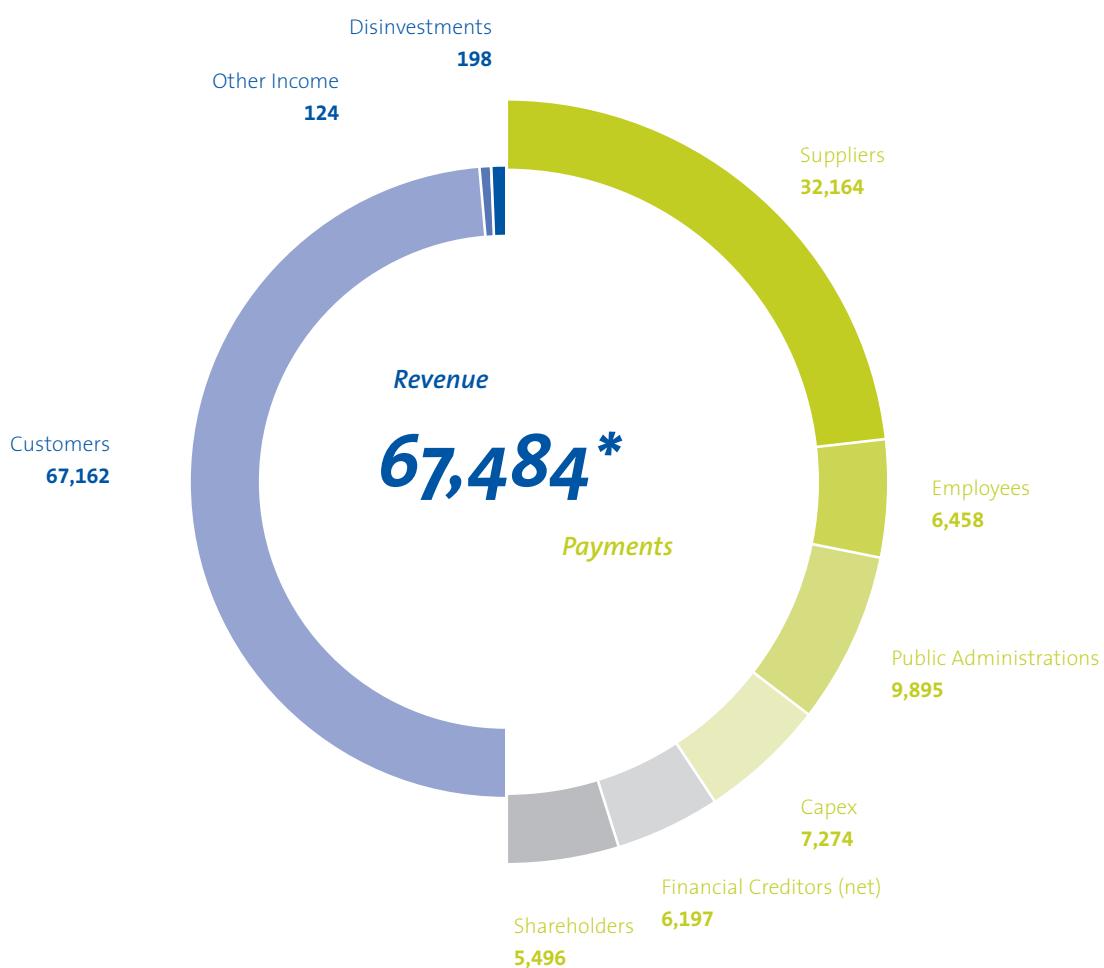
*These forward looking statements are not, due to their very nature, guarantees of future performance and are subject to many risks, uncertainties and other significant assumptions that are difficult to predict and that could cause actual results to differ materially from the opinions expressed in these forward-looking statements.*

## Telefónica is a driver of economic, technological and social development in the countries where it operates

In 2007 the Company earned nearly 67,000 million euros from its customers.

Of this 6,458 million euros went in wages to its employees, 9,895 million in tax to Public Administrations, 32,164 million in payments to its suppliers and nearly 5,500 million as dividends to its shareholders. This is the effect of wealth creation.

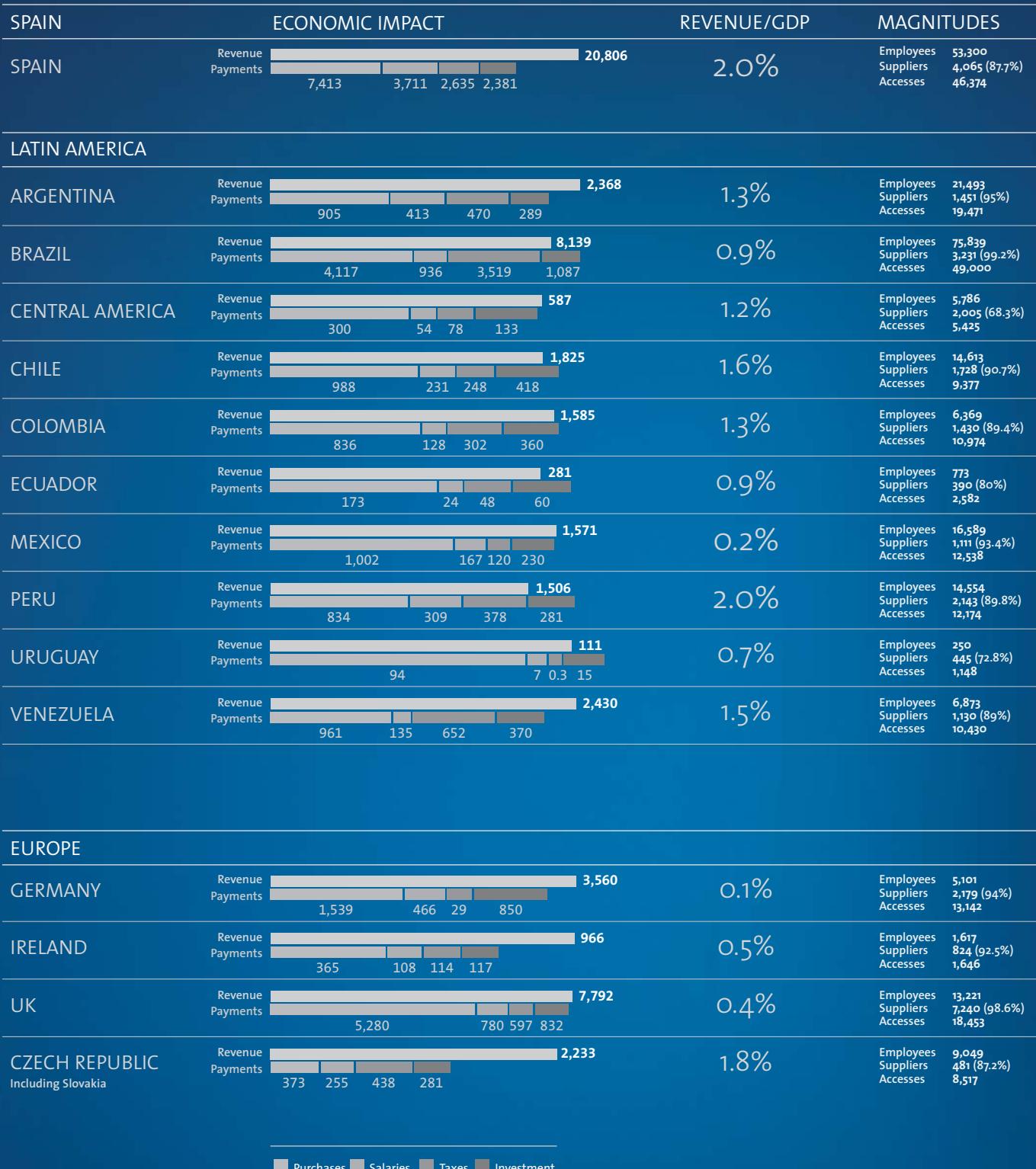
In addition, the Company's sales and business in 2007 contributed an average of 1.2% to the GDP of the countries where it operates.



\* Figures in million 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.

# Contribution to progress



## Note:

Revenue, personnel expenses, payment of tax in the country, purchases and investment (capex) in million euros.

Revenue correspond to all Telefónica business units in the country.

Employees: direct employees of the Telefónica Group in the country (headcount at 31 December 2007).

Suppliers: suppliers awarded businesses in the country in 2007.

% in parentheses represents the % awarded to local suppliers (% awarded to suppliers domiciled in the country/total awards based on volume).

Accesses: number of fixed + mobile + ADSL + TV accesses (thousand).

Revenue TEF/GDP: ratio between Telefónica revenue (contribution by the country to consolidated revenue of the Telefónica Group) and forecast GDP for the country (source: IMF).

## Employees

In 2007, the Group created over half a million direct and indirect jobs



For more information:  
[www.telefonica.es/cro7/employees](http://www.telefonica.es/cro7/employees)

# Telefónica directly employs over 248,000 professionals

By region, Latin America accounts for 66% of total headcount. Spain, at 22%, is the second most important region by employment, while Europe accounts for 12%.

Atento, with a staff of over 123,000, is the largest employer among the Telefónica Group companies.

## Headcount Trend

At the end of 2007, the Telefónica Group had over 248,000 employees, 5.78% more than the year before. Growth was highest in Latin America at almost 15%.

The most significant factors affecting headcount during the year were:

- New hires. The total number of employees was lifted by job creation at Atento (+16%) and t-gestiona (+37%).
- Business integration, in line with the Group's reorganisation into three major regions, integrating the fixed and mobile businesses.
- Disposals. The European workforce declined 13.3% with the sales of Endemol (Europe) and Airwave (UK).
- Redundancies. Telefónica de España reduced its staff by 7% as part of an ongoing redundancy programme.

## Professional Profiles

By job type, and excluding Atento, 41% of Telefónica's workforce is engaged in sales roles, 45% in service provision and 14% in support services. 48.3% of the Company's workers is female, a figure that rises to 61.5% at Atento.

Telefónica Group employees have been with the Company on average for 5.8 years and are 31.3\* years of age, on average. Length of service is lowest at Atento at 2 years on average while the average age of its employees is 27.

90% of the workforce has a permanent or indefinite employment contract. Atento has the highest percentage of temporary workers of all Telefónica Group companies.

The hierarchical degree of the Group's workforce stands at 11.9% up from 7% in 2006, due to the additions of companies in Telefónica O2 Europe.

## Indirect Employment

In 2007, the Group created almost 225,000\*\* indirect jobs in Spain and Latin America, the majority by outsourcing certain activities to collaborating companies.

## PHYSICAL WORKFORCE BY REGION

	2007	2006	2005	% GROWTH(07/06)
Spain	53,300	57,058	60,405	-6.6
Europe	29,310	33,818	14,326	-13.3
Latin America	164,231	142,983	131,968	14.9
Rest of the World	1,646	1,041	942	58.1
<b>Total Telefónica Group</b>	<b>248,487</b>	<b>234,900</b>	<b>207,641</b>	<b>5.8</b>

\* Figures excluding Atento

\*\*Calculation: Total cost of hirings in the year/average cost per employee on staff This figure includes Spain, Europe and Latin America.

## INDICATORS OF EMPLOYEES 2007

	With Atento	Without Atento
<b>Total Number of employees</b>	<b>248,487</b>	<b>124,895</b>
Spain	53,300	40,284
Europe	29,310	29,310
Latin America	164,231	55,201
Rest of the World	1,646	-
<b>Job creation</b>		
Number of incorporations	146,292	17,419
Number of voluntary redundancies	78,242	5,834
Number of mandatory redundancies	47,685	8,683
External chum	50.68%	11.62%
<b>Professional development</b>		
Total expenditure on training	59,143	53,430
Hours of training	14,350,414	4,675,838
<b>Diversity</b>		
% of women	48.3%	35.2%
Number of employees with a disability	1,538	975

## New ways of working

Technology facilitates full connectivity, enabling professionals to work when and where they need to. At the end of 2007, Telefónica had nearly 30,000 teleworkers and more than 8,600 employees in mobility, representing 15.3% of total staff.

## Healthy and Safety

Telefónica provides the means for avoiding accidents, injuries and illness at work related to the job by strictly complying with all health and safety regulations. In 2007, over 500 emergency drills were carried out, nearly 135,000 employees underwent medical tests and more than 2,700 risk assessments were made on the health of employees.

## Career development

In 2007, we spent 59 million euros on employee training. Employees received more than 14 million hours of training and nearly 100,000 employees were given individual training, 36.3 % more than in 2006.

### The Telefónica Corporate University

The Telefónica Corporate University began in 2007. It was a year of transition, with the definitive campus at La Roca del Vallés, 30km outside Barcelona, scheduled to open its doors by the end of 2008.

During the year, the University offered 39 senior level programmes and started up a virtual campus to promote relations among the over 1,000 Telefónica professionals and managers who studied at the centre.



## Telefónica and Social Dialogue

In December 2007, the Company and the UNI, UGT and CC.OO. trade unions signed a new code of conduct, which replaced one in place since 2001. With this agreement, Telefónica is committed to upholding union and worker rights at all our operations, providing protection to all Group employees regardless of where they work.

Representatives of Telefónica, UNI, UGT and CC.OO. at the signing of the new code.

## Innovation

In 2007, Telefónica spent 594 million euros<sup>1</sup> on R&D, the fourth most among global operators and the first of any Spanish company



For more information:  
[www.telefonica.es/abouttelefonica](http://www.telefonica.es/abouttelefonica)

# In 2007, Telefónica spent over 4.35 billion euros on Technological Innovation

Last year Telefónica launched over 600 products and services worldwide.

The Company has built up an open innovation network, with inputs from each of the Group companies and a corporate innovation programme spearheaded by Telefónica I+D.

It participates in 190 projects sponsored by Spanish and European authorities and collaborates with 920 institutions.

## Research

Last year, Telefónica's applied research projects (Expertise Building) enabled the Company to develop and identify new technology applications and business models. It is worth noting Telefónica's participation in the European Union "Framework Programme". Telefónica I+D plays the most prominent role in initiatives of this nature of all European ICT players. In 2007, it participated in 190 projects sponsored by Spanish and European authorities and collaborated with 920 institutions across 41 countries, including 169 universities. In relation to projects backed by public funding in Spain, it is worth highlighting the initiation in 2007 of 5 CENIT projects; CENIT is the Spanish government's most important programme for encouraging corporate R&D in Spain.

## Development

### Product and service development

Last year the number of intellectual and industrial property copyrights registered by the Group rose to 3,327 with 267 new Telefónica I+D developments.

### Movilforum

In 2007, Telefónica España's catalogue of solutions included 193 products developed by 67 of movilforum's 119 member firms. Meanwhile, movilforum Latin America defined a portfolio of regional mobile solutions. This project, located in 13 countries, currently comprises over 50 developers and 170 products.

## Innovation

In 2007, Telefónica resolved to put the client even more firmly under the spotlight, not only to increase customer satisfaction, but also to boost knowledge of customers' real needs under the framework of developing new ideas for products and services.

### Corporate Innovation

Last year at the corporate level Telefónica launched a series of initiatives under the umbrella of its innovation programme. The overriding goal of these programmes is to boost organic growth at Telefónica.

- The Venture Capital programme. In 2007, Telefónica set up a venture capital fund to take minority interests in leading

## TELEFÓNICA'S NETWORK OF OPEN INNOVATION

### BUSINESS UNITS

#### TELEFÓNICA I+D & TELEFÓNICA S.A.

##### Research

Programmes of applied research  
(Expertise Building Projects)

Public Programmes of R+D

##### Development

Development of systems, products  
and services in collaboration

Movilforum

##### Innovation

New ways of getting closer to the customers:  
Campus Party, Open Movilforum and Living  
Labs

New systems, ways of marketing and products  
and services

Corporate innovation: venture capital,  
Projects of Corporate Innovation,  
Employees' ideas and Covenants.

**61 Million euros**

**533 Million euros**

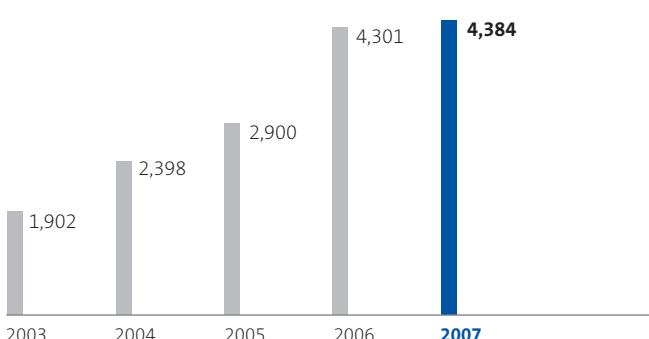
**3.79 Billion euros**

**Total 4.384 Billion euros**

<sup>1</sup> Investment in technological innovation according to OCDE criteria.

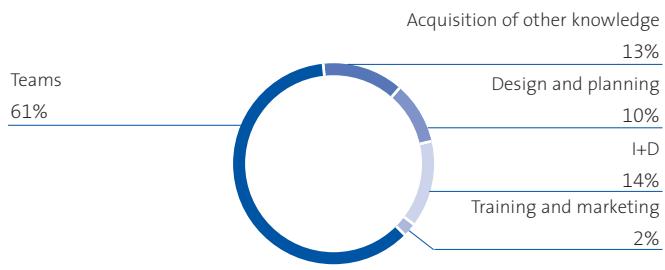
## TOTAL INVESTMENT IN TECHNOLOGICAL INNOVATION<sup>1</sup>

(Data in million euros)

<sup>1</sup> Technological innovation according INE and OCDE criteria.

## DISTRIBUTION OF 2007 INVESTMENT

(Data in % on 4,394 million euros)



companies with the goal of broadening the Company's ability to innovate in core areas. The fund invested 10 million euros in 2007, specifically it took minority stakes in decentral.tv or Kyte (a P2P user generated content platform), GestureTek (specialised in gesture recognition technology) and Amobee (advertising solutions for mobile handsets).

- Corporate innovation projects. Telefónica finances projects in core business areas (internet, the digital home, etc.) that are developed and executed by Telefónica I+D (the spend in 2007 amounted to 45.4 million euros). Over 1,000 ideas were analysed in 2007, which were distilled into 35 specific projects.
- The “Incubator” programme. Mid-2007, Telefónica launched a 2 million euro programme with the aim of transforming ideas into commercially viable products/services. Last year the incubator fund made investments in Brazil, Spain, Ireland, Mexico, Peru and the UK. Some of these projects, at the pre-commercial phase, are already generating revenues.
- “Ambassadors for Innovation”. This programme was created in 2007 to identify and group all employees related, directly or indirectly, to innovation. The community was inaugurated last October with a multi-day event in Madrid. Leading companies on the innovation front (Nike, Starbucks, Philips, etc.) participated in the event alongside the Telefónica’s Group’s senior management. Today the community is made up of almost 400 Group people.

## Telefónica I+D

Telefónica I+D is the Group subsidiary engaged in core R&D initiatives. Last year the Company hired scientists and professionals from the most prestigious research institutions and universities in the world. 1,800 Group employees (1,285 of Telefónica I+D) and almost 5,000 professionals from outside companies and institutions worked on Telefónica’s R&D initiatives in 2007.

- Alliances with innovation leaders. During 2007 Telefónica signed or expanded agreements with a range of companies (Apple, Sony, Ericsson, Motorola, Huawei, ALU, Nokia, etc.), and signed collaboration agreements with prestigious institutes, such as MIT (Massachusetts Institute of Technology).

### Open Movilforum

Telefónica España launched Open Movilforum last year, an open source platform to enable developers and programmers to access services on Telefónica’s network and incorporate them into their applications (mash-ups).

### Living Labs

Telefónica I+D launched its first living lab in Granada in 2007, dedicated to health and wellbeing related services, and backed by the Andalusian regional government. The idea is to bring research out of the laboratory into real-life contexts to stimulate innovation. Citizens are brought into the process, testing services in their homes.

### New products and services

Innovation is measured by results: in 2007 ,Telefónica launched over 600 new products, services and commercial packages (bundles). Of these, 174 were launched by Telefónica España.

During the year Telefónica I+D continued to reinforce its network of research centres across Madrid, Huesca, Valladolid, Barcelona and Granada. The latter two are dedicated centres (the Barcelona centre is specialised in internet and multimedia while the Granada centre is focused on telemedicine and teleassistance). Abroad, the level of activity at the Mexico City and São Paulo centres, with combined investment of 23 million euros, was noteworthy. Research initiatives were also launched in conjunction with China Netcom Labs.



## Telefónica offers wireless services via 80,499 base stations

The Company continued to transform its network in 2007, bringing fibre optic to the home and expanding its 3G and 3.5G capacity

Work in the infrastructure arena also concentrated on setting common service standards for the entire Group to reduce time to market.

In 2007 Telefónica continued to work on several fronts to extend and upgrade its network infrastructure and equipment, not only to boost capacity and coverage but also to exploit synergies between the various Group companies by leveraging economies of scale and tapping growth opportunities in complementary businesses. The overriding goal of this strategy is to reinforce the company's leadership as an integrated operator.

### Network infrastructure

The Group's network infrastructure initiatives extended to all layers of the network: the personal digital environment or customer devices (fixed and mobile handsets, portable devices, etc.), customer access (fixed, mobile, voice, data accesses), transmission (connectivity and the core layer), the control layer (where intelligence regarding the network and service switching is centralised) and the service layer (where the logic underpinning the customer services provided over the networks is stored). The main achievements in each of these areas in 2007 are summarised below:

#### The personal digital environment

In 2007, Telefónica continued to work on enhancing the digital home concept to configure tailored services; the goal is to become a reference point in connectivity and end services/content for the home. One of the noteworthy initiatives on this front was the reinforcement of *Imagenio*'s IPTV Centre of Excellence, an Advanced Services Centre set up at the end of 2006 whose main mandate is to coordinate and manage the actions necessary to ensure rapid customer response times.

On the devices front, Telefónica worked to generate common mobile handset specifications for all Group companies to increase bargaining power with manufacturers and reduce time to market.

#### Network transformation

Last year, the Company continued to upgrade its network to increase coverage and capacity. In fixed access, in a pioneering move, Telefónica began the rollout of fibre to the home (FTTH) technology. The FTTH rollout was most intense in Spain, but was also implemented, albeit to a lesser extent, in Latin America. In 2008 this process will pick up pace across the Group.

In terms of wireless networks, work continued on making 3G and 3.5G technology more broadly available across all operators to increase wireless data connection capacity. At year-end 2007, the Group had 80,499 base stations.

In 2007, Telefónica focused more on rolling out GSM rather than CDMA technology in Latin America. The aim is to broaden 2G coverage as available spectrum increases (at present, spectrum is shared by several technologies that coexist over time).

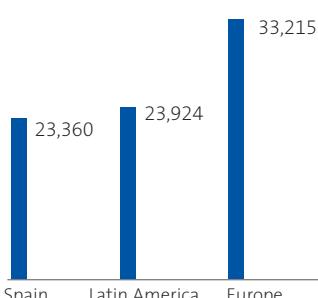
#### Fixed-mobile convergence

In 2007, Telefónica continued the process of extending its fixed-to-mobile architectures to boost convergent services. The work in this field was concentrated in Spain, Argentina, Brazil, Chile, Colombia, Peru, the UK, Germany and the Czech Republic.

#### Control

One of the most important milestones last year was the strategic agreement reached with Ericsson to rollout IMS (Internet

### NUMBER OF BASE STATIONS BY REGIONS



## CAPEX BY BUSINESS UNITS

Unaudited figures (million euros)

		January-December	
	2007	2006	% Chg
T. España	2,381	2,304	3.4
T. Latinoamérica	3,343	2,811	18.9
T. O2 Europe <sup>1</sup>	2,125	2,552	(16.7)
Other companies and eliminations	178	336	(47.1)
<b>Total Telefónica Group</b>	<b>8,027</b>	<b>8,003</b>	<b>0.3</b>

Note: Telefónica Group CapEx at accumulated average exchange rates.

<sup>1</sup> On 2006, Telefónica O2 Europe includes Telefónica O2 Czech Republic (January-December), T.Deutschland (January-December), O2 Group (February-December) and O2 Germany (February-December).

Multimedia Subsystem) technology at all the operators. This technology enables network control, the provision of fixed-to-mobile services and shortens time to market for new services, among other features.

### Services

Telefónica focused on the implementation of VoIP services and corporate solutions such as IP-Centrex, across all the various Group operators. The Company also analysed SDP (Service Delivery Platform) architectures, which enable faster service development.

### Basic infrastructure

Last year the Company conducted the first studies on the viability of fuel cell technology for energy supply at its base stations as an alternative to conventional, and more pollutant, lead-acid batteries (lead, cadmium, etc.).

Best practices were cross-fertilised in various areas ranging from the rollout of new FTTH services to energy saving initiatives in temperature control in radio stations and central buildings. This was achieved by holding internal workshops targeted at the operators from the Group's three regions.

### Transmission

In 2007, Telefónica continued to extend its optical transmission technologies (DWDM and CWDM, and GPON in part of the access layer and on a pilot basis in Spain and Brazil). These technologies are more efficient and provide greater capacity at lower cost. This entails a gradual tapering off of investment in 'traditional' transport technology such as ATM and SDH.

To complement the rollout, the Company analysed new higher capacity interfaces; the goal is to introduce the first 40 Gb/s interfaces in 2008. These interfaces are necessary so that increased network capacity results in the ability to offer new Broadband services by multiplying user bandwidth in a transparent manner.

### Two million ADSL users have already gone from 1Mb to 3Mb

By the end of 2007 Telefónica España had concluded the migration of almost two million retail ADSL customers from 1Mb to 3Mb, including ADSL accesses managed in bundled packages such as Duo and *Imagenio*.

This migration has multiplied speed on Telefónica's benchmark Broadband access product by a factor of three.

This enhanced service was provided at no additional cost to its customers, with no impact whatsoever on their monthly bills, i.e. customers continued to pay exactly what they were paying for their 1Mb ADSL service. All customer segments benefited from the initiative, including employees and customers of the Senior Club. The move enabled 90% of the retail Broadband customer base to enjoy speeds of 3Mb or higher.





## Telefónica launched over 600 products and services in 2007

The Company took advantage of new technologies and drove convergence of its offer for retail customers and companies alike. Its product portfolios were enhanced with Broadband and wireless services, content offering, etc.

### New Technology

#### Faster internet

In 2007, Telefónica started to rollout HSPA (high-speed packet access) which extends and complements 3G mobile technology. The new technology has accelerated web access speeds in Spain, Brazil and Argentina, allowing customers to download information up to 10 times faster. At the same time, Telefónica also launched the USB HSPA Novatel MC950D, the first HSPA modem on the market in memory stick format.

#### The iPhone, exclusive UK rights

Telefónica started selling iPhones in November 2007 as exclusive dealer on the UK market.



#### Mobile innovations

Telefónica launched a people location system using cell phones.

At Mundo Internet 2007, held in Spain in May, Telefónica unveiled the two-dimensional codes (pictograms that work as access keys, bypassing the keypad) that extend mobile functionality by, for instance, generating virtual movie tickets.

Cutting edge handsets: Chinese manufacturer ZTE began developing 3G mobiles for Telefónica.

#### New technology for the home

The Company rolled out trials for its "Fibre to the home" (FTTH) technology, customised by Telefónica R&D. The first commercial phase of this high performance Broadband network starts in 2008.

#### Products for companies

In Spain, Telefónica launched Ibercom IP and Corporate IP, enhancing corporate communications with IP telephony solutions.

### Convergence

#### An integrated response for business

Telefónica launched "Company Response" in 2006, turning itself into a full-service provider for all the ICT needs of small and mid-sized companies, businesses and professionals in Spain. For a single monthly fee Telefónica will supply and maintain all the workplace technologies a company needs: office IT (PCs, peripherals, servers and applications), voice (lines, handsets and switchboards) and data communications (web access, cabled or wireless LAN and corporate intranets).

As part of "Business Response", in 2007 a number of different services were launched: Professional Office, creating a mobile workplace in a context of convergence, with maintenance for the IT equipment, corporate data networks, etc.

The project was extended to Latin America.



#### Convergent communications

Several countries also launched the first convergent communications services in 2007, including Chile, Peru and Colombia. These integrated traditional telephony networks with IP services, to create a closed user group for each customer with unlimited communications and advanced functionalities, such as a network-based PBX for places with no normal PBX, etc.

Similarly, Telefónica in Spain presented "Uno Pymes" the first convergent rate for the SME segment. This creates a closed user group of fixed and wireless lines in a company where users can talk free.



## Content

### Digital TV

In 2007, Telefónica began offering digital TV for the first time in countries such as Brazil. The Brazil start-up included an offer of 76 channels and customisable bundles.

In Spain, the Company also expanded *Imagenio*, its IPTV offering, with a video service: "You Missed it", which allows customers to see content broadcast on different TV channels and to pause or fast-forward the picture. A similar video system was also launched in Chile (PVR or Personal Video Recorder) for digital TV.

### Advertising and other mobile content

Last year Telefónica became the first company to offer mobile adverts to advertisers. Telefónica brought TV to mobile screens. In Chile, it launched the "Multimedia Generation", a service where cell phone users can access TV programmes live as well as swapping and commenting on video clips. And in Spain it brought out a 42-channel flat rate offer.

Also in Spain, Telefónica began marketing the mobile version of Pixbox, where movistar users can choose from more than 750,000 songs to download. Later, the music download services to mobile and PC were expanded with the first flat-rate offer. Telefónica also linked up with Yahoo! to give its customers access to Flickr, one of the leading online photo sharing communities. In addition, the Group signed a content sharing deal with Nokia through its new internet portal.

In Argentina it offered its customers "Fotolog", with unlimited capacity to upload up to ten images daily, and created the first online mobile video community. It also rolled out a new version of m-Play to download whole tunes directly to a mobile phone.

## Commercial activity

### Double and triple play offers

Last year, Telefónica led the transformation of the internet in Latin America by selling a bundled offer of Broadband web access and voice for a single monthly rate. This was structured into different bundles of double and triple play offers for home customers in various markets.

Meanwhile, in Europe, Telefónica O2 Czech Republic launched the Dúo-Móvil service.

### Flat rates

The Company continues to push low and flat rates: in Spain it launched a new email format (Blackberry and Mail Movistar), with flat rates for video calls and wireless Broadband for each day's connection.

### Low cost solution

In Germany, Telefónica O2 Europe launched the discount mobile brand Fonic in August 2007.

### Services for pre-pay customers

Movistar extended to countries including Argentina or Mexico its continuous connection service for pre-pay customers ("They want to talk to you", "Call me, I'm out of credit", etc.), where other users can return calls.

### Home offer

Telefónica España launched last year its Easy PC offer for home customers (finance, two-year guarantee, technical support, etc.) with the aim of driving bundled sales of computers with ADSL service.

### One-stop Messaging

In December 2007 Telefónica launched its "Business Messaging" service, allowing users to send and receive multi-operator SMSs facilitating two-way communication with customers, providers and employees.

## Suppliers

In 2007, more than 28,000 suppliers were awarded business



For more information:  
[www.telefonica.es/cro7/suppliers](http://www.telefonica.es/cro7/suppliers)  
[www.adquira.com](http://www.adquira.com)

## Telefónica awarded more than 27 billion euros of contracts to its suppliers in 2007

By country, Spain and Brazil were again the biggest sources by purchase volumes. The ten biggest suppliers by volume are: Nokia, Ericsson, Sony Ericsson, Alcatel, Motorola, Brightstar, Samsung, LG, Siemens and Nokia Siemens.

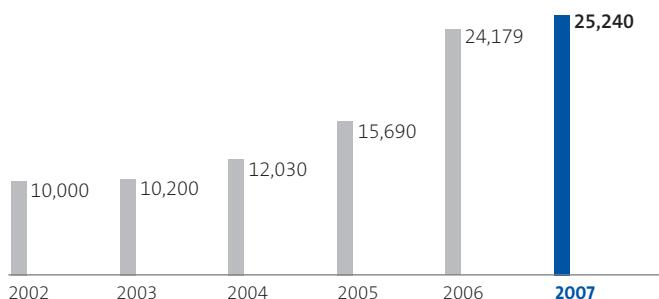
### The Telefónica Procurement Model

Telefónica has developed a coordinated procurement system that relies on a management model first introduced ten years ago. The basic principals are: aggregation of needs, transparency, equality of opportunities, objectivity and unanimity in decision-making, a service culture for internal and external customers, and meeting commitments with suppliers.

Telefónica divides its purchasing into six product lines. Most of its procurement in 2007 came under the category of "Services and Works" which, along with "Market Products" (including mobile handsets) and "Network Infrastructure" made up over 80% of total purchasing. The rest was split between "IT systems", "Advertising and Marketing" and "Content".

### VOLUME OF PURCHASES

(Data in million euros)



### E-Commerce

At Telefónica we take the view that internet tools improve efficiency for both purchaser and supplier, create greater transparency and ensure better control at every stage of the supplier relationship by linking operations together electronically: sourcing, contract, order, delivery note, reception and billing. Also, access to a broad market of suppliers combined with transparency means a real increase in competition, which is healthy not only for Telefónica's own purchasing but for the market as a whole.

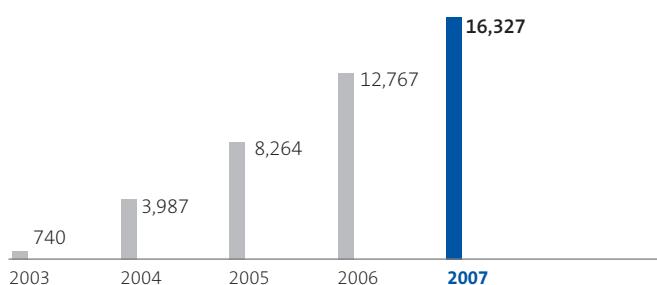
E-commerce is also a real medium for developing the internet and the information society in Telefónica's markets, as well as encouraging values such as professionalism, honesty and objectivity in commercial dealings and transactions.

Telefónica now e-sources 87% of its Spanish and Latin American operators' supply budgets in a process that last year involved 33,000 transactions, including 4,100 electronic auctions.

In December 2007 nearly 16,000 Telefónica suppliers were registered in this e-market, which covers sixteen countries: Spain, Argentina, Brazil, Chile, Mexico, Peru, Colombia, Venezuela, Guatemala, Panama, Nicaragua, El Salvador; the Czech Republic with the UK, Germany and Ireland currently being integrated to the system.

## EVOLUTION OF NEGOTIATED PURCHASES THROUGH E-SOURCING

(Data in million euros)



Besides the negotiation process, e-transactions available are: formal processing of deals through contracts; award of tender letters or orders; dispatch of the delivery note by the supplier; reception of the goods/services; and e-billing, based on the order data once the receipt for the goods has been received. In 2007, 111,519 orders were carried out in this way on purchases for a total of 6,411 million euros.

The e-market where Telefónica trades with its providers is Adquira España. Adquira also works with other major companies such as BBVA, Iberia and Repsol and others of similar size. The use of a shared system means companies can pool resources and costs: the infrastructure of the suppliers market. For suppliers, too, it is an advantage to have a single access point for a set of their customers.

### Telefónica Compras Electrónicas

As a complement to the Adquira e-market, with the aim of developing e-commerce internally among its 140 companies, in 2007 Telefónica created Telefónica Compras Electrónicas (TCE).

This subsidiary will manage the technical support platform for e-sourcing, contracts and orders, using it to develop new functionalities tailored to Telefónica's needs and completing the rollout of e-procurement to all products and services.

## Supplier Satisfaction Survey

Every two years Telefónica carries out a confidential survey among its main registered suppliers to find out how satisfied they are with the Telefónica purchase model.

In 2007, 7,094 suppliers were surveyed with responses from 13.47%. The main conclusions were as follows.

### Strong Points

#### The Procurement Model

- Transparent decision-making process
- Promotion and defence of competition
- Equal opportunities
- Standardised operation in all countries

#### Purchaser Management

- Ethics and honesty of the purchaser
- Training in technical aspects of purchasing
- Notification of results to tender winners

#### Operational Relationship with Telefónica

- Consideration given to suppliers' recommendations
- Auctions are a transparent way to award contracts

#### E-Commerce

- Introduction of tools for electronic formalisation of commitments
- Convenience of Telefónica's e-commerce tools

#### Corporate Responsibility

- There were no practises that could be considered unethical
- Telefónica requires compliance with minimum standards for working conditions

### Areas for improvement in

#### The Procurement Model

- Management time required for each purchase

#### Operational Relationship with Telefónica

- Notification of results to those not awarded a tender

#### Corporate Responsibility

- Telefónica is concerned to ensure suppliers meet environmental standards



## Our Soul

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## Business Principles

The goal is to provide training to over 80% of employees in 2008



For more information:  
[www.telefonica.es/cro7/businessprinciples](http://www.telefonica.es/cro7/businessprinciples)

# 36,000 Telefónica Group employees have received training on the Business Principles

In December 2006 Telefónica approved its Business Principles. Based on its Vision and Business Principles, the Company is building a new corporate culture.

The Business Principles management model is three-pronged: (i) employee involvement, (ii) compliance policies and (iii) internal control.

## Involvement

### Ratification

Throughout 2007, following approval by the Board of Directors, each Group company and subsidiary ratified the Business Principles in their respective governing bodies, using them as the basis for their codes of conduct in substitution of any previously existing ethics guidelines. By year-end 81% of Telefónica companies had incorporated the Business Principles into their ethics codes.

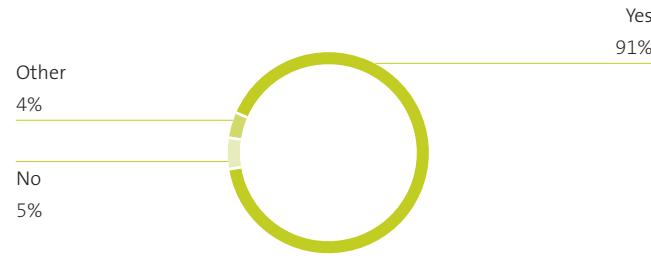
### Internal communications

Internal dissemination of the Business Guidelines kicked off with personnel communication to employees, with the emphasis on the importance of knowing and applying the Business Principles. To back this effort, the Company published related articles in the in-house magazine, SOMOS, distributed throughout the entire Group, and set up a dedicated intranet page. The online brochure, available in English, Spanish and Portuguese, has been downloaded over 50,000 times. In some countries, awareness campaigns were launched.

### Training

In 2007, Telefónica launched an online training programme, mandatory for all employees, with the goal of:

### % OF GROUP COMPANIES THAT HAVE RATIFIED THE BUSINESS PRINCIPLES



Note: The information published on this graph has been obtained from the assessment of the financial report internal control required by Section 404 of the Sarbanes-Oxley Law.

- Conveying the relationship between the Group's Vision, Values and Business Principles.
- Explaining the importance of following a set of basic business principles.
- Describing how their application can benefit brand image, culture and the work environment.

Latin America was the first of the Group's three regions to gradually implement the training programme. Training began in Mexico, Ecuador, Nicaragua, Colombia, Salvador, Panama and Guatemala in June of last year. It was subsequently initiated in the other Latin American markets and in Spain. Elsewhere in Europe, existing O2 courses were left in place with the exception of the Czech Republic, where the training initiative began in February 2008.

In all, 35,949 Telefónica Group employees had completed the Business Principles training programme by the end of 2007. The idea is that over 80% of the workforce will partake of the programme in 2008 (excluding tele-operations staff).

### EMPLOYEES TRAINED ON BUSINESS PRINCIPLES



Note: The graph does not include Atento because it has different training plans on business principles aimed to telephone operators.

## Related Rules

Telefónica wants the Business Principles to influence and shape the way the company interacts with its stakeholders. Against this backdrop, and in order to distil the principles, in 2007 the Company approved the "Corporate guidelines for extending the Business Principles to the supply chain" as well as the "Responsible supplier contracting guidelines". The Group is also working on other lines of initiative related to data protection, responsible advertising, environmental protection and encouraging the responsible use of telecommunications by children. At the country level, Argentina published a Manual for Living Side by Side containing rules devised to encourage specific behaviour.

## Internal Control

The third and final cornerstone of the Business Principles is compliance monitoring: verification of the degree of implementation of the principles throughout the Group and compliance with the related rules and regulations.

Looking to 2008, the goal is to verify the degree of compliance on the training front and to subsequently check fulfilment of the rules implemented to date.

### **The Business Principles Office and Mailbox**

The Business Principles Office is made up of the Human Resources, Internal Audit, the General and Legal Secretariat and the General Technical Secretariat for the Chairman's Office departments plus a representative of Telefónica Esàña, Telefónica Latinoamérica and Telefónica O2 Europe, respectively. The office is responsible for disseminating the principles and related policies and monitoring compliance. It also manages employee, supplier and partner queries and claims.

These issues can be raised either anonymously or on a named basis through the Business Principles Mailbox. To date, the service has handled 213 queries, mostly in response to information requests and in some instances to convey inconsistencies observed in customer dealings or supplier contracting. Telefónica O2 Europe has investigated ten claims of breach of compliance and around 300 disciplinary actions have been taken.

In 2007, the Business Principles Office monitored the training initiative, the main claims and queries lodged and the approval of rules, etc.

This mechanism already existed in Europe to monitor o2's Business Principles. This function was introduced in all significant markets in Latin America. The composition of all the regional offices mirrors that of the corporate Business Principles Office.



## Extension of the Business Principles to suppliers

Telefónica's Business Principles state the following in relation to responsibility throughout the supply chain: "We require our suppliers to develop their businesses by applying similar principles to those highlighted here and will insist on compliance with the laws and regulations of each country".

To this end, in addition to implementing supplier specific principles, in 2007 Telefónica promoted training and self-assessment for its suppliers to ensure that they share the Business Principles. This led to identification of firms supplying products or services classified as presenting risk in terms of corporate social responsibility – 2,453 suppliers by the end of 2007, less than 5% of the total. The Company plans to evaluate over 1,000 suppliers in 2008.

This self-assessment questionnaire, devised by Telefónica, must be filled out online by at-risk suppliers when they sign up for, or renew their membership of, the Company's catalogue of suppliers, or when they are awarded a tender for the provision of a risky product/service. The questionnaire enables Telefónica to measure its corporate responsibility risks more accurately.

Where necessary, the company follows up in-person or by telephone. Improvement plans are drawn up with suppliers at risk for breaching the Business Principles. Other risk-management tools used in the supply chain include on-site audits of the installations.

Telefónica proposes offering responsible suppliers rights of first refusal in tender processes (in countries where there is no legal impediment to doing so) and exoneration of commerce platform usage fees.

For more information:  
[www.telefonica.es/businessprinciples](http://www.telefonica.es/businessprinciples)  
[www.telefonica.es/cro7/businessprinciples](http://www.telefonica.es/cro7/businessprinciples)

## Employee Satisfaction

The aim is to be the best workplace by 2010



For more information:  
[www.telefonica.es/abouttelefonica](http://www.telefonica.es/abouttelefonica)  
[www.telefonica.es/shareholdersandinvestors](http://www.telefonica.es/shareholdersandinvestors)

# The employee satisfaction index in 2007 was 65%, 3 points higher than in 2006

Giving employees a high-value deal that boosts their commitment to the Company. This is one of the aims of the “Employee Promise” initiative, designed to make Telefónica the best workplace by 2010.

In 2007, employee satisfaction improved substantially at Telefónica, by more than two and half percentage points from the year before according to the Employee Satisfaction Survey, which achieved a response rate of 67.6%.

Telefónica has already started to see results in the best employer rankings: Telefónica Colombia is rated as the best workplace in the country. Similarly, Ecuador Móviles, Uruguay Móviles, and the UK all rank among the top five. And in 2007, Telefónica O2 won the “Most Desired Employer” award.

### “Employee Promise”: a key project in 2007

As part of its drive to improve employee satisfaction and become the best place to work, last year the Company extended one of its flagship initiatives: the “Employee Promise”. Following a methodology based on research and external best practice, tests began with this initiative at Telefónica O2 Europe. As at the date of this report, each region had its own employee promise, tailored to its own culture and strategy. All the promises start from a common set of priorities:

### To consolidate a performance culture

Telefónica wants to continue transforming itself into a company where performance is valued, encouraged and rewarded appropriately. This means having clear and transparent ways of evaluating performance. In 2007, 171,626 employees or 70% of the workforce were assessed against evaluation targets in the Group.

### EVOLUTION OF EMPLOYEES SATISFACTION

	Total Company	Executives	Intermediate staff	Collaborators
2005	58%	79%	64%	57%
2006	62%	80%	70%	60%
<b>2007</b>	<b>65%</b>	<b>85%</b>	<b>76%</b>	<b>62%</b>

### To belong to an international company

The Company wants to make use of its size and international reach, increasing opportunities for mobility as a way to exchange ideas and best practice. In 2007, 200 employees took part in international mobility projects and international rotation reached 1,600.

### To encourage global talent

Telefónica lays special emphasis on developing high potential employees, encouraging their development into the future leaders of the Group. In 2007, it invested more than 58 million euros in training. Employees received more than 14.7 million hours of face-to-face training. And over 1,000 participated in at least one strategic programme at Telefónica’s Corporate University.

### Challenges for 2008

Some of the challenges in Telefónica’s management as the best workplace in 2008 are to:

- Drive forward an international mobility programme with more than 300 employees taking part, and achieving a 95% retention rate among the Global Talent Group.
- Instill practices that help work-life balance and wellbeing, such as new working practices in Telefónica’s Campus in Madrid, District C.
- Develop a training programme on customer orientation and leadership with Telefónica’s Corporate University.
- Drive the global diversity project and carry out initiatives that boost the inclusion of cultures, ways of thinking, gender, etc.
- Put into practice the professional means of promoting development.

## Customer Satisfaction

Significant progress was made in Latin America



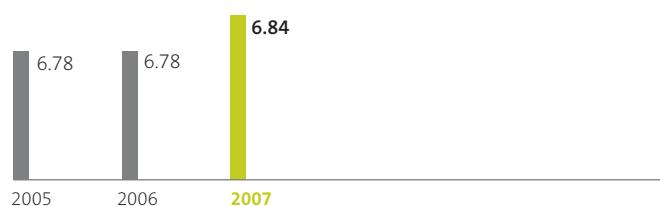
For more information:  
[www.telefonica.es/cro7/customers](http://www.telefonica.es/cro7/customers)

# Customer satisfaction reached 6.84 in 2007, up from 6.78 the year before

The Telefónica Group's commitment is to be leader in customer satisfaction in all businesses by the end of 2009. One of the key ways to achieve this is the "Customer Experience" programme, aimed to raising the degree of loyalty.

In 2007, Telefónica's overall Customer Satisfaction Index (CSI) ended the year at 6.84 on a scale of 10, compared to 6.78 in both 2006 and 2005.

### GLOBAL CUSTOMER SATISFACTION\*



The CSI of Telefónica España in 2007 was 6.67 and included notable improvements among residential wireline and large corporate customers. The wireless business maintained a more than 0.3 point lead over its competitors.

In comparative terms, the highlight is still the satisfaction of European users which rose again last year, driven by the UK which again had the best customer satisfaction ratings in the British market.

In Latin America the CSI improved by 4% over the year. The contribution of the wireless business was essential to this gain, with most operators improving their scores steadily throughout the year. Meanwhile, the fixed-line business posted a modest improvement.

### "Customer Experience" a key programme in 2007

In 2007, Telefónica embarked on the "Customer Experience" programme spearheaded by the Executive Committee. Internally, the programme strives to raise customer satisfaction and, in this way, increase loyalty. It is based on best practice at Telefónica O2 Europe and is a global initiative.

### Actions in 2007

The key actions in this project include identifying the touchpoint or point of interaction between customers and the Company and defining promises to meet their expectations. Throughout the process, Telefónica uses satisfaction surveys, specialised tracking tools, focus groups, etc.

To fulfil its "Customer Promises" in 2008, Telefónica will rollout initiatives to improve key processes and internal communication plans and will encourage the exchange of best practice between Group companies.

\* Refers to the degree of satisfaction of the customer in relation to the service provided by the company, on a scale of 1 to 10, where 1 means not satisfied whatsoever and 10 means completely satisfied.



## Telefónica: Corporate Governance and Transparency

The basic rules for Telefónica's corporate governance are set out in its by-laws, in the Regulations for the General Shareholders' Meeting and in the Regulations for the Board of Directors.

### Corporate Governance Principles

#### **Regarding the best interests of the company**

The Board must act in the best interests of the company. This means acting to guarantee the company's long-term viability and to maximise its value, while also taking account of the various legitimate interests, both public and private, that are involved in the conduct of any business.

#### **Regarding shareholders**

The Board, as the link between the owners and the managers of the company, is responsible for providing appropriate channels for shareholders to put forward any proposals they have regarding the management of the company. It also undertakes to guarantee equal treatment in its dealings with all shareholders.

#### **Regarding the market**

The Board undertakes to do whatever is necessary to ensure the company's transparency vis-à-vis the financial markets and to promote correct pricing of the company's shares. Specifically, it must not manipulate or abuse privileged information.

### General Shareholders' Meeting

The General Meeting is the supreme decision-making forum at which shareholders make their decisions. Its structure and functional rules are laid down in the Regulations for the General Meeting.

### Board of Directors

Under its Regulations, the Board of Directors is mandated with the supervision and control of the company's operations. The Board delegates the day-to-day management of the business to the executive bodies and management team.

Nonetheless, the Board of Directors retains exclusive competence for certain matters that cannot be delegated. These include:

- General corporate strategy and policy.
- Evaluation of the performance of the Board, its Committees and its Chairman.
- Appointment of senior management and director and senior management compensation.
- Strategic investments.

The by-laws state that the Board of Directors must have between a minimum of five and a maximum of twenty Directors. In March 2008, the Board of Directors was made up of 17 Directors, comprising 3 executive directors, 4 proprietary directors, 8 independents and a further 2 classed as "other external Directors".

## Telefónica wins awards for transparency

- “The Good Corporate Governance prize” awarded by Spanish financial weekly “Mi Cartera de Inversión” in the listed companies category.
- “The Information Transparency Prize”, decided by journalists from more than 100 Spanish media organisations through the El Nuevo Lunes weekly magazine.
- Telefónica was Spain’s top company for CSR according to a study by UGT.
- Telefónica is one of the best three Ibex35 companies at reporting on corporate responsibility, according to a study by Observatorio de RSC.

- Telefónica’s CSR reports were finalists at awards held by Accountability and the Global Reporting Initiative.
- Telefónica stands out as one of the best Spanish companies for the effectiveness of its investor relations, based on rankings drawn up by UK consultants the Institutional Investor Research Group.
- Telefónica del Perú won the “ProCapitales award” for best annual report.

## The Executive Committee

The Board of Directors has delegated all powers and attributes to an Executive Committee, which is responsible for taking general management decisions, in compliance with laws in force, except for those powers that cannot be delegated under by-laws or regulations.

The relationship between the Board of Directors and its Executive Committee is based on principles of transparency such that the Board will always be kept fully informed of decisions taken by the Committee. The appointment of members of the Board of Directors to the Executive Committee requires the support of at least two thirds of the Board.

## Consultative and Control Committees

Telefónica’s Board of Directors has a number of consultative or control committees - currently six - which are charged with examining and monitoring particular areas of importance to the good governance of the company and which can also investigate specific major issues as occasion demands.

The most important of these committees are: the Audit and Control Committee, the Appointments, Compensation and Governance Committee, the Human Resources Committee, the Regulation Committee, the Quality and Customer Service Committee, and the International Affairs Committee.

## Directors

### Appointment

As required by the Spanish Corporations Law, Directors’ appointments are subject to approval by shareholders at the General Meeting and, in accordance with the Board of Directors’ Regulations, proposals to appoint a Director must be preceded by the corresponding report from the Appointments, Compensation and Governance Committee and, in the case of Independent Directors, by the corresponding proposal.

### Rights and obligations

The Board Regulations set out in full the rights and obligations of Directors, detailing the duties that derive from their obligations to act with diligence, good faith and loyalty, notably as regards possible conflicts of interest, confidentiality, business opportunities and use of company assets.

### Policy on compensation

The Company reports annually on the compensation received by members of its Board of Directors in the Notes to the Financial Statements and in its Corporate Governance Report in compliance with the criteria laid down for each of these documents. Also, the company has for the first time drawn up a report on compensation policy setting out the criteria and grounds that determine the compensation paid to Directors for the current year.



For more information:  
[www.telefonica.es/adviceforparents](http://www.telefonica.es/adviceforparents)  
[www.protectourchildren.O2.co.uk](http://www.protectourchildren.O2.co.uk)

## In 2007 Telefónica stepped up its commitment to fostering a safe environment for use of new technologies by children

Telefónica is giving parents and children more tools and recommendations to ensure responsible use of its products and services...

In order to foster a safe environment for the use of new technologies, last year Telefónica developed an internal regulation to ensure an appropriate product and service range. It also signed a framework agreement with the other main European mobile operators under which it commits to collaborate on the control and suitable labelling of content provided. The initiative is sponsored by the European Commission.

### Products and Services

In 2007, Telefónica worked on the development of mobile handsets, packages and tools designed especially with parents and children in mind:

- Together with toy retailer, Imaginarium, it developed the CAM1, a more advanced version of the M01 handset, targeted at children over 6 years of age, including a digital camera and MP3 player.
- It released the fourth edition of Play Pack for children aged 8 to 14. Features include restricted calling lists, reverse charge calling, localisation services, adult content filters, etc. A euro from each pack is donated to the NGO, Aldeas Infantiles.
- Telefónica launched its so-called Family Management mobile telephony savings and management plan comprising one main line and a maximum number of dependent lines (either contract or prepaid). The plan includes features such as the ability to set consumption thresholds and an alert system when they are exceeded and the Mobile Babysitter content filter, among others.



- *Imagenio* continued to offer parental controls over the service (parents have a PIN number with which to block access to adult channels or prevent children from using the PPV service without permission), while Telefónica O2 Europe also offered service control features.
- Telefónica O2 Europe provides its customers with telephone numbers and websites for lodging concerns or reporting on inappropriate third-party use of its services.
- In Europe, Telefónica's Nuisance Call Bureau also provided customers with advice on child bullying and useful information on schools.

### Educational Initiatives for Parents and Children

In 2007, Telefónica continued to collaborate on the Safer Internet Plus initiative sponsored by the European Commission. Training provided in Spain, together with the NGO Protégeles (Protect Them), on safe internet browsing and mobile telephony usage guidelines benefited 100,000 children in 400 schools.

In addition, Telefónica O2 Europe collaborates with the NGO Childnet International, with which it launched educational programmes, among other initiatives. In-store the Company provides brochures on handset theft, nuisance calls, prevention of bullying, etc. In the UK, Telefónica O2 Europe has developed its 'Champions' programme, a voluntary training programme to address child protection in the area of new technology usage.

In Latin America, Telefónica launched the "Interactive Generations" project to encourage the responsible use of ICTs among children and adolescents. Underpinning this initiative is the "Interactive Generations in Latin America. Young people in front of screens. Educational and Social Challenges" study, spearheaded by Telefónica and developed by the Navarre University in conjunction with Educared. As at the date of this report, a total of 28,917 surveys had been conducted. In tandem, other initiatives are being drawn up.

## Climate Change

Telefónica also launched a series of internal initiatives to fight climate change



For more information:  
[www.telefonica.es/cro7/climatechange](http://www.telefonica.es/cro7/climatechange)

# Last year, the Company took its first global inventory of greenhouse gas emissions based on recognised standards, such as the GHG Protocol

In 2007, we emitted just over 1.6 million tonnes of CO<sub>2</sub> equivalent, which equates to 7kg of CO<sub>2</sub> per access.

## Telefónica's strategy against Climate Change

The telecommunications sector is classified as "Carbon Light" on account of its low greenhouse gas emissions. Factor in the industry's potential to cut emissions by circumventing travel, and it can be said of the industry that it is "part of the solution to the climate change issue".

In this field, Telefónica's strategy is to collaborate actively with the best known organisations such as the European Network Operator Association (ETNO) and the Global eSustainability Initiative (GeSI), in order to pool efforts. In July 2007, Telefónica, along with 152 other companies, joined the "Caring for Climate" initiative endorsed by the UN Global Pact, thereby committing to work actively to fight Climate Change.

To deliver on these promises, the Company launched an in-house strategic climate change plan, a horizontal initiative affecting the entire Group, the targets of which are:

- To compile and standardise carbon emission data in all of Telefónica's operating markets and companies.
- To identify risks associated with future emission limits and opportunities to cut them in order to improve Telefónica's environmental record.
- To elaborate an energy efficiency plan.
- To calculate the carbon emissions prevented by the products and services marketed by Telefónica.
- To raise awareness of the need to fight climate change among social and economic agents.
- To spread a climate change and energy savings awareness culture across Telefónica.

In 2007 Telefónica prepared an in-house work procedure to establish, using benchmark standards (GHG Protocol, IPCC and ISO 14064-1), the methodology for measuring its greenhouse gas emissions. Last year, Telefónica emitted just over 1.5 million equivalent tonnes of CO<sub>2</sub>, 7kg of CO<sub>2</sub> per access\*.

During the year the Company implemented measures designed to induce energy savings at both the office and operations buildings. These will be reinforced in 2008 under a plan laying out specific targets.

## ICTs, part of the solution

### Mobile Marketing

- Reduction in paper consumption.
- Elimination of mail marketing campaigns and the associated logistics costs.

### Fleet Localisation and Management

- Route and travel optimisation.
- Reduction in fuel costs.

### Boosting Productivity

- Reduction in paper consumption.
- Work mobility and tele-working.
- Optimisation of internal management.
- Improvements in commercial management.

### Remote and Domotic control Systems

- Reduction in travel requirements.
- Control of natural environment sensors and surveillance devices.
- Rational energy use.
- Renewable energy use instrument.

\* The number of accesses is used to obtain a relative value to the activity.

## Environment

In 2007 Telefónica set up a Corporate Environmental Unit, backed by Regional Committees to ensure implementation of the programme on the ground



For more information:  
[www.telefonica.es/cro7/environmentalmanagement](http://www.telefonica.es/cro7/environmentalmanagement)

# More than half of Telefónica's mobile operations have received ISO 14001 environmental certification

Over the next four years, the Telefónica Group will carry out an environmental action plan targeting five areas: Climate Change, Environmental Management, Waste Management, Responsible Network Rollout, and Telecommunications & Sustainable Development.

Looking ahead to 2008, Telefónica will develop a Global Environmental Management System.

## Consistent Practice in the whole Group

To make sure that environmental management policy is developed consistently across the whole of Telefónica Group, in 2007 the Company set up the Corporate Environmental Unit within the General Technical Secretariat for the Chairman's Office, at the petition of Telefónica S.A.'s Board of Directors. It also developed a functional organisational model with Environmental Committees comprising multi-disciplinary teams in the different countries where the Group operates.

The same year, it approved the Telefónica Environmental Action Plan and Targets 2008-2012, structured around 5 core themes:

- Climate change. Improving the energy efficiency of processes and developing telecommunications services as a way to reduce CO<sub>2</sub> emissions.
- Environmental management. Consistent Practice, integrated into all operations and throughout the supply chain.
- Waste management. Through international agreements with accredited organisations.
- Responsible network rollout. Ensuring compliance with environmental standards and taking account of local sensitivities when developing fixed and mobile installations.
- Telecommunications & sustainable development. Developing telecoms services that help with energy saving, atmospheric control, acoustics and the prevention of natural disasters

### Environmental management

In 2007, Telefónica made progress on designing internal regulations to ensure environmental management.

The Minimum Environmental Requirement Standard, approved in 2005, was updated, paving the way for the General Environmental Standard and specific rules for business lines, such as the Standard

for Verifying Legal Requirements to identify environmental legislation application to the Telefónica Group's activity.

In addition, management of operations in Latin America was strengthened during the year: Móviles Colombia was awarded ISO 14,001 certification and Móviles España, Móviles Perú, Móviles México and Móviles Ecuador all passed their follow-up audits.

### Control of environmental issues

The biggest environmental issues for Telefónica, in terms of their environmental and social impact, are energy use, waste from electrical and electronic equipment, hazardous waste (batteries), the noise produced by installations, electromagnetic emissions and the visual impact of infrastructure. The Company exercises preventative and corrective control over all these points, with the planning and maintenance of installations playing a crucial role.

### CONTROL OF ENVIRONMENTAL ISSUES IN TELEFÓNICA

	2007	2006
Operations electricity (MWh)	3,375,908	3,230,861
Offices electricity (MWh)	925,281	932,290
Water <sup>1</sup> (ML)	5,508,661	2,354,062 <sup>1</sup>
Facilities fuel (ML)	12,016	12,294
Vehicles fuel <sup>1</sup> (ML)	67,838	23,905 <sup>1</sup>
Paper consumption (t)	8,131,320	10,549,646
Electric and electronic systems waste (t)	3,251	5,477

<sup>1</sup> No data available in all 2006 operations.  
MWh = Megawatts/hour  
ML = Thousands of litres  
t = tonne

## Responsible Network Rollout

The Company carried out 15,167 measurements on levels of radio wave emissions



For more information:  
[www.telefonica.es/cro7/responsibledeployment](http://www.telefonica.es/cro7/responsibledeployment)

# In 2007, the Company invested over 5.2 million euros to minimise the visual impact of its infrastructure

Environmental and sustainability criteria are integrated into the planning, construction and maintenance processes for Telefónica's global network.

## Blending into the landscape

Over the last few years, Telefónica has developed practices to reduce the environmental impact of its infrastructure, so that its operations are as environmentally-friendly as possible wherever they are located. The first consisted in leveraging existing infrastructure to avoid new construction. In 2007, this enabled the Company to avoid building 4,688 new facilities.

When new infrastructure is created, mainly telecoms masts, the Company endeavours to blend it as unobtrusively as possible into the landscape. In the mid-1990s Telefónica developed a methodology to evaluate the visual impact of the masts using a parameter called "Visual Fragility" (VF). This determines the need to adapt infrastructure based on its visual impact. Over the course of 2007, 413 pieces of infrastructure considered to be of high impact were adapted, with 5,268,441 euros invested to correct or minimise this impact.

Another common practice is to share infrastructure with other operators. Telefónica currently uses 6,376 shared facilities. The Group also met its legal obligations by carrying out 862 environmental impact studies when installing new facilities in 2007.

Another environmental issue monitored by Telefónica is the noise generated by installations (mobile and fixed telephony networks). In 2007, it carried out 974 acoustic surveys, recorded 38 complaints and took remedial action in 54 cases at a cost of 94,795 euros.

## Radio frequency and emission levels

Mobile telephony is a wireless technology that relies on a broad network of fixed masts or base stations that transmit information using signals sent at radio frequency (RF), or radio waves, of between 900 MHz (GSM) and 2,000 MHz (UMTS).

Although this is only 2% of total radio wave emissions in the environment, it has raised popular concerns about the possible long-term health effects of masts and base stations. The World Health Organisation (WHO, [www.who.int](http://www.who.int)) has stated that given the very low levels of exposure and based on the results of research trials conducted so far there is no persuasive scientific evidence that the weak RF signals emitted by base stations have any adverse effects on health. They have also set international standards, in cooperation with the International Commission on Non-Ionising Radiation Protection (ICNIRP), for exposure to electromagnetic fields and the power of emissions from base station and mobile handset aerials.

Telefónica controls and monitors levels of radio wave emissions from its infrastructure - in 2007 it made 15,167 measurements - to guarantee the safety of its installations.

## Dialogue and transparency

Based on the fundamental principle of transparency, Telefónica is in constant dialogue with stakeholders, making available solid and proven information to the scientific community and providing documentation from official bodies responsible for Health and Telecommunications.

The company also responds to requests for information through a number of channels, including, among others, web pages and participation in open days in cooperation with consumer associations and users' groups as well as with other bodies.

## Social and Cultural Action

Over 19,000 employees took part in the Company volunteering programme in 2007. Meanwhile, the ATAM association helped nearly 4,000 people living with disabilities



For more information:  
[www.fundacion.telefonica.com](http://www.fundacion.telefonica.com)  
[www.atam.es](http://www.atam.es)

# Telefónica devoted close to 90 million euros to social and cultural projects in 2007

To better measure and evaluate its social actions, Telefónica adopted the international LBG accounting method last year. This means concepts that had previously been ignored, such as the time contributed by employees, can now be valued.

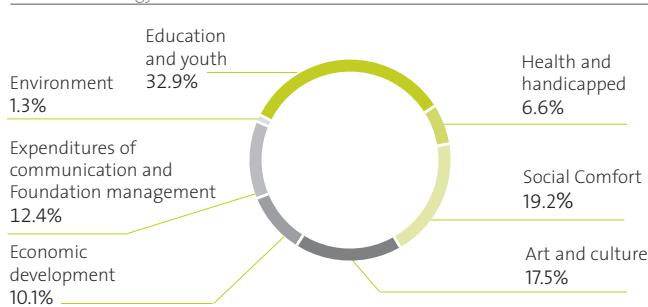
Overall investment in social projects totalled 88.8 million euros. Telefónica Foundation remains the strategic driving force for Group social actions: it channelled 51.1 million euros into more than 700 projects, benefiting 39.8 million people (95% of them from the use of ICT).

### TOTAL NUMBER OF PARTICIPANTS/BENEFICIARIES DIRECTLY AFFECTED BY TELEFÓNICA FOUNDATION ACTIVITY IN 2007

Area	Number of people
Educared	35,900,656
Proniño	66,963*
Telefónica Volunteers	246,427
Forum	532,842
Art and Technology	2,112,299
Other programmes	953,309
<b>Total</b>	<b>39,812,496</b>

### CULTURAL AND SOCIAL ACTION BY ACTIVITY

LBG methodology



### CULTURAL AND SOCIAL ACTION BY REGIONS

LBG methodology



### Telefónica Foundation: more than 700 social projects

Telefónica Foundation was set up in 1998 to coordinate Telefónica's social and cultural actions. Its strategic aims, which were revised in 2005, are themed around the use of ICT in education.

Telefónica Foundation operates directly in 8 countries: Argentina, Brazil, Chile, Colombia, Mexico, Peru, Spain and Venezuela. But its work through schemes such as Proniño or Telefónica Volunteers raises the tally to 14, including Ecuador, El Salvador, Guatemala, Nicaragua, Panama and Uruguay. In 2007, work continued on its various programmes, most notably:

- **Proniño**, which aims to help eradicate child labour by getting children into education. In 2007, it provided schooling for over 52,000 children in Latin America.
- **EducaRed**, which seeks to improve the quality of education through new technologies, combining online resources for teachers and students with on-site events that promote and encourage education. Its website received more than 60 million visits in 2007.
- **Telefónica Volunteers**, a programme that seeks to develop employees' participation in social action projects, with more than 164,408 hours in 2007.
- **Forum**, which is concerned with knowledge creation in the framework of the information society and its social impacts.
- **Art and Technology**, a programme to spread contemporary art and culture, linking together cutting edge creation and technological innovation. It also looks after Telefónica's artistic, historical and technological heritage.

In pursuit of its aims, Telefónica Foundation works alongside educational, social and cultural institutions, both public and private: last year it collaborated with 416 organisations.

\* 66,963 includes 52,991 children, 6,507 teachers, and 7,465 social agents.

## TELEFÓNICA'S CULTURAL AND SOCIAL ACTION

LBG methodology since 2007. Data in thousands of euros

	2007	2006	2005
Telefónica Fundación	51,054	33,015	28,999
ATAM <sup>1</sup>	4,500	4,500	4,500
Social and cultural sponsorships <sup>2</sup>	28,988	1,608	2,571
O2 social activities	4,228	2,493	0
<b>Total</b>	<b>88,770</b>	<b>41,616</b>	<b>36,070</b>

<sup>1</sup> On 2007, LBG methodology does not allow counting the contributions of the 60,000 employees collaborating with ATAM nor the expenditure aimed in benefit handicapped people related to employees. Amounts of previous years have been adjusted.

<sup>2</sup> According to LBG methodology criteria, sponsorships with a positive impact on society, art and culture are considered as social and cultural sponsorships. In 2006 and 2005, amounts have not been readjusted.



The LBG model helps companies manage, measure and report on their community contribution and commitment. It moves beyond straightforward contributions to include a full range community contributions (time spent by employees and contributions in kind or money) and measures the real benefits for the community and the company. The model was developed by a group of companies in 1995 as an internal evaluation tool and a means of ensuring greater consistency and comparability of reported information. Today, over 150 companies around the world use this model.

## Telefónica Volunteers

Nearly 19,000 Telefónica Group volunteers took part in community projects last year, in Spain and in 13 countries of Latin America, as part of the company volunteering programme run by Telefónica Foundation. The programme covered more than 443 initiatives, and employees gave more than 164,408 hours of their time. The projects sought to help nearly 246,427 people, including children, the economically disadvantaged, the elderly and victims of natural disasters.

Among the highlights of 2007 was the support given to Proniño: the Euro Solidario campaign collected funds and employees took part in Solidarity Holidays helping out in Proniño schools (the aim in 2008 is to include volunteers from Latin America and O2 in these holidays). This was also the first year that Telefónica's International Volunteering Day had been dedicated to Proniño.

Spain saw the arrival of the cyber-volunteer: people who volunteer to receive training in ICT so that they can subsequently act as trainers. There were also initiatives to support people with disabilities, including sporting activities in conjunction with the "También Foundation" and the Special Olympics, as well as schemes to help young people at risk of dropping out of school, through the "Junior Achievement" educational programmes.

### Europe

Nearly 900 workers for Telefónica O2 Europe volunteered in the different countries where the company operates. In the Czech Republic, the O2 foundation focuses on projects to improve the lives of children and young people with mental disabilities as well as on social and environmental initiatives.

Last year, Telefónica O2 Europe also sponsored its fourth "Global Community Awards" designed to encourage and recognise community involvement by employees from across the Group. It presented the "Volunteer of the Year" and "Fundraiser of the Year" awards to those who had made an exceptional contribution to collecting funds for different causes.

## ATAM

ATAM is the Telefónica support association for people with disabilities. Sponsored by Telefónica Group and its employees it aims to improve the quality of life for those living with disabilities.

At the end of 2007, the association had over 60,000 members and had received 13.9 million euros in contributions. Each member contributes 0.2% of their monthly salary individually and the company donates another 0.4% for all employees. The organisation helped 3,986 people in different ways over the year. In Spain, it has a network of offices where people can receive help face to face, including direct monetary assistance. It also runs a work integration department (offering general guidance, advice on where to get training and work, plus follow-up support). It has a multidisciplinary team of qualified clinicians, experienced in disability issues, and it runs a number of direct assistance centres.

### Milestones in 2007

Extending the support network for members, ATAM opened new offices in Seville and Granada (covering the whole of Andalusia), Oviedo (Asturias), Zaragoza (Aragon) and Palma de Mallorca (the Balearic Islands). It also created a system of quality control using a range of techniques (surveys, suggestion boxes, inspections, etc.).

Development of a new service methodology that incorporates clinical diagnosis.

Agreements with Telefónica Foundation for ATAM to take over technical management of the Mercadis job portal, draw up a training plan for Telefónica Volunteers and help improve the technical aids offered by Retadis, the Spanish network of accessible computers.

ATAM also worked with Telefónica Group to develop a Handbook of Concepts and Methodological Guidelines for Action to integrate employees with disabilities into the company.



## Proniño achieved its 2007 target of providing schooling for more than 50,000 boys and girls in 13 Latin American countries

Through the programme the Telefónica Foundation is helping to eradicate child labour. Its guiding principles are child protection, quality of education and strengthening social and institutional commitment to the problem.

Proniño is a social action programme run by the Telefónica Foundation that seeks to help eradicate child labour in Latin America by providing high quality schooling for children. At December 31, 2007, Proniño was directly supporting 52,991 children and teenagers in Argentina, Brazil, Chile, Colombia, El Salvador, Ecuador, Guatemala, Mexico, Nicaragua, Panama, Peru, Venezuela and Uruguay. It more than met its target of educating 50,000 children in 2007 and expects to help 100,000 in 2008.

The development of Proniño in 2007 would have been impossible without the cooperation of NGOs - 93 were involved by the end of the year - who worked directly with the project, and of the schools and public and private institutions working together with the communities where the children live. In a different way, the Telefónica Volunteers also continued to play a key role, giving their time and talents to support a multitude of activities.

### Strategic principles

Over the past year, Proniño based its activities around three strategic principles announced in April 2007 in Bogotá and which will continue to guide the project in 2008:

#### Total protection for minors involved in child labour

Support is offered to children but also to their family and the surrounding community, so that they can stay at school, gradually eradicating the circumstances that drive them into the world of work.

#### Quality of education

As well as improving the infrastructure at the centres it supports, Proniño uses information and communication technologies (ICT) to familiarise even the smallest children and infuse their environment with digital technology, seeing this as the only way to provide real opportunities for development and dignified access to the world of work.

The aim of providing high-quality education creates ample opportunities for synergies with EducaRed in 2008:

- Experience from EducaRed can be applied to the schools sponsored by Proniño, with free accesses, the creation of Telefónica Foundation classrooms and the development of the EducaRed channel as an aid to Proniño teachers.
- Dissemination of these applications into new social environments to improve education among socially at-risk communities.

#### Strengthening social and institutional commitment

The Foundation makes use of Telefónica's institutional clout to guarantee the long-term sustainability of actions undertaken:

- To generate and disseminate of knowledge about child labour and its impact on the children involved, their families and the community.
- To raise of social and institutional awareness to achieve commitment to change.
- To support those in the front line of the fight against child labour.
- To create intervention and preventative networks that can respond effectively to the problem.

The biggest milestone for Proniño in this area was the first World Day against Child Labour, which was the focus for activities in all countries.

*A problem for us all ...  
 Despite the progress made in recent years,  
 child labour is still one of the most  
 worrisome problems of our society.  
 According to the International Labour  
 Organisation (ILO), there are currently  
 211 million boys and girls aged 5 to 17  
 working in the world, and some 5.1 million  
 children working in Latin America and the  
 Caribbean. The success in reducing child labour in  
 recent years is due to the work of governments  
 and of the many social agents involved,  
 recognised by the ILO, including Proniño.*



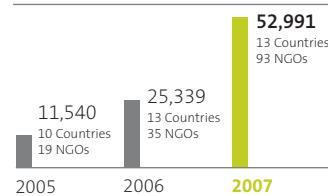
## How does Proniño work?

The children who receive support must meet general criteria that apply to all countries where the programme is active, although these are then refined by those on the ground to take account of local circumstances. The general criteria are: 1) Boys and girls aged 4 to 18. 2) Minors who are being exploited for work, whether paid or unpaid, inside or outside the home, who are carrying out work that should be done by an adult or which is dangerous, harmful or degrading, which inhibits their normal development and prevents them from learning. 3) Who are at risk of dropping out of school in order to work. 4) Whose education has fallen behind or who are underperforming at school for work-related reasons: fatigue, etc. 5) Children with siblings that have dropped out of the education system. 6) Willingness on the part of children to take part in the training and teaching on offer. 7) Children who have parents or teachers, and 8) Whose family undertakes to cooperate.

Children can be selected for the programme in three ways: 1) The educational authorities present a list of schools that meet the criteria for the programme. 2) NGOs, through their field workers, identify cases of children who are working or are at risk and those that could go to school but are too poor. 3) Institutions, working through child protection organisations in the schools, minors' courts etc. tell the Proniño coordinator or an NGO about a child working or ask that they be admitted to the Program.

Proniño provides appropriate grants, incentives and other forms of support which are followed up by home visits to supervise commitments made, by the NGO sponsors and by Proniño workers. Specifically, they sit down with the parents and children to discuss issues such as performance, attendance, awareness of child labour as a problem, any problems they may have in keeping to commitments, etc.

### FAVoured CHILDREN



### CHILDREN SUPPORTED IN 2007

Country	Number of Children	Educational centres
Argentina	2,968	120 Educational centres
Brazil	8,291	234 Educational centres
Chile	1,364	12 Educational centres
Colombia	6,035	111 Educational centres
Ecuador	5,514	581 Educational centres
El Salvador	2,379	26 Educational centres
Guatemala	3,242	76 Educational centres
Mexico	5,297	39 Educational centres
Nicaragua	2,200	50 Educational centres
Panama	1,000	19 Educational centres
Peru	6,324	82 Educational centres
Uruguay	2,500	33 Educational centres
Venezuela	5,877	46 Educational centres
<b>Totals</b>	<b>Direct beneficiaries (52,991 children and teenagers)</b>	
	<b>1,429 educational centres (1,119 schools and 310 childcare centres)</b>	



For more information:  
[www.educared.net](http://www.educared.net)

## EducaRed up and running in seven countries

EducaRed, the Telefónica Foundation's programme to encourage the educational use of information and communications technologies (ICT) as a didactic tool, developed 395,330 hours of onsite, online and mixed format training in 2007 targeted at teachers, pupils, parents and other individuals. Its Spanish, Argentine, Brazilian, Colombian, Chilean, Mexican and Peruvian portals were visited over 60 million times.

Set up in Spain in 1998 together with the main associations in the educational community, EducaRed's objectives are two-fold: to contribute to improving education standards and to use emerging technologies to foster equal opportunities. At the core of the programme lies the EducaRed.net portal, filled with tools, online training and virtual work communities. This programme has been shored up more recently with the addition of onsite training.

EducaRed was established in Mexico and Colombia in 2007. The initiative is now up and running in seven countries. Last year, 35.9 million people benefited from the programme, 10.8 million more than in 2006. Its value added lies with the ability to provide the most innovative tools and resources to teachers, pupils, parents and schools. Last year the movement was focused on the following initiatives and targets:

### 2007 milestones

**To boost innovation on EducaRed.net.** using two tools launched in 2008: EducaLab 2.0 (a tool to create a shared knowledge base) and Navegador 2.0 (a management and communications tool). During 2007 the various country portals had almost 60 million visitors (2006: over 40 million).

**To increase onsite activities** with the rollout of programmes in Spain and Latin America. Here it is worth highlighting EducaRed Innova, designed to provide teachers based in Spain with more in-depth training on the use of new technologies applicable in their fields of specialisation, including subsequent tutoring.

**To consolidate EducaRed as an international platform.** In addition to launching two new EducaRed portals in Colombia and Mexico, the IV International EducaRed Congress included a guest country participant for the first time and the first international Educared competition was held among teachers and students in Argentina, Brazil, Colombia, Chile and Spain to acknowledge the best projects for integrating ICT in the education field. On a parallel basis, collaboration between all the EducaRed operations was stepped up through strategy and project swapping.

**To step up collaboration with educational organisms.** This can be achieved through agreements such as those reached in 2007 with the OEI (Organisation of Latin American states) and Universia. It is also worth highlighting the fact that Educared joined the RELPE (network of Latin American portals), which includes the portals for the ministries for education of almost all countries in the region and the agreement with the International Labour Organisation. This year an agreement was signed with Microsoft to extend the Innovative Teachers portal to all of Latin America, building it into EducaRed. This initiative is already up and running in Spain and Mexico to assist teachers leveraging emerging technologies in their teaching.

**To cement the Model Schools project.** EducaRed works with certain schools - the fourth was added in Spain in 2008 - to boost technological and methodological innovation. Best practice across this network of schools will be gleaned in 2008 for cross fertilisation at other schools.

Looking ahead to 2008, the next challenge is "Global Portal: EducaRed 2.0". The plan is to build in the latest internet technology and to unify all the country's portals into a single site with global and local content and features.

### Just one click away...



The EducaRed.net portal includes features for teachers (related news, job exchange, educational software, work tools, experience sharing, etc.), pupils (extracurricular ideas, the EducaRed encyclopaedia, homework, etc.) and parents (information on how to get into university, internet training and tools, etc.).

## Social and Cultural Action

### Other projects

O2 earmarked 4.2 million euros to welfare projects in 2007



For more information:  
[www.fundacion.telefonica.com](http://www.fundacion.telefonica.com)  
[www.arsvirtual.com](http://www.arsvirtual.com)  
[www.itsyourcommunity.co.uk](http://www.itsyourcommunity.co.uk)

## Over 2 million people enjoyed the Telefónica Foundation's art and technology activities

In Europe, the Telefónica Group supports more than 500 community and environmental development and preservation projects through the It's Your Community programme.

### Art and Technology

The Art and Technology initiative made further progress on its four lines of action in 2007: collections, exhibitions, the Vida awards and arsVirtual. The highlights of 2007 were:

- The Luis Ramón Marín exhibition. This project entailed three years of preparation to bring back a unique archive of photographs. The exhibit received a record number of daily visits - 773. The Nam June Paik retrospective was the first in Europe following the death of the Korean artist and father of video art.
- The international edition of the artificial life Vida awards, created to acknowledge artistic originality in robotics, bio-IT and cinematics, etc., was relaunched. The Foundation took the awards' tenth anniversary as an opportunity to revitalise the Vida prizes and unveil the vision for the future. 172 artists participated in Vida 10.0 from 32 countries.

### Heritage

The Telefónica Group's artistic heritage is considered one of the finest in Europe:

- Contemporary Spanish art collection
- Cubist art collection
- Contemporary photography collection
- Telefónica's historic-photographic archive
- The Telos collection

The telecommunications museum, inaugurated in 1992, was closed at the end of 2007 for renovation.

### arsVIRTUAL

The arsVIRTUAL programme ([www.arsvirtual.com](http://www.arsvirtual.com)) is a Telefónica Foundation project designed to enable interactive, 3D tours of 50 outstanding monuments of Spanish, Latin American and Moroccan artistic, cultural and historic heritage. Content includes the Burgos Cathedral in Spain and the San Ignacio Mini ruins in Argentina, among others.

### *It's Your Community*

*It's Your Community* is Telefónica O2's programme supporting community projects in the UK. Through it, the company lends financial support to individual or group initiatives to foster positive change in their local communities. After one year of pilot testing, the initiative was officially launched in July 2007 with an initial budget of £1 million.

*It's Your Community* encourages citizen initiative with the slogan: If you could change one thing about where you live, what would it be? The programme has already donated £362,947 to over 500 projects (community awards range from £100 to £1,000).

Projects backed include turning derelict sites into community gardens, repair of bicycles donated by neighbours and support of a youth fishing club.

### Other initiatives by Telefónica O2 Europe

- The Just Ask Me mentoring programme set up in the UK together with charity organisation Weston Spirit to help youths.
- Support for the Prison, Me - No Way! programme targeted at high-risk youths: O2 employees visited 34 schools across the UK in 2007. ([www.pmnw.co.uk](http://www.pmnw.co.uk)).
- In Germany the company collaborated with Schola-21, an internet based platform for raising educational standards.
- Collaboration with Irish Autism Action (IAA) which works to improve the lives of people afflicted with autism: the first dedicated diagnostic and assessment centre was inaugurated in Ireland last year.



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## A Dynamic Sector

Sector opportunities will be generated by the ability to be relevant to our customers, meeting and satisfying their needs



For more information:  
[www.telefonica.es/informationsociety](http://www.telefonica.es/informationsociety)

# Customers, new technologies and the competitive environment are shaking up the telecommunications sector

Every year dedicated telecommunications analysts say that the business is at an historic and fundamental crossroads. 2007 undoubtedly highlighted the accuracy of the crossroads metaphor, marked by expanding customer bases, revolution in handsets and devices, penetration of Broadband and global deal-making.

Customer trends, technological developments and the competitive environment are the vantage points from which to analyse the sector. Increasingly these three factors need to be assessed in relation to each other.

## Customers

The number of global telecommunications customers is set to continue to grow. Customers will increasingly adopt emerging technologies and related applications.

### More customers

Each year the telecommunications sector adds millions of new customers. In 2H07 alone, the world's ten largest operators added 200 million accesses, bringing the total to 2.1 billion. This reflects two trends:

- First, the incorporation of consumers in new countries. According to sector projections, Latin America is the region set to add most connection per year between 2006 and 2010.
- At the same time, new telecommunications consumer segments are emerging, e.g., the elderly, immigrant populations and single parent homes.

### More accesses

Emerging customer demands and requirements are shaping new industry opportunities. Below we list a few examples:

- Customer demands for personalised services will give rise to an explosion in numbers of channels and products.
- Customers will be segmented and even polarised by their usage of basic products versus adoption of the most avant-garde services. This in turn will result in brand and service positioning along the spectrum from premium to low cost.
- User involvement in the creation, distribution and promotion of content and services implies permanent connectivity, the generation of social networks and increased traffic.

### More individual

Service provision in today's global market requires segmenting and tailoring services almost on an individual basis.

- Customer demands shift rapidly, requiring firms to structure nimble organisations designed to focus on the customer.
- From the sales and marketing standpoint, it no longer makes sense to plan classic mammoth advertising campaigns or to set price schedules in stone. Campaigns need to be tailored to specific segments that are additionally targeted through sliding price scales and bundled packages.

### More demanding

Customer knowledge of products, services, quality standards and prices is expanding vastly, with the onus on the operator to measure up. This pattern is repeated across residential customers, small companies and large corporations:

- All these customers generally know what they want.
- They are free to choose which company will supply them. Switching operator is easier than ever.
- They are increasingly demanding value for their money, especially at the top end of the market.
- They are up to speed on the latest trends in technology.

## TOTAL EXPECTED GROWTH OF MARKET PENETRATION 06-10E

	Fixed Broadband	Mobiles
(VI Investor conference – London 2007)		
Western Europe	+22p.p.	+20p.p.
Latin America	+13p.p.	+27p.p.

## OPORTUNITIES AND CHALLENGES IN 2008

<b>Macroeconomic environment</b>	<ul style="list-style-type: none"> <li>■ Positive macroeconomic environment in Latin America .</li> <li>■ Some uncertainty in Europe.</li> </ul>
<b>Customers</b>	<ul style="list-style-type: none"> <li>■ Significant mobile and Broadband penetration growth.</li> <li>■ Greater use of telecommunications being, each day, more necessary for society.</li> </ul>
<b>Technology</b>	<ul style="list-style-type: none"> <li>■ Increase of Broadband (FTTH, HSPA, LTE...).</li> <li>■ More convergent and powerful systems.</li> </ul>
<b>Competition</b>	<ul style="list-style-type: none"> <li>■ More consolidate regional competitors, integrating local competitors.</li> <li>■ Collaboration with adjacent sectors.</li> </ul>

## Technology

Ever increasing bandwidth and the emergence of convergent and more powerful devices are handing the sector opportunities for new waves of growth. These waves in turn require still greater innovation.

### More technology

There are four trends in the technology environment:

- The evolution of service networks towards All-IP technology. During the last five years the traffic carried on Telefónica's networks has multiplied by a factor of 25; over 90% of this traffic was IP.
- Higher bandwidth: while the number of Broadband accesses multiplied by 13 between 2001 and 2006, service bandwidth increased 60-fold.
- Fixed-mobile convergence: a growing number of applications and services can be accessed using any technology/device enabled for multi-technology connectivity.
- Convergence with IT: there are almost 200 million PCs in our operating markets; telecommunications users are adding multimedia messaging, online communities, games and blogs to the applications used on a daily basis.

### More accessible for the customer

Customers are adopting and witnessing these technological trends via specific products and services such as IP digital television, wireless devices to enable laptop Broadband connectivity, video console connectivity and increasing bandwidth.

The most visible feature of technological progress in the eyes of customers is the emergence of new user handsets and devices. These devices, created and marketed under very ambitious marketing strategies, are increasingly raising the bar for customer expectations. It is important to highlight that although from a technological standpoint it is possible to isolate this equipment from the network enabling its use, the end customer does not understand this division, preferring a one-stop solution. New devices open up customer horizons to new services that require increasing cooperation between the manufacturer and the operator to meet the expectations raised.

In sum, technological change will offer increasing opportunities to those companies capable of innovation in:

- New products and services.
- New service development models.
- New sales and operating models.

## Net Network Technologies 2007/2008

- HSPA (high-speed packet access) technology extends and complements 3G mobile technology. It is also known as 3.5G. It enables maximum download speeds of 14.4 Mbps and maximum uplink speeds of 2Mbps, depending on the network and implementation.
- Fiber to the Home or FTTH telecommunications technology uses fibre optics to delivery advanced Broadband services.
- Third Generation Partnership Project Long Term Evolution (3GPP LTE) is the name given to the project for the development of mobile communications standards of the future.
- WiMAX (Worldwide Interoperability for Microwave Access) is a wireless transmission standard for the provision of data over long distances (at a radius of up to 48 km) and at speeds of up to 70 Mbps.

## Competition

The ongoing transformation of the telecommunications sector has triggered a shift in the competitive environment. While the classic market configuration focused around traditional access and voice traffic enabled a select number of operators to coexist, the content and service development opportunities created by Broadband are lowering barriers to entry and giving rise to new players.

### Increasing competition in the traditional market

Analysis of the competitive environment for access and Broadband services leads us to conclude that the telecommunications operators are moving in global environments shaped by global customers and technologies, while remaining strongly dependent on local markets.

As a telecommunications operator, Telefónica is subject to industry specific regulation, competition rules and a range of other regulations. Fixed telephony tends to be the most closely regulated activity. The scope of telecommunications regulations varies by business in any given country and can have a direct and indirect impact on business development, especially in countries inclined towards greater intervention.

Competition in traditional telephony services is proving intense and market shares are waning; this business continues to constitute a core revenue component.

### Related sectors: emerging competition

In 2004 various analysts concluded that companies such as Microsoft, Google, Yahoo, Apple, etc. will represent a series of competitive threats to the telecommunications operators.

These companies have been very adept at leveraging the networks made available to all by the operators to become truly global service and content suppliers.

Operators need to do their homework on retaining control over products and services delivered over their networks in 2008. Recouping investment on the expensive networks rolled out requires that these services and products be spearheaded by the operators themselves, although it is vital to strike a broad range of alliances and agreements in order to be in a position to provide customers with a wide range of products.

The high degree of specialisation of many of the companies offering services over the operators' networks makes direct competition with them a non-starter as the evolution of their own businesses can result in profound changes and even render them irrelevant over short periods of time. However, it will be necessary to implement a policy of agreements and alliances with these companies to enable the operators to regain control of their bandwidth and the products and services carried.

Last year, information and communications technology convergence triggered collaboration between operators and service providers. We have gone from an environment marked by competition and confrontation to a new paradigm shaped by focal points of collaboration in specific services side by side with healthy competition in others.

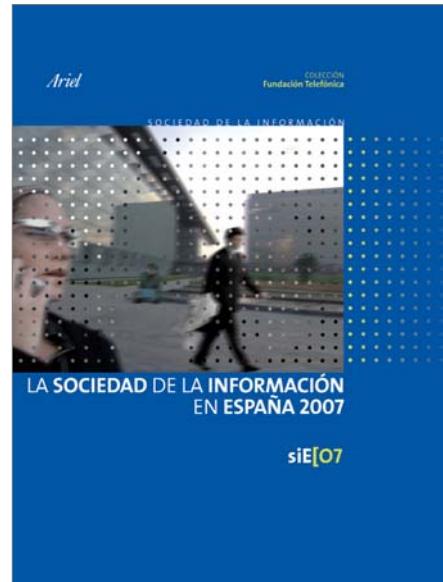
## TELEFÓNICA GROUP MARKET SHARE

By regions	By services		
Spain	53%	Mobile	29%
Europe	18%	Fixed	73%
Latin America	36%	Broadband	20%
		TV	14%

*Forum is a Telefónica Foundation programme that fosters and coordinates research, analysis and debate with top level agents to drive the information society.*

*Forum has also made significant contributions in the publishing arena: the Telefónica Foundation Collection, together with publishing house Ariel, has edited a number of publications on topical issues as well as editing the Telos magazine, a benchmark in communications studies. This journal has been renovated for 2008 and new topics have been added. On the Foundation's website there is also a Forum page which contains the content from all the seminars and congresses it organises as well as the Information Society news bulletin.*

[www.fundacion.telefonica.com/forum](http://www.fundacion.telefonica.com/forum)



## The Information Society: a task for all

Emerging technologies are playing a vital role in society's development and are proving a key growth driver across all productive sectors, which is in turn making their development a priority in national political agendas.

The company has supported the information society from the outset through multiple development and promotional initiatives, leading to the over 200 new products and services in existence today designed to satisfy demands related to the internet, Broadband, voice and wireless services. In addition, Telefónica collaborates actively with organisms that promote the development of the information society through the publication of studies and analysis and by encouraging debate on the status of emerging technologies.

### Spain

The institutional efforts to develop the information society in Spain fall under the umbrella of the Avanza programme (which means progress plan) launched in 2005 within the framework of the INGENIO 2010 programme. The overriding goal of the programme is to encourage the proper use of ICT in order to contribute to a successful model of economic growth based on enhanced competitiveness and higher productivity, the promotion of social and regional equality and improved wellbeing and living standards for Spanish citizens.

### Conclusions regarding the information society in Spain in 2007

1. The number of internet users is growing as is service usage
2. Broadband is gradually improving and reaching rural areas
3. There is a wave of M&A activity underway among large media and internet companies
4. The web is going wireless with «mobile 2.0».
5. Manufacturers are concentrated on the search for new handset categories
6. The TV revolution is ongoing and the music sector is undergoing transformation.

### Latin America

ICTs are playing a key role in the growth being witnessed in Latin America, driven by growth in mobile telephony and Broadband. Looking beyond overall penetration rates for the various technologies, there are submarkets within the region of significant size (typically cities) with technology implantation indicators on a par with those of developed economies.

According to the DigiWorld study for Latin America (Enter), the positive developments and trends in ICT in Latin America are picking up pace. Digital services are clearly on the rise, in both the corporate and residential segments, although the market's development and dynamism would be clearly aided by increased government intervention.

### Europe

The European ICT market represents around 30% of the global market. Following the 2001/2002 recession, the market is currently being reactivated: Community ICT policy includes pan-European initiatives, fundamentally devised by the European Union (e.g., in June 2005, the European Commission launched i2010, designed to promote digital convergence) plus a series of country and region specific measures.

### Challenges facing the information society in Latin America (Digiworld Latam; Enter)

1. Regional market integration
2. Development of an adequate regulatory environment
3. Closing the digital divide to unlock development through public-private sector cooperation
4. Commitment by the leading players in the region
5. Development of public policy to underpin progress of ICT

## Position of Telefónica

Evident in league tables, acknowledged by analysts and noted for its performance in recent years



For more information:  
[www.telefonica.es/shareholdersandinvestors](http://www.telefonica.es/shareholdersandinvestors)

## Telefónica is best positioned to spearhead sector progress

The number of customers placing their trust in the Company, together with its excellent financial position and management capacity place Telefónica as the best prepared company to face the future.

### On scale and diversity

Telefónica's ability to execute and its vision have ranked it among the industry leaders by market capitalisation and by number of accesses worldwide.

During the last ten years (1997-2007), Telefónica's growth has been spectacular, as highlighted by the following indicators:

- In 1997 it operated in 4 countries; by 2007 in 24.
- Foreign markets account for over two-thirds of revenues.
- accesses have grown by a multiple of 6: from 36 to 228 million.
- The workforce has expanded by a factor of 2.5 from 92,000 to 248,000.
- Revenues have risen four-fold and assets three-fold.

With over 228 accesses managed, Telefónica is the fourth largest global telecoms operator by customers, and is similarly ranked by market value

### On earnings momentum

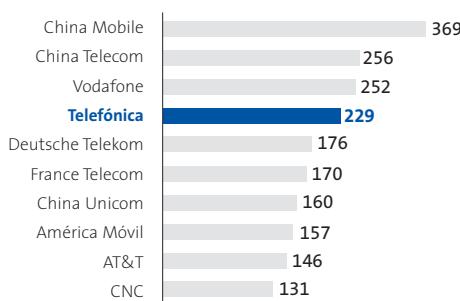
2007 marked another consecutive year of spectacular top and bottom line earnings growth. Revenues rose 7% on 2006, while net profit soared 42%.

### On credibility: delivering on its promises

In recent years Telefónica has made a habit of sharing its earnings forecasts with the analyst and investor communities. Despite the level of uncertainty inherent in such a dynamic sector, and in contrast to its peers, Telefónica has consistently beaten the earnings guidance provided. Its credibility is underpinned by ongoing and systematic delivery of the promises made to the markets.

#### TOTAL ACCESSES

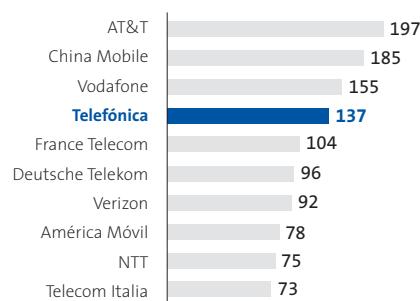
(Data in million euros – 31/12/07)



Source: Reports of the companies

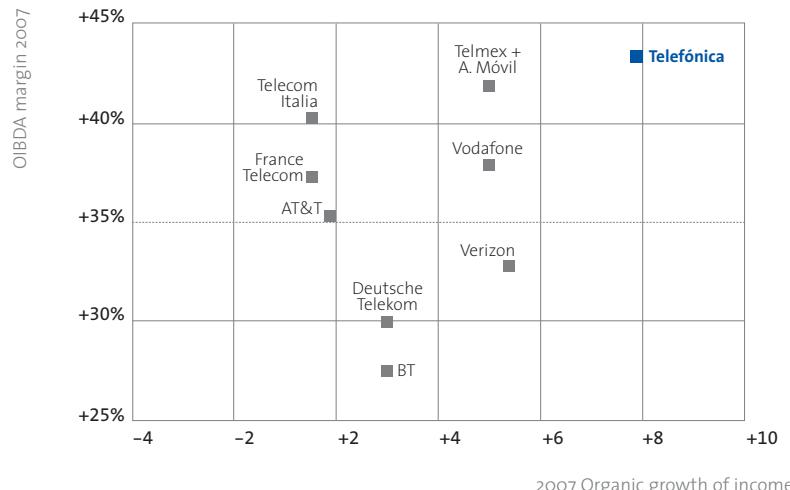
#### COMPANY VALUE

(Data in million euros – 11/02/08)



Source: Bloomberg

## OUR LEADERSHIP IS A SYNONYM OF GROWTH AND EFFICIENCY



Source: Merrill Lynch

### Because its leadership is growth based

Telefónica is the fastest growing and most profitable of its peers. Telefónica's relatively faster organic growth has not eroded profitability thanks to the exploitation of economies of scale and ongoing initiatives to boost efficiency

### By growth opportunities

#### Business opportunities in all its markets

Telefónica's management teams in place in the three main regions have demonstrated their ability to execute growth strategies in recent years. And they will continue to tap current growth opportunities.

#### In Spain, Telefónica will seek to emulate its excellent performance on a long-term and sustained basis. More specifically:

- This is Telefónica's flagship business unit; it is a unit with a clear leadership vocation.
- There is significant demand for telecommunications services in Spain.
- The Company is making important strides in terms of customer orientation.

#### Telefónica O2 Europe has the opportunity to reinforce its competitive positioning:

- Growth rates are higher than the sector average.
- Scope for leveraging the opportunities derived from being an integrated operator.
- Room to exploit the scale and dimension of the entire group to raise profitability.

#### Telefónica Latinoamérica is driving growth at the Group, thanks to:

- Growing demand for telecommunications services combined with better than ever macroeconomic forecasts for the region.
- The company is well positioned to capture this growth and pick up market share.
- Operating indicators are improving across all business lines.

#### Strategic and industrial alliances

Telefónica is tapping new growth opportunities through strategic and industrial alliances, specifically with China Netcom and Telecom Italia.

#### China Netcom

- Telefónica holds a strategic 7.22% stake in China Netcom. Of this, the investment for a 2.22% interest has yet to be completed.
- China Netcom has over 130 million accesses in a rapidly growing economy with a population of over 1.3 billion.
- The strategic alliance between China Netcom and Telefónica is giving rise to the joint development of new services, entry into new businesses with global customer bases and joint technology purchases.

#### Telecom Italia

- Telefónica has invested in Telecom Italia as a core shareholder.
- This industrial alliance entails a foothold in 9 European countries and combined market share in the 25 EU member states of 22%.

## Leading Progress

Telefónica's goal is to be a more motivating, more personal, more open and more nimble company.



For more information:  
[www.telefonica.es/shareholdersandinvestors](http://www.telefonica.es/shareholdersandinvestors)

## Telefónica's motto: "Leading Progress"

The Chairman of Telefónica has issued a clear message: "Telefónica is better than ever; we have become a sector leader thanks to our vision and our ability to execute. That is why the challenge we face today is not just to be leader, but to make that leadership sustainable in time".

This strategy requires a strong team that conveys enthusiasm and motivation to customers, getting them involved in the innovation process and capable of providing more products and services in a world where Broadband will increasingly take centre stage.

### Leadership strategy

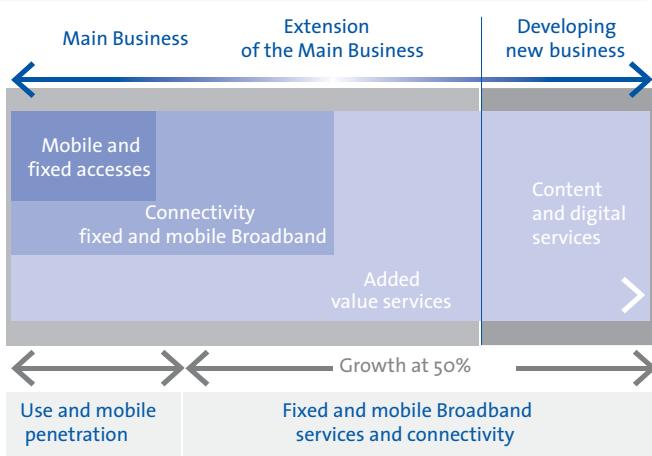
Telecommunications leaders will be able to take advantage of huge opportunities in the coming years, deriving from the increasing tailoring of product and services on offer to an ever growing customer base that is increasingly involved in the generation, distribution and promotion of content.

The customer is the driving force underpinning these opportunities; the key to success lies with remaining increasingly relevant to our customers, raising and satisfying their expectations, with the spotlight on access and voice traffic, defending the traditional business while capturing growth and increasing penetration of wireless telephony, firmly boosting wireless Broadband while continuing to develop the fixed Broadband business and fostering digital services and content to underpin strong positioning in ICT solutions for corporates, PC services, TV services and mobile content activities.

The Company's growth depends on:

- Connectivity (voice and Broadband), the main source of growth.
- New businesses, essentially digital content and services.

### LEADERSHIP STRATEGY



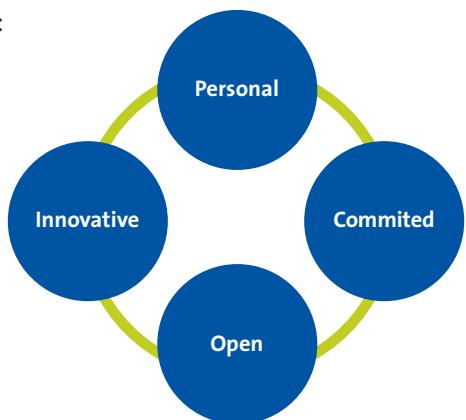
### A new type of leadership

All this implies a new type of leadership. A more ambitious vision of the Company we want to become. The Telefónica of 2011 needs to be:

- More personal (knowing our customers better and targeting them with a multi-segmented approach).
- More motivating (committed team; commitment to society).
- More open (implicate our customers in innovation and collaborate with third parties along the value chain).
- More nimble (manage our businesses efficiently and nimbly, making the most of our global scale).

### A NEW KIND OF LEADERSHIP

One Telefónica:



*"We want to enhance people's lives, 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"*

*Spirit of Progress*

## Strategic priorities

Telefónica is heading into 2008 with clear priorities, in line with its medium term business strategy:

**In terms of the customer:** meeting their every need and increasing customer satisfaction levels.

**In terms of growth:** leveraging current opportunities and creating new ones. The Company needs to leverage growth opportunities in traditional sectors while intensifying entry into related and innovation driven sectors.

**In terms of efficiency:** by continuing to make progress on the operating model to transform the company more rapidly and deliver on the efficiency targets assumed. To this end it will be necessary to move more quickly on operational integration at the local level, to maximise synergies and revise the operating model in order to ensure speedy adaptation to changing customer behaviour patterns and evolving technology.

**In terms of human resources:** sharing the project with all the company's professionals and motivating them by so doing. Increasing employee and team satisfaction will have a major impact on customer satisfaction and target achievement.

In 2008 the pace of growth and transformation needs to be stepped up. The targets for the year ahead are:

- To improve employee and customer satisfaction levels.
- To win market share.
- To increase the number of new accesses and meet ARPU targets.
- To enhance productivity.

## III Management Summit:

### *"Leading Progress"*

28 and 29 February 2008, Madrid

Telefónica has completed one era and is setting out on another, one in which we will shape the society of tomorrow and remain leaders over time. This is one of the conclusions of the III Management Summit held on 28 and 29 February, which brought together almost 1,500 executives from the company's 24 operating markets. Telefónica's goal is to be a more motivating, more personal, more open and more nimble company.

The company's 2007 results, which Telefónica's chairman, Cesar Alierta, called spectacular, guarantee Telefónica's leadership, which is synonymous with growth, efficiency and credibility. They reflect the company's strength and set the stage for continued growth.

To meet these goals the company needs a strong team that conveys enthusiasm and motivation to customers, getting them involved in the innovation process and capable of providing more products and services in a world where Broadband will increasingly take centre stage. In sum, "customer satisfaction must be our constant guide".

Throughout the course of the event, in addition to the chairman, the COO and members of the executive committee, took the stage, all highlighting the need to lead progress, to place customers at the centre of everything we do and to improve employee satisfaction with the overriding goal of thereby boosting customer satisfaction.



## The four business levers of the business unveiled at the III Management Summit: customers, growth, efficiency and human resources

### Personal customer relationships

The key to consolidating Telefónica's leadership in all its operating markets and sustaining earnings momentum is to place the customer at the centre of everything we do and to get closer to them. By placing an unflinching spotlight on the customer it is possible to increase the value of the company to its shareholders and boost earnings.

Telefónica O2 Europe's campaign to "turn its customers into fans" has been adopted by Telefónica as a cornerstone of its business strategy. Telefónica's global vision has two key aspects:

- Happy customers, employees and shareholders.
- Improved contribution to society in all its operating markets.

To put this philosophy into practice, the company's leadership needs to adjust. A 'Turning customers into fans' executive committee was put in place to launch the strategy throughout the entire Group. It is not enough to be familiar with the concepts of this strategy; employees need to be sold on the concept and capable of transmitting it to their teams in their everyday work by:

- Addressing 'the basics' in terms of service offering.
- Delivering on customer promises.
- Sharing best practices.

The overriding goal is to make Telefónica the number one operator in all its markets by December 2009.

### Growth and innovation

In all, in 2007 the Telefónica Group spent 4.5 billion euros on innovation-related initiatives and involved over 2,000 professionals in pioneering projects. The innovation challenge lies with bringing more people into the process to harvest new commercial success

Our innovation model, "shared and in each of our DNAs", is developed around four pillars:

- To improve the customer's perception by developing products and services.
- To collaborate with third parties.
- To foster a culture of innovation.
- To reinforce our diversity and scale.

This strategic focus on innovation has enabled us to configure the industry and top the integrated operators in terms of organic revenue growth. Looking to the future, we have set Group level growth targets for 2006-2010 of 5% to 8% in revenue, 7% to 11% in OIBDA and 16% to 20% in operating income.

## Telefónica will be better yet in 2010...

What Telefónica should not be

- A company that relies on acquisitions to grow
- A defensive player vis-à-vis its competitors in related industries
- An operator focused on leveraging its regional scale
- A company with a centralised organisational structure
- An efficient company where the sole focus is on defending margins
- A company preoccupied with providing the broadest product/service range
- A highly efficient utility

What Telefónica should be

- A company delivering organic growth in emerging and developed markets
- A company capturing growth opportunities in related industries
- A company capable of leveraging its global scale and not just its regional scale
- A skilled and nimble company guided by an international mindset
- A company able to anticipate opportunities to enhance efficiency and remain more profitable than its competitors
- A group focused on being the leader in customer satisfaction and innovation
- The best combination of growth and profitability in the region

## An operating model designed to boost profitability

It is necessary to continue to transform Telefónica's operating model in order to face:

- An increasingly complex and ever changing business landscape in which all participants are more demanding.
- Aggressive competition that is managing better and threatening Telefónica's leadership.
- The need to satisfy shareholders seeking higher remuneration.

To transform its operating model, Telefónica must rely on three levers:

**Integration:** sharpen the focus on the customer.

- Integrating the fixed and mobile businesses in the countries where Telefónica is present in both segments.
- Integrating the technology, operations and systems divisions into a single area in order to manage technical resources more effectively.
- Integrating cross-departmental processes to give us an end-to-end vision of our interaction with the customer.

**The "Single Telefónica" concept:** at the regional and global levels, the key lies with identifying shared initiatives that bring us closer to this concept in order to unlock the value inherent in the company's scale and diversity.

**The opportunities created by the transformation of our business:**

We need to take advantage of the emergence and adoption of new technologies to review our processes and increase the degree of automation.

## Commitment to our people

The people at Telefónica are playing a central and pivotal role in the company's business strategy. Against this backdrop, the company set an ambitious target in 2006, specifically to turn its employees into fans, a factor which additionally contributes to improving the customer experience and one which will make Telefónica the best telecommunications company to work at by 2010.

This challenge entails creating a common culture based on a sense of belonging and pride, consistent and effective management, work motivation and teamwork, all underpinned by the values of responsibility, flexibility, diversity and customer focus.

To implement this new culture and leadership style, the company has been developing the Employee Promise, adapted by region, focused on four priorities:

- Turning employees into fans.
- Establishing a performance based culture.
- Fostering a sense of belonging to an international company.
- Leveraging global talent.

A series of initiatives have been launched on each front. At a global level the Business Principles are noteworthy, as are the Reconócame (Acknowledge Me) programme in Latin America, the Leading for Total Engagement initiative in Europe and ConóceTE (KnowURself) in Spain, the Telefónica Corporate University, the launch of the Commercial Wings initiative and the promotion of e-learning, among other programmes underway.

A series of milestones have been set for 2008. These include making progress on the Integra plan, making international job mobility a reality by upping the 190 long term placements put in place in 2007 and achieving a 95% global talent retention rate at the Group.

In 2007, Telefónica spent a net 161 million euros to make sure telecoms services are accessible to all in Latin America



For more information:  
[www.telefonica.es/cro7/accessible](http://www.telefonica.es/cro7/accessible)

## Telefónica helps to bridge the digital divide by investing in infrastructure, and services for people on low incomes or with disabilities

Telefónica considers that the main way it can help reduce the digital divide is by doing its job as well as possible. Efficiency, effectiveness, innovation and investment in developing networks are what will ultimately bring more services to more places at better prices.

Meanwhile, the company also contributes, via Telefónica Foundation and the Accessible Telefónica Plan, to schemes for eliminating the barriers that prevent people accessing services.

### Accessible Telefónica

One of Telefónica's aims is to turn itself into a fully accessible company in all its processes and to make an active contribution to full equality of opportunity for those with disabilities. Therefore, in 2004 it put in place the "Telefónica Accesible" integrated plan. In 2007, the Company upgraded its Accessible Telefónica Standards, setting minimum accessibility criteria in 13 areas. At the same time it began to implement the policy internally and started applying it to web accessibility, phone handsets, stores and customer service.

With this in mind, last year Telefónica increased its range of accessible products and services, bringing a great many of them into its stores. It also worked on new developments at Telefónica's R&D centres, notably the Granada research unit which is exclusively dedicated to social and health issues.

To make sure that the needs of people coping with disabilities are being well met Telefónica stepped up its work with organisations in the field, carrying out studies, checking products, running training programmes, etc. As well as the collaboration with ATAM, in 2007 the Company signed new agreements with FEAPS, ASPAYM, SERVIMEDIA, ONCE Foundation and CNSE Foundation and renewed existing arrangements with CERMI and FIAPAS.

Meanwhile, in Latin America, Telefónica continued to take forward initiatives under its Accessible Telefónica plan. And in Europe, the O2 Ability Awards again recognised Irish organisations with the best practice for inclusion of people with disabilities.

### Universal Service

Telefónica's statutory universal service obligations in Spain, originally due to expire on 31 December, 2007, were extended for one year by the Ministry for Industry, Tourism and Commerce.

At the end of 2007, the CMT recognised a total net cost for Telefónica's provision of the universal service in Spain during 2003, 2004 and 2005 of 284 million euros. In addition, Telefónica España puts the 2006 investment at 131 million euros. The net cost for 2007 has yet to be assessed.

In Latin America, Telefónica companies are collaborating with a number of public sector initiatives to provide universal telephony services. In 2007, Telefónica contributed a net 157 million euros to Universal Service Funds in Argentina, Brazil, Peru, Colombia and Venezuela. On this point, Telefónica joined AHCIET and Regulatil at the "Second Latin American conference on ICT and the millennium goals", to underline the urgent need for governments that receive the Universalisation Funds to dedicate them to digital inclusion projects.



Telefónica adhered to the "2007 European Year of Equal Opportunities for All".

## MAIN MAGNITUDES OF DIGITAL INCLUSION IN LATIN AMERICA 2007

	Argentina	Brazil <sup>1</sup>	Chile	Colombia	Ecuador	El Salvador	Guatemala	Mexico	Nicaragua	Panama	Peru	Uruguay	Venezuela
<u>Geographical Inclusion</u>													
Geographical coverage	30%	13%	32%	8%	20%	80%	15%	27%	49%	60%	12%	65%	17%
Population coverage	88%	91%	93%	70%	85%	77%	65%	88%	80%	68%	68%	80%	94%
Accumulated supply <sup>2</sup>	9,745	84,392	-	39,447	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	9,441	n.a.	18,513
<u>Economic inclusion</u>													
% Prepay fixed	25%	22%	7%	2%	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	62%	n.a.	n.a.
% Prepay mobile	64%	81%	75%	79%	84%	81%	88%	94%	89%	92%	89%	83%	85%
Public telephones	108,804	251,000	22,209	12,969	52,027	n.a.	n.a.	n.a.	n.a.	n.a.	199,514	n.a.	-

<sup>1</sup> Joint Venture with Portugal Telecom.

<sup>2</sup> Prepay fixed customers is equivalent to customers by social subscription.

## Economic and geographic inclusion

Latin America has one of the highest levels of social inequality found anywhere in the world. In Europe, the population density and level of economic development tends to ensure services are available in all parts of the country. But in Latin America some social groups or rural areas are often left without access to technology.

Telefónica's over 18 years' experience in the region enable it to understand the digital divide in two ways:

- As a barrier cutting off poorer sections of society from mobile telephony, Broadband, handsets, etc. because of the cost of the services.
- As a barrier preventing rural communities from accessing services because of the greater cost of providing services. However, thanks to new technologies and, above all, the rollout of the wireless network, isolated areas are gradually gaining access to ICTs.

Regarding the economic divide, at the end of 2007 more than 81% of Telefónica's 102 million mobile customers in Latin America used pre-pay products that allow them to keep control of their consumption. In addition, the rollout of GSM networks continues to make handsets cheaper.

By the end of 2007, too, the Company had over 6 million pre-pay fixed lines with controlled usage, which made up 25.9% of their fixed-line accesses in Latin America: a unique proportion anywhere in the world. It also provided nearly 595,000 public phones.

Meanwhile, the Telefónica Group developed a number of initiatives in 2007 to expand the availability of telephony in rural areas and to bring people together through communications technology. These included the launch of the ADSL Duo service for rural parts of Spain, the launch in Peru of the Iris Project, which seeks to extend fixed telephony coverage using wireless technology, and the commitment in Chile to install one radio base station every six months until 2010 under an agreement between Telefónica and the Ministry of Transport and Telecommunications.

## Initiatives for rural communities

### New Broadband service for 100,000 Spaniards

In 2007, Telefónica began to market its rural wireless Broadband service, aimed at customers in isolated rural areas that have no ADSL coverage. The initiative will bring coverage to 6,500 more districts and more than 8,700 scattered population centres with a total of over 100,000 users.

New Broadband service for 100,000 Spaniards. The new service, based on LMDS/Wimax and satellite technology will allow Broadband at speeds of up to 2Mb to be rolled out in areas where ADSL would not be feasible, due to the low population density, the local topography or the excessive costs involved. The same solutions work for both voice and internet accesses.

### Public private partnership brings telephone services to 62,300 people in Peru

"Intégrame" (integrate me) is a programme developed in Peru to extend telephony and internet services to remote rural areas via public-private partnerships. The wider aim of the project is to help rural communities integrate and develop through ICT.

This social initiative of Telefónica's began in September 2006 and has so far brought public telecoms services to more than 180 places throughout Peru, benefiting more than 62,300 residents.

The programme won the 2007 prize for Business Creativity in the public services category, awarded by the Peruvian University of Applied Sciences.



## Our Results

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# January - December 2007 Results

## Market Size

### Mexico

Employees: **16,589**  
 Suppliers: **1,111**  
 Data accesses and internet Terra ISP: **2**  
 Mobile Access TEM México: **12,538**

### Peru

Employees: **14,554**  
 Suppliers: **2,143**  
 Fixed Telephony accesses Peru: **2,782**  
 Data accesses and Internet T. Perú: **623**  
 Mobile Access T. Perú: **8,129**  
 Clients of Magic Cable payment TV: **640**

### Ecuador

Employees: **773**  
 Suppliers: **390**  
 Mobile Access TEM Ecuador: **2,582**

### Chile

Employees: **14,613**  
 Suppliers: **1,728**  
 Fixed Telephony accesses T. Chile: **2,172**  
 Data accesses and Internet T. Chile: **687**  
 Mobile Access T. Chile: **6,283**  
 Clients of digital pay TV: **220**

### Central America

Employees: **5,786**  
 Suppliers: **2,005**  
 Fixed Telephony accesses: **125**  
 Data accesses and Internet: **22**  
 Mobile Access: **5,278**

### Colombia

Employees: **6,369**  
 Suppliers: **1,430**  
 Fixed Telephony accesses T. Telecom: **2,329**  
 Data accesses and Internet T. Telecom: **200**  
 Mobile Access TEM Colombia: **8,372**  
 Clients of pay TV: **73**

### Venezuela

Employees: **6,873**  
 Suppliers: **1,130**  
 Mobile Access TEM Venezuela: **10,430**

### Argentina

Employees: **21,493**  
 Suppliers: **1,451**  
 Fixed Telephony accesses T. Argentina: **4,578**  
 Data accesses and internet T. Argentina: **1,150**  
 Mobile Access T. de Argentina: **13,734**

### Spain

Employees: **53,300**  
 Suppliers: **4,065**  
 Fixed Telephony accesses Negocio Fijo: **15,898**  
 Data accesses and internet Negocio Fijo: **5,279**  
 Mobile Access Negocio Móvil: **22,827**

Clients of Imagenio pay TV: **511**

### Morocco

Employees: **1,646**  
 Suppliers: **442**  
 Mobile Accesses Morocco: **6,153**

### Brazil

Employees: **75,839**  
 Suppliers: **3,231**  
 Fixed Telephony accesses Telesp: **11,960**  
 Data accesses and internet Telesp: **3,289**  
 Terra ISP: **982**  
 Mobile Access VIVO: **33,484**  
 TV Clients of Digital pay TV: **231**

### Uruguay

Employees: **250**  
 Suppliers: **445**  
 Mobile Access TEM Uruguay: **1,148**

### UK

Employees: **13,221**  
 Suppliers: **7,240**  
 Data accesses and internet O2 United Kingdom: **71**  
 Mobile Access O2 United Kingdom: **18,382**

### Ireland

Employees: **1,617**  
 Suppliers: **824**  
 Mobile Access O2 Ireland: **1,646**

### Germany

Employees: **5,101**  
 Suppliers: **2,179**  
 O2 Germany Internet and data accesses: **75**  
 O2 Germany mobile accesses: **12,472**

### Slovakia

Employees: **354**  
 Suppliers: **90**  
 TO2 Slovakia Mobile Accesses: **565**

### Czech Republic

Employees: **8,695**  
 Suppliers: **391**  
 TO2 Czech Republic fixed telephony accesses: **2,069**  
 TO2 Czech Republic internet and data accesses: **573**  
 TO2 Czech Republic internet and data accesses: **5,125**  
 O2TV: **73**

### Note:

Accesses data in thousands.

## TELEFÓNICA GROUP ACCESSES

Unaudited figures (thousands)

	January-December		
	2007	2006	% Chg
<b>Final Client Accesses</b>	<b>225,910.3</b>	<b>200,700.7</b>	<b>12.6</b>
Fixed telephony accesses <sup>1</sup>	41,974.2	42,340.7	(0.9)
Internet and data accesses	12,968.4	12,170.9	6.6
Narrowband	2,532.9	3,997.7	(36.6)
Broadband <sup>2</sup>	10,277.8	7,974.8	28.9
Other <sup>3</sup>	157.7	198.4	(20.5)
Mobile accesses	169,219.7	145,125.1	16.6
Pay TV	1,748.1	1,064.0	64.3
<b>Wholesale Accesses</b>	<b>2,628.0</b>	<b>2,479.4</b>	<b>6.0</b>
Unbundled loops	1,396.5	962.2	45.1
Shared ULL	776.4	527.7	47.1
Full ULL	620.1	434.5	42.7
Wholesale ADSL <sup>4</sup>	575.5	1,288.6	(55.3)
Other <sup>5</sup>	656.0	228.6	n.m.
<b>Total Accesses</b>	<b>228,538.3</b>	<b>203,180.2</b>	<b>12.5</b>

<sup>1</sup> PTSN (including Public Use telephony) x1; ISDN Primary access; 2/6 Access x30. Company's accesses for internal use.<sup>2</sup> ADSL, satellite, optical fibre, cable modem and Broadband circuits.<sup>3</sup> Remaining non-Broadband final client circuits.<sup>4</sup> Includes Unbundled Lines by T. Deutschland.<sup>5</sup> Circuits for other operators.

Note: Mobile accesses, Fixed telephony accesses and Broadband accesses include MANX customers.

## Telefónica Group Financial highlights

Key highlights of the Telefónica Group's 2007 results:

- Revenues rose +6.7%, OIBDA jumped +19.3%, OI, +42.1% and net profit, +42.9% year-on-year in 2007, driven by significant geographical and business diversification.
  - OIBDA 2007 is heavily impacted by the personnel reorganisation announced by the company that will boost efficiency in the coming years. Personnel reorganisation expenses at Telefónica Group stood at 1,199 million euros in 2007 (1,084 million euros in 2006) and 900 million euros in the fourth quarter of 2007 (651 million euros in 2006).
  - Additionally, in 2007 the Company has recorded other expenses related to operations restructuring, amounting to 199 million euros (16 million euros in 2006), mainly related to the cessation of the national roaming contract with T-Mobile.
- Telefónica posted consolidated net profit<sup>1</sup> of 8,906 million euros:
  - Basic earnings per share rose 43.5% to 1.872 euros (1.304 euros per share in December 2006), the fourteenth consecutive increase.

- Strong organic revenue growth<sup>2</sup>, up 7.4% from 2006.
  - By region, Telefónica Latinoamérica reported a 13.0% year-on-year revenue growth, while Telefónica España and Telefónica Europe reported increases of 4.6% and 4.5%, respectively.
- Commercial activity was boosted by the success of the Company's customer acquisition and retention schemes, resulting in a sharp year-on-year rise in total accesses (+12.5%) to 228.5 million, underpinned by wireless and Broadband accesses:
  - The wireless customer base increased by 16.6% year-on-year to 169.2 million.
  - The number of retail Broadband accesses stood above 10.2 million at the end of 2007, an increase of 28.9% from 2006.
  - Pay TV customer base grew 64.3% year-on-year to 1.7 million.
- Operating cash flow (OIBDA-CapEx) amounted to 14,797 million euros thanks to synergies stemming from the integrated management of operations, cost optimisation and growing diversification.

- Telefónica Group's results for 2007 provide further evidence of the differential profile of the Company. Once again, the Group met all its financial targets<sup>3</sup>:
  - Consolidated revenue growth of 9.8% versus the forecast range of 8%-10%;
  - Operating income before depreciation and amortisation (OIBDA) growth stood at 12.8%, towards the top of the forecast range of 10% - 13%.
  - Operating income (OI) increased by 27.6%, above the given range of 19% to 23%.
  - CapEx totalled 8,087 million euros, lower than the forecast investment of 8,100 million euros.
  
- The Group's strong business performance allows to announce sound growth prospects in 2008 and to reiterate the long-term growth targets announced in October 2007. For 2008, the Company forecasts<sup>4</sup>:
  - Consolidated revenue growth in the range of +6.0%/+8.0%;
  - Consolidated OIBDA growth in the range of +7.5%/+11.0%;
  - Consolidated OI growth in the range of +13.0%/+19.0%;
  - CapEx is expected to stand around 8,600 million euros.

**2007 Bases for Guidance purposes:**

- Consolidated revenues: 55,550 million euros;
- Consolidated OIBDA: 20,863 million euros;
- Consolidated OI: 11,467 million euros;
- CapEx: 7,975 million euros.
  
- The Company reinforces its shareholder remuneration policy:
  - The dividend of 1 euro per share corresponding to 2008 fiscal year announced back in October is now complemented with a new share buy-back programme, announced on February, 27th, 2008, for a total amount of 100 million shares, representing close to 2.095% of the Company's share capital. The programme will be effective during 2008 and the first half of 2009.

<sup>4</sup> 2007 adjusted figures exclude Airwave and Endemol, include 3 months of consolidation of TVA. 2007 T. España revenues are adjusted for new public voice telephony services business model. Group revenues are also adjusted accordingly. 2008 figures includes TVA, Deltax and Telemig (from April 2008). Telefónica's CapEx excludes Real Estate Efficiency Program. Guidance growths assume 2007 constant FX. In terms of guidance calculation OIBDA and OI exclude other exceptional revenues/expenses not foreseeable in 2007 and 2008.

## Telefónica Group Consolidated Results

Telefónica Group organisational restructuring by Regional Business Units: Telefónica España, Telefónica Latinoamérica and Telefónica Europe, in accordance with the new regional and integrated management model, defines that the companies legal structure is not relevant for the presentation of the Telefónica Group financial information. In this sense, operating results of each regional business units are presented independently of their legal structure.

In line with this new structure, Telefónica Group has incorporated in Telefónica España and Telefónica Latinoamérica regional businesses units all the information corresponding to fixed, cellular, cable and Internet businesses.

Likewise, Telefónica Europe includes O2 Group, O2 Germany and Telefónica O2 Czech Republic results.

In the caption Other companies and Eliminations Content and Media Business is included, where the results of Telefonica S.A. direct stake has been integrated in the share capital of Endemol Entertainment Holding, N.V.

For the presentation of the segment reporting, revenue and expenses arising from the use of the trademark and that do not affect the Group's consolidated results have been eliminated from the operating results of each Group segment.

## Telefónica Group Consolidated Results

Telefónica Group's 2007 results continue to show the differential profile of the Company, underpinned by its strong execution of operations and its ability to consistently meet its financial targets. The solid growth achieved in 2007 highlights the Group's potential for organic growth, the value of its geographic and business line diversification, an efficient cost structure and the synergies tapped through the integrated management of the Company.

In a context of a strong expansion of the customer base (+12.5%), revenues (+6.7%), OIBDA (+19.3%), OI (+42.1%) and net profit (+42.9%) all rose sharply compared with 2006, while operating cash flow (OIBDA-CapEx) increased by 33.0% year-on-year to 14,797 million euros (+9.1% ex-capital gains from the Airwave and Endemol disposals).

Once again, the Company's outstanding performance in 2007 has enabled the Telefónica Group to meet all its financial targets<sup>1</sup> for the year. In accordance with the criteria applied for setting its targets for 2007:

- Revenue growth stood at 9.8% vs. the forecast range of 8%-10%;
- Operating income before depreciation and amortisation (OIBDA) grew 12.8%, in the upper part of the forecast range of 10%-13%.
- Operating income increased by 27.6%, above the given range of 19% to 23%.
- CapEx totalled 8,087 million euros, lower than the forecast investment of 8,100 million euros.

Commercial activity picked up in the fourth quarter due to successful customer acquisition and retention campaigns, boosting total accesses by 12.5% to 228.5 million from 2006.

Telefónica España has 46.4 million accesses, an increase of 5.0% on 2006, underpinned by growth in wireless and Broadband customers together with the contention of fixed lines losses, at 0.3% year-on-year, the smallest decline since 2001.

Growth in the number of total accesses at Telefónica Latinoamérica picked up the pace (+16.9% year-on-year to 134.1 million) thanks to the strong growth in Broadband, a robust wireless market, which registered a new record for net adds in the fourth quarter (7.3 million customers), and an expanding Pay TV customer base, which increases close to 75% compared with 2006.

Telefónica Europe reported growth of 8.7% in its customer base to 42 million, driven by the strong performance of its wireless business, especially in the contract segment.

By access type, growth in mobile accesses at the Telefónica Group accelerated to 16.6% year-on-year to 169.2 million. In Latin America, it is worth highlighting the quarterly net adds registered in Brazil (2.2 million, close to seven-fold increase on the same period in 2006), and in Mexico (almost 1.5 million, up 32% year-on-year). In Spain, net adds in the quarter totalled 406,837 thousand, exceeding the figures seen in the last three quarters and boosting the customer base to over 22.8 million, up 6.4% compared with 2006. In Europe, the customer base increased by 8.6% to 38.3 million, with net adds of 1.0 million customers in the quarter.

Retail Internet Broadband accesses at the Telefónica Group surged 28.9% year-on-year to over 10.2 million at the end of December. Take-up for ADSL, TV and voice bundles remained strong, making a significant contribution to developing the Broadband market and forging customer loyalty. In Spain, retail Broadband accesses surpassed 4.5 million (up +22.1% year-on-year), in Latin America, 5.0 million (+33.2%) and in Europe, 670,000 (+48.3%). Net adds in the quarter stood at 227,500 in Spain, while this figure amounted to 332,300 and 97,500 in Latin America and Europe respectively.

Pay TV accesses at the end of the quarter exceeded 1.7 million, 64.3% more than in 2006, with operations up and running in Spain, the Czech Republic, Peru, Chile, Colombia and Brazil.

Thanks to the sound increase in the Group's customer base, revenues in 2007 totalled 56,441 million euros, a year-on-year increase of 6.7%. Negative exchange rate effects detracted 1.2 percentage points from top-line growth (-1.0 percentage points to September, -1.4 percentage points to June, -2.6 percentage points to March), while changes in the consolidation perimeter contributed 0.5 percentage points to this growth (vs. +1.9 percentage points to September, +4.5 percentage points to June, +9.8 percentage points to March). Organic revenue growth<sup>2</sup> was 7.4%, with Telefónica Latinoamérica (4.4 percentage points) and Telefónica España (1.6 percentage points) making the largest contributions. By business, mobile services and Broadband were the main revenue drivers underpinning organic growth, up 11.1% and 22.6% year-on-year respectively.

In absolute terms, Telefónica España contributed most to Telefónica Group revenues, accounting for 36.6% of the total. Telefónica España reported revenues of 20,683 million in 2007, up 4.7% from 2006. Revenues at Telefónica España's wireline business

<sup>1</sup> Base 2006 reported numbers include eleven months of O2 Group (consolidated since February 2006), eight months of Telefónica Telecom (consolidated since May 2006), six months of Iberbanda (consolidated since July 2006), three months of start-up losses in Slovakia, and exclude Endemol and Airwave results. 2007 guidance assumes constant exchange rates as of 2006 and excludes changes in consolidation (TVA). In terms of guidance calculation, OIBDA and OI exclude other exceptional revenues/expenses not foreseeable in 2007. Personnel Restructuring and Real Estate Programs are included as operating revenues/expenses, with the exception of the ones decided after the guidance communication at the beginning of the year. For comparison purposes the equivalent other exceptional revenues/expenses registered in 2006 are also deducted from reported figures. CapEx excludes investments related to Real Estate Efficiency Plan.

<sup>2</sup> Assuming constant exchange rates and including the consolidation of the O2 Group, Telefónica Telecom and Iberbanda in January-December 2006. It excludes the consolidation of Telefónica O2 Slovakia in January-December 2007, the consolidation of TVA in October-December 2007, the consolidation of Airwave in April-December 2006 and the consolidation of Endemol in July-December 2006.

amounted to 12,401 million euros in the year, a year-on-year increase of 3.7%. This was largely underpinned by strong Internet and Broadband service revenues and, to a lesser extent, data and IT services, not forgetting the noteworthy performance of voice and traditional access revenues. Telefónica España's wireless business reported full-year revenues of 9,693 million euros, up 5.4% year-on-year, driven by strong service revenues (+4.5%), which in turn were buoyed by customer revenues (+8.0%).

Telefónica Latinoamérica (35.6% of consolidated revenues) recorded revenues of 20,078 million euros in 2007, 11.0% more than in 2006 (14.5% in constant euros). In organic terms<sup>3</sup>, revenues grew by 13.0%. In constant currency terms, Mexico and Venezuela contribute most to topline growth with respective contributions of 3.2 and 3.1 percentage points. Brazil continues to make the largest contribution to Telefónica Latinoamérica's revenues (38.2%) followed by Venezuela (11.9%) and Argentina (11.3%). TASA remains the best performing fixed operator in the region, reporting 9.9% growth in local currency thanks to higher Broadband revenues (+45.7% in local currency) and a robust traditional business (+5.4% in local currency). In Brazil, Vivo (revenues up 16.5% in local currency) should be highlighted, where results reflect the impact of the management measures implemented in 2006 and 2007 to achieve profitable growth and improved customer satisfaction.

Telefónica Europe contributed 14,458 million euros (25.6%) to the Telefónica Group's total revenues in 2007. Telefónica Europe's 2006 revenues included the O2 Group for February-December 2006, as well as Telefónica Deutschland and Telefónica O2 Czech Republic for January-December 2006. In the UK, the continued growth of the customer base and ARPU boosted revenues, in comparable terms, by 9.5% in local currency vs. 2006 despite the strong competitive pressure in the market. At Telefónica O2 Czech Republic, 2007 revenues rose 2.9% year-on-year boosted by the wireless business (+4.4% in local currency) and a stable fixed business. At O2 Germany, in comparable terms, revenues fell by 1.9% vs. 2006 as traffic growth failed to offset the major price cuts made over the year in a highly competitive market.

In 2007, Telefónica Group's operating expenses grew 7.0% vs. 2006 to 37,431 million euros. These higher costs are mainly due to changes in the consolidation perimeter, higher commercial efforts carried out in Latin America and Europe and the impact of operational and personnel reorganization plans announced by the Company that will boost efficiency in the coming years.

Supplies rose 7.7% year-on-year in 2007 to 17,907 million euros (up 9.0% excluding the exchange rate effect). Stripping out also changes to the consolidation perimeter, supplies would have risen 9.2%, mainly due to higher interconnection expenses at Telefónica Latinoamérica and O2 UK.

Personnel expenses rose 3.6% year-on-year to 7,893 million (+4.6% in constant euros). The average number of employees in the period was 244,052, 16,915 more than the previous year, due to net hires at the Atento Group and the inclusion of new companies in the consolidation perimeter. Excluding the Atento Group workforce, the average number of employees at the Telefónica Group would have been virtually flat year-on-year at 127,102 employees.

Personnel reorganization expenses at Telefónica Group stood at 1,199 million euros in 2007 (1,084 million euros in 2006):

- Telefónica España: 667 million euros, including the 2003-2007 redundancy programme and a new personnel reorganization programme for 2008 started in 2007;
- Telefónica Latinoamérica: 318 million euros booked for personnel reorganization programmes carried out in different companies of the Group corresponding to plans implemented in 2007 and in force throughout 2008;
- Telefónica Europe: 158 million euros relating to personnel reorganization programmes implemented in Germany, the UK and Ireland.

External service expenses (9,991 million euros) grew by 8.2% year-on-year (+9.5% in constant currency), partly due to the cessation of the roaming agreement in Germany with T-Mobile in the fourth quarter. In organic terms, this increase was mainly due to increased commercial activity at Telefónica Latinoamérica and in Telefónica España's wireline business.

Also, gains on sale of fixed assets in 2007 totalled 2,766 million euros due to the recognition in the second quarter of 1,296 million euros in capital gains from the sale of Airwave and in the third quarter of 1,368 million euros in capital gains from the disposal of Endemol. Meanwhile a capital loss of 45 million euros was recorded in the second quarter in connection with the disposal of the Group's 6.9% stake in CANTV.

At the end of 2007, operating income before depreciation and amortisation (OIBDA) stood at 22,825 million euros, up 19.3% from 2006. Stripping out gains from the sale of Airwave and Endemol, OIBDA growth would have been 5.4% year-on-year. Organic OIBDA growth<sup>4</sup> would have stood at 20.8% (+6.8% stripping out both capital gains). The OIBDA margin in 2007 was 40.4% (35.7% excluding the Airwave and Endemol capital gains vs. 36.2% the previous year).

Telefónica España (46.9%<sup>5</sup> of consolidated OIBDA) reported OIBDA of 9,448 million euros in 2007, up 9.3% from 2006. The OIBDA margin stood at 45.7%, 1.9 percentage points higher than one year ago.

<sup>3</sup> Assuming constant exchange rates and including the consolidation of Telefónica Telecom in 2006. It excludes the consolidation of TVA in October-December 2007.

<sup>4</sup> Assuming constant exchange rates and including the consolidation of the O2 Group, Telefónica Telecom and Iberbanda in January-December 2006. It excludes the consolidation of Telefónica O2 Slovakia in January-December 2007, the consolidation of TVA in October-December 2007, the consolidation of Airwave in April-December 2006 and the consolidation of Endemol in July-December 2006.

OIBDA at Telefónica Latinoamérica (7,121 million euros) represented 35.3% of consolidated OIBDA for 2007<sup>5</sup>, a year-on-year increase of 8.4%. In organic terms<sup>6</sup> OIBDA growth was 10.6%. In constant currency terms, OIBDA growth in Latin America was 11.5%. By country, Venezuela contributed most to OIBDA growth (5.2 percentage points), followed by Mexico (3.1 percentage points). In absolute terms, Brazil was the largest contributor to Telefónica Latinoamérica's OIBDA, accounting for 43.1% of the total, followed by Venezuela (14.9%) and Argentina (11.1%). Telefónica Latinoamérica's OIBDA margin in 2007 amounted to 35.5%, 0.9 percentage points lower than in 2006, affected by the personnel reorganization provisions outlined above. Excluding these provisions, the margin would have been 37.1% (0.3 percentage points higher than the one recorded in 2006).

Telefónica Europe generated OIBDA<sup>7</sup> of 4,977 million in 2007 including the 1,296 million euro capital gain from the sale of Airwave recorded in the second quarter, a contribution of 18.3% to total Group OIBDA<sup>7</sup>. In 2006 Telefónica Europe reported OIBDA of 3,708 million euros; this figure reflected the consolidation of the O2 Group in February-December and Telefónica O2 Czech Republic and Telefónica Germany for the full twelve months. The OIBDA margin excluding the Airwave capital gain was 25.5% vs. 28.2% in 2006.

In the fourth quarter O2 UK's OIBDA fell by 4.9% year-on-year in local currency due to a 20.5 million euros charges, mainly due to personnel reorganization costs at its IT and technology business aimed at achieving future efficiencies. Stripping out this expense, OIBDA would have been almost flat vs. 2006. At O2 Germany, fourth-quarter OIBDA fell by 77.9% year-on-year due to non-recurrent charges of 151 million euros. Most of these were accounted for by the early cancellation of the roaming agreement in Germany with T-Mobile mentioned earlier and the personnel reorganization plan initiated in the second quarter of the year. Telefónica O2 Czech Republic recorded a fall of approximately 1.1 percentage points in its OIBDA margin partly explained by the negative contribution of its operations in Slovakia.

Depreciation and amortisation in 2007 totalled 9,437 million euros, 2.8% lower than 2006 figure. Both Telefónica España and Telefónica Latinoamérica contributed the most to lower depreciation and amortisation (6.0% and 3.0% less year-on-year, respectively). Telefónica Europe recorded a decrease (0.4% year-on-year) owing to the purchase price allocations in the O2 Group acquisition (802 million euros) and the Telefónica O2 Czech Republic acquisition (158 million euros). In organic terms<sup>8</sup>, depreciation and amortisation for the Telefónica Group fell 3.7%

in 2007 year-on-year, with Telefónica España and Telefónica Europe chiefly responsible for this decline.

The sharp rise in OIBDA and fall in depreciation and amortisation drove operating income (OI) 42.1% higher in the year to 13,388 million euros. Stripping out the impact of the Airwave and Endemol disposals, OI would have increased by 13.8%. Organic growth<sup>8</sup> was 47.0% (+18.1% excluding the capital gains from the disposals of Airwave and Endemol).

Profit from associates jumped 83.3% in 2007 to 140 million euros. The bulk of the increase was due to Portugal Telecom and Lycos Europe, which in April sold its investment in the Czech-based IP provider Seznam, c.z. The improvement was also underpinned by the fact that Sogecable and The Link have not been consolidated under the equity method since the fourth quarter of 2006.

Net financial results at the end of 2007 amounted to 2,844 million euros, 4.0% above those of the same period of 2006. This variation arises mainly from the increase in the average cost of debt for Telefónica Group due to higher interest rates in Europe and higher percentage of debt in Latinoamérica, that drives financial expenses up by 207 million euros. The increase in the average cost of debt is offset by the 200 million euros reduction due to the decrease of average total debt in 2007. Management of the present value of pre-retirement plan commitments and other positions associated to marked-to-market positions, have a positive impact of 84 million euros, 42 million euros behind the figure reported for 2006. The average cost calculated on average total net debt for 2007 is 5.59% and 5.61% when excluding FX results.

Free cash flow generated by the Telefónica Group in 2007 amounted 8,847 million euros of which 2,113 and 3,076 million euros were assigned to Telefónica's share buyback programme and dividend payment respectively, and 781 million euros to commitment cancellations derived mainly from the pre-retirements plans. Due to the fact that financial divestitures for the period amounted to 2,512 million euros, mainly due to Airwave and Endemol disposals and TELCO participation, net financial debt decreased in 5,389 million euros. Also, net debt was reduced by an additional 1,472 million euros because of FX impact, changes in the consolidation perimeter and other effects on financial accounts. All this has been translated in a decrease of 6,861 million euros in respect to the net financial debt of the fiscal year 2006 (52,145 million euros), reaching the net financial debt of Telefónica Group at 2007 45,284 million euros.

<sup>5</sup> 2007 OIBDA for Telefónica Group does not consider the capital gains of 1,296 million euros and 1,368 million euros from the disposals of Airwave and Endemol respectively.

<sup>6</sup> Assuming constant exchange rates and including the consolidation of the O2 Group, Telefónica Telecom and Iberbanda in January-December 2006. It excludes the consolidation of Telefónica O2 Slovakia in January-December 2007, the consolidation of TVA in October-December 2007, the consolidation of Airwave in April-December 2006 and the consolidation of Endemol in July-December 2006.

<sup>7</sup> Excluding the capital gain from Airwave (1,296 million euros) from Telefónica Europe and from Group OIBDA the Airwave capital gains and the capital gain of 1,368 million euros from the disposal of Endemol.

<sup>8</sup> Assuming constant exchange rates and including the consolidation of the O2 Group, Telefónica Telecom and Iberbanda in January-December 2006. It excludes the consolidation of Telefónica O2 Slovakia in January-December 2007, the consolidation of TVA in October-December 2007, the consolidation of Airwave in April-December 2006 and the consolidation of Endemol in July-December 2006.

The tax provision for 2007 totalled 1,565 million euros, a tax rate of 14.65% in the year. However, the cash outflow for the Group will be lower as it offsets loss carryforwards generated in previous years and which have not yet been used.

In 2007 the tax rate was affected by several issues that resulted in it being significantly reduced. Chief among these were the disposal of Endemol, which generated a fiscal loss, the tax reforms in the UK, which resulted in a reduction in deferred liabilities, and the disposal of Airwave, which had no fiscal impact.

Minority interests subtracted 213 million euros in 2007, a 38.5% year-on-year decrease mainly due to the merger by absorption of Telefónica Móviles by Telefónica S.A. in July 2006. Minority stakes in Telesp and Telefónica O2 Czech Republic accounted for the bulk of profit attributable to minority interests.

In all, consolidated net profit to December totalled 8,906 million euros, up 42.9% year-on-year. Basic earnings per share jumped 43.5% to 1.872 euros. In the fourth quarter, net profit amounted to 1,058 million euros, up 2.3% year-on-year, while earnings per share stood at 0.224 euros compared to 0.213 euros per share in the fourth quarter of 2006.

CapEx in 2007 totalled 8,027 million euros, an increase of 0.3% year-on-year. Exchange rate effects detracted 1.4 percentage points.

## **2008 Financial Targets**

In accordance with the criteria used to establish its financial targets for 2008<sup>9</sup>, Telefónica Group expects:

- Annual growth in consolidated revenues to be in the range of 6.0%-8.0% for 2008 (2007 Base for guidance purposes: 55,550 million euros).

### **By regions:**

- Telefónica España : +2.0%/+3.5% (2007 Base for guidance purposes: 20,536 million euros);
  - Telefónica Latinoamérica: +11.0%/+14.0% (2007 Base for guidance purposes: 20,078 million euros);
  - Telefónica Europe: +4.0%/+7.0% (2007 Base for guidance purposes: 14,358 million euros).
- Annual OIBDA growth in 2008 to be in the range of 7.5%-11.0% (2007 Base for guidance purposes: 20,863 million euros).

### **By regions:**

- Telefónica España : +6.0%/+8.0% (2007 Base for guidance purposes: 9,635 million euros);
  - Telefónica Latinoamérica: +12.0%/+16.0% (2007 Base for guidance purposes: 7,408 million euros);
  - Telefónica Europe: +2.0%/+6.0% (2007 Base for guidance purposes: 3,974 million euros);
- Annual operating income (OI) growth in 2008 to be in the range of 13.0%-19.0% (2007 Base for guidance purposes: 11,467 million euros).
- CapEx in 2008 will stand around 8,600 million euros (2007 Base for guidance purposes: 7,975 million euros)

<sup>9</sup> 2007 adjusted figures exclude Airwave and Endemol, include 3 months of consolidation of TVA. 2007 T. España revenues are adjusted for new public voice telephony services business model. Group revenues are also adjusted accordingly. 2008 figures includes TVA, Deltax and Telemig (from April 2008). Telefónica's CapEx excludes Real Estate Efficiency Program. Guidance growths assume 2007 constant FX. In terms of guidance calculation OIBDA and OI exclude other exceptional revenues/expenses not foreseeable in 2007 and 2008.

## Financial Data

TELEFÓNICA GROUP SELECTED FINANCIAL DATA		January-December		
	Unaudited figures (Euros in millions)	2007	2006	% Chg
Revenues		56,441	52,901	6.7
Operating income before D&A (OIBDA)		22,825	19,126	19.3
Operating income (OI)		13,388	9,421	42.1
Income before taxes		10,684	6,764	58.0
Net income		8,906	6,233	42.9
Basic earnings per share		1,872	1,304	43.5
<b>Weighted average number of ordinary shares outstanding during the period (millions)</b>		<b>4,758.7</b>	<b>4,799.0</b>	<b>(0.4)</b>

Note: Figures are presented considering the Purchase Price Allocation of O2 as of February 2006.

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.

## TELEFÓNICA GROUP RESULTS BY REGIONAL BUSINESS UNITS

Unaudited figures (Euros in millions)		January-December				
	REVENUES	OIBDA	OPERATING INCOME			
	2007	2006	% Chg	2007	2006	% Chg
Telefónica España	20,683	19,750	4.7	9,448	8,647	9.3
Telefónica Latinoamérica	20,078	18,089	11.0	7,121	6,571	8.4
Telefónica Europe <sup>1</sup>	14,458	13,159	9.9	4,977	3,708	34.2
Other companies and eliminations <sup>2</sup>	1,221	1,903	(35.8)	1,278	200	n.m.
<b>Total Group</b>	<b>56,441</b>	<b>52,901</b>	<b>6.7</b>	<b>22,825</b>	<b>19,126</b>	<b>19.3</b>

Note: Figures are presented considering the Purchase Price Allocation of O2 as of February 2006.

Note: OIBDA for wireline operations in Latin America is presented after management fees.

<sup>1</sup> Telefónica Europe includes in 2006 Telefónica O2 Czech Republic (January-December), T. Deutschland (January-December), O2 Group (February-December) and O2 Germany (February-December). OIBDA figures exclude brand fee.

<sup>2</sup> OIBDA and Operating Income exclude the variation in investment valuation allowances accounted by Telefónica, S.A.

## CAPEX BY REGIONAL BUSINESS UNITS

Unaudited figures (Euros in millions)		January-December		
	2007	2006	% Chg	
Telefónica España		2,381	2,304	3.4
Telefónica Latinoamérica		3,343	2,811	18.9
Telefónica Europe <sup>1</sup>		2,125	2,552	(16.7)
Other companies and eliminations		178	336	(47.1)
<b>Total Group</b>	<b>8,027</b>	<b>8,003</b>	<b>0.3</b>	

Note: Group CapEx in 2006 at cumulative average exchange rate.

<sup>1</sup> Telefónica Europe includes in 2006 Telefónica O2 Czech Republic (January-December), T. Deutschland (January-December), O2 Group (February-December) and O2 Germany (February-December).

**TELEFÓNICA GROUP  
CONSOLIDATED INCOME STATEMENT**

	January-December			October-December		
	2007	2006	% Chg	2007	2006	% Chg
Unaudited figures (Euros in millions)						
Revenues	56,441	52,901	6.7	14,426	14,196	1.6
Internal exp capitalized in fixed assets <sup>1</sup>	708	719	(1.5)	211	195	8.3
Operating expenses	(37,431)	(34,995)	7.0	(10,381)	(9,992)	3.9
Supplies	(17,907)	(16,629)	7.7	(4,653)	(4,645)	0.2
Personnel expenses	(7,893)	(7,622)	3.6	(2,578)	(2,421)	6.5
Subcontracts	(9,991)	(9,230)	8.2	(2,771)	(2,578)	7.5
Bad Debt Provisions	(666)	(609)	9.4	(130)	(125)	3.5
Taxes	(974)	(905)	7.7	(249)	(224)	11.4
Other net operating income (expense)	358	346	3.3	192	127	51.2
Gain (loss) on sale of fixed assets	2,766	236	n.m.	132	012	n.m.
Impairment of goodwill and other assets	(17)	(81)	(79.2)	(4)	(66)	(94.5)
<b>Operating income before D&amp;A (OIBDA)</b>	<b>22,825</b>	<b>19,126</b>	<b>19.3</b>	<b>4,577</b>	<b>4,472</b>	<b>2.3</b>
Depreciation and amortization	(9,437)	(9,704)	(2.8)	(2,452)	(2,510)	(2.3)
<b>Operating income (OI)</b>	<b>13,388</b>	<b>9,421</b>	<b>42.1</b>	<b>2,125</b>	<b>1,962</b>	<b>8.3</b>
Profit from associated companies	140	077	83.3	034	016	n.m.
Net financial income (expense)	(2,844)	(2,734)	4.0	(749)	(805)	(7.0)
<b>Income before taxes</b>	<b>10,684</b>	<b>6,764</b>	<b>58.0</b>	<b>1,409</b>	<b>1,172</b>	<b>20.2</b>
Income taxes	(1,565)	(1,781)	(12.1)	(294)	(64)	n.m.
Income from continuing operations	9,119	4,983	83.0	1,115	1,108	0.6
<b>Income (Loss) from discontinued ops.</b>	<b>0</b>	<b>1,596</b>	<b>n.m.</b>	<b>0</b>	<b>0</b>	<b>n.m.</b>
Minority interests	(213)	(346)	(38.5)	(57)	(73)	(22.5)
Net income	8,906	6,233	42.9	1,058	1,035	2.3
<b>Weighted average number of ordinary shares outstanding during the period (millions)</b>	<b>4,758.7</b>	<b>4,779.0</b>	<b>(0.4)</b>	<b>4,718.5</b>	<b>4,853.6</b>	<b>(2.8)</b>
<b>Basic earnings per share</b>	<b>1.872</b>	<b>1.304</b>	<b>43.5</b>	<b>0.224</b>	<b>0.213</b>	<b>5.2</b>

Note: Figures are presented considering the Purchase Price Allocation of O2 as of February 2006.

"Bad debt provisions" have been reclassified from "Other net operating income (expense)" to "Operating expenses".

<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.

**TELEFÓNICA GROUP  
CONSOLIDATED BALANCE SHEET**

Unaudited figures (Euros in millions)

	January-December		
	2007	2006	%Chg
<b>Non-current assets</b>	<b>87,395</b>	<b>91,269</b>	<b>(4.2)</b>
Intangible assets	18,320	20,758	(11.7)
Goodwill	19,770	21,739	(9.1)
Property, plant and equipment and Investment property	32,469	33,888	(4.2)
Long-term financial assets and other non-current assets	9,007	6,183	45.7
Deferred tax assets	7,829	8,702	(10.0)
<b>Current assets</b>	<b>18,478</b>	<b>17,713</b>	<b>4.3</b>
Inventories	987	1,012	(2.4)
Trade and other receivables	9,662	9,666	(0.0)
Current tax receivable	1,010	1,555	(35.0)
Short-term financial investments	1,622	1,679	(3.4)
Cash and cash equivalents	5,065	3,792	33.6
Non-current assets classified as held for sale	132	9	n.m.
<b>Total Assets = Total Equity and Liabilities</b>	<b>105,873</b>	<b>108,982</b>	<b>(2.9)</b>
<b>Equity</b>	<b>22,855</b>	<b>20,001</b>	<b>14.3</b>
Equity attributable to equity holders of the parent	20,125	17,178	17.2
Minority interest	2,730	2,823	(3.3)
<b>Non-current liabilities</b>	<b>58,044</b>	<b>62,644</b>	<b>(7.3)</b>
Long-term financial debt	46,942	50,675	(7.4)
Deferred tax liabilities	3,926	4,700	(16.5)
Long-term provisions	6,161	6,287	(2.0)
Other long-term liabilities	1,015	982	3.4
<b>Current liabilities</b>	<b>24,974</b>	<b>26,337</b>	<b>(5.2)</b>
Short-term financial debt	6,986	8,382	(16.7)
Trade and other payables	8,729	8,533	2.3
Current tax payable	2,157	2,841	(24.1)
Short-term provisions and other liabilities	7,102	6,580	7.9
<b>Financial data</b>			
<b>Net Financial debt <sup>1</sup></b>	<b>45,284</b>	<b>52,145</b>	<b>(13.2)</b>

Note: Figures are presented considering the Purchase Price Allocation of O2 as of February 2006.

<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**

		January-December		
		2007	2006	% Chg
Unaudited figures (Euros in millions)				
I	<b>Cash flows from operations</b>	<b>20,132</b>	<b>18,824</b>	<b>6.9</b>
II	Net interest payment <sup>1</sup>	(3,097)	(2,296)	
III	Payment for income tax	(1,457)	(1,100)	
A=I+II+III	<b>Net cash provided by operating activities</b>	<b>15,578</b>	<b>15,428</b>	<b>1.0</b>
B	Payment for investment in fixed and intangible assets	(7,205)	(6,828)	
C=A+B	<b>Net free cash flow after CAPEX</b>	<b>8,373</b>	<b>8,600</b>	<b>(2.6)</b>
D	Net Cash received from sale of Real Estate	129	24	
E	Net payment for financial investment	2,383	(21,574)	
F	Net payment for dividends and treasury stock <sup>2</sup>	(5,496)	(5,542)	
G=C+D+E+F	<b>Free cash flow after dividends</b>	<b>5,389</b>	<b>(18,492)</b>	<b>n.c.</b>
H	Effects of exchange rate changes on net financial debt	(819)	(511)	
I	Effects on net financial debt of changes in consolid. and others	(653)	4,097	
J	Net financial debt at beginning of period	52,145	30,067	
K=J-G+H+I	<b>Net financial debt at end of period</b>	<b>45,284</b>	<b>52,145</b>	<b>(13.2)</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 minoritaries from subsidiaries that are under full consolidation method and treasury stock.

**RECONCILIATIONS OF CASH FLOW  
AND OIBDA MINUS CAPEX**

		January-December		
		2007	2006	% Chg
Unaudited figures (Euros in millions)				
OIBDA		<b>22,825</b>	<b>19,126</b>	<b>19.3</b>
- CapEx accrued during the period		(8,027)	(8,003)	
- Payments related to commitments		(781)	(830)	
- Net interest payment		(3,097)	(2,296)	
- Payment for income tax		(1,457)	(1,100)	
- Results from the sale of fixed assets		(2,766)	(236)	
- Invest. in working cap. and other deferred income and exp		1,676	1,939	
= Net Free Cash Flow after CapEx		<b>8,373</b>	<b>8,600</b>	<b>(2.6)</b>
+ Net Cash received from sale of Real Estate		129	24	
- Net payment for financial investment		2,383	(21,574)	
- Net payment for dividends and treasury stock		(5,496)	(5,542)	
= Free Cash Flow after dividends		<b>5,389</b>	<b>(18,492)</b>	<b>n.c.</b>

Note: The concept "Free Cash Flow" reflects the amount of cash flow available to remunerate Telefónica S.A. Shareholders, to protect solvency levels (financial debt and commitments), and to accomodate 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 minoritaries, due to cash recirculation within the Group.

		January-December	
		2007	2006
Net Free Cash Flow after CapEx			
+ Payments related to cancellation of commitments		8,373	8,600
- Ordinary dividends payment to minoritaries		781	830
= Free Cash Flow		(307)	(514)
Weighted average number of ordinary shares outstanding during the period (millions)		8,847	8,916
= Free Cash Flow per share		4,758.7	4,779.0
		1.859	1.866

## NET FINANCIAL DEBT AND COMMITMENTS

### Unaudited Figures (Euros in millions)

December 2007

	Long-term debt	47,269
	Short term debt including current maturities	6,986
	Cash and Banks	(5,065)
	Short and Long-term financial investments <sup>1</sup>	(3,906)
<b>A</b>	<b>Net Financial Debt</b>	<b>45,284</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>	5,437
	Value of associated Long-term assets <sup>3</sup>	(676)
	Taxes receivable <sup>4</sup>	(1,472)
<b>C</b>	<b>Net commitments related to workforce reduction</b>	<b>3,289</b>
<b>A+B+C</b>	<b>Total Debt + Commitments</b>	<b>48,938</b>
	 <b>Net Financial Debt / OIBDA<sup>5</sup></b>	 <b>2.3x</b>
	<b>Total Debt + Commitments/ OIBDA<sup>5</sup></b>	<b>2.4x</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> Calculated based on December 2007 OIBDA, excluding results on the sale of fixed assets.

# TELEFÓNICA GROUP EXCHANGE RATES APPLIED

EXCHANGE RATES APPLIED	Jan-Dec 2007	Jan-Dec 2006	December 2007	December 2006
USA (US Dollar/Euro)	1.368	1.255	1.472	1.317
United Kingdom (Sterling/Euro)	0.685	0.682	0.733	0.672
Argentina (Argentinean Peso/Euro)	4.263	3.857	4.636	4.033
Brazil (Brazilian Real/Euro)	2.661	2.728	2.608	2.816
Czech Republic (Czech Crown/Euro)	27.756	28.338	26.620	27.495
Chile (Chilean Peso/Euro)	714.637	665.336	731.472	701.262
Colombia (Colombian Peso/Euro)	2,837.126	2,949.853	2,965.928	2,949.853
El Salvador (Colon/Euro)	11.974	10.977	12.881	11.524
Guatemala (Quetzal/Euro)	10.502	9.548	11.234	10.004
Mexico (Mexican Peso/Euro)	14.953	13.664	15.996	14.330
Nicaragua (Cordoba/Euro)	25.229	22.031	27.827	23.703
Peru (Peruvian Nuevo Sol/Euro)	4.282	4.108	4.409	4.205
Uruguay (Uruguayan Peso/Euro)	32.101	30.183	31.724	32.201
Venezuela (Bolivar/Euro)	2,942.254	2,695.418	3,165.015	2,832.861

<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/Dec/07 and 31/Dec/06.

January -  
December  
2007  
Results

Results by  
Regional  
Business Units

## Telefónica España

Telefónica España successfully bolstered its position in an extremely active and competitive market, meeting all the financial targets announced for 2007.

Revenues grew by 4.7% in 2007 to 20,683 million euros, beating the growth target of 3.5% - 4.5%. Operating income before depreciation and amortisation (OIBDA) jumped by 9.3% to 9,448 million euros, putting the OIBDA margin at 45.7%. For purposes of comparison with the OIBDA growth target for 2007 of between 9% and 11%, factoring in the factors taken into consideration when this target was set, OIBDA growth stood at 11.6%, meeting the target upgraded in July 2007.

CapEx amounted to 2,381 million euros, an increase of 3.4% from 2006. CapEx target for 2007, which excluded investments related to Real Estate Efficiency Plan, was set at keeping the figure below 2,400 million euros in 2007. Investment effort has been mainly devoted to growing the Internet and Broadband businesses, with significant investments related to ADSL and IP services (Imagenio). Worth to highlight is the launching of the mobile and fixed network transformation processes.

Operating Cash Flow (OIBDA-CapEx) for the year amounted to 7,067 million euros, growing by 11.4% compared to the January-December 2006 period.

As with regards to the Redundancy Plan (E.R.E. 2003-2007) at the Wireline Business, it should be noted its conclusion after registering 1,102 sign-ups in the final year of the programme, with a related provision of 345 million euros.

During the last quarter of 2007, Telefónica took decisions of organizational nature aiming to foster a structure to ease technological convergence and services delivering in the businesses where the company operates. With this objective, and within the integration model adopted, ongoing efforts on personnel reorganization are being implemented. This has resulted in a new personnel reorganization programme approved,

which by December 31st 2007 had already been initiated. The estimated cost of this programme amounts to 322 million euros (168 million euros at the Wireline Business and 154 million euros at the Wireless Business), with the corresponding provision already included in 2007 accounts.

Total personnel reorganization costs for year 2007 amount to 667 million euros at Telefónica España, of which 551 million euros were accounted for in the last quarter.

### Highlights of Telefónica España's Wireline Business:

- Sustained topline growth (+3.7% in 2007) underpinned by the good performance of Internet and Broadband services and, to a lesser extent, data and IT services.
- Strong competitive position in the Broadband market, maintaining its estimated market share above 56%. At the end of December Telefónica's retail Broadband accesses reached 4.6 million.
- Losses in the number of fixed telephony lines were contained at just 0.3% year-on-year (December 2007 vs. December 2006) after posting 32,801 net adds in the fourth quarter. Net losses for the year 2007 stood at 51,901 lines, the best year-on-year performance since 2001.
- 5.1% underlying OIBDA growth in 2007 (stripping out specific effects such as personnel reorganization costs, the Real Estate Programme and subsidies among others).
- Conclusion of the Redundancy Plan (2003/2007), to which a total of 13,870 employees signed up during the five years it was in force.

### Highlights of Telefónica España's Wireless Business include:

- Solid service revenues growth of 4.5% in 2007, driven by the strong performance of customer revenues (+8.0%).
- The customer base grew by 6.4% year-on-year to 22.8 million lines, with growth in the contract segment jumping 12.4%. Contract customers now account for almost 60% of the total customer base.
- Churn remained flat at 1.8% in the face of increased competitive pressure, similar to the 2006 figure, with a slight reduction in contract churn achieved down to 1.0%.

- Increasing contribution from data revenues (+12.4% in 2007 vs. 2006), with connectivity revenues posting the best performance, up over 70% in 2007.
- 6.5% increase in OIBDA under guidance criteria in year 2007 (excluding costs related to personnel reorganization). OIBDA reaches 4,395 million euros in 2007, with an OIBDA margin over revenues of 45.3%.

### **Wireline Business**

Revenues in 2007 amounted to 12,401 million euros, with growth reaching 3.7% year-on-year in the fourth quarter. Cumulative growth to December stood at 3.7%, slightly exceeding the growth target of between 2.5% and 3.5%.

This rise was underpinned by growth in Internet and Broadband services and data and IT services, not forgetting the noteworthy performance of traditional voice and access revenues, with the former falling slightly and the latter remaining stable.

Traditional access revenues amounted to 2,772 million euros, a year-on-year increase of 0.1%, led by the 2.0% increase in the PSTN line monthly fee and fewer losses of fixed telephony accesses relative to 2006.

- The Spanish wireline access market grew by an estimated 1.9% over the course of the year. The Company's fixed telephony accesses totalled 15,897,966 at the end of 2007 in the wake of fourth quarter net line gains of 32,801, stemming the pace of the year-on-year decline to 0.3% (-0.7% at September 2007). The strong performance during the fourth quarter, the best figure since the first quarter of 2001, means that net line losses in 2007 were contained at 51,901, down substantially on those recorded in 2006 (-185,696 net access losses). These figures make 2007 the best year since 2001 in terms of net adds.
- Telefónica's share of the wireline access market remained stable vs. September 2007 at 81%.

Voice service revenues continued to follow the positive trend seen in previous quarters, and fell by 1.6% in 2007 (-2.1% in the first nine months of the year). Voice service revenues remained flat in year-on-year terms in the fourth quarter, underpinned by a 12.5% jump in interconnection revenues, driven by higher incoming international and carrier traffic and falls in outgoing traffic (-1.4%) and handset sales (-6.1%).

- The number of pre-selected lines fell further, declining by 110,859 in 2007 to 1,795,660 at the end of December.
- In line with the positive revenue trend, Telefónica España's estimated share of wireline traffic remains stable at around 65%.

Internet and Broadband revenues surged by 11.9% in the fourth quarter, boosted by revenues in the retail Broadband segment which were 17.4% higher year-on-year. Internet and Broadband revenues increased by 15.5% in 2007 from 2006.

Retail Broadband service revenues were up +24.2% in December, accounting for 3.8 percentage points of the revenue growth registered by Telefónica España's Wireline Business. Growth in these revenues slowed through the year, to post a growth of 17.4% in the last quarter, due to the decline in retail Broadband net adds in 2007 vs. 2006 (-19.0%).

At the same time, wholesale Broadband service revenues fell 11.3% in 2007 mainly on account of the migration of wholesale ADSL to unbundled loops.

- Estimated net adds in the fixed Broadband Internet access market amounted to 0.4 million in the fourth quarter, resulting in estimated net adds of around 1.4 million for the entire year, 18.9% down on 2006. The total estimated market in Spain in December 2007 stood at 8.1 million accesses.
- Telefónica's retail Internet Broadband accesses net adds in the fourth quarter came to 227,480, taking total accesses to 4,571,599 at the end of December. This gave Telefónica continued segment leadership with an estimated market share of over 56%, slightly higher than in 2006.
- The estimated share of unbundled loops in the Broadband Internet access market increased to almost 17% (14% in 2006). Net adds during the fourth quarter amounted to 116,088 loops, down 29.3% on that recorded in the same quarter of 2006. Total unbundled loops at the end of December amounted to 1,353,940, of which 57.3% were shared access loops.
- The wholesale ADSL service continued to lose steam during the fourth quarter due to the lower number of migrations to unbundled loops. In the wake of net fourth quarter losses of 13,658 total wholesale accesses amounted to 499,263 at the end of December.
- Telefónica continues to spearhead the development of the pay TV market in Spain, achieving an estimated market share below 13% (10% by December end 2006) after adding 42,020 new customers in the fourth quarter. As a result its customer base had risen to 511,087 by the end of December 2007.
- The total number of Duo and Trio bundles stood at 3,792,002 units at the end of December 2007. It is worth highlighting that over 80% of the Company's retail Internet Broadband accesses are included in a double or triple play bundle (over 70% by December 2006 end).

Data service revenues grew sharply in the fourth quarter to 14.1% from 5.6% in the nine months to September 2007. This increase in the pace of growth is underpinned by the 12.0% increase in revenues from Virtual Private Networks (VPNs) in the fourth quarter of 2007, driven by the strong uptake in fibre and ADSL VPNs. Wholesale services also posted an impressive 22.8% growth in the fourth quarter, compared with growth of 6.8% in the January-September 2007 period.

IT service revenues grew 11.6% in 2007 versus 2006.

Operating expenses at Telefónica España's Wireline Business totalled 7,337 million euros in 2007, 4.0% less than in 2006. This fall relates to lower personnel reorganization costs (513 million

euros in 2007 vs. 980 million euros in 2006), which fell by 47.7%. These costs are broken up into 345 million euros in connection with the E.R.E. 2003-2007 (Redundancy Plan) to which 1,102 employees have joined in 2007, the ending year of the programme, plus 168 million euros of the new personnel reorganization programme initiated in 2007 and to be implemented through 2008.

Stripping out personnel reorganization costs in 2006 and 2007 and the actuarial review, operating expenses grew 2.5% in 2007. This growth was due to: i) the 8.5% rise in external services expenses to 1,413 million euros due to increased commercial activity and PUT (Public Use Telephony) expenses; ii) the 1.2% increase in supply expenses to 3,008 million euros, especially expenses associated with Internet and Imagenio; and iii) the 0.2% growth in personnel expenses, once stripped out personnel reorganization costs, amounting 2,129 million euros. Personnel expenses fell by 14.9% in the year as a whole to 2,642 million euros due to the impact of the above mentioned lower personnel reorganization costs.

Topline growth outpaced expenses excluding personnel reorganization costs. This, together with the decline of personnel reorganization costs, boosted operating income before depreciation and amortisation (OIBDA) by 14.8% to 5,249 million euros in 2007.

OIBDA in October-December 2007 totalled 1,181 million euros, substantially higher than the figure reported in the same period of 2006 (+47.1%). This was due primarily to the higher personnel reorganization costs accounted for in the last quarter of 2006 (588 million euros vs. 397 million euros in the fourth quarter of 2007).

Stripping out specific items such as the redundancy provision (E.R.E. 2003-2007), the new personnel programme, the real estate programme, subsidies, the fine imposed by the EU and recognised in the second quarter, and others, underlying OIBDA rose 5.1% in 2007, having grown by 3.5% in the fourth quarter of 2007. For purposes of comparison with the stated financial targets, if a total provision of 630 million euros had been booked for personnel reorganization costs (compared with the actual provision of 513 million euros), and capital gains from property sales and others stood at 162 million euros (compared with the reported amount of 163 million euros), OIBDA growth would have been 15.8%, at the top end of the growth target of 13.5% - 16% (the 151.9 million euro fine imposed by the European Union is considered a unforeseeable expense and consequently is not included as part of the financial targets).

The OIBDA margin in 2007 stood at 42.3%. Excluding the effect of personnel reorganization programmes and the actuarial review in both years, along with the fine imposed by the European Union in the second quarter of 2007, the OIBDA margin would have expanded by 1.3 percentage points year-on-year to 47.7%.

### Wireless Business

The Spanish wireless market surpassed the 50.7 million-line mark by the end of 2007, with an estimated penetration rate of 111% (an increase of more than 6 percentage points vs. December 2006).

Against this backdrop, Telefónica España's Wireless Business achieved net adds of 406,837 customers in the fourth quarter (426,235 in the fourth quarter of 2006), beating the figures recorded in the first three quarters of the year. In cumulative terms, Telefónica España's net adds stood at 1,380,596 lines (1,556,027 in 2006), with a noteworthy number of customer gains in the contract segment (1,501,800, up 4.3% on 2006). This made Telefónica España clear leader in contract adds in the Spanish market, improving its share of net adds in this segment in an increasingly competitive market.

Commercial activity grew by 4.4% in the final quarter in year-on-year terms, with a total of more than 11.9 million commercial actions in the year, a 2.9% increase on 2006. Customer base now totals more than 22.8 million (+6.4% vs. December 2006), underpinned by growth in the contract segment (+12.4% vs. December 2006), which accounted for almost 60% of the total customer base at the end of 2007 (up more than 3 percentage points on December 2006).

In portability, lines balance was positive in the fourth quarter of 2007, underpinned by the strong performance of the highest value segment, specifically 36,593 net contract adds. In the year as a whole, the net portability balance was positive (494 lines), with net adds in the contract segment of 238,320 lines.

Strong gross adds (+3% in 2007 vs. 2006) and stable churn were key to the positive outcome of the company's commercial strategy. Particularly noteworthy was the growth in contract adds, which rose 12.0% year-on-year. Churn in 2007 stood at 1.8%, the same rate as in 2006 despite increased pressure from competition, and the company even achieved a slight reduction in contract churn (-0.03 percentage points) to 1.0%. Prepay churn in the final quarter of the year was lower than in the third quarter of 2007 (-0.3 percentage points) and than in the final quarter of 2006 (-0.1 percentage points). Handset upgrades once again played a key role in churn performance. Driven by loyalty campaigns, these grew by 7.8% versus the fourth quarter of 2006 and rose 7.4% in year-on-year terms.

In terms of usage, the volume of traffic carried in the final quarter grew by 6.2% year-on-year (more than 15,500 million minutes) and by 11.5% in the year as a whole (over 63,300 million minutes). On-net traffic rose 7.4% in the fourth quarter and by 14.0% in the year. MoU amounted to 161 minutes in 2007 (+3.0% vs. 2006). The drop in MoU in the fourth quarter of 2007 vs. the fourth quarter of 2006 was due to the different types of promotions carried out in the two periods.

Voice ARPU reached 26.7 euros in the final quarter of the year, 4.5% lower than in the same quarter of 2006. The main causes of this decrease were the April and October cuts in interconnection rates (14.9% in cumulative terms) and the regulation of roaming tariffs in the European Union. Year-on-year voice ARPU terms falls 2.8% to 27.6 euros. Outgoing voice ARPU in 2007 fell slightly to 22.9 euros (-1.0%), declining by 2.9% in the fourth quarter of 2007 to 22.3 euros.

Meanwhile, data ARPU reached 5.0 euros in the fourth quarter, with year-on-year growth of 1.8% (with an increase of +2.6% in outgoing data ARPU), and full-year growth of 4.8% (5.2% in outgoing data ARPU) to 4.8 euros. The lower data ARPU growth in the fourth quarter was due to the slowdown in content services, driven by the restructuring process affecting the sector and the regulatory uncertainty (although this was recently resolved). Stripping out content revenues both in the fourth quarter of 2007 and the year as a whole, data ARPU would be growing at a rate of over 6%, underpinned by connectivity revenues (over 70% growth versus the fourth quarter of 2006).

At the end of December Telefónica España's customers held more than 3.5 million UMTS/HSDPA handsets, representing a penetration of 16% excluding M2M, up 10 percentage points from 2006.

As a result, total ARPU in the fourth quarter of 2007 was 31.8 euros, 3.6% lower than in the fourth quarter of 2006 and down 1.8% in the full year at 32.3 euros. Outgoing ARPU in 2007 remained at a similar level to 2006 (27.1 euros).

With regard to data roaming, on January 14th the Wireless Business of Telefónica España and Telefónica Europe announced a range of new Internet roaming rates for users travelling in Europe. These will be between 42% and 61% lower than at present.

Revenues rose 5.4% in 2007 to 9,693 million euros vs. 2006 and by 3.2% in the fourth quarter to 2,407 million euros. It is worth noting that since January 1st 2007 the way prepay sales and top-up commissions are accounted has changed. Instead of being recognised as a decrease in revenues, they are now reported as costs. Also, revenues/costs of portability transit routing are now reported at the net amounts. The net effect of this change is neutral at OIBDA level, although revenues would have risen 2.9% in the fourth quarter and 5.1% in 2007 excluding these accounting changes. Highlights by revenue item:

- Service revenues grew by 2.6% in the fourth quarter and by 4.5% in 2007 to 8,509 million euros, within the target of between 4.0% and 5.0% growth respectively. Growth was primarily driven by customer revenues, which surged 8.0% in 2007 (+5.8% in the quarter, impacted by the regulation of roaming tariffs in the EU from September 2007) to 6,861 million euros.
- Interconnection revenues fell 8.6% in 2007 (-10.8% in the fourth quarter), due to the reduction in interconnection rates. Roaming-in revenues fell by 12.4% over the year due to the downward trend in wholesale prices (-6.3% in the fourth quarter).

- Revenue from handset sales totalled 1,184 million euros, a year on-year rise of 11.9% and of 7.6% in the fourth quarter.
- During the last quarter of 2007, Telefónica took decisions of organizational nature aiming to foster a structure to ease technological convergence and services delivering in the businesses where the company operates. With this objective, and within the integration model adopted, ongoing efforts on personnel reorganization are being implemented. This has resulted in a new personnel reorganization programme approved, which by December 31st 2007 had already been initiated. The estimated cost of this programme amounts to 154 million euros, with the corresponding provision already included in 2007 accounts.
- Operating costs amounted to 5,541 million euros in 2007, up 7.6% on the 2006 total, underpinned by greater cost efficiency and impacted by the provision mentioned. In the fourth quarter, operating costs were 13.1% up year-on-year, totalling 1,531 million euros. Excluding this provision, the operating costs would have amounted to 5,387 million euros in 2007 (1,378 million euros in the fourth quarter), up 4.6% vs. 2006 (+1.8% in the quarter).

Operating income before depreciation and amortisation (OIBDA) grew by 2.8% in 2007 in relation to 2006 to 4,241 million euros. Fourth-quarter OIBDA amounted to 902 million euros, a year-on-year decline of 10.0%.

Excluding the aforementioned provision, the OIBDA would have increased by 6.5% vs. 2006 amounting 4,395 million euros comfortably beating the target of between 4.0% and 5.0% growth. In the fourth quarter, the OIBDA excluding the provision reached 1,056 million euros, up 5.3% year-on-year. The OIBDA margin stood at 43.9% in the fourth quarter (43.0% in the same period of 2006), and 45.3% in cumulative terms vs. 44.9% in 2006, despite increasing commercial activity in a highly competitive market.

**TELEFÓNICA ESPAÑA****ACCESSES**

Unaudited figures (thousands)	2006		2007			% Chg y-o-y
	December	March	June	September	December	
<b>Final Clients Accesses</b>	<b>42,620.8</b>	<b>43,115.8</b>	<b>43,508.2</b>	<b>43,885.2</b>	<b>44,514.9</b>	<b>4.4</b>
Fixed telephony accesses <sup>1</sup>	15,949.9	15,920.3	15,906.2	15,865.2	15,898.0	(0.3)
Internet and data accesses	4,842.0	4,963.2	5,048.4	5,131.3	5,279.3	9.0
Narrowband	1,040.5	916.0	798.1	736.5	660.8	(36.5)
Broadband <sup>2</sup>	3,742.7	3,992.7	4,198.4	4,344.1	4,571.6	22.1
Other <sup>3</sup>	58.8	54.4	52.0	50.7	47.0	(20.1)
Mobile accesses	21,446.0	21,813.7	22,102.7	22,419.7	22,826.6	6.4
Pre-Pay	9,303.0	9,283.8	9,182.9	9,158.0	9,181.8	(1.3)
Contract	12,142.9	12,529.9	12,919.8	13,261.7	13,644.7	12.4
Pay TV	383.0	418.6	450.9	469.1	511.1	33.4
<b>Wholesale Accesses</b>	<b>1,531.8</b>	<b>1,640.8</b>	<b>1,707.8</b>	<b>1,757.2</b>	<b>1,859.2</b>	<b>21.4</b>
Unbundled loops	939.0	1,071.2	1,170.0	1,237.9	1,353.9	44.2
Shared ULL	527.7	605.2	664.5	713.5	776.4	47.1
Full ULL	411.3	466.0	505.5	524.4	577.6	40.4
Wholesale ADSL	586.4	561.7	530.5	512.9	499.3	(14.9)
Other <sup>4</sup>	6.4	7.8	7.4	6.5	6.0	(5.4)
<b>Total Accesses</b>	<b>44,152.6</b>	<b>44,756.6</b>	<b>45,216.0</b>	<b>45,642.5</b>	<b>46,374.2</b>	<b>5.0</b>

<sup>1</sup> PSTN (including Public Use Telephony) x1; ISDN Basic access x1; ISDN Primary access; <sup>2</sup>/6 Access x30. Company's accesses for internal use included.<sup>2</sup> ADSL, satellite, optical fibre, cable modem and Broadband circuits.<sup>3</sup> Leased lines.<sup>4</sup> Wholesale circuits.

Note: Does not include Iberbanda's accesses

**TELEFÓNICA ESPAÑA  
CONSOLIDATED INCOME STATEMENT**

Unaudited figures (Euros in millions)	January-December			October-December		
	2007	2006	% Chg	2007	2006	% Chg
Revenues	20,683	19,750	4.7	5,222	5,030	3.8
Internal exp capitalized in fixed assets <sup>1</sup>	220	215	2.5	59	65	(9.3)
Operating expenses	(11,505)	(11,429)	0.7	(3,366)	(3,328)	1.2
Other net operating income (expense)	(71)	48	C.S.	8	25	n.m.
Gain (loss) on sale of fixed assets	137	80	72.6	145	(3)	n.m.
Impairment of goodwill and other assets	(17)	(17)	1.1	(3)	(5)	(41.7)
<b>Operating income before D&amp;A (OIBDA)</b>	<b>9,448</b>	<b>8,647</b>	<b>9.3</b>	<b>2,064</b>	<b>1,783</b>	<b>15.7</b>
Depreciation and amortization	(2,382)	(2,533)	(6.0)	(587)	(619)	(5.1)
<b>Operating income (OI)</b>	<b>7,067</b>	<b>6,113</b>	<b>15.6</b>	<b>1,476</b>	<b>1,164</b>	<b>26.8</b>

Note: "Bad debt provisions" have been reclassified from "Other net operating income (expense)" to "Operating expenses".

<sup>1</sup> Including work in process.

**TELEFÓNICA ESPAÑA:  
WIRELINE BUSINESS SELECTED FINANCIAL DATA**

Unaudited figures (Euros in millions)	January-December			October-December		
	2007	2006	% Chg	2007	2006	% Chg
Revenues	12,401	11,964	3.7	3,183	3,070	3.7
OIBDA	5,249	4,572	14.8	1,181	803	47.1
OIBDA margin	42.3%	38.2%	4.1 p.p	37.1%	26.1%	11.0 p.p
CapEx	1,614	1,555	3.8	552	506	9.1

**TELEFÓNICA ESPAÑA:  
WIRELINE BUSINESS SELECTED REVENUES DATA**

Unaudited figures (Euros in millions)	January-December			October-December		
	2007	2006	% Chg	2007	2006	% Chg
<b>Traditional Access<sup>1</sup></b>	<b>2,772</b>	<b>2,768</b>	<b>0.1</b>	<b>688</b>	<b>689</b>	<b>(0.2)</b>
<b>Traditional Voice Services</b>	<b>4,792</b>	<b>4,868</b>	<b>(1.6)</b>	<b>1,203</b>	<b>1,203</b>	<b>0.0</b>
Domestic Traffic <sup>2</sup>	2,921	3,014	(3.1)	729	740	(1.4)
Interconnection <sup>3</sup>	952	907	5.0	237	211	12.5
Handsets sales and others <sup>4</sup>	918	947	(3.1)	237	252	(6.1)
<b>Internet Broadband Services</b>	<b>2,775</b>	<b>2,403</b>	<b>15.5</b>	<b>716</b>	<b>640</b>	<b>11.9</b>
Narrowband	95	143	(33.4)	18	26	(30.2)
Broadband	2,679	2,260	18.6	698	615	13.6
Retail <sup>5</sup>	2,361	1,901	24.2	624	532	17.4
Wholesale <sup>6</sup>	318	359	(11.3)	74	83	(10.2)
<b>Data Services</b>	<b>1,160</b>	<b>1,076</b>	<b>7.8</b>	<b>309</b>	<b>270</b>	<b>14.1</b>
<b>IT Services</b>	<b>437</b>	<b>392</b>	<b>11.6</b>	<b>133</b>	<b>136</b>	<b>(2.0)</b>

Note: Telefónica de España parent company's operating revenues includes Terra España's revenues as of the first quarter 2006.

<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, interprovincial and international) fixed to mobile traffic, Intelligent Network Services, Special Valued Services, Information Services (n8xy), bonuses and others.

<sup>3</sup> Includes revenues from fixed to fixed incoming traffic, mobile to fixed incoming traffic, and transit and carrier traffic.

<sup>4</sup> Managed Voice Services and other businesses revenues.

<sup>5</sup> Retail ADSL services and other Internet Services.

<sup>6</sup> Includes Megabase, Megavía, GigADSL and local loop unbundling.

**TELEFÓNICA ESPAÑA:  
WIRELESS BUSINESS SELECTED FINANCIAL DATA**

	January-December			October-December		
	2007	2006	% Chg	2007	2006	% Chg
Unaudited figures (Euros in millions)						
Revenues	9,693	9,199	5.4	2,407	2,333	3.2
OIBDA	4,241	4,128	2.8	902	1,002	(10.0)
OIBDA margin	43.8%	44.9%	(1.1 p.p)	37.5%	43.0%	(5.5 p.p)
CapEx	767	750	2.4	257	341	(24.6)

**TELEFÓNICA ESPAÑA: WIRELESS BUSINESS  
SELECTED REVENUES DATA**

	January-December			October-December		
	2007	2006	% Chg	2007	2006	% Chg
Unaudited figures (Euros in millions)						
Service Revenues	8,509	8,142	4.5	2,111	2,058	2.6
Customer Revenues	6,861	6,353	8.0	1,718	1,623	5.8
Interconnection	1,372	1,500	(8.6)	333	373	(10.8)
Roaming-in	220	251	(12.4)	44	47	(6.3)
Other	57	38	49.5	17	15	13.2
Handsets	1,184	1,058	11.9	296	275	7.6

**TELEFÓNICA ESPAÑA: WIRELESS BUSINESS  
SELECTED OPERATING DATA**

	2006				2007	
	December	March	June	September	December	% Chg y-o-y
Unaudited figures						
<b>Mobile customer (thousands)</b>	<b>21,446.0</b>	<b>21,813.7</b>	<b>22,102.7</b>	<b>22,419.7</b>	<b>22,826.6</b>	<b>6.4</b>
Pre-pay	9,303.0	9,283.8	9,182.9	9,158.0	9,181.8	(1.3)
Contract	12,142.9	12,529.9	12,919.8	13,261.7	13,644.7	12.4
	<b>4Q</b>	<b>1Q</b>	<b>2Q</b>	<b>3Q</b>	<b>4Q</b>	<b>% Chg y-o-y</b>
<b>MoU (minutes)</b>	<b>157</b>	<b>160</b>	<b>159</b>	<b>168</b>	<b>156</b>	<b>(0.8)</b>
Pre-pay	66	74	67	89	64	(2.8)
Contract	228	224	225	223	218	(4.4)
<b>ARPU (EUR)</b>	<b>33.0</b>	<b>31.7</b>	<b>32.8</b>	<b>33.1</b>	<b>31.8</b>	<b>(3.6)</b>
Pre-pay	15.9	14.9	15.7	16.5	15.0	(5.7)
Contract	45.7	44.3	45.1	44.8	43.2	(5.6)
<b>Data ARPU</b>	<b>5.0</b>	<b>4.6</b>	<b>4.6</b>	<b>4.9</b>	<b>5.0</b>	<b>1.8</b>
% non-P2P SMS over data revenues	45.3%	48.1%	49.5%	48.4%	47.7%	2.4 p.p

Note: MoU and ARPU calculated as monthly quarterly average.

## Telefónica Latinoamérica

In accordance with the Group's new structure, Telefónica Latinoamérica's results include Telefónica Group's fixed line and wireless operators' results in the Latin American region. Furthermore, figures for the Telefónica Latinoamérica Group also include the results of Telefónica Telecom, from the 1st of May 2006.

At the end of December 2007, Telefónica Latinoamérica managed 134.1 million accesses, a year-on-year increase of 16.9%, boosted by growth of 22.4% in cellular customers to almost 102 million. Net adds during the fourth quarter amounted to 7.3 million, the Group's best ever figure.

Growth rates were high in almost all the countries in the mobile business, with customer growth especially robust in Mexico (+46.6% year-on-year to over 12.5 million customers), Argentina (+22.6%, 13.7 million customers), and Peru (+58.5%, 8.1 million customers).

Wireline telephony accesses reached 23.9 million, in line with those managed a year earlier, with significant growth in Peru (+11.3% year-on-year) which offset the lower number of lines in service in other countries. Growth in retail internet Broadband accesses remained strong, up 33.2% year-on-year to over 5.0 million accesses, reflecting the sales and marketing efforts made by all the operators. Telefónica Latinoamérica now has close to 1.2 million pay TV customers, with operations in Peru, Chile, Colombia and, since the third quarter of 2007, Brazil, where Telesp's satellite TV licence was complemented in the fourth quarter of 2007 with the incorporation of TVA.

The currencies of the countries in which Telefónica operates depreciated against the euro in year-on-year terms, with the exception of the Brazilian real and the Colombian peso, whose average exchange rates appreciated by 2.5% and 3.7% respectively. This detracted 3.5 and 3.2 percentage points from revenue and OIBDA growth in 2007 respectively, although less than in previous quarters (currency effects reduced revenue and OIBDA growth by 3.7 and 3.5 percentage points in the first nine months, respectively, and by 5.0 and 4.9 percentage points respectively in the first half of 2007).

Revenues at Telefónica Latinoamérica in 2007 rose 11.0% year-on-year in current euros to 20,078 million euros. In constant euros revenue growth was 14.5%, within the growth range communicated to the market of +13% to +16%<sup>1</sup>. Changes in the consolidation perimeter contributed 1.5 percentage points to constant currency revenue growth. In constant currency terms, the countries contributing most to top line growth are Mexico and Venezuela with respective contributions of 3.2 and 3.1 percentage points. Brazil continues to make the largest contribution to Telefónica Latinoamérica's revenues (38.2%) followed by Venezuela (11.9%) and Argentina (11.3%).

Operating income before depreciation and amortisation (OIBDA) jumped 8.4% in current euros in 2007 to 7,121 million euros. In constant currency terms, Telefónica Latinoamérica's OIBDA growth increased to 11.5%. Changes in the consolidation perimeter contributed 1.0 percentage points to constant currency OIBDA growth. By country, Venezuela contributed most to OIBDA growth (5.2 percentage points), followed by Mexico (3.1 percentage points). In absolute terms, Brazil is the largest contributor to Telefónica Latinoamérica's OIBDA, accounting for 43.1% of the total, followed by Venezuela (14.9%) and Argentina (11.1%).

<sup>1</sup> T. Latam base reported figures include eight months of Telefónica Telecom (consolidated since May 2006). 2007 guidance assumes constant exchange rates as of 2006. All figures exclude changes in consolidation. In terms of guidance calculation, OIBDA excludes other exceptional revenues/expenses not foreseeable in 2007. Personnel reorganization plans and Real Estate Programs are included as operating revenues/expenses, with the exception of the ones decided after the guidance communication at the beginning of the year. For comparison the equivalent other exceptional revenues/expenses registered in 2006 are also deducted from reported figures.

Telefónica Latinoamérica's OIBDA growth slowed in the fourth quarter of 2007 (+13.8% in constant euros to September) as a result of a provision of 258 million euros in the quarter for personnel reorganization plans in several group companies, after the company decided to accelerate the implementation of plans already in place, and the launching of new ones. Personnel reorganization costs stood at 318 million euros in 2007, with the departure of 1,684 people in the year accounting for 105 million euros of this sum. The company's plans for 2008 account for the remaining 213 million euros, affecting Telesp, Telefónica del Perú, Telefónica de Argentina, Telefónica Telecom and Telefónica Móviles Colombia. Regarding the objectives communicated to the market, OIBDA grew by 15.5%, within the range of 14% to 17%<sup>1</sup> forecast by the company, which did not factor in the personnel reorganization expenses recorded in the fourth quarter of 2007.

Telefónica Latinoamérica's OIBDA margin in 2007 amounted to 35.5%, 0.9 percentage points lower than in 2006, affected by the personnel reorganization provisions outlined above. Excluding these provisions, the margin would have been 37.1% (0.3 percentage points higher than the one recorded in 2006).

Telefónica Latinoamérica's CapEx in 2007 stood at 3,343 million euros, up 18.9% year-on-year (+23.0% in constant euros). This increase was driven by stronger commercial activity at its wireline business, both in Broadband and TV, the increased coverage and capacity of its GSM networks and the acquisition of spectrum in Venezuela, Brazil and Panama to expand coverage and guarantee service quality in areas where traffic is heaviest.

In 2007 Telefónica Latinoamérica generated operating cash flow (OIBDA-CapEx) of 3,778 million euros, growth of 0.5% in current euros (+3.0% in constant euros).

### Brazil

Telefónica Latinoamérica managed close to 49 million accesses in Brazil at 31 December 2007, 9.5% more than a year earlier. This growth reflects a 15.2% year-on-year increase in Vivo's customer base and, to a lesser extent, the expansion of Telesp's Broadband business and the incorporation of TVA's MMDS pay TV customers. This is offset by a reduction in the number of wireline accesses at Telesp and the changes to the accounting criteria used to record narrowband internet accesses made in the second quarter of 2007.

In 2007, Telefónica Latinoamérica in Brazil reported revenues of 7,662 million euros, up 3.2% in local currency vs. 2006 thanks to the sharp increase in Vivo's sales, which offset Telesp's lower revenues. Operating income before depreciation and amortisation (OIBDA) totalled 3,026 million euros, down 3.8% on 2006 due to the fall in earnings at Telesp, partly related to tax reversals booked in 2006 and the higher provisions made in 2007 for personnel reorganization (explaining 0.8 percentage points of this reduction) which were not offset by the significant improvement in Vivo's results. Meanwhile CapEx amounted to 1,087 million euros, an increase of 3.1% year-on-year in local currency, driven by the larger investments carried out by Telesp in its growth businesses (Broadband and television).

### TELESP

At the end of December, Telesp managed 15.5 million telephony, Broadband and TV accesses, 1.2% less than in 2006, due both to the reduction in the number of wireline accesses, in a context of a strong growth in the cellular business in the country, and the implementation of more restrictive accounting criteria (based on activity) for narrowband Internet accesses. The company ended the year with just under 12 million wireline accesses (-1.2% year-on-year), of which approximately 22% were prepay or lines with consumption limits. A total of 196,300 MMDS TV accesses from TVA (acquired recently) were added in December 2007 to the 34,600 satellite TV (DTH) subscriber base. This latter service was launched in August 2007.

The Broadband market continued to grow strongly in 2007 (+36% vs. 2006). Telesp accounted for around 56% of this growth, increasing its retail Broadband customer base by 28.7% vs. 2006 to over two million accesses. A number of significant milestones were achieved in 2007. These included: the launch of the Trío Telefónica triple play bundle on 12 August, with different connection speed options and a range of TV content choices, on 1 October the company included GloboSat content in its TV offer, and in the fourth quarter the acquisition of TVA's MMDS operations was completed.

Telesp carried slightly more (+1.5%) traffic in 2007 (71,140 million minutes) than a year earlier, due mainly to growth in long distance traffic by SMP mobile accesses (+36.2%) as a result of the joint marketing strategy rolled out with VIVO. Local traffic levels were similar to those recorded in 2006 despite the reduction in the number of wireline accesses. Fixed-mobile traffic fell a noteworthy 4.4% year-on-year as a result of heavy migration to wireless networks.

Telesp is focusing on the sale of traffic bundles, both bundled lines (monthly fee + unlimited local calling) and traffic packages (long distance, fixed-mobile and narrowband Internet traffic).

Telesp reported revenues of 5,619 million euros in 2007, down 1.5% year-on-year in local currency. This slight drop in revenues was due to the fall in traditional business revenues (-3.1% vs. 2006 in local currency), attributable to the loss of basic telephony billable lines, the change in customer mix with a higher percentage of lines with consumption limits, the negative tariff adjustment made in July 2006 and the 20% reduction in local interconnection tariffs in January.

The increase in Broadband revenues (+16.2% in local currency), lagged access growth due to more intense competition and was not sufficient to fully offset the fall in traditional revenues. Nonetheless, the operator readjusted ADSL tariffs in mid October to coincide with the launch of an improved range of speeds for new ADSL services. The pace of growth marked by Internet revenues (narrowband + Broadband + TV) picked up (+14.1% year-on-year in local currency vs. +10.3% to September) and these now account for 9.9% of the company's revenues (8.5% in 2006) due to the increase in Broadband revenues and the incorporation of TVA's revenues in the fourth quarter.

Operating expenses rose 5.9% in local currency in 2007, affected by a higher level of bad debt, leading to higher provisions (+65.5% in local currency vs. 2006). The ratio of bad debt to revenues was 3.6%, lower than the figure of 3.9% reported in September, due to the implementation of various measures adopted to stem this ratio. These include stricter entry filters and more actions to recover bad debts. Another factor behind the rise in operating expenses is the higher external service expenses (+5.4% in local currency) caused by stronger commercial activity. Supply costs rose by 3.2% in local currency despite the 20% reduction in the local interconnection tariff, due mainly to the rise in

interconnection traffic (especially SMP). Personnel expenses rose by 5.0% in local currency due to the provisions associated with personnel reorganization programmes, which affected 800 employees in 2007. Total provisions amounted to 54 million euros, of which around 22 million euros correspond to plans that will be implemented in the first months of 2008. Personnel costs excluding these provisions decreased 1.0% vs. 2006 in local currency.

Telesp reported Operating income before depreciation and amortisation (OIBDA) of 2,438 million euros in 2007, down 9.7% year-on-year in local currency due to the loss of traditional business revenues, higher bad debt provisions and higher personnel reorganization costs. The comparison is further affected by the fact that in September 2006 Telesp recorded tax reversals (PIS/COFINS). The OIBDA margin stood at 43.4%, 3.9 percentage points lower than in 2006, impacted by the two factors mentioned above. Stripping out personnel reorganization expenses, Telesp's OIBDA would have fallen by 8.7% vs. 2006 in local currency, with a margin of 44.3%.

CapEx in 2007 was 729 million euros in local currency, 11.2% higher than the figure reported a year earlier due to greater investment in Broadband and pay TV and higher cable theft recorded in the last three quarters.

#### VIVO

Vivo's strong earnings in 2007 reflect the management measures implemented in 2006 and 2007 to achieve profitable growth and increase customer satisfaction, resulting in a significant increase in the customer base and the ARPU growth.

Momentum remained strong in the fourth quarter, with the Christmas campaign launched in November resulting in fierce competition on the market. Also, Vivo has been involved in convergent offer campaigns since October, with minute combinations for cellular, wireline and Internet calls and two mobile-fixed packages. Vivo maintained its leadership in the quarter in terms of market share and adds in its operating area.

The company reported 4.2 million gross adds in the final quarter of the year, 1.7 million more than in the same quarter last year (+66.5%), one of the highest figures in recent years. Factors contributing to this strong performance include the wider range of handsets, Vivo's leadership in terms of commercial reach, ongoing incentive campaigns for prepay traffic and the improved capacity to attract contract customers with the "Vivo Escolha" plans. It is worth highlighting that Vivo achieved net adds close to 2.2 million new customers in the fourth quarter, enjoying a position of market leadership in terms of customer acquisitions in December (1.4 million customers, a net gain market share above 38% in its operating area). As a result, Vivo's net adds for the year stood at over 4.4 million customers.

By the end of 2007, 42% of the contract segment had subscribed to a Vivo Escolha plan, significantly enhancing the market's perception of Vivo's commercial offer. Contract gross adds rose 39.7% in the fourth quarter year-on-year and by 47.2% year-on-year for the full year. These plans also helped to increase customer loyalty, with total churn in the fourth quarter standing at 2.1% (0.4 percentage points less than in the same quarter a year earlier) and at 2.3% in the year (compared with 2.9% in 2006).

Also noteworthy was the market's positive reaction to Vivo's GSM network. Vivo obtained 85% of gross GSM adds in the quarter, putting its GSM customer base at the end of December at 11.3 million, 34% of its total customer base.

Vivo ended December with a total of 33.5 million customers (+15.2% vs. December 2006) in a market with an estimated penetration rate of 65.6%, up more than 10 percentage points year-on-year in the company's area of activity. This figure reflects the high levels of commercial activity, especially in the fourth quarter.

Revenues for the year totalled 2,396 million euros, a year-on-year increase of +16.5% in local currency, with growth further accelerating in the final quarter (+15.8% year-on-year in local currency in the first nine months of 2007). Service revenues grew 18.4% year-on-year in local currency, vs. 2006, largely driven by higher interconnection revenues after the elimination of the Bill & Keep rule in July 2006. Stripping out this impact, service revenues would have grown 10.2% (vs. +8.1% in the first nine months of the year). In the contract segment, the Vivo Escolha plans remain the main tool for attracting and retaining the most valuable customers; leading to outgoing ARPU rise of 8.9%.

The prepay segment also continued to fare well in the fourth quarter, with outgoing ARPU up 22.9% year-to-date as a result of successful traffic incentive campaigns, leading to a 22.7% year-on-year increase in MoU.

Total MoU rose by 3.9% compared with the same period in 2006, with cumulative total ARPU up 14.5% year-on-year at 11.9 euros.

Vivo recorded Operating income before depreciation and amortisation (OIBDA) through to December of 588 million euros, an increase of 30.8% on 2006 in local currency. Contributing factors include strong topline growth combined with control over customer management costs, notably the 49.3% year-on-year reduction in bad debts in local currency. This in turn evidences the strict control exercised over new customer acquisitions in the campaigns. These controls were sufficient to offset higher commercial expenses.

The OIBDA margin in 2007 was 24.5%, up 2.7 percentage points on 2006, improving by 5.6 percentage points year-on-year in the final quarter to 25.6%. Excluding the impact of the elimination of the Bill&Keep rule, OIBDA growth in 2007 would have been 30.6%, with a margin of 27.4%.

In 2007 the company achieved full national coverage, winning thirteen of the fifteen 1900 licences auctioned in September, and the entirety of the J band in the 3G licence auction carried out by Anatel last December. This means it can now guarantee service quality in the areas with heaviest traffic. Also, Vivo is awaiting the final green light from Anatel to acquire Telemig, although the company agreed the sale of the Amazonía shares to Telemar in December.

## **Argentina**

Telefónica maintained its leadership in its operating area in 2007, to reach 19.5 million accesses, a year-on-year growth of 15.8%. This increase was underpinned by the sharp growth in cellular customers, up by 22.6% vs. December 2006 to more than 13.7 million, and by Broadband accesses, which totalled 819,000, 58.3% more than in 2006. This strong operating performance is reflected in the financial data, with revenues rising by 15.7% in local currency vs. 2006 to 2,264 million euros. Operating income before depreciation and amortisation (OIBDA) rose 8.0% year-on-year in local currency to 773 million euros in 2007, reaching an OIBDA margin of 32.9%. CapEx stood at 289 million euros (243 million euros in 2006). This higher investment is due to the development of Broadband and new businesses, as well as the increase in wireless network capacity.

### **Telefónica de Argentina**

Telefónica de Argentina had 5.7 million accesses at the end of 2007, up 2.1% on 2006. This figure was underpinned by the 58.3% growth in retail Broadband accesses to 819,000, which offset the slight fall in wireline accesses (-1.3%).

Total voice traffic remained stable year-on-year despite the sharp growth in the company's cellular business in the country. The falls in local (-5.6% vs. 2006) and interconnection (-4.8% vs. 2006) fixed-to-fixed traffic were offset by the healthy performance of mobile-to-fixed interconnection traffic (+27.4% vs. 2006). Intelligent network traffic improved throughout 2007 (+51.1% vs. 2006) while public use telephony traffic fell by -20.8% vs. 2006.

Revenues in the fixed line business came to 984 million euros in 2007, a year-on-year growth of 9.9% in local currency terms, with the traditional wireline business contributing 45% of this growth, the Internet business contributing 40%, and data and IT businesses accounting for the remainder.

Traditional revenues rose 5.4% in local currency in 2007, reflecting the strong uptake of flat rate plans, strong traffic (mobile to fixed interconnection) and momentum in value added services and the sale of equipment. Bundle revenue growth was underpinned mainly by local fixed-to-fixed calling plans on the back of strong uptake for the flat-rate per call plan launched in mid-2006, whose performance in 2007 exceeded all expectations. Higher interconnection revenues were driven primarily by traffic generated by mobile operators and incoming international traffic.

Internet and Broadband revenues were up by 34.8% vs. 2006, accounting for 14% of total revenues. The Broadband business was the main growth driver in 2007 with revenues up 45.7% in local currency and 819,000 accesses at the end of December, 1.6 times the number in December 2006; this offsets the fall in narrowband revenues. Broadband was boosted by the launch of the DUO plan (a flat rate plan bundling voice and Broadband) in the last quarter of 2006 with 34% of Broadband users currently using this plan.

Thanks to higher revenues from virtual private networks, turnkey projects and satellite services, data and information technology business lines continued to make heavy inroads (20.8% in local currency vs. 2006).

Operating expenses grew 30.6% year-on-year in local currency in 2007. This was largely due to the increase in personnel expenses (+68.5% in local currency) caused by salary rises and payments in connection with the personnel reorganization plan launched during the second half of 2006, which gathered pace in the second half of 2007. Personnel reorganization costs stood at 90 million euros in 2007 (67 million euros in the fourth quarter of 2007), with the departure of 741 personnel in 2007 accounting for 50 million euros of this sum; remaining 40 million euros correspond to reorganization to be executed in the coming months. Stripping out these personnel reorganization costs, operating expenses would have grown by 14.3% vs. 2006 and personnel costs by 18.7%. Supply costs rose 22.3% in local currency in 2007, driven up by higher equipment rental and higher purchases of equipment for resale. External service expenses rose 7.7% year-on-year in local currency due to the rise in activity (customer services, advertising, commissions and logistics and distribution), as well as price increases across various services including rents, energy and supplies, which do not offset other cost savings (general costs and temporary works).

The ratio of bad debt to revenues stood at 0.9%, 0.4 percentage points higher than in 2006 due to the impact of the strike action which meant lower collection activity during the troubles. However, sound management over this period permitted a reduction in the ratio of 1.1% reported in September 2007. Prepay and controlled consumption segments accounted for 25% of the total, down slightly compared with previous quarters.

Telefónica de Argentina's operating income before depreciation and amortisation (OIBDA) fell 13.3% year-on-year in local currency in 2007 to 356 million euros. This fall was chiefly attributable to the higher personnel expenses detailed earlier. Stripping out the personnel reorganization expenses, OIBDA would have grown by 6.2% vs. 2006 in local currency. The 2007 OIBDA margin stood at 30.9% (39.0% in 2006). Stripping out the impact of these expenses, the OIBDA margin would have reached 38.7% in 2007 (39.9% in 2006).

CapEx amounted to 165 million euros, a 30.3% increase in local currency on 2006. Investment was primarily earmarked for the development of Broadband and new businesses.

### **TEM Argentina**

The Argentine cellular market continued to grow at a strong pace in 2007, boosting estimated penetration to over 97% at December 2007 (+20 percentage points higher than at December 2006), ending the year with the highest penetration in Latin America.

Net adds in TEM Argentina in the fourth quarter of 2007 stood at 656,269 new customers. Over the year as a whole, churn was down on 2006 (1.7%, -0.3 percentage points vs. 2006), boosting net adds in the year to more than 2.5 million (compared with almost 2.9 million in 2006). It is noteworthy the strong focus in contract customer acquisition during 2007 and the fourth quarter of 2007, adding along the year 1.1 million customers (+68.5% vs. 2006), weighting the contract net adds in the fourth quarter 2007 more than 58% of the total. The company ended the year with almost 13.7 million customers, a 22.6% increase vs. the customer base at year-end 2006. GSM customers now account for 86.5% of the total customer base (+13.3 percentage points from December 2006).

Revenues hit the 1,353 million euro mark in 2007, an 18.7% year-on-year increase in local currency. The sound performance of service revenues, up 21.4% in local currency vs. 2006, drove growth.

Revenue growth, coupled with lower unit commercial costs and customer management expenses as well as lower network expenses, translated into an increase in operating income before depreciation and amortisation (OIBDA) of 36.5% year-on-year in local currency to 418 million euros. This left the OIBDA margin in 2007 at 30.9%, 4.1 percentage points higher than the previous year's figure.

CapEx in 2007 totaled 123 million euros, an increase of 33.2% in local currency from 2006 due to the increase of the network capacity.

### **Chile**

At the end of 2007 Telefónica Latinoamérica managed a total of 9.4 million accesses in Chile, 9.6% more than in December 2006, underpinned by growth in cellular accesses (+10.6% to 6.3 million), and, to a lesser extent, an increase in retail Broadband Internet accesses (+30.6% to 646,000) and pay TV (+133.4% to 220,000), while wireline telephony accesses fell 1.5% to 2.2 million.

Telefónica Latinoamérica's revenues in Chile totalled 1,814 million euros in 2007, a year-on-year increase of 14.3% in local currency. Revenues were fostered by the strong growth in the cellular telephony, Broadband and TV businesses, which offset the decline in the traditional wireline telephony business. Operating income before depreciation and amortisation (OIBDA) in 2007 totalled 716 million euros, up 8.2% in local currency vs. 2006 due to higher OIBDA in the cellular business which offset the drop in the results of the wireline business.

Telefónica Latinoamérica continues to invest heavily in Chile. CapEx in 2007 totalled 418 million euros, an increase of 32.3% in local currency from 2006. Main investments continue concentrating into the fastest growing businesses: mobile telephony, ADSL and pay TV.

### **Telefónica Chile**

At the end of 2007 Telefónica Chile managed a total of 3.1 million accesses, 7.5% more than in 2006. Telefónica Chile's wireline accesses fell by 1.5% from 2006, though the quarterly loss in wireline accesses has notably decreased (just 300 accesses in the fourth quarter compared with almost 29,000 in the first, 3,000 in the second and 1,700 in the third). Telefónica Chile remains the market leader with an estimated share of 65% in lines.

Broadband and pay TV accesses continued to grow. The commercial focus was on customer loyalty by pushing the DUO and TRIO bundles, packages which additionally increase ARPU. Telefónica Chile managed 646,000 retail Broadband Internet accesses at the end of 2007, maintaining its leadership of the Chilean Broadband market with an estimated 50% market share.

Telefónica Chile is still growing the pay TV business, reaching 220,000 subscribers by the end of 2007. After eighteen months of operations, Telefónica Chile has established itself as the second ranking pay TV operator in the country with an estimated market share of 17%. In June 2007 the company launched its IPTV service in certain areas of Santiago, becoming the first company to do so in Latin America. In addition, new services on the DTH platform, such as new decoders equipped with personal video recorders, were launched in the final months of the year.

The competitive landscape in telephony in Chile is marked by a significant fixed to mobile substitution effect. Triple play is the cornerstone of Telefónica Chile's strategic focus, aiming to increase the number of services per customer and accordingly, ARPU. In this way the operator continued to offset the contraction of its traditional telephony business with revenue growth in

Broadband and pay TV services. Revenues in 2007 totalled 974 million euros, a year-on-year increase of 4.0% in local currency. The launch of TV services in June 2006 and the increased Broadband penetration drove a 79.7% increase in Internet and Broadband revenues in local currency, offsetting the lower revenues from its traditional business (-5.8% in local currency). Internet and Broadband accounted for 18.5% of the operator's total revenues in 2007, 7.8 percentage points more than in 2006, while the weighting of its traditional business fell to 75% (-7.8 percentage points from 2006).

Operating expenses grew 8.9% in local currency vs. the same period in 2006. The highest increases were in external services (+19.3%), driven by higher commercial activity and improved service quality and customer services. Personnel expenses rose by 4.4% in local currency, primarily as a result of the enactment of the new Chilean Subcontracting Law. Stripping out personnel reorganization expenses, which fell by 65.1% in local currency, personnel expenses rose by 13.8% due to the impact of this law. Supply costs were up 2.1% in local currency, with the increase in expenditure on TV content and satellite capacity offset by lower interconnection costs, especially in fixed-mobile traffic. Bad debt provisions over revenues ratio in 2007 was 2.9%.

Operating income before depreciation and amortisation (OIBDA) fell 5.3% in local currency in 2007 to 368 million euros.

CapEx totalled 198 million euros, an increase of 30.1% in local currency from 2006, driven mainly by sharp growth in satellite TV services (DTH), the launch of IPTV, growth in the ADSL access base and initiatives designed to enhance network quality.

#### **TEM Chile**

The Chilean market grew strongly again during 2007 with estimated penetration up 8 percentage points to 90%.

Telefónica Móviles Chile remains market leader with over 6.3 million customers at the end of 2007, boosted by net adds of 602,457 customers over the year. Growth in the customer base was driven by net adds to the GSM service, which accounted for 89% of the total, 17 percentage points more than in December 2006. The number of contract customers rose by 31.4% year-on-year to 1.5 million, accounting for more than 60% of net adds in the year, though growth in the prepay customer base picked up in the final quarter (+5.2% year-on-year vs +2.2% to September). The customer base increased 10.6% year-on-year (+7.7% to September). A highlight in December 2007 was the launch of the 3G network.

Revenues for 2007 totalled 930 million euros, a year-on-year increase of 25.5% in local currency. Service revenues jumped 23.0% in local currency compared to 2006, driven by growth in ARPU, which rose 12.7% in local currency, and continues increasing its growth rate quarter after quarter (+8.4%, +10.5% and +11.6% in local currency in the first, second and third quarters respectively. This trend is underpinned by migration to GSM technology,

growth in the contract customer base (24.5% of the customer base in December 2007 vs. 20.6% in December 2006), plan upgrades and the sale of minute bundles and value added services.

Operating income before depreciation and amortisation (OIBDA) rose 27.3% in local currency in 2007 to 348 million euros, fuelled by the strong growth in revenues. Thanks to this operating efficiency, the OIBDA margin jumped 0.5 percentage points to 37.5% in 2007 despite increased commercial efforts in light of the market aggressiveness and despite the initiatives towards technology and segment migration.

CapEx in 2007 totalled 220 million euros, an increase of 34.5% in local currency from 2006.

## Peru

At the end of the year, accesses in Peru stood at 12.2 million, an increase of 39.8%, year-on-year driven by the 58.5% increase in mobile accesses, 8.1 million accesses at the end of the period, especially in the prepay segment. Also noteworthy is the growth in accesses from the IRIS project, collaboration between wireline and wireless operators launched in March 2007, with the aim of boosting the penetration of wireline telephony, and the growth in Broadband and TV accesses.

Telefónica's revenues in Peru hit the 1,513 million euros mark in 2007, a 10.5% year-on-year increase in local currency. This strong revenue growth was primarily driven by outgoing revenues in the prepay segment of its wireless business and Broadband services and by television in its wireline business.

Operating Income before depreciation and amortisation (OIBDA) stood at 469 million euros at the end of 2007, down 15.6% year-on-year in local currency due to the decline in OIBDA in the wireline business (-28.6%) resulting from the registration of 104 million euros in the fourth quarter in provisions for the personnel reorganization that was started in 2007 and will be implemented along 2008. In 2007, the total provision for the personnel reorganization programme amounted to 105 million euros. OIBDA margin in 2007 stood at 31.0% compared to 40.6% in 2006. Stripping out the impact of the reorganization programme, the OIBDA would have grown 3.2% year-on-year in local currency and the OIBDA margin would have been 37.9%, 2.7 percentage points lower than previous year's margin.

CapEx in 2007 totalled 281 million euros, an increase of 35.8% in local currency from 2006. Particularly noteworthy is the major investment in the expansion of the mobile network due to higher traffic levels. As a result, the wireless business accounted for 55% of CapEx.

## Telefónica del Perú

Telefónica del Perú had total accesses of 4.0 million in 2007, an increase of 13.0% year-on-year, thanks to the surge in fixed wireless telephony and Broadband accesses. Fixed telephony accesses, which stood at 2.8 million in December (+11.3%), grew over the year as a result of the strength of fixed wireless telephony accesses, which totalled 228,584 lines. Broadband accesses grew by 22.1% to 572,088 users. In addition, TV accesses totalled 640,045 users recording a growth of 14.9% primarily due to satellite subscribers.

Voice traffic advanced by 7.2% in 2007, slightly below the cumulative growth figure to September 2007 (+8.7%). This deceleration was due to the slight fall in fixed-to-fixed traffic (-0.4%), which was partially offset by the increase in fixed-to-mobile traffic resulting from the greater penetration of wireless telephony; the fall in domestic long distance traffic (-7.4%) resulting from the abolition of pre-selection by default in October and the decline in public telephony traffic which fell further (-34.5%) due to the competition from wireless telephony and informal

public call centres. In contrast we highlight the sharp growth in incoming traffic (+39.2%), both wireless and international.

Revenues totalled 1,031 million euros, down 2.0% in local currency from 2006. This is primarily due to the fall in public telephony revenues (-28.6%) and to the lower revenues from the basic telephony service, affected by the cut in tariffs following the agreements made with the government in 2006 and by the decline in revenues from long distance traffic due to the abolition of pre-selection by default in October. In contrast, revenues from Broadband (+24.9% in local currency) and television (+24.0% in local currency) continued to rise sharply. Internet and Broadband (Broadband + narrowband + TV) revenues accounted for 25.2% of total revenues in 2007 (20.2% in 2006).

Operating expenses grew by 19.9% in local currency, due to higher personnel expenses resulting from the registration of the 105 million euros provision related to the personnel reorganization that was started in 2007 and will be implemented along 2008. Stripping out the impact of this reorganization, total operating expenses would have grown by 2.5% year-on-year in local currency. The higher expenses relating directly to the increased commercial activity were offset, by the lower growth in personnel costs excluding those related to personnel reorganization and in interconnection supply and media rental expenses. However, it is also worth highlighting the rise in the bad debt provision (1.8% of revenues) for services provided to the lowest income bracket groups.

Operating Income before depreciation and amortisation (OIBDA) in 2007 was 311 million euros, a year-on-year decline of 28.6% in local currency due to higher spending on the personnel reorganization and higher commercial expenses and costs associated with labour and fiscal eventualities. The 2007 OIBDA margin stood at 30.2%. Stripping out the impact of personnel reorganization expenses, OIBDA would have fallen 4.7% year-on-year in local currency and the OIBDA margin would have been 40.3%, 1.1 percentage points lower than previous year's margin.

CapEx in 2007 totalled 126 million euros, a decrease of 0.2% in local currency from 2006.

## **TEM Peru**

The pace of growth of the Peruvian mobile market accelerated in 2007, with an estimated penetration of 48% at the end of December (+16 percentage points compared to December 2006).

At the year end Telefónica Móviles Peru's customer base stood at 8.1 million, an increase of 58.5%, year-on-year, with the prepay segment growing by more than 66% year-on-year. Migration to GSM technology continued during the year. At the end of December, GSM customers accounted for 77% of the total, up from 42% at year-end 2006. Telefónica Móviles Peru's intense commercial activity translated into significant 74.5% year-on-year growth of gross adds in 2007. Additionally, gross adds and net gain achieved during the quarter reached a record level of 1.6 million and 908,230 accesses respectively.

Revenues totalled 603 million euros in 2007, up 40.5% in local currency. Particularly noteworthy was the significant growth in service revenues. Boosted by the outstanding performance throughout the year of outgoing revenues in the prepay segment (+129.9% in local currency in 2007), their growth comfortably outstripped that of the average customer base, showing high elasticity to the promotions made in the prepaid cards top-ups with "Double" and "Triple" play campaigns. Outgoing revenues in the contract segment also grew, although less sharply (+14.6%).

Operating income before depreciation and amortisation (OIBDA) amounted to 158 million euros, a year-on-year rise of 27.3% in local currency, despite the increase in commercial costs due to commercial and marketing campaigns to increase the customer base. The OIBDA margin stood at 26.2%, a drop of 2.7 percentage points compared to 2006.

CapEx stood at 155 million euros at the end of 2007, up 92.3% in local currency compared to 2006, being the bulk of this invested in expanding the network capacity.

## **Colombia**

At the end of December 2007, Telefónica reached 11.0 million accesses in Colombia which translates into growth of 7.7% compared to December 2006.

During the year, revenues from the fixed and mobile businesses reached 1,569 million euros, up 27.9% on 2006 in constant currency, reflecting the first time consolidation of Telefónica Telecom in May 2006 and strong growth in Internet and Broadband revenues and service revenues at the mobile business.

Operating income before depreciation and amortisation (OIBDA) rose 42.5% year-on-year in local currency to 485 million euros. Telefónica Telecom is consolidated in these figures from May 2006. The OIBDA margin for the period stood at 30.9% (+3.2 percentage points from December 2006).

## **Telefónica TELECOM<sup>2</sup>**

Telefónica Telecom reached a total of 2.6 million accesses at 31 December 2007, up 7.1% year-on-year, with an almost three-fold increase in the number of Broadband users since December 2006 (a total of 200,271 accesses at 31 December 2007); which offsets the drop in wireline accesses (-1.3% year-on-year).

The Satellite TV product was launched at the start of the year. This key product, which enables Telefónica Telecom to launch 'Trio' triple play bundles (voice, Broadband and TV), had 72,930 TV customers at the end of December 2007.

Revenues for the wireline telephony business reached 739 million euros in 2007, representing 8.1% growth in local currency, driven mainly by Internet and Broadband growth (+100.3% year-on-year in local currency). The contribution from this business to total revenues increased to 8.8% in 2007 from 4.7% in December 2006. The strong growth in Broadband revenues (+165.4% year-on-year in local currency) offset the drop in the narrowband business (-22.8% in revenues in local currency) due to the migration to Broadband. The company extended Broadband coverage to new towns and cities in 2007 and cemented its position in areas where it maintains a leadership position. The Broadband business was also boosted by marketing bandwidth upgrades to corporate customers.

Operating expenses in 2007 rose 16.0% year-on-year in local currency, pushed up by increases in supplies and bad debt provisions. Personnel expenses increased by 17.4% in local currency impacted by a provision of 3.2 million euros registered due to the personnel reorganization of the company initiated in 2007 and in force throughout 2008. Excluding the impact of this provision, personnel expenses would have risen by 13.4%.

Operating income before depreciation and amortisation (OIBDA) amounted to 299 million euros, which represents year-on-year

<sup>2</sup> T. Telecom has been fully consolidated in the Telefónica Group from May 2006. Published variations are based on proforma 2006 figures..

growth of 16.0% in local currency, driven largely by the strategic commitment to Broadband. Excluding the impact of the personnel reorganization provision, OIBDA would have rose by 16.9%.

CapEx to 31 December 2007 stood at 180 million euros. The bulk of this was invested in deploying Broadband and a series of regional systems projects.

#### **TEM Colombia**

The Colombian cellular market ended 2007 with 32.3 million customers, although growth is slowing, reaching an estimated penetration of 75% on December 2007, up 8 percentage points from 2006.

In 2007 the company focused on its commercial restructuring, registering sharp increases in its capillarity and higher productivity, screening and reactivating customers and expanding its GSM coverage. Also, the company continued to work on a commercial offering with similar price schemes regardless of call destination.

Gross adds increased by 61.1% in the fourth quarter of 2007 compared with the same period a year earlier and fell by 8.4% over the year. This was a result of the cut in subsidies from the final quarter of 2006 following the aggressive commercial campaigns carried out until then. Churn in 2007 stood at 3.7%, 0.6 percentage points up year-on-year, due to the disconnection of low value customers who were signed up in the aggressive campaigns carried out in 2006. Churn in the fourth quarter was 2.5%, -1.0 percentage point compared to the fourth quarter of 2006. As a result, net adds in 2007 totalled 820,532 customers, leaving the customer base at 8.4 million at 31 December 2007 (up 7.9% compared to December 2006). Of this total, 81.4% were GSM customers (+21.8 percentage points on 2006).

Revenues in 2007 amounted to 869 million euros, up 7.4% year-on-year in local currency. Service revenues climbed 13.4% in local currency compared to 2006, which is above the growth of the average customer base despite the impact of the reduction in interconnection rates from December 2007.

Operating income before depreciation and amortisation (OIBDA) rose 30.0% year-on-year in local currency to 186 million euros in 2007. The OIBDA margin stood at 21.4% in 2007, up 3.7 percentage points from 2006. Telefónica Móviles Colombia made a provision of 2.5 million euros in the fourth quarter of 2007 for personnel reorganization initiated in 2007 and in force throughout 2008. Excluding the impact of this provision, OIBDA growth would have stood at 31.7% and OIBDA margin would have reached 21.7%.

CapEx in 2007 stood at 180 million euros.

#### **Mexico**

Growth in the Mexican market accelerated yet again, with the penetration rate reaching an estimated 64% by December 2007 (up 11 percentage points vs. December 2006).

The focus of Telefónica Móviles México's commercial activity in the fourth quarter was its Christmas Campaign, with the company again launching innovative products to make up a competitive commercial offer that met customer expectations. In addition, the development of its commercial network and ongoing improvements to the quality of its network, enabled the company to maintain robust growth in its commercial activity.

The customer base of Telefónica Móviles México stood at 12.5 million at the end of December 2007 (of which 700,000 were contract customers), an increase of 46.6% from December 2006. This growth was underpinned in the fourth quarter by the introduction of a competitive and flexible commercial offer in the prepay segment, "Movistar Pagamenos" ("Movistar pay less"), which enabled the company to achieve over 2.3 million gross adds in the period, a 30.8% increase on the same period in 2006. Gross adds totalled almost 7.3 million in 2007, up 42.7% on 2006.

With regard to churn, the significantly higher quality of the gross adds acquired in 2007 along with the introduction of lower top-up amounts, led to a year-on-year improvement in churn to reach 2.5% in the fourth quarter of 2007 (-0.4 percentage points vs. the fourth quarter of 2006), and in line with the figure recorded in the third quarter of 2007.

As a result of the strong customer gross adds and improved churn, net adds in the fourth quarter were approximately 1.5 million, signalling year-on-year growth of 32.0%. Cumulative net adds for 2007 totalled almost 4.0 million, 1.8 times the figure recorded in 2006.

With regard to usage, although more than a year has passed since the launch of the commercial offer that introduced the new concept of "Fixed rate per call", traffic growth remains buoyant. Outgoing and on-net traffic have grown substantially compared to the fourth quarter of 2006, albeit at slower rates than in previous quarters. As a result, fourth quarter MoU reached 164 minutes, a year-on-year increase of 56.6%, and fourth quarter 2007 ARPU grew by 5.4% in local terms year-on-year to 9.2 euros. ARPU growth in local currency for the full year stood at 15.8%.

The company's strong business momentum fuelled a 56.4% year-on-year increase in revenues in local currency in the fourth quarter of 2007 to 420 million euros and a 58.5% year-on-year increase in 2007 to 1,431 million euros. This growth was underpinned by strong service revenues, both in the fourth quarter of 2007 (+55.9% year-on-year) and in 2007 as a whole (+65.4% vs. 2006). This outstripped growth of the company's customer base (+46.6%) in both periods, underscoring the higher quality of its customers and increased usage.

The strong performance of service revenues was fuelled by higher outgoing and incoming revenues, both underpinned by the introduction of the national calling party pays service in November 2006. Growth in outgoing revenues in local currency slowed in the fourth quarter to 67.7% year-on-year, while cumulative growth stood at 82.1% due to the steady year-on-year growth in on-net traffic. Meanwhile, the launch of the national calling party pays service drove a 31.4% increase in incoming traffic revenues in the fourth quarter vs. the fourth quarter of 2006 and a rise of 42.9% in 2007 compared with 2006.

Operating income before depreciation and amortisation (OIBDA) in the fourth quarter reflected both solid revenue growth and the efficiency gains achieved thanks to economies of scale. Despite the intense commercial activity in the fourth quarter, OIBDA totalled 66 million euros compared with the figure of 22 million euros reported in the fourth quarter of 2006. As a result, the OIBDA margin increased by 8.3 percentage points to 15.7% in the fourth quarter. OIBDA in 2007 stood at 179 million euros, a margin of 12.5% compared with an operating loss of 11 million euros in 2006.

CapEx in 2007 amounted to 230 million euros compared with 180 million euros in 2006, as a result of the capacity expansion carried out to manage increases in traffic. Operating cash flow (OIBDA-CapEx) came to -51 million euros in 2007, a significant improvement on the 2006 figure of -191 million euros.

### Venezuela

Penetration in the Venezuelan cellular market stood at an estimated 85% in December 2007, up 15 percentage points from December 2006.

Telefónica Móviles Venezuela's commercial strategy during the fourth quarter was designed around broadening the range of handsets on offer vs. its competitors, offering certain models on an exclusive basis. The operator also launched new plans in the prepay segment. These so-called "A tu medida" personalised plans enable customers to adapt the package to their specific needs. Customers can add on to the basic usage plan additional plans, such as higher on-net traffic plans, calls to other operators, flat rate text messages or data download packages, depending on their individual preferences.

As a result, Telefónica Móviles Venezuela's customer base stood at over 10.4 million (+18.2% year-on-year) at the end of 2007, recording net adds of over 1.6 million new lines in the year. Since the GSM network was launched at the beginning of the year, GSM gross adds have accounted for 61% of the total and GSM customers made up over 35% of the total cellular customer base at December 2007.

This rapid migration of the customer base to GSM technology is behind the 0.6 percentage point increase in churn to 2.6% in the fourth quarter of 2007 vs. the fourth quarter of 2006.

Revenues in 2007 totalled 2,392 million euros (+27.8% vs. 2006 in local currency), driven by higher growth in service revenues (+27.1% year-on-year) than in the customer base. It is noteworthy the 1.4% increase in ARPU, underpinned by the 4.1% growth in outgoing ARPU, which offsets the 34% cut in interconnection rates implemented last July.

Operating income before depreciation and amortisation (OIBDA) reached 1,060 million euros in 2007, 42.0% higher than the 2006 figure in local currency, owing to growth in revenues and to lower unit costs for GSM handsets. This enabled the OIBDA margin to rise by 4.4 percentage points year-on-year to 44.3%.

CapEx totalled 370 million euros in 2007 (232 million euros in 2006) as a result of the major investment in the rollout of the GSM network and the acquisition of a licence to provide service on the 1900 MHz band for 88 million euros.

## **Central America**

Telefónica Móviles Centroamerica (Panama, Guatemala, El Salvador and Nicaragua) substantially stepped up its commercial activity in 2007 compared to 2006, once again especially in Guatemala.

At the end of 2007, estimated penetration of the Central American market stood at 69% (up 23 percentage points on 2006). Against this backdrop, Telefónica Móviles de Centroamérica's customer base rose 37.8% year-on-year to 5.3 million (268,186 fixed wireless and 381,230 contract customers). Growth was fuelled by the effectiveness of commercial campaigns carried out throughout the year, focused on traffic promotions and flat tariff plans (with a very competitive average charge per minute) that increase usage. Also, the Christmas campaigns and Mother's Day campaign (in Panama) drove a 25.0% year-on-year increase in gross adds in the fourth quarter. As a result, net adds in the fourth quarter stood at 400,681 customers, up 51.4% on the same quarter in 2006. Net adds in 2007 stood at 1,448,530.

At the operating level, traffic growth was once again robust, especially outgoing, buoyed by the promotional plan which encourages prepay usage and the application of a very economical flat-rate tariff for customers. Consequently, outgoing MoU increased by 18.5% year-on-year in 2007 to 86 minutes.

As a result of the company's healthy commercial performance, revenues in 2007 totalled 585 million euros, up 15.9% year-on-year in constant terms. Service revenues (up 10.3% compared to the fourth quarter of 2006) continued to follow the positive trend marked in previous quarters, growing by 16.9% in constant currency on 2006. This strong performance of service revenues in 2007 was chiefly underpinned by higher outgoing revenues (+28.9% in constant terms on 2006), which in turn were buoyed by the robust growth in on-net traffic (+76.3% compared to the same period in 2006).

Despite the increase in commercial activity, Operating income before depreciation and amortisation (OIBDA) reached 236 million euros in 2007, a 26.7% year-on-year increase in constant terms. The OIBDA margin stood at 40.3% in 2007, an improvement of 3.5 percentage points from 2006.

In 2007, CapEx totalled 133 million euros, a 35.0% year-on-year increase in constant currency. The bulk of this investment was allocated to boosting the capacity and coverage of the region's wireless network.

## **Ecuador**

The Ecuadorian cellular market experienced strong growth in 2007, with an estimated penetration of 70% by the end of the year, 9 percentage points higher than a year earlier.

Telefónica Móviles Ecuador's customer base at the end of December 2007 stood at 2.6 million. Of this number, 70.3% were GSM customers (+18.8 percentage points on 2006). Especially noteworthy is the sharp growth in the number of customers on the "movistar tariff" and "multicolour" (preferential tariffs for on-net and off-net calls respectively), which totalled around one million in December 2007 (a ten-fold increase on the beginning of the year).

Revenues at December 2007 stood at 291 million euros, up 9.5% in local currency compared to 2006. Service revenues rose 0.2% in local currency year-on-year, showing a shift in the previous trend (14.1% growth in the fourth quarter of 2007 compared to the year-on-year fall of 3.9% reported in September 2007) largely attributable to the improvement in outgoing revenues in the contract segment (+8.8% on 2006).

Operating income before depreciation and amortisation (OIBDA) rose 24.8% year-on-year in local currency to 73 million euros in 2007. The 2007 OIBDA margin stood at 25.1%, 3.1 percentage points higher than in 2006.

CapEx in 2007 totalled 60 million euros, up 36.8% in local currency compared to the previous year in order to service the sharp increase in traffic being carried by the operator.

## **Telefónica International Wholesales Services**

Telefónica International Wholesale Services (TIWS) again put in a strong performance in the fourth quarter, reporting significant growth in its key operating and financial figures in the year. Revenues in 2007 totalled 275 million euros, a year-on-year increase of 22.4% in constant euros.

Of the company's main business lines, International IP capacity revenues grew 18.0% year-on-year in constant euros, underpinned by the growth of Telefónica Group's Broadband business in the region, to 137 million euros (50% of TIWS' total revenues). Revenues from the sale of international bandwidth capacity also grew sharply (+46.5% in constant euros), VPNs (+32.1%) and satellite services (+27.3%).

The growth in revenues pushed up Operating income before depreciation and amortisation (OIBDA) to 88 million euros (+13.9% in constant euros); the OIBDA margin stood at 31.9%.

## TELEFÓNICA LATINOAMÉRICA

### ACCESSES

	2006	2007				
Unaudited figures (thousands)	December	March	June	September	December	% Chg y-o-y
<b>Final Clients Accesses</b>	<b>114,604.4</b>	<b>116,905.7</b>	<b>121,773.0</b>	<b>126,423.0</b>	<b>134,041.8</b>	<b>17.0</b>
Fixed telephony accesses <sup>1</sup>	23,916.9	23,810.9	23,894.7	24,027.4	23,946.3	0.1
Internet and data accesses	6,723.7	6,757.6	6,467.8	6,803.4	6,954.8	3.4
Narrowband <sup>2</sup>	2,813.5	2,615.3	1,989.8	2,000.6	1,815.6	(35.5)
Broadband <sup>3,4</sup>	3,780.3	4,045.6	4,380.4	4,703.5	5,035.9	33.2
Other	130.0	96.7	97.6	99.3	103.4	(20.4)
Mobile accesses	83,298.4	85,637.0	90,610.9	94,712.1	101,976.9	22.4
Contract	67,329.9	69,112.7	73,654.3	77,117.4	83,162.9	23.5
Pre-Pay	14,705.4	15,208.7	15,582.9	16,210.8	17,379.3	18.2
Fixed wireless	1,263.1	1,315.5	1,373.7	1,384.0	1,434.7	13.6
Pay TV	665.3	700.1	799.6	880.0	1,163.8	74.9
<b>Wholesale Accesses</b>	<b>65.9</b>	<b>64.6</b>	<b>64.5</b>	<b>64.1</b>	<b>62.6</b>	<b>(5.1)</b>
<b>Total Accesses</b>	<b>114,670.3</b>	<b>116,970.3</b>	<b>121,837.5</b>	<b>126,487.1</b>	<b>134,104.4</b>	<b>16.9</b>

<sup>1</sup> PSTN (including Public Use Telephony) x1; ISDN Basic access x1; ISDN Primary access; <sup>2</sup>/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 and Terra México.

<sup>4</sup> Includes ADSL, optical fiber, cable modem, Broadband circuits and Telefónica de Argentina ISP in the North part of the country.

## TELEFÓNICA LATINOAMÉRICA

### CONSOLIDATED INCOME STATEMENT

Unaudited figures (Euros in millions)	January-December			October-December		
	2007	2006	% Chg	2007	2006	% Chg
Revenues	20,078	18,089	11.0	5,402	4,847	11.4
Internal exp capitalized in fixed assets <sup>1</sup>	105	109	(4.3)	36	37	(4.1)
Operating expenses	(13,422)	(11,814)	13.6	(3,783)	(3,128)	20.9
Other net operating income (expense)	363	227	59.9	163	42	n.m.
Gain (loss) on sale of fixed assets	(3)	13	n.c.	(6)	14	n.c.
Impairment of goodwill and other assets	0	(53)	n.m.	0	(52)	n.m.
<b>Operating income before D&amp;A (OIBDA)</b>	<b>7,121</b>	<b>6,571</b>	<b>8.4</b>	<b>1,812</b>	<b>1,761</b>	<b>2.9</b>
Depreciation and amortization	(3,559)	(3,671)	(3.0)	(1,010)	(919)	9.8
<b>Operating income (OI)</b>	<b>3,562</b>	<b>2,900</b>	<b>22.8</b>	<b>802</b>	<b>841</b>	<b>(4.7)</b>

Note: "Bad debt provisions" have been reclassified from "Other net operating income (expense)" to "Operating expenses".

<sup>1</sup> Including work in process.

**TELEFÓNICA LATINOAMÉRICA****ACCESES BY COUNTRIES (I)**

Unaudited figures (thousands)	2006		2007			% Chg y-o-y
	December	March	June	September	December	

**BRAZIL**

<b>Final Clients Accesses</b>	<b>44,716.9</b>	<b>44,599.1</b>	<b>45,344.4</b>	<b>46,607.3</b>	<b>48,963.1</b>	<b>9.5</b>
Fixed telephony accesses <sup>1</sup>	12,107.1	12,033.6	12,031.3	12,019.0	11,960.0	(1.2)
Internet and data accesses	3,556.8	3,535.2	3,072.6	3,259.5	3,288.6	(7.5)
Narrowband	1,856.6	1,786.3	1,201.1	1,262.3	1,155.9	(37.7)
Broadband <sup>2</sup>	1,608.2	1,690.8	1,813.0	1,973.3	2,069.6	28.7
Other	92.0	58.1	58.6	59.9	63.1	(31.4)
Mobile accesses	29,053.1	29,030.3	30,240.5	31,320.2	33,483.5	15.2
Pre-Pay	23,543.4	23,377.0	24,549.4	25,456.8	27,236.4	15.7
Contract	5,509.6	5,653.2	5,691.1	5,863.5	6,247.1	13.4
Pay TV	0.0	0.0	0.0	8.5	230.9	n.m.
<b>Wholesale Accesses</b>	<b>38.4</b>	<b>38.9</b>	<b>38.1</b>	<b>37.4</b>	<b>37.4</b>	<b>(2.6)</b>
<b>Total Accesses</b>	<b>44,755.3</b>	<b>44,638.0</b>	<b>45,382.5</b>	<b>46,644.7</b>	<b>49,000.5</b>	<b>9.5</b>

**ARGENTINA**

<b>Final Clients Accesses</b>	<b>16,809.4</b>	<b>17,464.1</b>	<b>18,112.1</b>	<b>18,812.2</b>	<b>19,462.1</b>	<b>15.8</b>
Fixed telephony accesses <sup>1</sup>	4,636.3	4,627.9	4,633.5	4,633.1	4,578.2	(1.3)
Internet and data accesses	973.7	1,023.2	1,069.5	1,101.3	1,149.9	18.1
Narrowband	439.2	418.0	392.9	363.6	312.2	(28.9)
Broadband <sup>2</sup>	517.7	588.1	659.0	719.7	819.3	58.3
Other	16.8	17.1	17.7	18.1	18.4	9.4
Mobile accesses	11,199.4	11,813.0	12,409.1	13,077.8	13,734.0	22.6
Pre-Pay	7,315.8	7,753.1	8,112.8	8,553.1	8,836.0	20.8
Contract	3,742.9	3,925.8	4,169.9	4,410.4	4,793.7	28.1
Fixed wireless	140.7	134.2	126.3	114.3	104.3	(25.9)
<b>Wholesale Accesses</b>	<b>7.3</b>	<b>7.6</b>	<b>8.7</b>	<b>8.9</b>	<b>9.3</b>	<b>27.4</b>
<b>Total Accesses</b>	<b>16,816.6</b>	<b>17,471.7</b>	<b>18,120.8</b>	<b>18,821.2</b>	<b>19,471.4</b>	<b>15.8</b>

**CHILE**

<b>Final Clients Accesses</b>	<b>8,538.4</b>	<b>8,670.5</b>	<b>8,909.3</b>	<b>9,077.8</b>	<b>9,361.7</b>	<b>9.6</b>
Fixed telephony accesses <sup>1</sup>	2,206.2	2,177.4	2,174.4	2,172.7	2,172.4	(1.5)
Internet and data accesses	557.7	597.3	636.0	656.0	686.8	23.1
Narrowband	53.3	59.0	52.5	40.1	31.8	(40.2)
Broadband <sup>2</sup>	494.5	528.2	574.1	606.9	646.0	30.6
Other	10.0	10.0	9.5	9.0	8.9	(10.8)
Mobile accesses	5,680.2	5,766.8	5,927.5	6,051.9	6,282.7	10.6
Pre-Pay	4,507.6	4,515.7	4,557.9	4,591.4	4,742.2	5.2
Contract	1,172.7	1,251.1	1,369.6	1,460.5	1,540.5	31.4
Pay TV	94.2	129.1	171.4	197.3	219.9	n.m.
<b>Wholesale Accesses</b>	<b>19.9</b>	<b>17.6</b>	<b>17.2</b>	<b>17.3</b>	<b>15.4</b>	<b>(22.3)</b>
<b>Total Accesses</b>	<b>8,558.3</b>	<b>8,688.1</b>	<b>8,926.5</b>	<b>9,095.1</b>	<b>9,377.2</b>	<b>9.6</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, cable modem and Broadband circuits.

## TELEFÓNICA LATINOAMÉRICA

### ACCESES BY COUNTRIES (II)

Unaudited figures (thousands)

	2006			2007		
	December	March	June	September	December	% Chg y-o-y
<b>PERU</b>						
<b>Final Clients Accesses</b>	<b>8,710.9</b>	<b>9,303.2</b>	<b>10,152.5</b>	<b>11,199.0</b>	<b>12,173.8</b>	<b>39.8</b>
Fixed telephony accesses <sup>1</sup>	2,498.5	2,531.2	2,605.7	2,742.1	2,781.9	11.3
Internet and data accesses	525.5	547.4	581.8	608.4	623.1	18.6
Narrowband	47.8	40.3	44.2	42.4	40.3	(15.7)
Broadband <sup>2</sup>	468.5	497.7	527.8	555.9	572.1	22.1
Other	9.2	9.4	9.7	10.2	10.7	16.0
Mobile accesses	5,129.8	5,663.5	6,365.0	7,220.5	8,128.7	58.5
Pre-Pay	4,353.3	4,882.3	5,570.7	6,389.7	7,238.1	66.3
Contract	705.2	711.0	724.4	763.2	829.2	17.6
Fixed wireless	71.3	70.2	70.0	67.7	61.5	(13.8)
Pay TV	557.2	561.1	600.0	628.0	640.0	14.9
<b>Wholesale Accesses</b>	<b>0.4</b>	<b>0.4</b>	<b>0.5</b>	<b>0.5</b>	<b>0.5</b>	<b>7.2</b>
<b>Total Accesses</b>	<b>8,711.4</b>	<b>9,303.6</b>	<b>10,153.0</b>	<b>11,199.5</b>	<b>12,174.3</b>	<b>39.8</b>
<b>COLOMBIA</b>						
<b>Final Clients Accesses</b>	<b>10,190.0</b>	<b>9,995.9</b>	<b>10,095.6</b>	<b>10,105.5</b>	<b>10,973.8</b>	<b>7.7</b>
Fixed telephony accesses <sup>1</sup>	2,359.4	2,346.5	2,330.5	2,340.3	2,328.5	(1.3)
Internet and data accesses	70.9	94.3	125.0	167.5	200.3	n.m.
Narrowband	2.9	0.0	0.0	0.0	0.0	n.m.
Broadband <sup>2</sup>	68.0	94.3	125.0	167.5	200.3	n.m.
Other	0.0	0.0	0.0	0.0	0.0	n.m.
Mobile accesses	7,759.7	7,545.2	7,611.8	7,551.5	8,372.1	7.9
Pre-Pay	5,960.5	5,734.6	5,887.0	5,867.4	6,612.9	10.9
Contract	1,799.2	1,810.6	1,724.8	1,684.1	1,759.2	(2.2)
Pay TV	0.0	10.0	28.3	46.2	72.9	n.m.
<b>Wholesale Accesses</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>n.m.</b>
<b>Total Accesses</b>	<b>10,190.0</b>	<b>9,995.9</b>	<b>10,095.7</b>	<b>10,105.5</b>	<b>10,973.8</b>	<b>7.7</b>
<b>MEXICO</b>						
Mobile accesses	8,553.2	9,319.6	10,232.8	11,072.7	12,537.6	46.6
Pre-Pay	8,017.8	8,775.0	9,655.2	10,446.9	11,833.7	47.6
Contract	533.4	542.4	574.8	622.6	700.4	31.3
Fixed wireless	2.0	2.2	2.8	3.2	3.6	79.4
<b>Total Accesses</b>	<b>8,553.2</b>	<b>9,319.6</b>	<b>10,232.8</b>	<b>11,072.7</b>	<b>12,537.6</b>	<b>46.6</b>
<b>VENEZUELA</b>						
Mobile accesses	8,826.2	9,100.3	9,746.6	9,840.0	10,429.9	18.2
Pre-Pay	7,520.2	7,724.2	8,345.1	8,392.2	8,900.3	18.4
Contract	469.4	495.4	474.7	510.3	533.7	13.7
Fixed wireless	836.6	880.7	926.8	937.5	995.9	19.0
<b>Total Accesses</b>	<b>8,826.2</b>	<b>9,100.3</b>	<b>9,746.6</b>	<b>9,840.0</b>	<b>10,429.9</b>	<b>18.2</b>

<sup>1</sup> PSTN (including Public Use Telephony) x1; ISDN Basic access x1; ISDN Primary access; <sup>2</sup>/6 Access x30. Company's accesses for internal use

<sup>2</sup> Includes ADSL, optical fiber, cable modem and Broadband circuits.

**TELEFÓNICA LATINOAMÉRICA  
ACCESSES BY COUNTRIES(III)**

Unaudited figures (thousands)	2006	2007				% Chg y-o-y
	December	March	June	September	December	
<b>CENTRAL AMERICA<sup>3</sup></b>						
Fixed telephony accesses <sup>1</sup>	109.4	94.4	119.4	120.3	125.3	14.5
Internet and data accesses	26.0	26.0	22.3	22.2	22.0	(15.4)
Broadband <sup>2</sup>	24.1	24.0	20.2	20.0	19.8	(17.9)
Other	1.9	2.0	2.1	2.2	2.2	15.9
Mobile accesses	3,829.5	4,042.1	4,469.4	4,877.4	5,278.1	37.8
Pre-Pay	3,303.1	3,472.5	3,856.6	4,240.8	4,628.6	40.1
Contract	315.6	342.8	366.6	376.7	381.2	20.8
Fixed wireless	210.9	226.7	246.2	259.8	268.2	27.2
Pay TV	14.0	0.0	0.0	0.0	0.0	n.m.
<b>Total Accesses</b>	<b>3,978.9</b>	<b>4,162.5</b>	<b>4,604.1</b>	<b>5,019.8</b>	<b>5,425.3</b>	<b>36.4</b>

**ECUADOR**

Mobile accesses	2,490.0	2,481.7	2,645.0	2,653.2	2,582.4	3.7
Pre-Pay	2,133.0	2,116.8	2,275.2	2,272.1	2,177.5	2.1
Contract	355.3	363.3	368.2	379.6	403.6	13.6
Fixed wireless	1.7	1.6	1.5	1.5	1.3	(21.5)
<b>Total Accesses</b>	<b>2,490.0</b>	<b>2,481.7</b>	<b>2,645.0</b>	<b>2,653.2</b>	<b>2,582.4</b>	<b>3.7</b>

**URUGUAY**

Mobile accesses	777.3	874.6	963.1	1,047.0	1,147.8	47.7
Pre-Pay	675.3	761.4	844.3	907.0	957.0	41.7
Contract	102.0	113.2	118.8	140.0	190.8	86.9
<b>Total Accesses</b>	<b>777.3</b>	<b>874.6</b>	<b>963.1</b>	<b>1,047.0</b>	<b>1,147.8</b>	<b>47.7</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

<sup>2</sup> Includes ADSL, optical fiber and Broadband circuits.

<sup>3</sup> Includes Guatemala, Panama, El Salvador and Nicaragua

## TELEFÓNICA LATINOAMÉRICA

### SELECTED FINANCIAL DATA (I)

Unaudited figures (Euros in millions)

January-December

	2007	2006	% Chg	% Chg Local Cur
<b>BRAZIL</b>				
<b>Telesp</b>				
Revenues	7,662	7,238	5.9	3.2
OIBDA	3,026	3,068	(1.4)	(3.8)
OIBDA margin	39.5%	42.4%	(2.9 p.p)	
CapEx	1,087	1,028	5.7	3.1
<b>Vivo</b>				
Revenues	5,619	5,565	1.0	(1.5)
OIBDA	2,438	2,632	(7.4)	(9.7)
OIBDA margin	43.4%	47.3%	(3.9 p.p)	
CapEx	729	639	14.0	11.2

## ARGENTINA

Revenues	2,264	2,163	4.7	15.7
OIBDA	773	792	(2.3)	8.0
OIBDA margin	32.9%	35.1%	(2.2 p.p)	
CapEx	289	243	19.0	31.5
<b>Telefónica de Argentina</b>				
Revenues	984	989	(0.6)	9.9
OIBDA	356	453	(21.5)	(13.3)
OIBDA margin <sup>1</sup>	30.9%	39.0%	(8.1 p.p)	
CapEx	165	140	17.9	30.3
<b>TEM Argentina</b>				
Revenues	1,353	1,260	7.4	18.7
OIBDA	418	339	23.5	36.5
OIBDA margin	30.9%	26.9%	4.1 p.p	
CapEx	123	102	20.5	33.2

## CHILE

Revenues	1,814	1,706	6.4	14.3
OIBDA	716	711	0.7	8.2
OIBDA margin	39.5%	41.7%	(2.2 p.p)	
CapEx	418	339	23.2	32.3
<b>Telefónica Chile</b>				
Revenues	974	1,006	(3.2)	4.0
OIBDA	368	417	(11.8)	(5.3)
OIBDA margin	37.7%	41.4%	(3.7 p.p)	
CapEx	198	163	21.1	30.1
<b>TEM Chile</b>				
Revenues	930	796	16.8	25.5
OIBDA	348	294	18.5	27.3
OIBDA margin	37.5%	36.9%	0.5 p.p	
CapEx	220	176	25.1	34.5

OIBDA is presented after management fees.

<sup>1</sup> Margin over revenues includes fixed to mobile interconnection.

**TELÉFONICA LATINOAMÉRICA**  
**SELECTED FINANCIAL DATA (II)**  
 Unaudited figures (Euros in millions)

	January-December			
	2007	2006	% Chg	% Chg Local Cur
<b>PERU</b>				
Revenues	1,513	1,428	6.0	10.5
OIBDA	469	579	(19.0)	(15.6)
OIBDA margin	31.0%	40.6%	(9.6 p.p.)	
CapEx	281	216	30.3	35.8
<b>Telefónica del Perú<sup>2</sup></b>				
Revenues	1,031	1,097	(6.0)	(2.0)
OIBDA	311	454	(31.5)	(28.6)
OIBDA margin	30.2%	41.4%	(11.2 p.p.)	
CapEx	126	132	(4.3)	(0.2)
<b>TEM Peru</b>				
Revenues	603	447	34.8	40.5
OIBDA	158	129	22.1	27.3
OIBDA margin	26.2%	28.9%	(2.7 p.p.)	
CapEx	155	84	84.5	92.3
<b>COLOMBIA</b>				
Revenues	1,569	1,182	32.8	27.9
OIBDA	485	328	47.9	42.5
OIBDA margin	30.9%	27.7%	3.2 p.p.	
CapEx	360	333	8.3	4.3
<b>Telefónica Telecom<sup>3</sup></b>				
Revenues	739	417	n.c.	n.c.
OIBDA	299	189	n.c.	n.c.
OIBDA margin	40.4%	45.4%	(5.0 p.p.)	
CapEx	180	140	n.c.	n.c.
<b>TEM Colombia</b>				
Revenues	869	779	11.5	7.4
OIBDA	186	138	34.9	30.0
OIBDA margin	21.4%	17.7%	3.7 p.p.	
CapEx	180	192	(6.4)	(9.9)
<b>MEXICO</b>				
<b>TEM Mexico</b>				
Revenues	1,431	988	44.8	58.5
OIBDA	179	(11)	n.c.	n.c.
OIBDA margin	12.5%	(1.1%)	13.7 p.p.	
CapEx	230	180	27.8	39.9
<b>VENEZUELA</b>				
<b>TEM Venezuela</b>				
Revenues	2,392	2,041	17.2	27.8
OIBDA	1,060	815	30.1	42.0
OIBDA margin	44.3%	39.9%	4.4 p.p.	
CapEx	370	232	59.1	73.6

OIBDA is presented after management fees.

<sup>2</sup> Telefónica del Perú includes Cable Mágico.

<sup>3</sup> Data for Telefónica Telecom (formerly Colombia Telecom) only include results for May-December 2006 period, including Telefónica Data Colombia.

**TELEFÓNICA LATINOAMÉRICA  
SELECTED FINANCIAL DATA (III)**

Unaudited figures (Euros in millions)

	January-December			
	2007	2006	% Chg	% Chg Local Cur
<b>CENTRAL AMERICA<sup>1</sup></b>				
Revenues	585	556	5,3	n.c.
OIBDA	236	205	15,3	n.c.
OIBDA margin	40.3%	36.8%	3.5 p.p.	
CapEx	133	108	22,5	n.c.

**ECUADOR****TEM Ecuador**

Revenues	291	290	0,4	9,5
OIBDA	73	64	14,4	24,8
OIBDA margin	25.1%	22.0%	3.1 p.p.	
CapEx	60	48	25,4	36,8

**URUGUAY****TEM Uruguay**

Revenues	104	77	34.4	42.9
OIBDA	28	18	51.9	61.6
OIBDA margin	26.6%	23.5%	3.1 p.p.	
CapEx	15	13	12.6	19.7

**TIWS**

Revenues	275	232	18.4	22.4
OIBDA	88	79	10.9	13.9
OIBDA margin	31.9%	34.0%	(2.1 p.p.)	
CapEx	54	45	21.4	21.4

<sup>1</sup> Includes Guatemala, Panama, El Salvador and Nicaragua  
OIBDA is presented after management fees.

## Telefónica Europe

At the end of December 2007, Telefónica Europe's customer base reached 41.9 million accesses, compared with 38.6 million accesses at year end 2006 (+8.7% year-on-year).

In 2007, Telefónica Europe revenue was 14,458 million euros, (+9.9% year-on-year), while in the quarter declined 1.1% year-on-year, mainly due to a weaker sterling/euro exchange rate and the exit of Airwave from the perimeter. Operating income before depreciation and amortization (OIBDA) reached 4,977 million euros, 34.2% above 2006 figures<sup>1</sup>. 2007 OIBDA included personnel reorganization and other non-recurring charges totaling 338 million euros related to the UK, Ireland and German businesses, as well as the capital gain from the sale of Airwave (1,296 million euros), booked in the second quarter. Operating Income (OI) was 1,591 million euros in the January-December period, mainly affected by the impact of higher assets amortizations derived from the Purchasing Price Allocation (PPA) process, which also impacted negatively the 2006 OI figure (309 million euros).

Telefónica Europe CapEx for the full year 2007 amounted to 2,125 million euros (2,552 million euros in 2006 February-December period). The year-on-year decline was largely due to O2 Germany (30.6% lower year-on-year) bringing forward capital investment from 2007 into 2006 as part of the 3G network build. Operating Cash Flow (OIBDA-CapEx) for the year amounted to 2,852 million euros (1,156 million euros in 2006 February-December period).

Telefónica Europe 2007 financial targets<sup>2</sup> have been achieved:

- 11.7% year-on-year growth in revenues (vs. guidance of 11% - 14%)
- 10.1% year-on-year growth in OIBDA (vs. guidance of 7% - 10%)
- CapEx of 2,095 million euros (vs. guidance of less than 2,200 million euros)

### Strategic and operational highlights:

- iPhone success. The iPhone is the fastest-ever selling product for O2 UK. The ARPU of an iPhone customer is 30% higher than an average contract user and it has helped O2 UK to gain high value customers in the market, as approximately 60% of iPhone customers have migrated from other networks. Customer satisfaction levels are the highest of any device that O2 UK has sold, with the lowest ever rate of return. From 1 February 2008, the three iPhone tariffs were upgraded as part of O2 UK's new and improved contract tariff structure.
- iPhone to launch in Ireland. O2 Ireland will be the exclusive network partner for the iPhone in Ireland. The iPhone will be available from March 14th.
- O2 Germany builds foundations for further growth. As part of the 3.5 billion euros investment program for 2007-2010 announced in October 2007, O2 Germany has already selected vendors to expand both its GSM and UMTS network coverage. This will provide the business with a strong platform to capture the significant growth opportunities in Germany, including the business segment, leveraging the global reach of Telefónica to offer new propositions to multinational corporations as well as in the areas of the country not currently covered by the O2 network. In conjunction, the national roaming agreement which allowed for roaming by O2 customers in Germany on the T-Mobile 2G and 3G mobile networks was cancelled. Roaming minutes available as part of the agreement can be used until the end of 2009. O2 Germany will also double its store network to 1,000 over the next 2 years.
- Accolades for O2 Broadband in the UK. Since launch, O2 UK's Broadband service was rated above the major ISPs in the monthly "thinkBroadband.com" ISP comparison in November and December 2007, just two months after service launch. O2

<sup>1</sup> Telefónica Europe includes in 2006 Telefónica O2 Czech Republic (January-December), T.Deutschland (January-December) and O2 Group (February-December).

<sup>2</sup> 2006 base reported figures include eleven months of O2 Group (consolidated since Feb.06), three months of start-up losses in Slovakia, and exclude Airwave results. 2007 guidance assumes constant exchange rates as of 2006, and exclude changes in consolidation. OIBDA excludes other exceptional revenues/expenses not foreseeable in 2007. Personnel reorganization and Real Estate Programs are included as operating revenues/expenses, except for those decided after guidance was set at the beginning of the year (redundancies in O2 Group and Real Estate Program in TEF O2 CR). For comparison, the equivalent other exceptional revenues/expenses registered in 2006 are also deducted from reported figures.

Broadband scored the highest out of all its main competitors in all key satisfaction areas for customers, including speed, reliability and customer service.

- New bundles launched in the Czech Republic. Telefónica O2 Czech Republic launched new TRIO bundle, including DSL, calls and O2 TV.
- New data roaming tariffs announced. The O2 businesses and Telefónica mobile business in Spain will launch a range of new data roaming tariffs before summer 2008 (Telefónica in Spain already from February), aimed at customers travelling within Europe, with important savings for customers.

## O2 UK

Total revenues in the last quarter of 2007 were 1,877 million euros, an increase of 7.8% year-on-year in local currency compared to the same period of last year. For the full year, total revenues were 7,403 million euros, an increase of 18.7% year-on-year in local currency compared to the 11 month period to 31 December 2006. On a like for like basis total revenue growth was 9.5% year-on-year. Service revenue for the quarter was 1,702 million euros, an increase of 9.7% year-on-year in local currency compared to the same period last year, driven by continued strong customer and ARPU growth, while for the full year, service revenue amounted to 6,790 million euros (+10.3% year-on-year in local currency on a comparable basis).

Operating income before depreciation and amortization (OIBDA) for the quarter was 503 million euros, a decrease of 4.9% year-on-year in local currency compared to the same period of 2006. OIBDA included additional personnel reorganization and other non recurring charges in the quarter of 20.5 million euros, mostly related to the UK IT and Technology function to capture efficiencies in the future. Excluding this charge in the quarter, OIBDA would have been flat in local currency. OIBDA for the full year totalled 1,923 million euros, an increase of 8.7% year-on-year in local currency compared to the 11 month period to 31 December 2006. On a like for like basis, OIBDA grew 1.0% year-on-year in local currency. Excluding all personnel reorganization charges for the year OIBDA was 10.7% ahead in local currency compared to the 11 month period to 31 December 2006; on a like for like basis it was 2.8% ahead in local currency.

In the UK, guidance<sup>3</sup> for the full year 2007 has been accomplished, with growth of 18.6% year-on-year in revenues (vs. guidance of 15% - 18%) and 10.6% year-on-year growth in OIBDA (vs. guidance of 9% - 12%).

<sup>3</sup> 2006 base reported figures include eleven months of O2 UK (consolidated since Feb.06), 2007 guidance assumes constant exchange rates as of 2006, and exclude changes in consolidation. OIBDA excludes other exceptional revenues/expenses not foreseeable in 2007. Personnel reorganization and Real Estate Programs are included as operating revenues/expenses, except for those decided after guidance was set at the beginning of the year (redundancies in O2 UK). For comparison, the equivalent other exceptional revenues/expenses registered in 2006 are also deducted from reported figures.

OIBDA margin in the fourth quarter was 26.8% (27.8% excluding personnel reorganization and non recurring charges), compared to 30.3% in the same quarter in 2006. This margin dilution was due to costs associated with the launch of O2 Broadband, increased retention and reduced national roaming revenues from “3”. OIBDA margin for the year was 26.0%, while excluding personnel reorganization charges it was 26.4%.

The business once again outperformed the market, with gross additions in the quarter around 22% higher than the same period in 2006. The market continues to be competitive, especially in the prepay segment, with increasing prepay to contract migration, where O2’s “Simplicity” tariff, offering a SIM only contract tariff with a 30 day notice period has proved highly successful.

O2 UK added a total of 483,000 net mobile customers in the quarter (the highest in the market), an increase of 63.8% year-on-year, and 749,000 customers in the year (-54.7% year-on-year, reflecting the highly penetrated market), taking the base to 18.4 million (excluding the Tesco Mobile customer base) representing growth of 4.2% year-on-year.

A total of 276,000 net contract customers were added in the quarter, more than double the figure for the fourth quarter 2006 and an all time record, reflecting the success of the iPhone in addition to a strong underlying performance in traditional handsets. For the full year 591,000 contract customers were added to reach a base of 6.8 million (+9.5% year-on-year). At the end of the period contract customers made up 37.0% of the total base, compared to 35.3% at the same time last year.

Quarterly monthly contract ARPU of 61.0 euros was up 1.2% in local currency compared to the fourth quarter last year, due to increased MoU and non-voice services, while the ARPU for the year was 63.2 euros (+1.1% year-on-year in local currency). Average monthly contract churn fell to 1.5% in the quarter, from 1.9% in the fourth quarter last year. The contract churn for the year was 1.7%, from 1.9% in 2006.

The number of prepay customers increased by 207,000 during the quarter, while for the year the prepay base grew by 158,000 to reach 11.6 million customers. Quarterly monthly prepay ARPU of 18.0 euros was 4.1% higher in local currency than the fourth quarter last year, while the ARPU for the year was 18.2 euros (+4.0% year-on-year in local currency).

As a result, O2 UK’s blended monthly ARPU of 33.9 euros was 4.4% higher than the fourth quarter last year in local currency, while the ARPU for the year was 34.4 euros (+3.6% year-on-year), reflecting the increased proportion of contract customers in the base, customer adoption of new products and services and the continued growth in both data and voice ARPUs. On a customer level, elasticity continues to be above 1.

Quarterly MoU was up 9.8% year-on-year at 197 minutes, driven by propositions such as “Call Freedom”, while the MoU for the year was 190 minutes (+10.6% year-on-year).

Quarterly data ARPU of 11.1 euros was 9.1% higher in local currency than the fourth quarter last year, driven by growth in text messaging volumes, up 21.0% in the quarter, as well as increasing usage of a range of non-SMS services. Data ARPU for the year was 11.0 euros (+8.2% year-on-year in local currency). The new “unlimited” data bolt-on proved successful with 59,000 customers taking this product from launch in October until the end of the year.

O2 UK had rolled out ULL capabilities to 833 exchanges by the end of the quarter, giving its Broadband network a population coverage of 52%, with 71,000 Broadband customers at the end of 2007. The base has since grown to over 100,000 to date.

## O2 Germany

O2 Germany includes Telefónica Deutschland and comparable 2006 figures have been restated on this basis. Total revenues in the fourth quarter were 929 million euros, a decrease of 0.3% year-on-year compared to same period of 2006. For the full year total revenues were 3,541 million euros, an increase of 6.7% compared to the 11 month period to 31 December 2006. On a like for like basis, revenue declined by 1.9%.

Mobile service revenue for the quarter was 725 million euros, down 6.5% compared to the same period last year, reflecting the continued ARPU weakness in the German market and the impact of the approx. 10% termination rate cut in November 2007, partly offset by growth of the customer base. The termination rate cut reduced fourth quarter service revenue by 0.6%. Mobile service revenue for the year was 2,901 million euros, and year-on-year decrease of 5.1%.

Operating income before depreciation and amortization (OIBDA) for the last quarter of 2007 was 17 million euros, a decrease of 77.9% compared to the same period in 2006. This included non recurrent charges totalling 151 million euros, the majority of them reflecting the cessation of the national roaming contract with T-Mobile, along with additional personnel reorganization charges to enable future efficiency savings.

OIBDA for the full year totalled 473 million euros, a decline of 18.9% compared to the 11 month period to 31 December 2006. On a like for like basis the decline was 24.2%. Excluding all one-off charges during the year (which totalled 247 million euros), OIBDA for the 2007 would be 15.4% ahead of the same period last year, and growth of 23.5% compared to the 11 month period to 31 December 2006.

O2 Germany guidance<sup>4</sup> for the full year 2007 has been partially met, with 6.7% year-on-year growth in revenues (vs. guidance of 7% - 10%) and 23.8% year-on-year growth in OIBDA (vs. guidance of 21% - 25%).

<sup>4</sup> 2006 base reported figures include eleven months of O2 Germany (consolidated since Feb.06). 2007 guidance exclude changes in consolidation. OIBDA excludes other exceptional revenues/expenses not foreseeable in 2007. Personnel reorganization and Real Estate Programs are included as operating revenues/expenses, except for those decided after guidance was set at the beginning of the year (redundancies in O2 Group). For comparison, the equivalent other exceptional revenues/expenses registered in 2006 are also deducted from reported figures.

OIBDA margin in the fourth quarter was 1.8% and for the full year it was 13.3%, while excluding the personnel reorganization and other charges it would have been 18.1% and 20.3%, respectively.

The business traded well in the quarter, with gross additions up 63.3% year-on-year. Net additions in the quarter reached 303,000 customers, while for the full year they were 1.4 million, taking the mobile customer base to 12.5 million, 13.1% higher than at the same time last year. The Tchibo Mobile customer base grew by 81,000 to 1.18 million by the end of the quarter, while the Fonic brand added 129,000 customers to end the year with a base of 200,000.

O2 Germany added a total of 244,000 net contract customers in the quarter, with 756,000 for the full year. Quarterly monthly ARPU in the fourth quarter was 32.3 euros, 17.6% lower than the same quarter last year. For the year contract ARPU was 34.1 euros, 13.7% lower than in 2006. This reflected the impact of the approx. 10% termination rate cut in November 2007, the level of competition in the German market and the migration of the existing customer base to new customer offers. The Genion S/M/L base reached 2.14 million customers at the end of the year.

A total of 369,000 prepay customers were added during the quarter, while 310,000 existing customers were also removed from the base after an analysis of the contribution of prepay customers to revenue generation. This resulted in net additions in the quarter of 59,000 customers, with 691,000 for the full year, using the market's most stringent definition of customer activity. The prepay base at the end of the year was 6.23 million customers.

Quarterly monthly prepay ARPU of 6.4 euros was 22.8% lower than the fourth quarter last year, reflecting the market factors mentioned above, while the prepay ARPU for the year was 6.7 euros, a decline of 23.5% compared to 2006.

Blended quarterly monthly ARPU in the fourth quarter was 19.4 euros, 17.9% lower than the same quarter last year. Blended ARPU for the year was 20.4 euros, a decline of 15.7% compared to 2006.

Blended quarterly MoU grew by 3.7% year-on-year to 134 minutes, driven by new propositions such as Genion S/M/L/XL and new prepay offers. MoU for the year were 131 minutes, an increase of 3.0% compared to last year.

Quarterly monthly data ARPU was 5.1 euros, 12.8% lower than the fourth quarter last year due to the higher number of lower spending prepay users in the base and a shift from SMS to voice usage with the introduction of flat rate voice tariffs. Data ARPU for the year was 5.1 euros, 10.9% lower than 2006, although total data revenues were flat year on year with a 12.8% increase in non-SMS data.

O2 DSL had acquired 75,000 customers by the end of the quarter, with a strong order book of circa 50,000 which were not reflected in the net additions number for the quarter. Telefónica Deutschland reported 671,000 ULL lines in total at the end of December, from around 187,000 lines at the end of the fourth quarter in 2006. Equivalent ADSL lines in service reached 837,000 at the end of December, from 619,000 at the end of December last year.

### **O2 Ireland**

Total revenues in the fourth quarter of the year were 250 million euros, an increase of 1.4% compared to the same period last year. Revenue for the full year 2007 was 991 million euros, an increase of 11.9% compared to the 11 month period to 31 December 2006. On a like for like basis growth was 2.8%. Mobile service revenue for the quarter was 231 million euros, an increase of 3.7% compared to the same period last year, reflecting the growth of the customer base and the increase in blended ARPU. The termination rate cut reduced fourth quarter service revenue by just under 1%. Mobile service revenue for the year was 935 million euros, a year-on-year increase of 4.0% over the previous year on a comparable basis.

Operating income before depreciation and amortization (OIBDA) for the quarter was 63 million euros, a decrease of 15.2% compared to the same period last year. This included a charge of 13.4 million euros, related to costs to reorganize the IT and networks division in order to capture future efficiency savings, as the business has entered exclusive negotiations with IBM to supply and manage O2 Ireland's IT services. Excluding this charge OIBDA would have been 76 million euros. OIBDA for the year was 316 million euros, 2.0% higher compared to the 11 month period to 31 December 2006 and 6.6% lower year-on-year on a comparable basis, while excluding personnel reorganization charges (totalling 16.2 million euros), OIBDA would have been 333 million euros, a decline of 1.8% year-on-year on a comparable basis.

OIBDA margin in the fourth quarter was 25.1%; excluding the above-mentioned charge it was 30.5%. OIBDA margin for the year was 31.9%, while excluding all personnel reorganization charges it was 33.6%.

O2 Ireland traded well in the fourth quarter, with gross accesses up 4.6% compared to the same quarter last year. Net accesses totalled 14,000 in the fourth quarter. At the end of December the total customer base was 1.6 million customers, 0.9% higher than at the same time last year. The number of mobile Broadband customers stood at 24,500 by the end of the year, after a successful launch in July 2007.

O2 Ireland added a total of 22,000 net contract customers in the quarter, 26.8% higher than the fourth quarter last year, and for the year total contract net additions were 70,000, 24.2% higher than in 2006. Quarterly monthly contract ARPU of 78.8 euros was 3.3% lower than the fourth quarter last year and for the year contract ARPU was 82.3 euros, 3.1% lower than 2006 due to the introduction of new offers and promotions.

Due to the impact of increased competitor activity, the prepay customer base fell during the quarter by 8,000 customers. During the year the prepay base fell by a total of 56,000 customers, compared to a loss of 26,000 in 2006, and ended the year at 1.1 million customers, a decline of 4.9% year-on-year. Monthly prepay ARPU was 29.0 euros, a decrease of 1.9% on the same period a year ago, while ARPU for the year was 29.0 euros, a decline of 1.2% year-on-year.

Blended monthly ARPU in the fourth quarter of 45.7 euros was 1.6% higher than the fourth quarter last year, mainly due to the higher proportion of contract subscribers on the base. Blended ARPU for the year was 45.9 euros, growth of 1.6% year-on-year.

Blended MoU in the quarter increased by 2.5% year-on-year to 252 minutes, again driven by the higher proportion of contract subscribers in the base. MoU for the year were 248 minutes, with a year-on-year growth of 4.9%.

Quarterly monthly data ARPU was 12.4 euros, 23.5% higher than the fourth quarter last year, driven by increased use of non-SMS services. Data ARPU for the year was 11.7 euros (+19.6% year-on-year)

#### **Telefónica O2 Czech Republic**

Total revenues for the fourth quarter amounted to 590 million euros, up 1.7% year-on-year in local currency. For the full year, revenues reached 2,257 million euros, an increase of 2.9% year-on-year in local currency. In line with the first nine months of the year, the Czech mobile business was the key driver of this growth. Business revenues in the Czech fixed line segment were flat in 2007 compared to the previous year, confirming the trend seen since the first quarter.

Operating income before depreciation and amortization (OIBDA) reached 247 million euros in the fourth quarter, up by 14.7% year-on-year in local currency, while OIBDA in 2007 reached 1,010 million euros, up 0.5% year-on-year in local currency.

Telefónica O2 Czech Republic guidance<sup>5</sup> for the full year 2007 has been met, with 2.8% year-on-year growth in revenues (vs. guidance of 1% - 3%), 0.1% year-on-year decrease in OIBDA (vs. guidance of -1% - 0%) and CapEx of 274 million euros (vs. guidance of approx. 310 million euros).

OIBDA margin was 41.9% in the fourth quarter compared to 37.1% in the fourth quarter of 2006, the difference largely due to the re-branding costs incurred in 2006. OIBDA margin for the full year was 44.8% compared to 45.8% for 2006. The decrease in Group OIBDA margin in 2007 was mainly due to dilution by the Slovak operation (approx. 2 percentage points).

The Czech mobile business continued focusing on development of attractive voice and data packages, along with its policy of prepay to contract migration. Total business revenues in the Czech mobile business for the full year were 1,173 million euros, an increase of 4.4% year-on-year in local currency, with an increase of 1.7% in the fourth quarter in local currency. Mobile service revenue amounted to 1,117 million euros, up 4.8% year-on-year in local currency, with an increase of 1.9% in the fourth quarter.

<sup>5</sup> 2006 base reported figures include three months of start-up losses in Slovakia. 2007 guidance assumes constant exchange rates as of 2006, and exclude changes in consolidation. OIBDA excludes other exceptional revenues/expenses not foreseeable in 2007. Personnel reorganization and Real Estate Programs are included as operating revenues/expenses, except for those decided after guidance was set at the beginning of the year (Real Estate Program in TEF O2 CR). For comparison, the equivalent other exceptional revenues/expenses registered in 2006 are also deducted from reported figures.

The total number of mobile customers in the Czech Republic increased by 5.4% year-on-year to reach 5.1 million at the end of December 2007, with net additions for the full year up to 38.4% year-on-year.

The contract customer base reached 2.2 million, representing 19.7% growth year-on-year, with net additions of 369,000 in 2007 (+12.1% year-on-year), and 83,000 in the fourth quarter. Contract customers accounted for 43.8% of the total base at the end of 2007, up from 38.5% at the end of 2006. Contract quarterly monthly ARPU reached 34.5 euros, a year-on-year decline of 7.7% in local currency, mainly due to the dilution caused by customer migration from the prepay to contract segment. Contract ARPU for the year was 34.5 euros, a year-on-year decrease of 8.3% in local currency.

The number of prepay customers decreased by 3.6% year-on-year to 2.9 million at the end of 2007, with a net decrease in the year of 108,000 customers, but a net increase of 75,000 in the fourth quarter, mainly due to the continuing trend of prepay to contract migrations. Prepay quarterly monthly ARPU was 9.7 euros, up 2.8% year-on-year in local currency compared to the fourth quarter of 2006. Prepay ARPU for the year was 9.4 euros, a year-on-year increase of 3.5% in local currency.

Blended quarterly monthly ARPU reached 20.5 euros in the fourth quarter, up 2.3% year-on-year in local currency, while blended ARPU for the year was 19.9 euros, a year-on-year increase of 2.5% in local currency.

Blended quarterly MoU grew by 11.9% year-on-year to 122 minutes, mainly due to the growing number of contract customers generating higher average traffic per customer and tariffs designed to stimulate traffic. Blended MoU for the year stood at 117 minutes, 14.7% above 2006 levels.

Due to the success of connectivity flat data services, based on GPRS/UMTS and CDMA technologies, data ARPU improved by 2.8% year-on-year to 4.4 euros in 2007. Non-SMS data ARPU represented 43% of total data ARPU in 2007 compared to 41% in 2006.

Activities in the Czech fixed line business continued to focus on the development of Broadband services and increasingly the ICT/Business Solutions area. Total business revenues in the Czech fixed business for the full year fell by 0.2% year-on-year in local currency to 1,068 million euros; while in the fourth quarter, revenues fell by 1.1% year-on-year in local currency, despite the healthy growth of revenues from Broadband Internet services, value added services and IT services.

The total number of fixed telephony accesses amounted to 2.1 million at the end of 2007, down by 13.9% year-on-year, mainly as the result of the strong fixed to mobile substitution. As a result of improving the number of gross adds and lower number of disconnections following the Company's effort to enhance the quality of fixed lines via Broadband and bundled offers, the decline in fixed telephony accesses decelerated during 2007. The net losses decreased to 65,000 in the fourth quarter, from 135,000 in the fourth quarter 2006, limiting net losses in 2007 to 333,000 from 506,000 registered in 2006. Total number of customers currently having a bundled product amounted to close to 100,000 at the end of 2007.

The total number of ADSL accesses (retail and wholesale) reached 570,000 at 31 December 2007, up 21.3% year-on-year. Net gain for the year was 100,000 (-49.0% year-on-year), while fourth quarter's net gain stood at 25,000 (-42.5% year-on-year). After the successful take up of bundled products, total number of O2 TV's customers increased to 73,000 at the end of 2007, representing 20,000 net adds in the fourth quarter, up from 16,000 in the previous quarter.

In line with the previous quarters, during the fourth quarter Telefónica O2 Slovakia successfully continued in building its footprint in the Slovak market. The key activities focused on marketing of company's prepaid and recently introduced postpaid offer, customer care enhancement with the aim to further expand the customer base and improve the customer mix via migration to postpaid tariffs. This will lead to higher customer activity in terms of network usage with a positive impact on ARPU and financial performance.

By the end of 2007, the total number of mobile registered customers in Slovakia amounted to 565,000, of which the majority are prepaid customers. Although a significant proportion of these customers use their O2 SIM as a second or third SIM, the market share of active customers is more than 5%. Telefónica O2 Slovakia continued to focus on further rollout of its own network, which will allow for the gradual migration of the traffic from national roaming with positive impact on margins. By the end of the fourth quarter, the company had in operation around 550 Base Stations, resulting in more than 60% of traffic captured over its own network. The sales network comprised 14 own brand stores, 16 franchises and about 3,500 other points of sale.

## TELEFÓNICA EUROPE ACCESSES

Unaudited figures (thousands)	2006			2007		% Chg y-o-y
	December	March	June	September	December	
<b>Final Clients Accesses</b>	<b>38,310.9</b>	<b>38,866.0</b>	<b>39,341.4</b>	<b>40,136.3</b>	<b>41,201.2</b>	<b>7.5</b>
Fixed telephony accesses <sup>1</sup>	2,462.9	2,347.8	2,267.2	2,194.9	2,130.0	(13.5)
Internet and data accesses	607.1	627.3	637.0	648.9	734.2	20.9
Narrowband	143.7	110.9	85.6	68.4	56.6	(60.6)
Broadband <sup>2</sup>	451.9	505.2	540.5	572.8	670.3	48.3
Other	11.6	11.2	10.9	7.7	7.3	(36.7)
Mobile accesses	35,225.2	35,865.5	36,399.7	37,239.6	38,263.8	8.6
Contract	21,143.6	21,504.0	21,643.9	21,972.2	22,419.5	6.0
Pre-Pay	14,081.7	14,361.5	14,755.8	15,267.3	15,935.8	13.2
Pay TV	15.6	25.5	37.5	53.0	73.2	n.m.
<b>Wholesale Accesses<sup>2</sup></b>	<b>243.8</b>	<b>329.5</b>	<b>410.8</b>	<b>543.9</b>	<b>706.2</b>	<b>n.m.</b>
<b>Total Accesses</b>	<b>38,554.7</b>	<b>39,195.5</b>	<b>39,752.2</b>	<b>40,680.3</b>	<b>41,907.3</b>	<b>8.7</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> Includes Unbundled Lines by T.Deutschland.

Note: Mobile accesses, Fixed telephony accesses and Broadband accesses include MANX customers.

## TELEFÓNICA EUROPE CONSOLIDATED INCOME STATEMENT

Unaudited figures (Euros in millions)	January-December			October-December		
	2007	2006	% Chg	2007	2006	% Chg
Revenues	14,458	13,159	9.9	3,682	3,725	(1.1)
Internal exp capitalized in fixed assets <sup>1</sup>	200	219	(8.5)	44	57	(22.3)
Operating expenses	(10,987)	(9,662)	13.7	(2,896)	(2,868)	1.0
Other net operating income (expense)	14	9	52.2	2	3	(17.0)
Gain (loss) on sale of fixed assets	1,292	(8)	c.s.	(6)	1	n.c.
Impairment of goodwill and other assets	(0)	(9)	(99.3)	(0)	(7)	(93.8)
<b>Operating income before D&amp;A (OIBDA)<sup>2</sup></b>	<b>4,977</b>	<b>3,708</b>	<b>34.2</b>	<b>826</b>	<b>910</b>	<b>(9.2)</b>
Depreciation and amortization	(3,386)	(3,399)	(0.4)	(820)	(937)	(12.4)
<b>Operating income (OI)</b>	<b>1,591</b>	<b>309</b>	<b>n.m.</b>	<b>6</b>	<b>(27)</b>	<b>n.c.</b>

Note: Figures are presented considering the Purchase Price Allocation of O2 as of February 2006.

Note: "Bad debt provisions" have been reclassified from "Other net operating income (expense)" to "Operating expenses".

Note: Telefónica Europe includes in 2006 Telefónica O2 Czech Republic (January-December), T. Deutschland (January-December), O2 Group (February-December) and O2 Germany (February-December).

<sup>1</sup> Including work in process.

<sup>2</sup> OIBDA figures exclude brand fee.

**TELEFÓNICA EUROPE  
ACCESSES BY COUNTRIES**

Unaudited figures (thousands)	2006	2007				% Chg y-o-y
	December	March	June	September	December	
<b>UK</b>						
<b>Final Clients Accesses</b>	<b>17,650.0</b>	<b>17,774.9</b>	<b>17,815.4</b>	<b>17,938.0</b>	<b>18,452.8</b>	<b>4.5</b>
Internet and data accesses	16.8	24.0	30.7	38.4	70.7	n.m.
Broadband	16.8	24.0	30.7	38.4	70.7	n.m.
Mobile accesses	17,633.2	17,750.9	17,748.7	17,899.6	18,382.1	4.2
Pre-Pay	11,415.1	11,452.9	11,410.7	11,366.4	11,573.4	1.4
Contract	6,218.1	6,298.0	6,374.1	6,533.2	6,808.7	9.5
<b>Total Accesses</b>	<b>17,650.0</b>	<b>17,774.9</b>	<b>17,815.4</b>	<b>17,938.0</b>	<b>18,452.8</b>	<b>4.5</b>
<b>GERMANY</b>						
<b>Final Clients Accesses</b>	<b>11,043.8</b>	<b>11,215.2</b>	<b>11,591.5</b>	<b>12,205.1</b>	<b>12,546.2</b>	<b>13.6</b>
Internet and data accesses	19.0	31.4	33.7	37.0	74.7	n.m.
Broadband	19.0	31.4	33.7	37.0	74.7	n.s.
Mobile accesses	11,024.8	11,183.8	11,557.8	12,168.1	12,471.5	13.1
Pre-Pay	5,544.1	5,609.6	5,792.4	6,175.4	6,235.0	12.5
Contract	5,480.7	5,574.2	5,765.4	5,992.7	6,236.6	13.8
<b>Wholesale Accesses<sup>1</sup></b>	<b>149.3</b>	<b>227.4</b>	<b>305.1</b>	<b>435.9</b>	<b>596.0</b>	<b>n.s.</b>
<b>Total Accesses</b>	<b>11,193.1</b>	<b>11,442.6</b>	<b>11,896.6</b>	<b>12,641.0</b>	<b>13,142.3</b>	<b>17.4</b>
<b>IRELAND</b>						
Mobile accesses	1,631.7	1,632.5	1,631.5	1,632.5	1,646.1	0.9
Pre-Pay	1,146.7	1,133.6	1,118.7	1,098.8	1,090.9	(4.9)
Contract	485.1	499.0	512.8	533.7	555.2	14.5
<b>Total Accesses</b>	<b>1,631.7</b>	<b>1,632.5</b>	<b>1,631.5</b>	<b>1,632.5</b>	<b>1,646.1</b>	<b>0.9</b>
<b>CZECH REPUBLIC</b>						
<b>Final Clients Accesses</b>	<b>7,842.9</b>	<b>7,712.3</b>	<b>7,698.1</b>	<b>7,714.6</b>	<b>7,841.0</b>	<b>(0.0)</b>
Fixed telephony accesses	2,402.5	2,287.5	2,207.2	2,134.6	2,069.2	(13.9)
Internet and data accesses	560.3	559.9	559.8	559.5	573.3	2.3
Narrowband	143.7	110.9	85.6	68.4	56.6	(60.6)
Broadband	405.1	437.9	463.3	483	509	25.7
Other	11.6	11.2	10.9	7.7	7.3	(36.7)
Mobile accesses	4,864.5	4,839.5	4,893.7	4,967.4	5,125.4	5.4
Pre-Pay	2,989.7	2,873.2	2,816.7	2,806.6	2,881.5	(3.6)
Contract	1,874.8	1,966.3	2,076.9	2,160.9	2,243.9	19.7
PayTV	15.6	25.5	37.5	53.0	73.2	n.m.
<b>Wholesale Accesses</b>	<b>94.5</b>	<b>102.1</b>	<b>105.7</b>	<b>108.0</b>	<b>110.2</b>	<b>16.6</b>
<b>Total Accesses</b>	<b>7,937.4</b>	<b>7,814.4</b>	<b>7,803.8</b>	<b>7,822.6</b>	<b>7,951.2</b>	<b>0.2</b>
<b>SLOVAKIA</b>						
Mobile accesses	-	386.8	455.0	495.6	565.4	n.c.
Pre-Pay	-	386.8	454.0	475.9	502.4	n.c.
Contract	-	0.0	1.0	19.7	63.0	n.c.
<b>Total Accesses</b>	<b>-</b>	<b>386.8</b>	<b>455.0</b>	<b>495.6</b>	<b>565.4</b>	<b>n.c.</b>

<sup>1</sup> Includes Unbundled Lines by T. Deutschland.

<sup>2</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.

**TELEFÓNICA EUROPE****SELECTED OPERATING DATA MOBILE BUSINESS BY COUNTRIES**

Unaudited figures	2006		2007			% Chg y-o-y
	4Q	1Q	2Q	3Q	4Q	
<b>O2 UK</b>						
<b>MoU (minutes)</b>	<b>180</b>	<b>179</b>	<b>189</b>	<b>193</b>	<b>197</b>	<b>9.8</b>
<b>ARPU (EUR)</b>	<b>34.1</b>	<b>33.3</b>	<b>34.5</b>	<b>35.7</b>	<b>33.9</b>	<b>4.4</b>
Pre-Pay	18.2	17.0	18.2	19.3	18.0	4.1
Contract	63.5	63.2	63.9	64.8	61.0	1.2
<b>Data ARPU</b>	<b>10.7</b>	<b>11.0</b>	<b>11.0</b>	<b>11.1</b>	<b>11.1</b>	<b>9.1</b>
%non-P2PSMS over data revenues	12.5%	13.4%	14.2%	15.2%	15.9%	3.4 p.p.

**O2 GERMANY**

<b>MoU (minutes)</b>	<b>129</b>	<b>129</b>	<b>133</b>	<b>128</b>	<b>134</b>	<b>3.7</b>
<b>ARPU (EUR)</b>	<b>23.7</b>	<b>20.5</b>	<b>20.9</b>	<b>20.8</b>	<b>19.4</b>	<b>(17.9)</b>
Pre-Pay	8.3	6.8	6.7	6.8	6.4	(22.8)
Contract	39.2	34.2	35.2	34.9	32.3	(17.6)
<b>Data ARPU</b>	<b>5.9</b>	<b>5.1</b>	<b>5.1</b>	<b>5.2</b>	<b>5.1</b>	<b>(12.8)</b>
%non-P2PSMS over data revenues	22.6%	24.9%	25.0%	25.9%	25.7%	3.1 p.p.

**O2 IRELAND**

<b>MoU (minutes)</b>	<b>246</b>	<b>240</b>	<b>249</b>	<b>250</b>	<b>252</b>	<b>2.5</b>
<b>ARPU (EUR)</b>	<b>45.0</b>	<b>44.2</b>	<b>46.7</b>	<b>47.0</b>	<b>45.7</b>	<b>1.6</b>
Pre-Pay	29.6	28.0	30.0	29.2	29.0	(1.9)
Contract	81.4	82.0	83.8	84.9	78.8	(3.3)
<b>Data ARPU</b>	<b>10.0</b>	<b>11.5</b>	<b>11.2</b>	<b>11.6</b>	<b>12.4</b>	<b>23.5</b>
%non-P2PSMS over data revenues	19.6%	19.9%	23.4%	26.5%	31.4%	11.8 p.p.

**TELEFÓNICA O2 CZECH REPUBLIC<sup>1</sup>**

<b>MoU (minutes)</b>	<b>109</b>	<b>109</b>	<b>120</b>	<b>117</b>	<b>122</b>	<b>11.7</b>
<b>ARPU (EUR)</b>	<b>18.8</b>	<b>17.7</b>	<b>18.5</b>	<b>19.2</b>	<b>20.5</b>	<b>2.3</b>
Pre-Pay	8.8	8.3	8.8	9.1	9.7	2.8
Contract	35.0	32.2	32.2	32.6	34.5	(7.7)
<b>Data ARPU</b>	<b>4.0</b>	<b>3.8</b>	<b>3.9</b>	<b>4.0</b>	<b>4.4</b>	<b>1.8</b>
%non-P2PSMS over data revenues	40.0%	41.0%	42.0%	45.0%	42.0%	2.0 p.p.

Note: MoU and ARPU calculated as monthly quarterly average.

<sup>1</sup> KPIs for Mobile business in Czech Republic do not include Slovakia.

**TELEFÓNICA EUROPE**  
**SELECTED FINANCIAL DATA**

Unaudited figures (Euros in millions)

	January-December			
	2007	2006	%Chg	% Chg Local Cur
<b>O2 UK<sup>1</sup></b>				
Revenues	7,403	6,265	18.2	18.7
OIBDA	1,923	1,777	8.2	8.7
OIBDA margin	26.0%	28.4%	(2.4 p.p.)	
CapEx	832	760	9.5	10.0
<b>O2 GERMANY<sup>2</sup></b>				
Revenues	3,541	3,320	6.7	6.7
OIBDA	473	583	(18.9)	(18.9)
OIBDA margin	13.3%	17.6%	(4.2 p.p.)	
CapEx	850	1,224	(30.6)	(30.6)
<b>O2 IRELAND<sup>1</sup></b>				
Revenues	991	885	11.9	11.9
OIBDA	316	310	2.0	2.0
OIBDA margin	31.9%	35.0%	(3.1 p.p.)	
CapEx	117	141	(17.1)	(18.0)
<b>TELEFÓNICA O2 CZECH REPUBLIC</b>				
Revenues	2,256.5	2,148.0	5.1	2.9
OIBDA	1,010	985	2.6	0.5
OIBDA margin	44.8%	45.8%	(1.1 p.p.)	
CapEx	281	229	22.6	20.1

(\*) OIBDA figures exclude brand fee

<sup>1</sup> In 2006 includes February-December period.

<sup>2</sup> In 2006 includes February-December period for O2 Germany and Telefónica Deutschland.

**ATENTO GROUP**  
**CONSOLIDATED INCOME STATEMENT**

Unaudited figures (Euros in millions)	January-December			October-December		
	2007	2006	% Chg	2007	2006	% Chg
Revenues	1,174	1,027	14.4	305	269	13.6
Internal exp capitalized in fixed assets <sup>1</sup>	0	0	n.m.	0	0	n.m.
Operating expenses	(1,017)	(885)	15.0	(261)	(228)	14.5
Other net operating income (expense)	2	(0)	n.c.	(0)	(2)	n.m.
Gain (loss) on sale of fixed assets	2	(0)	n.c.	0	0	n.c.
Impairment of goodwill and other assets	0	0	n.m.	0	0	n.m.
<b>Operating income before D&amp;A (OIBDA)</b>	<b>161</b>	<b>142</b>	<b>13.9</b>	<b>44</b>	<b>39</b>	<b>12.1</b>
Depreciation and amortization	(30)	(28)	7.8	(8)	(7)	12.5
Operating income (OI)	131	113	15.5	36	32	12.0

<sup>1</sup> Including work in progress

## Other companies

### Atento Group

The Atento Group performed well in 2007, consolidating year-on-year revenue and OIBDA margin growth. This strong earnings performance was driven by the implementation of the Group's strategy to differentiate itself from competitors. For the fifth consecutive year Atento achieved profitable business growth, diversified its customer portfolio and added customers from a range of sectors.

Revenues totalled 1,174 million euros at year-end 2007, up 14.4% from 2006. Revenues were driven by the increase in the activity of its main customers and new accounts in almost all the countries in which it operates, primarily Brazil, Mexico, Peru, Argentina and Venezuela. The main customers driving this growth were:

- In Brazil, more business with Telefónica (Atento ao Cliente services, Speedy, Sera and Cobranzas) and growth in the financial sector (Itaú, Banco IBI, Bradesco, Unibanco, Redecard).
- In Mexico, expansion in tandem with BBVA, primarily mortgage, finance, collections and insurance services.
- In Peru, growth in on-site sales services along with the expansion of services outsourced from the Spanish market.
- In Argentina, growth in the multisector market both via current customers (Alcatel, Nokia, Microsoft, YPF) and new customers (Lexmark, SAP, P&G, Lan, Bosch), together with the expansion with Telefónica (Telefónica Móviles Argentina and Telefónica de Argentina)
- In Venezuela, increase in activity with the CANTV Group and Movistar, and the addition of Banesco.

These factors offset the fall in activity in Spain due to the delocalisation of traffic from the Spanish market to Latin America and Morocco.

Atento's customer portfolio diversified further in 2007, with 50.1% of revenues deriving from multisector customers (outside the

Telefónica Group) compared with 47.0% in 2006. Brazil and Spain accounted for 44.2% and 12.3% of revenues respectively. Atento México's revenues rose sharply and accounted for 20.2% of the total compared with 15.9% a year earlier.

Operating expenses grew 15.0% year-on-year to 1,017 million euros, although growth slowed in the last quarter (+14.5% compared to the fourth quarter of 2006) as a result of the delocalisation of services from the Spanish market to Latin America (reducing personnel costs) and the change in mix arising from the reduced role of Atento's Spanish business within the Group. These factors offset the increase in structural costs relating to expenses booked from the leasing of capacity associated with the growth of the business.

The Atento Group's Operating income before depreciation and amortisation (OIBDA) amounted to 161 million euros, year-on-year growth of 13.9%, driven by the increase in activity and the reining in of structural costs. The OIBDA margin stood at 13.7%, in line with the margin posted at the end of 2006, showing an improvement in the fourth quarter (OIBDA margin of 14.5% for the fourth quarter of 2007).

Operating income (OI) in 2007 amounted to 131 million euros, representing year-on-year growth of 15.5% and an OIBDA margin of 11.2%.

CapEx in 2007 amounted to 39 million euros, compared to 35 million euros in 2006, as a result of the higher investment need to support the business growth, mainly in Brazil and Mexico.

Operating cash flow (OIBDA-Capex) improved significantly when compared to 2006, rising by 15.1% to 122 million euros.

At operating level, the Atento Group ended 2007 with 53,239 positions in place, marking a 13.6% year-on-year increase. The average number of occupied positions for 2007 stands at 42,971.

## Key Holdings of the Telefónica Group detailed by regional business units

### TELEFÓNICA ESPAÑA

	% Part
Telefónica España	100.00
Telefónica Móviles España	100.00
Telyco	100.00
Telefónica Telecomunic. Públicas	100.00
T. Soluciones de Informática y Comunicaciones de España	100.00
Iberbanda	51.00
Medi Telecom	32.18

### TELEFÓNICA EUROPE

	% Part
O2 UK	100.00
O2 Germany	100.00
O2 Ireland	100.00
Manx	100.00
Be	100.00
Group 3G (Germany) <sup>3</sup>	100.00
Telefónica O2 Czech Republic <sup>1</sup>	69.41
Telefónica O2 Slovakia <sup>2</sup>	100.00

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

<sup>2</sup> Company owned through Telefónica O2 Czech Republic

<sup>3</sup> Company owned through Telefónica O2 Germany

### OTHER PARTICIPATIONS

	% Part
3G Mobile AG (Switzerland)	100.00
Grupo Atento	100.00
Telefónica de Contenidos	100.00
Mobipay Internacional	50.00
Telco SpA (Italy) <sup>5</sup>	42.30
Tempos 21 <sup>1</sup>	43.69
IPSE 2000 (Italy) <sup>1</sup>	39.92
Lycos Europe	32.10
Sogecable <sup>2</sup>	16.79
Mobipay España <sup>1</sup>	13.36
Hispasat	13.23
Portugal Telecom <sup>3</sup>	8.21
China Netcom Group <sup>4</sup>	5.00
BBVA	0.97
Amper	6.10

<sup>1</sup> Ownership directly or indirectly held by Telefónica Móviles España.

<sup>2</sup> Telefónica de Contenidos, S.A. holds 15.63% and Telefónica, S.A. holds 1.20%.

<sup>3</sup> Telefónica's Group effective participation. Telefónica Group participation would be 9.96% if we exclude the minority interests. Taking into account the own shares held by the Portuguese company and excluding the minority interests, Telefónica's Group voting rights reached 10.96%.

<sup>4</sup> Ownership held by Telefónica Latinoamérica.

<sup>5</sup> Telefónica holds and indirect participation of the ordinary share capital (with voting rights) of Telecom Italia through Telco of approximately 10%. If we take into account the saving shares (azioni di risparmio), which do not have voting rights, the indirect participation of Telefónica over Telecom Italia would be 6.9%

### TELEFÓNICA LATINOAMÉRICA

	% Part
Telesp <sup>1</sup>	87.95
Telefónica del Perú	98.18
Telefónica de Argentina	98.04
TLD Puerto Rico	98.00
Telefónica de Chile	44.89
Telefónica Telecom	52.03
Telefónica USA	100.00
T. Intern. Wholesale Serv. (TIWS) <sup>2</sup>	100.00
Brasilcel <sup>3</sup>	50.00
T. Móviles Argentina	100.00
T. Móviles Perú	98.53
T. Móviles México	100.00
Telefónica Móviles Chile <sup>4</sup>	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	100.00
T. Móviles Uruguay	100.00
Telefonía Celular Nicaragua	100.00
T. Móviles Soluciones y Aplicac. (Chile)	100.00

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

<sup>2</sup> Telefónica, S.A. owns 92.51% and Telefónica DataCorp owns 7.49%.

<sup>3</sup> Joint Venture which fully consolidates the subsidiary Vivo S.A. through participations at Vivo Participações, S.A.

<sup>4</sup> Telefónica Móviles Chile made a capital increase in the month of may. As a result it became the unique shareholder of Telefónica Móviles de Chile, that was dissolved. this operation ended the 1st of July.

## Significant Events

- Strengthening its commitment to shareholder value creation, the Board of Directors of the Company, at its meeting held on February 27th, 2008, has announced the launching of a new share buy-back programme for a total amount of 100 million shares, representing 2.095% of the Company's share capital, which will be effective until the first half of 2009.
- At the meeting held on January 23th, 2008, the Board of Directors of the Company, was informed of and acknowledged the resignations tendered by Board members Mr. Manuel Pizarro Moreno and Mr. Antonio Viana-Baptista from their directorships. In view thereof, the Board of Directors has unanimously resolved, at the proposal of the Nominating, Compensation and Corporate Governance Committee, the interim appointment of Mrs. Eva Castillo Sanz and Mr. Luiz Fernando Furlán as new members of the Board of Directors, both as independent Directors.
- TELEFÓNICA, S.A., through its subsidiary TELEFÓNICA INTERNACIONAL, S.A.U., reached on January 18th, 2008, an agreement to acquire an additional stake equal to approximately 2.22% of the share capital of the Chinese telecommunications company CHINA NETCOM GROUP CORPORATION (HONG KONG) LIMITED ("CNC"). The execution of this acquisition is subject to prior attainment of the necessary regulatory approvals. After the acquisition, the TELEFÓNICA group's stake in CNC would stand at approximately 7.22%. If completed, the acquisition of the aforementioned stake in the equity in CNC will involve a total investment of approximately 309 million euros (depending on the exchange rate prevailing when the transaction is closed).
- At its ordinary meeting on December 19th, 2007, Telefónica's board, with the approval of the Nominating, Compensation and Corporate Governance Committee, has named Julio Linares, General Manager for Coordination, Business Development and Synergies, as the company's new Chief Operating Officer. It also decided to appoint Guillermo Ansaldi as General Manager of

Telefónica España. Mr Ansaldi will replace Antonio Viana-Baptista, who leaves the Company citing personal reasons. Meanwhile, Manuel Pizarro and Javier de Paz will replace Enrique Used and Maximino Carpio as members of Telefónica's board of directors. Both Manuel Pizarro, Javier de Paz and Alfonso Ferrari will join as well the Executive Commission of the Company's board of directors.

- On November 29th, 2007 Telefónica, S.A. announced Mr. Peter Erskine step down as General Manager of Telefónica O2 Europe, retaining his position on the Board of Directors of the Company and on its Executive Commission, as nonexecutive Director. Mr Matthew Key, former Chief Executive Officer of O2 UK plc., replaced him as General Manager of Telefónica O2 Europe and as member of the Executive Committee of Telefónica, S.A.
- On November 28th, 2007, the Board of Directors of TELEFÓNICA, S.A., in accordance with the "Performance Share Plan 2006" authorised by the Annual General Shareholders' Meeting of the Company held on June 21st, 2006 and notified on November 13th, 2006 resolved, subject to the report of the Nominating, Compensation, and Corporate Governance Committee, to allocate the shares corresponding to the second cycle of that Plan to the Executive Directors and Executives Officers of the Company.

## Changes to the Perimeter and Accounting Criteria of Consolidation

In 2007, the main changes have occurred in the consolidation perimeter were the following:

### Telefónica Europe

- In December 20th, 2007, O2 Group transferred its legal ownership over its business in Germany to Telefónica S.A. through a dividend in kind of 8,500 million euros.
- In April 2007, Telefónica O2 Europe PLC, 100%-owned by Telefónica, S.A. and its wholly owned subsidiary O2 Holdings LTD, sold for a total of 1,932 million pounds (equivalent to 2,841 million euros in the date of the operation) 100% of British firm Airwave O2 Ltd. which generated a capital gain of 1,296 million euros. This company, which was consolidated in the Telefónica Group financial statements using the full integration method, has been removed from the perimeter of consolidation.

### Other companies

- In December 2007 Telefónica, S.A. formed, as sole shareholder, the Spanish company Atento Holding, Inversiones y Teleservicios, S.A. with an initial share capital of 24 million euros and an additional paid-in capital reserve of 138,37 million euros. The shares were fully subscribed and reimbursed in the form of non-monetary contribution of all the shares of the Dutch company Atento, N.V., of which Telefónica, S.A. was sole shareholder. The company has been included in the consolidation scope using the full integration method.
- In December 2007 Telefónica, S.A. sold 18,558,181 shares of the Portuguese company Portugal Telecom, SGPS, S.A. (PT). Following this disposal, Telefónica Group has reduced its shareholding in the capital of the Portuguese company to 8.32%, 9.16% if the treasury stock of PT is taken into consideration. This company is still included in the financial statements of Telefónica Group under the equity method.
- In October 2007 a consortium formed by Telefónica, S.A. Assicurazioni Generali, S.p.A., Intesa Sanpaolo, S.p.A. and Sintonia, S.A. acquired 100% of the Olimpia, S.p.A. through the Italian company Telco, S.p.A. (in which Telefónica holds a 42.3% of equity stake), which holds approximately 23.6% of the Telecom Italia, S.p.A. voting capital. Telefónica's indirect participation with voting rights in Telecom Italia S.p.A. stands at 9.98% equivalent to 6,88% of the economic rights. This operation implied a payment of 2,314 million euros. The company is included in the financial statements of the Telefónica Group under the equity method.
- In August 2007 the Telefónica Group sold its 100% stake in Spanish company Azeler Automoción, S.A. for 0.34 million euros. This company, which had been fully consolidated in the Telefónica Group, was removed from the consolidation perimeter.

- In June 2007, Atento Teleservicios España, S.A. of Spain incorporated US company, Contact US Teleservices Inc., contributing 100% of the initial share capital of 0.1 million US dollars. This company was added to the Telefónica Group's consolidation perimeter and is fully consolidated. In August this company took out a 0.55 million US dollar capital increase, which was fully subscribed by Atento Teleservicios España, S.A.
- In June 2007, Telefónica, S.A. sold its entire 31.75% stake in Sistemas Técnicos de Loterías del Estado, S.A. This company, which had been accounted for by the Telefónica Group under the equity method was removed from the perimeter of consolidation.
- In May 2007, Telefónica, S.A. agreed to sell its 99.7% stake in Dutch company Endemol Investment Holding B.V. to a newly created consortium held equally by Mediacion Cartera S.L., a newly incorporated company owned by Mediaset and its listed Spanish subsidiary Gestevisión Telecinco, Cyte Fund II B.V. and G.S. Capital Partners VI Fund, L.P. The consortium paid 2,629 million euros, reaching the capital gain 1,368 million euros. The agreement was executed on 3 July. This company, which had been fully consolidated in the Telefónica Group, was removed from the consolidation perimeter.
- In April 2007, US firm Katalyx, Inc. sold its 54% stake in Brazilian company Mercador, S.A. The company had been consolidated in the financial statements of the Telefónica Group under the equity method and was thus removed from the perimeter of consolidation.
- During the first quarter of 2007, the Telefónica Group sold shares in the Italian company Ipse 2000 S.p.A. reducing its direct and indirect percentage in the Italian company to 39.9%. The company continues to be incorporated in the consolidated financial statements of the Telefónica Group using the equity method.
- In February 2007 the company sold 100% of its stake in Endemol France to the company Endemol, N.V., in which the Group has 75% participation, and thus reducing its stake in the company to that percentage.
- The Spanish company Communicapital Gestión, S.A., has been liquidated. The company, which was included in the financial statements of Telefónica Group using the full integration method, has been removed from the perimeter of consolidation.

## Market risk management policies

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

The main market risks affecting the Group are as follows:

### 1. Exchange rate risk.

Exchange rate risks arise mainly from two sources. The first is Telefónica's international presence, through its investments and businesses in countries that use currencies other than the euro. These are largely in Latin America, but also in the Czech Republic and the UK. The second is debt denominated in currencies other than that of the country where the business is conducted or the home country of the company taking on the debt.

### 2. Interest rate risk.

This arises from changes in (i) financial expenses on floating rate debt (or short-term debt likely to be renewed), due to changes in interest rates and (ii) the value of long-term liabilities at fixed interest rates.

### 3. Share price risk.

This arises from changes in the value of equity investments that may be bought, sold or otherwise involved in transactions, from changes in the value of derivatives associated with such investments, from treasury shares and from equity derivatives.

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

Finally, there is so-called "country risk" (which overlaps with market and liquidity risks). This refers to the possible decline in

assets, cash flows generated or cash flows returns to the parent company as a result of political, economic or social instability in the countries where Telefónica Group actively manages these risks with a view to stabilize:

- Cash flows, to facilitate financial planning and take advantage of investment opportunities,
- The income statement, to make it easier for investors to understand and forecast company results,
- Share capital, to protect the value of the investment.

Where these aims conflict, the Group's financial management will decide which should be given priority.

Telefónica uses derivatives to manage risks, basically on exchange rates, interest rates and shares.

### Exchange rate risk

The fundamental objective of the Group's exchange rate risk management policy is to offset (at least partly) any impairment of assets related to Telefónica's business due to declines in exchange rates versus the euro, with savings on the euro value of foreign-denominated debt (which will decline simultaneously). The degree of hedging (i.e. the proportion of foreign currency debt as a percentage of foreign currency assets) tends to be higher in the following circumstances:

- The closer is the estimated correlation between the value of the asset and the value of the currency.
- The cheaper is the estimated cost of hedging (measured as the difference between the additional financial expenses of borrowing in local currency and the expected depreciation in the local currency versus the euro).
- The more liquid is the local currency and derivative markets.

In general, the correlation between asset values and the exchange rate is higher when cash flows generated by the asset

in the early years of the investment represent a large proportion of its estimated value.

At December 31, 2007 net financial debt<sup>1</sup> in Latin American currencies amounted to nearly 6,968 million euros (7,306 million euros in 2006). However, this debt is not distributed proportionally to the cash flows generated in each country. Its future effectiveness as a hedge of exchange rate risks therefore depends on which currencies depreciate.

The Group further protects itself against declines in Latin American exchange rates affecting its assets through the use of dollar-denominated debt, either in Spain (where such debt is associated with the investment as long as it is considered to be an effective hedge) and in the country itself, where the market for local currency financing or hedges may be inadequate or non-existent. At December 31, 2007 the Group's net dollar-denominated debt amounted to the equivalent of 1,481 million euros net of the effect of the derivative contracts and financial assets in dollars (1,462 million euros in 2006).

To protect its investment in the Czech Republic, the Group has synthetic debt denominated in Czech crowns which, at December 31, 2007, amounted to the equivalent of 3,102 million euros, compared to 1,997 million euros in 2006. This increase was due to a change in the hedging objective in 2007 from 50% to 70% of the initial acquisition cost due to the expected appreciation of the Czech crown vis-à-vis the euro.

Regarding protection of the investment in the UK, the disposal of Airwave for 1,932 million pounds sterling prompted the Group to modify the hedging objective to 50% from 70%. Debt denominated in pounds sterling at December 31, 2007 was equivalent to 6,702 million euros, which is less than the 11,095 million euros at December 31, 2006.

The Group also manages exchange rate risk by seeking to minimize the negative impact of any remaining exchange rate exposure on the income statement. Such exposure can arise for

any of three reasons: (i) a thin market for local derivatives or difficulty in sourcing local currency finance, which makes it impossible to arrange a low-cost hedge (as in Argentina and Venezuela for example), (ii) financing through intra-group loans, where the accounting treatment of exchange rate risk is different from that for financing through capital contributions, (iii) as the result of a deliberate policy decision.

In 2007, exchange rate management resulted in gains totaling 7.3 million euros (61 million euros in 2006).

If the exchange rate position affecting the income statement at the end of 2007 would remain constant in 2008 and Latin American currencies depreciated against the US dollar and the rest of the currencies against the euro by 10%, the impact on the income statement would be an expense of 69 million euros. However, as mentioned above, the Group follows an active management policy to reduce these impacts.

As indicated previously, the fundamental objective of the Group's exchange rate risk management policy is to offset (at least partly) any impairment of assets related to Telefónica's business due to declines in exchange rates versus the euro, with savings on the euro value of foreign-denominated debt (from depreciation by the euro). For some investments, the hedge benchmark is a percentage of acquisition cost (e.g. pound sterling and Czech crown), whereas others are defined in terms of expected cash flows in the next two years (mainly Latin America). As management's objective is not an accounting indicator, no sensitivity analysis is presented of changes in translation differences (equity) due to currency appreciation against the euro.

#### **Interest rate risk**

Telefónica's financial expenses are exposed to changes in interest rates. In 2007, the rates applied to the largest volumes of short-term debt were based on the Euribor, sterling Libor (because of the acquisition of O2 plc), Brazilian SELIC, the dollar Libor and the Colombian UVR. At December 31, 2007, 50.4% of total nominal net debt (or 51.1% of nominal long-term net debt) was at fixed rates

<sup>1</sup> Net financial debt = LT financial debt + ST financial debt -short-term investments -cash and cash equivalents -financial and other non-current LT assets.

for over one year, compared to 45.4% of total debt<sup>2</sup> (46.3% of long-term debt) in 2006. Of the remaining 49.6% (debt at floating or fixed rates maturing in less than one year), the interest rate on 46 percentage points was set for a period of more than one year (27% of long-term debt), compared to 41 percentage points on debt at floating or fixed rates maturing in less than one year (23% of long-term debt) at December 31, 2006. In 2007, cap and floor structures were arranged for an equivalent amount of 7,972 million euros to increase and extend the term of the hedged debt.

In addition, early retirement liabilities were discounted to present value over the year using the forward interest rate curve on the swap markets. The increase in interest rates has reduced the size of these liabilities.

The net financial result for 2007 showed a loss of 2,844 million euros, 4% higher than in 2006. Excluding exchange rate differences, interest expense in 2007 and 2006 was 2,851 million euros and 2,795 million euros, respectively, implying a 2% increase in adjusted finance costs in 2007 compared to 2006. This increase is the result of two offsetting factors. On the one hand, the 5.8% decrease in the total average net debt balance (3,471 million euros at December 31, 2007) led to a decline of 200.4 million euros. On the other hand, interest expense rose by 257 million euros as a result of: a) a 38bp increase in the average cost of debt, mostly because the average net debt was at higher rates than the average for 2006 due to the higher relative weight of Latin American debt and the hikes in rates in GBP, EUR and USD versus 2006, and b) a 50 million euro increase in non-recurring income and the expense related to positions measured at fair value. The figure for financial expenses in 2007 implies an average cost of average total net debt of 5.59%, or 5.61% stripping out exchange rate gains.

To illustrate the sensitivity of finance costs to variability in short-term interest rates, assuming a 100 basis point rise in all currencies in which the Company has a financial position and no change in the currency make-up and balance of the position at year end, the financial expense would increase by 182 million euros.

#### Share price risk

In 2007, Telefónica carried out the share buyback program announced in October 2003 and renewed in April 2005, for a value estimated at 6,000 million euros to 2007 (inclusive), which depended on the generation of cash flows and on the share price. Although at the end of 2007 there were no commitments to buy back more shares, Telefónica could acquire new commitments in this respect in the future if so decided at the General Shareholders' Meeting.

At December 31, 2007, Telefónica, S.A. held 64,471,368 treasury shares (see Note 12). The net asset value of the treasury shares could increase or decrease depending on variations in the Telefónica share price.

At the Shareholders' Meeting of Telefónica, S.A. on June 21, 2006, shareholders approved the introduction of a long-term incentive plan for managers and senior executives of Telefónica, S.A. and other Telefónica Group companies. Under this plan, selected participants who met the qualifying requirements were given the rights to earn a certain number of Telefónica, S.A. shares as a form of variable remuneration (see Note 20.a).

This plan consisted of a number of cycles. For the first cycle (July 1, 2006), the maximum number of shares amounted to 6,530,615, while in the second that maximum number to be assigned would be 5,556,234. According to the plan, the shares may be either (a) treasury shares in Telefónica, S.A., acquired by either Telefónica, S.A. itself or any of the Telefónica Group companies, in compliance with the legal requirements in force in this connection; or (b) newly-issued shares. The possibility of delivering shares to employees in the future, in accordance with relative shareholder remuneration or profit, implies a risk since there could be an obligation to hand over a maximum number of shares at the end of each cycle, whose acquisition (in the event of acquisition in the market) in the future could imply a higher cash outflow than required on the start date of each cycle if the share price is above the corresponding price on the cycle start date. In the event that new shares are issued for delivery to the beneficiaries of the plan,

<sup>2</sup>Total debt = Net financial debt +financial guarantees not considered in net financial debt +net personnel reorganization commitments.

there would be a dilutive effect for the ordinary shareholder as a result of the higher number of shares outstanding.

To reduce risk and ensure the company has enough shares to meet its commitments at the end of the cycle commenced in 2006, Telefónica bought an instrument from a financial institution that will deliver to Telefónica, at the end of the cycle, a number of shares based on the same measure of success used in the plan. The maximum number of shares which Telefónica could receive is 7,200,000. The cost of this instrument was 46 million euros which, in unit terms, is equivalent to 6.43 euros per share (see Note 20).

Telefónica is also exposed to fluctuations in the share price of its investees, especially where these fall outside its core business and could be sold. In 2007, Telefónica sold its entire stakes in Airwave O2, Ltd. and Endemol Investment Holding, B.V. and part of its holding in Portugal Telecom, S.G.P.S., S.A. (representing 1.809% of share capital). Also in 2007, due to the non-monetary dividend paid by Portugal Telecom, Telefónica has received, directly and indirectly, a total of 16,879,406 shares of PT Multimedia, S.G.P.S., S.A (see Note 9).

#### **Liquidity risk**

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

1. Group debt must have a longer average maturity than the time it will take to earn the cash to pay it (assuming internal projections are met, and all cash flows generated go to pay down debt rather than on dividends or acquisitions).
2. The Group must be able to pay all commitments over the next 12 months without accessing new borrowing or tapping the capital markets (although including firm credit lines arranged with banks), assuming budget projections are met.

As of December 31, 2007, the average maturity of the Group's 45,284 million euros net financial debt was 6.24 years. The Group would need to generate around 7,257 million euros per year to repay the debt in this period if it used all its cash for this purpose. Cash generation in 2007 amply exceeded this amount, so that if it maintains the same pace of cash generation during the average lifetime of the debt, the Group would repay the debt in its entirety before 6.24 years if it used all its cash for this purpose.

Gross debt maturities in 2008 amount to approximately 6,776 million euros (including the net position of hedges) and are lower than the availability of the funds, calculated as the sum of: a) current financial investments and cash at December 31, 2007 (6,477 million euros excluding derivative financial instruments); b) annual cash generation projected for 2008; and c) undrawn credit facilities arranged with banks whose initial maturity is over one year (more than 4,000 million euros at December 31, 2007). Accordingly, Telefónica will not need to tap the capital or credit markets in at least the next 12 months.

As a result of the higher debt at Telefónica following the acquisition of O2 shares and the excessive concentration of short-term debt maturities, Telefónica embarked on an ambitious refinancing plan, which led to the following actions in 2006 and 2007: (1) the refinancing of approximately 15,977 million euros via issues of bonds and debentures in international capital markets such as the euro, pound sterling, US dollar, yen and Czech crown (of which 3,974 million euros were issued in 2007 before the deterioration of the credit market –see Note 13-), and approximately 11,000 million euros in the syndicated credit and loan market; (2) the extension of the debt maturity (including the additional debt taken on after the acquisition of O2 in the UK) and, as a result, the extension of the average life of net financial debt from 3.75 to 6.24 years at the end of 2007; and (3) an approximately 5,389 million euro decrease in net financial debt in 2007 and an approximately 1,610 million euro decrease in post-employment benefit obligations.

## CREDIT RATING ACCORDING TO STANDARD & POOR'S

Country	Rating	Change in notches from Jan 2007 to Dec 2007	Otlook
Argentina	B+	=	Stable
Brazil	BB+	+1	Positive
Chile	A+	+1	Stable
Colombia	BB+	+1	Stable
Ecuador	B-	+2	Stable
Mexico	BBB+	+1	Stable
Peru	BB+	+1	Positive
Uruguay	B+	+1	Positive
Venezuela	BB-	=	Stable

The liquidity cushion existing after the execution of the refinancing plan (assuming the internal projections are met) will allow the Company to meet the rest of the financial commitments it acquires, focus on growing the business through new investment and/or bringing forward or increasing shareholder remuneration.

Million euros	Total
1 year	2,495
2 years	3,278
3 years	2,254
4 years	2,055
5 years	1,491
Over 5 years	8,240
<b>Total</b>	<b>19,813</b>

The breakdown of estimated interest maturities without considering the remeasurement of financial liabilities existing at December 31, 2007 is as follows:

The estimate of interest rates applicable to floating rate debt is made based on forward rates of the most liquid money-market curves.

### Country risk

Sovereign risk perception (measured by credit spreads) in Latin America reached record lows (168 basic points) in late May 2007. Afterwards, increased volatility in financial markets halted this downward trend, and country risks began to climb ending the year at 270 basic points.

Macroeconomic developments in 2007 throughout the region remained positive, with a overall GDP growth rate at 5.6% (same rate as in 2006), with Argentina at the top of the ranking (8.6%) and Ecuador at the bottom (2.7%). With this number, the region has posted five consecutive years of high growth rates – the last four years with a rate surpassing 4.5% – with a solidly-based composition and domestic demand at the forefront. In this sense,

dynamic investment (11.6%) and the acceleration of consumption (6.8%) have been determining factors in the trend. As a percentage of GDP, investment exceeded 21% in 2007, the highest ratio recorded since 1990.

This positive macroeconomic picture has permitted a healthy per capita income growth of 4% in 2007, with an average of 4.1% during the last 4 years. This represents the highest consecutive increase since the 1970s. At the same time, inflation, after reaching historically low levels in 2006 (5%), increased marginally in 2007 (6.1%), basically driven by higher international prices, such as fuel and food. In some cases, domestic demand pressures were also a contributing factor, especially in countries with the highest growth rate. Venezuela (20%) and Argentina (8.5%) continue to lead the countries with the highest inflation rates amid the region.

A robust employment growth has promoted an improvement in most of social indicators across the region, with the unemployment rate falling to 8% – the lowest rate since the beginning of the 1990's. The upturn in formal employment was a particular feature of this trend (remarkably in Brazil), while real wages rose at a measured pace (1.5%). The increase in total wages contributed to a notable increase in household consumption and a further reduction in poverty rates. According to data from ECLAC, the fraction of people who live below the poverty or extreme poverty lines has been reduced from 42.5% in 1999 to 35.1 in 2006. This reduction has been accompanied also with an improvement in income distribution, as measured by the Gini index, which has fallen from 0.58 in 1999 to 0.55 in 2006, with important advances in the largest countries in the region such as Brazil, Mexico and Argentina.

This favorable economic performance does not eliminate the political risk that exists still in some Latin American countries linked in most of cases to uncertainty derived from unexpected and discretionary actions. In this sense, Venezuela and Ecuador are the countries most exposed to this type of risk. In the former, the "Ley Habilmente" led to the nationalization of the main services

providers in the energy and wireline telecommunication sectors with the state gaining additional stakes at the crude oil sector. In Ecuador, it's expected a larger government involvement in economic activity as have been witnessed with new agreements on share-profits in oil revenues in late 2007. Also, this process could potentially affect key contract renegotiations in which Telefónica is recently involved. Finally, we must notice that Argentina remains subject to an inflation uncertainty given the rising divergence among different released indicators in conjunction with a price freeze in many public service tariffs since 2001, hidden subsidies, and repressive policy affecting staple items from the basic shopping basket.

In most of Latin American countries, with the exception of Mexico, because of the lack of majority in the Congress or a political parties fragmentation in the Congress, the mood of structural reforms has halted, denting the boost to the human objectives that had been achieved in the last few years with the aim of reaching the Millennium Development Goals proposed by the World Bank. Scarce improvements in the institutional framework, despite the economic bonanza, and the scourge of corruption (much higher than in other regions with similar economic development) should generate strong incentives for implementing deep changes across the region. The 2008 Index of Economic Freedom compiled by The Heritage Foundation reports that in the region only Chile may be considered a mostly free country, whereas most Latin American countries are ranged between mostly unfree and moderately free. In the negative side, Cuba and Venezuela are in the opposite side from an economic viewpoint.

An analysis of the credit quality in the region shows that it has improved in 2007 as can be seen in the table below. In general terms, Latin American countries have taken advantage of the positive macroeconomic environment created by the increase of raw material prices, trade dynamism, capital flows (both portfolio and foreign direct investment) and workers' remittances to improve external indicators, such as foreign debt and the level of reserve assets. In this way, during 2007, Latin American countries

reduced again the external debt to GDP ratio to 20%, half of the ratio registered five years ago (42%), and accumulated \$113 bn – the highest amount since 1990, and twice the magnitude of 2006 – in international reserves (3.3% of regional GDP). Public sector balance sheets have also improved notably over the last 5 years, with regional fiscal balance close to equilibrium in 2007 (-0,1% GDP), and government debt at the lowest ratio in the last decade (31,8% GDP). As a consequence of all these developments, public sectors in countries as Chile, Brazil Peru and Venezuela have become net external creditors.

As a result of positive external developments and favorable management of debt positions (according to Rating Agencies' estimates, sovereign bond amortization through 2007 was higher than in 2006), all Latin American countries, except Venezuela and Argentina, improved their credit qualifications in 2007. This leaves three of the biggest countries, Brazil, Peru and Colombia, only one notch below Investment Grade qualification. In comparison with the median of Investment Grade emerging countries, Brazil has a low level of external debt but its public debt is still too burdensome. These two issues are rather favorable for Peru, though it carries the weakness of excessive dependence on commodities and lack of micro reform. Colombia's deterioration in the current account may spoil the rather positive data on external and short-term debt. Nevertheless, all these three countries fail to meet most of the requirements in the matter of institutional quality.

By country, debt amortizations or internal debt swaps with more favorable conditions remained in Brazil and Peru, which has afforded them to improve even more their external positions. Brazil accumulated \$87.5 billions in international reserves during 2007, accruing a stock of reserves which accounts for 12.5 months of imports, up from 5.5 in 2000. This financial buffer amounts roughly to the current total external debt. The servicing-debt burden as a percentage of exports lies at 36%, down from 41.3% in 2006. Peru has also dramatically improved his external vulnerability by means of debt rescheduling allowing for longer maturities and a \$1,794 millions prepayment to the Paris Club.

This permitted the country to drop the total external debt from 32.7 to 28.4 as a percentage of GDP.

Argentina's rating remained stable through 2007, while Uruguay's one improved, exceeding in both cases pre-default levels. It would be important for Argentina to reach an agreement with the Paris Club and bond-holders to continue improving its credit rating. This is a major challenge for the Argentine economy as the amounts outstanding are considerable: 4.8 billion dollars with the Paris Club and 27.1 billion dollars in hold-outs.

Chile and Mexico, the only Investment Grade countries in the region, showed in 2007 upgrades in their credit ratings after two years of stability. Chile's revision gave the country the highest qualification in its recent history. This responded to the soundness of the public finances, which enjoyed an international net creditor position of 12.9% of GDP in 2007. Helped by the continuous rising in the price of copper, the External Fiscal Fund reached \$22.5 billion and is expected to grow until, at least, 2010. In 2007 Chile modified its rule of structural fiscal surplus down from 1 to 0.5 as a percentage of GDP. This is acting as a counter cyclical policy which protects the country from external shock that may hit its economy. Mexico paid in advance an important external debt amount (\$6.5 billion) in 2007, reducing to almost 4% of GDP its external debt ratio. Unexpected structural reforms in the fiscal front and further announcements to come on energy have led the rating agencies to upgrade the credit rating of the Mexican economy.

Colombia again surprised in 2007 with a very positive economic and financial performance. For this reason, it was upgraded in May and now stands for the highest rating since 1999, a year during which the country experienced a deep financial crisis which caused the loss of its historic condition as an Investment Grade country. The return to a positive climate generated a historic growth rate in business investment, and a strong foreign bet on the large possibilities of the country, both in traditional and non-traditional products. This is spurred by the process of deregulations that led to the partial privatization of the state oil

company Ecopetrol and further perspectives of privatizations in the energy sector for 2008. This may potentially boost the Foreign Direct Investment for this year, advancing a well-behaved FDI in 2007: over \$7.6 billions.

Venezuela, the country with the least stable credit outlook in the last 10 years (14 rating changes), maintain the BB condition that it reached on February 2006 (not seen since 1994). The impact of oil price increases on public and external sectors were the main contributors. External surplus (greater than 10% GDP) made possible, for the second year in a row, an extraordinary accumulation of international reserves which allowed the government to buy 0.6 billion dollars of Argentina's bonds and to increase the amount of the "Fondo de Desarrollo Nacional" in more than \$7bn. In spite of these news, the capital control regime through CADIVI has been maintained and the exchange rate fixed with inflation hovering 20%. In order to avoid a huge depreciation of the parallel exchange rate, CADIVI authorized \$43.1 billion in 2007, 57.5% more than in 2006. This represents a covering of 88.6% of total imports in 2007 vs. 71.1% in 2006.

Different from what happened in 2006, Ecuador qualification was upgraded two notches in November 2007 from CCC to B-. This means a substantial improvement from the average CCC qualification that Ecuador has maintained during the last decade as a consequence of its political instability and financial problems that resulted in the country's debt restructuring. Statements by the new president and new finance minister rejecting the possibility of a selective default of considered "illegal" debt caused the credit outlook change. Moreover, financial numbers point to fiscal and external consolidation. Both external and public debt were in 2007 two points of GDP lower than in 2006, reaching 39% and 28%, respectively.

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

1. Partly matching assets to liabilities (those not guaranteed by the parent company) in its Latin American companies such that

any potential asset impairment would be accompanied by a reduction in liabilities,

2. Repatriating funds generated in Latin America that are not required for the pursuit of new, profitable business development opportunities in the region.

Regarding this first point, Telefónica's Latin American companies now have external net debt not guaranteed by the Spanish companies of 4,385 million euros, i.e. 8.7% of the Group's total net financial debt, with Colombia (2,650 million euros), Brazil (1,292 million euros) and Peru (809 million euros), accounting for the bulk of the total.

Regarding the second point – repatriation of funds – Telefónica repatriated 2,250 million euros from Latin America in 2007, mostly through inter-group loans (repayment of principal and interest payment), capital decreases (1,398 million euros) and dividends (852 million euros) and the rest as interest and the payment of management fees.

In this regard, it is worth noting that since February 2003, Venezuela has had an exchange control mechanism in place. The Currency Administration Commission (CADIVI) was set up to manage the exchange control system and determine authorizations of currency sales. This body has issued a number of regulations ("providencias") governing the types of currency sales in Venezuela at the official exchange rate. Foreign companies which are duly registered as foreign investors are entitled to request approval to acquire currencies at the official exchange rate by the CADIVI, in line with regulation number 029, article 2, section c) "Remittance of earnings, profits, income, interest and dividends from international investment." Telcel, the Group's subsidiary in Venezuela, obtained approval on 137 million US dollars under this heading in 2006 and 240 million US dollars in 2007. The final dividend of 365 million US dollars proposed recently is pending approval. Accordingly, the Group will have to continue obtaining the necessary authorizations in future for requests submitted to the CADIVI. It expects this to occur with the

same diligence and frequency as in the past, enabling it to continue carrying out its businesses in Venezuela as normal and to repatriate funds from this country.

#### **Credit risk**

The Telefónica Group trades in derivatives with creditworthy counterparties. Telefónica, S.A. trades with credit entities with senior debt ratings of at least "A." In Spain, where most of the Group's derivatives portfolio is, there are netting agreements with financial institutions, with debtor or creditor positions offset in case of bankruptcy, thus limiting the risk to the net position. Wherever operations allow, Telefónica, S.A. attempts to net risk positions with the various counterparties when arranging new trades. For example, if it takes a "pay" position in currency D, it will look for counterparties that have a "receive" position and it will settle with them when the conditions of the trade warrant. This reduces its potential credit risk. If the rating of a counterparty falls below "A," it will study on a case-by-case basis whether to cancel the trades. The factors considered are: the period of the trade, whether the global position is a debtor position (no current credit risk) or creditor position, and the new rating.

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

The Telefónica Group considers managing commercial credit risk as crucial to meeting its business and customer base growth targets in a manner that is consistent with its risk-management policy.

Therefore, the Group's commercial credit risk-management approach is based on continuous monitoring of the risk assumed and the resources necessary to manage the Group's various units, in order to optimize the risk-reward relationship in the development and implementation of their business plans in their ordinary management.

For this, uniform policies, procedures, authorization lines and management practices are established for all Group companies bearing in mind the individual needs and international best practice in this area, and including the commercial credit-risk management model in the Group's decision-making process, at both the strategic and the day-to-day operations level.

Meanwhile, with credit risk arising from cash and cash equivalents, the Telefónica Group places its cash surpluses in high quality and highly liquid money-market assets. These placements are regulated by a General Framework, revised annually based on the conditions of the market and countries where the Group operates. The General Framework sets: (i) the maximum amounts to be invested by counterparty based on its rating (short- and long-term debt rating); (ii) the maximum period of the investment; and (iii) the instruments in which the surpluses may be invested. For Telefónica, S.A., the company which places the bulk of the Group's surpluses, the maximum placement in 2007 was 180 days and the creditworthiness of the counterparties used, measured by their debt ratings, remained above A- and/or A3 by S&P and Moody's, respectively.

The Group's maximum exposure to credit risk is initially represented by the carrying amounts of the financial assets (Notes 11 and 13) and the guarantees given by the Group (Note 20).

### **Capital management**

The finance department of Telefónica, S.A., which is in charge of the Group's capital management, takes into consideration several factors when determining the company's capital structure.

Firstly is the consideration of cost of capital at all times to achieve a combination that optimizes it. For this, the company monitors the financial markets and updates to standard industry approaches for calculating cost of capital (WACC, weighted average cost of capital) in determining this variable. The second, a leverage ratio that enables the Company to obtain and maintain the desired credit rating over the medium term, and with which

the Company can use to match its potential cash flow generation and the alternative uses of this cash flow at all times.

These general arguments are rounded off with other considerations and specifics, such as country risk in the broadest sense, tax efficiency and volatility in cash flow generation, when determining the Company's financial structure.

### **Derivatives policy**

At December 31, 2007, the nominal value of outstanding derivatives with external counterparties amounted to 130,715 million euros. This amount is just 8.7% higher than in 2006 (120,267 million equivalent euros). This figure is inflated by the use in some cases of several levels of derivatives applied to the nominal value of a single underlying liability. For instance, a foreign currency loan can be hedged into floating rate, and then each interest rate period can be fixed using an FRA. Even using such techniques to reduce the position, it is still necessary to take extreme care in the use of derivatives to avoid problems arising through error or a failure to understand the real position and its associated risks.

The Group's derivatives policy emphasizes the following points:

*1. Derivatives based on a clearly identified underlying.*

Acceptable underlyings include profits, revenues and cash flows in either a company's functional currency or another currency. These flows can be contractual (debt and interest payments, settlement of foreign currency payables, etc.), reasonably certain or foreseeable (investment program, future debt issues, commercial paper programs, etc.). The acceptability of an underlying asset in the above cases does not depend on whether it complies with IFRS requirements for hedge accounting, as is required in the case of certain intra-group transactions, for instance. Parent company investments in subsidiaries with functional currencies other than the euro also qualify as acceptable underlying assets.

Economic hedges, i.e. hedges with a designated underlying asset and which in certain circumstances offset fluctuations in the underlying asset value, do not always meet the requirements and effectiveness tests laid down by the various accounting standards for treatment as hedges. The decision to maintain positions that cease to qualify as effective or fail to meet other requirements will depend on the marginal impact on the income statement and how far this might compromise the goal of a stable income statement. In any event, the variations are recognized in the income statement.

*2. Matching of the underlying to one side of the derivative.*

This matching basically applies to foreign currency debt and derivatives hedging foreign currency payments by Group subsidiaries. The aim is to eliminate the risk arising from changes in foreign currency interest rates. Nonetheless, even when the aim is to achieve perfect hedging for all cash flows, the lack of breadth to certain markets, especially in Latin American currencies, has meant that historically there have been mismatches between the terms of the hedges and those of the debts they are meant to hedge. The Telefónica Group intends to reduce these mismatches, provided that doing so does not involve disproportionate costs. In this regard, if adjustment does prove too costly, the financial timing of the underlying asset in foreign currency will be modified in order to minimize interest rate risk in foreign currency.

Sometimes, the timing of the underlying as defined for derivative purposes may not be exactly the same as the timing of the contractual underlying.

*3. Matching the company contracting the derivative and the company that owns the underlying.*

Generally, Telefónica aims to ensure that the hedging derivative and the hedged asset or liability belong to the same company. Sometimes, however, the holding companies (Telefónica, S.A. and Telefónica Internacional, S.A.) have arranged hedges on behalf of a subsidiary that owns the underlying asset. The main reasons for separating the hedge and the underlying asset were possible differences in the legal validity of local and international hedges

(as a result of unforeseen legal changes) and the different credit ratings of the counterparties (whether Group companies or the banks).

*4. Ability to measure the derivative's market value using the valuation systems available to the Group.*

Telefónica uses a number of tools to measure and manage risks in derivatives and debt. The main ones are Kondor+, licensed by Reuters, which is widely used by financial institutions, and MBRM specialist financial calculator libraries.

*5. Sale of options only when there is an underlying exposure.*

Options can only be sold when: i) there is an underlying exposure (on the balance sheet or associated with a highly probable cash outflow) that would offset the potential loss for the year if the counterparty exercised the option, or ii) the option is part of a structure in which another derivative offsets any loss. The sale of options is also permitted in option structures where, at the moment they are taken out, the net premium is either positive or zero.

For instance, it would be possible to sell short-term options on interest rate swaps that entitle the counterparty to receive a certain fixed interest rate, below the level prevailing at the time the option was sold. This would mean that if rates fell and the counterparty exercised its option, Telefónica would swap part of its debt from floating rate to a lower fixed rate, having received a premium.

*6. Hedge accounting:*

The main guiding principles for risk management are laid down by Telefónica Group's Corporate Finance Department and implemented by company CFOs (responsible for balancing the interests of each company and those of the Group). The Corporate Finance Department may allow exceptions to this policy where this can be justified, normally when the market is too thin for the volume of transactions required or on clearly limited and small risks. New companies joining the Group as a result of mergers or acquisitions may also need time to adapt.

## In more than 80 years of history Telefónica has gradually overtaken many past champions of the industry

Telefónica was created in 1924, when US multi-national (ITT) decided to invest in Spain. In a history stretching back more than 80 years, Telefónica is the greatest integrated operator of the world by number of customer accesses (more than 228 million). In addition, it operates in 24 countries, with a workforce over 248,000 employees, and keeps its identity as the main Spanish multi-national company under the Telefónica Brand.

1 million customer accesses					
1924	1928	1945	1953	1960	1967
The Compañía Telefónica Nacional de España (CTNE) was set up in Madrid, with investment from the International Telephone and Telegraph Corporation (ITT) of New York: 78,124 telephones in existence.  	Spanish king Alfonso XIII and US president Calvin Coolidge inaugurated the first transatlantic telephone links.  	The Spanish government nationalised 79.6% of CTNE's shares owned by ITT.  	The number of telephones in Spain topped a million, making it one of only eleven countries worldwide to achieve this penetration.  	CTNE was now the country's biggest company, with 100,000 shareholders, 10,412 million pesetas in capital and 32,000 employees.  	Start of satellite communications. Telefónica opened the ground station at Buitrago de Lozoya  

# history

**5** million customer accesses

**10** million customer accesses

**1971**

Telefónica launched the first public specialised data transmission network in Europe. 5 million telephone users.



**1974**

CTNE reached its 50th anniversary. Increased demand for data transmission lines led, a few years later, to development of the TESYS system.

**1978**

The 10 millionth telephone was installed.



**1985**

The new image was launched along with a new company name: Telefónica de España, S.A..



**1987**

Telefónica listed on the New York Stock Exchange.



**1988**

Spain's Telecommunications Regulation Law comes into force.

**1990**

Telefónica launched the analog mobile service MovilLine achieving 98% coverage of Spain's territory and population within three years.



Telefónica bought stakes in and took over the running of CTC and ENTEL in Chile, and part of the Argentine national operator.



**32** million customer accesses

**68** million customer accesses

**1993**

With the commercial launch of the first Spanish satellite Hispasat, Telefónica, already active in 6 Latin American countries, looked to move into trans-European networks.

**1994**

Launch of digital mobile telephony. Telefónica moved into Peru.

**MoviStar**



**1995**

First part privatisation of Telefónica.



Arrival of the internet. Telefónica launched Infovía.



**1998**

A consortium headed by Telefónica won the tender to take over Telesp, which operates in São Paulo state.



Telefónica launched its new corporate image.



**1999**

Start of Broadband services using ADSL technology.

**Línea ADSL »**

Telefónica is fully privatised and reorganised as a holding company to manage global business lines.

**2000**

Operation Veronica. Telefónica launches a buyout bid for Telefónica de Argentina, Telesp and Tele Sudeste (Brazil), and Telefónica del Peru, allowing the company to integrate management of its fixed telephony operations in Latin America.

**100 million customer accesses**      **200 million customer accesses**      **228 million customer accesses**

**2002**

Telefónica begins selling off its media holdings. Merger of its Digital TV platform.

**2003**

Telefónica and Portugal Telecom set up a joint company for their mobile assets in Brazil.

**2004**

Acquisition of the BellSouth's mobile assets in Latin America.

**2005**

Acquisition of 5% of China Netcom.



Acquisition of Cesky Telecom.



Global launch of the new Movistar identity.

**2006**

Telefónica buys 51% of Colombia Telecom.



Telefónica acquires the European assets of mobile operator O2 in the UK, Germany and Ireland.



Mobile licence in Slovakia.

Telefónica restructures to allow integrated customer management in three geographical regions: Spain, Latin America and Europe.

**2007**

Telefónica O2 Slovakia starts up.

Vivo reinforces its leadership in the Brazilian mobile telephony market by acquiring Telemig and Amazonía Celular.

Telefónica buys into Telecom Italia, taking a 10% stake.



Telefónica and China Netcom extend their strategic cooperation.



Opening of Telefónica's Corporate University.



## Chronology

“We want to enhance people’s lives, 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”.  
*Spirit of Progress*

### First Quarter

#### Development of the product/service range and customer focus

Telefónica signs an agreement to develop household domotics services in Spain leveraging Broadband.

Telefónica launches pay-TV in Colombia.

Telefónica, the first Spanish company to test interactive mobile TV services.

Movistar, the first Spanish operator to implement rate charging by the second.

Telefónica, the first operator in Spain to launch an exclusive package designed for the disabled.

Imagenio adds new features to facilitate advanced, comprehensive browsing.

#### Organisation and strategy

In Sao Paulo, the President of Brazil inaugurates Atento's largest global contact centre, creating 6,000 jobs.

**ATENTO:**

Launch of Telefónica O2 Slovakia, with over 110,000 active users in the first 12 days.

In Santiago, Chile, Telefónica Latam launches its growth program “Ahora” or Now, under the slogan “Even more, even better” with the goal of increasing the regional customer base to 170 million by 2010.

#### Promotion of the Information Society

Telefónica presents its report entitled “The Information Society in Spain in 2006”.

Telefónica showcases new HSDPA technology which will bring 3G services into homes at the 2007 3GSM World Congress in Barcelona.

Telefónica wins the Prince Felipe prize for Business Excellence in the Information Society and ICT category.



#### Corporate Social Responsibility

Telefónica creates a national computer network for the disabled.

Telefónica presents its “2015, A Better World for Joana” program representing its public commitment to the UN's Millennium Development Goals. This Project is carried out within the scope of the Corporate Reputation seminar.

Telefónica undertakes in Brussels to foster the correct use of mobile telephony among children.

# chronology

## Second Quarter

Brazil begins marketing its first Duo bundled package.



"Respuesta Empresarios", which translates roughly as Business Response, awarded the 2007 IMAN prize by the Spanish federation of e-commerce and direct marketing (FECEMD for its initials in Spanish) and "Most Innovative Service 2006" by the magazine Actualidad Económica.

Customers without Broadband coverage are extended service through Iberbanda, using LMDS technology at speeds of up to 4 Mbps.

Agreement between Telefónica and Sogecable to bundle telecommunications and satellite digital television services.

Telefónica forms a consortium to acquire an indirect stake of 10% in Telecom Italia.



Telefónica sells Endemol for 2.6 billion euros.



Telefónica and China Netcom expand their strategic collaboration.



Telefónica's Corporate University is launched.



Telefónica sells UK firm Airwave for 3 billion euros.



Telefónica, the first UNE certified IT services supplier: AENOR certifies Telefónica Soluciones under its benchmark IT infrastructure management and operations standard.

The Telefónica Foundation unveils "DigiWorld Latin America 2007", the first regional report on the Information Society in Latin America.



Emilio Botín and César Alierta seal a strategic deal on education.

Telefónica O2 is named Most Desired Employer 2007.

Telefónica recognised by the OAS (Organization of American States) for its Proniño program.

Telefónica organises in Spain the first forum dedicated to the eradication of child labour.

## proniño

## Third Quarter

### Development of the product/service range and customer focus

Terra launches its travel channel, its first P2P application where users can share information, photos and videos.

Telefónica revolutionises the Broadband mobile internet access market with the launch of the USB 3.5G Plus Novatel MC950D modem.

Telefónica O2 to sell the iPhone exclusively in the UK.

Telefónica announces capex of over 8 billion euros in infrastructure and services worldwide in 2007.

Telefónica O2 expands its network and revolutionises pricing in Slovakia.

Telefónica promotes mobile emailing in Spain introducing the lowest rates in the market.

### Organisation and strategy

Telefónica climbs in the Fortune Global 500 ranking of the 100 largest companies in the world by revenues.

Vivo reinforces its leadership of the Brazilian mobile telephony market with the acquisitions of Telemig and Amazonía Celular.

Telefónica O2 launches its low cost operator, Fonic, in Germany.



### Promotion of the Information Society



Movistar, the first mobile operator to create a community for free software developers.

Telefónica starts up its incubation programme for project and innovation development.

Telefónica boosts the Campus Lab, a virtual innovation lab for the campus community.

### Corporate Social Responsibility

Telefónica remains, for the fourth consecutive year, in the Dow Jones Sustainability Index, which tracks the financial performance of the leading sustainability-driven companies worldwide.



Telefónica participates in a climate change forum with Al Gore.

DISTRITO C wins 2007 Sustainability award for its commitment to the environment.

## Fourth Quarter

In the UK Telefónica O2 launches Broadband internet access services covering 50% of the population at speeds of up to 20 MBs.



The press applauds Alierta following the VI Investor Conference.

Telefónica starts up the Innovation Community "Ambassadors for Innovation".

Telefónica is awarded Best of European Business 2007 for its contribution to boosting Europe's competitiveness.

6,000 Telefónica volunteers in Latin America and Spain say NO to child labour.

Telefónica unveils a new range of landline phones designed for the elderly or disabled.

Brazil launches its digital TV service, with 76 channels and tailored packages.

Telefónica revolutionises the digital music market launching the first flat rate plan for downloading music onto handsets and PCs.

Agreement between Telefónica and Yahoo! to provide global services to over 100 million users.



Telefónica presents its Family Management service to encourage responsible mobile usage and safe mobile communications between parents and children.

Telefónica and its Italian partners close the Telecom Italia deal.

Julio Linares is appointed COO of Telefónica. Guillermo Ansaldi is appointed to run Telefónica España and Matthew Key to run Telefónica O2 Europe.

Telefónica and China Netcom sign a consultancy management agreement and a letter of intent to explore joint purchases.

The EU confirms Telefónica as the most important Spanish firm in terms of R&D spend.

Telefónica's newly created venture capital arm takes stakes in Amobee (advertising solutions for mobile phones), Kyte (mobile TV) and GestureTek (gesture technology).

Telefónica launches new services to lead a Digital Spain at "Full speed".

The President of Chile, Michelle Bachelet, acknowledges the Proniño initiative with the 2007 Bicentenary Stamp Prize.

Fonditel named best Spanish pension fund by Investment Pension Europe.

Telefónica Móviles Colombia awarded the best place to work in Colombia.

The Telefónica Foundation and the FAD, the foundation for the prevention of drug addiction, sign an agreement for the joint development of projects in Latin America.

**Telefónica, S.A.**

Annual Report 2007

This Report is also available on line from:

**www.telefonica.es**

Shareholders may request copies of this Report from  
**Telefónica's Shareholders Office** by calling  
freephone **900 111 004** (in Spain), or via email to:  
**accion.telefonica@telefonica.es**

The information required by law is also available  
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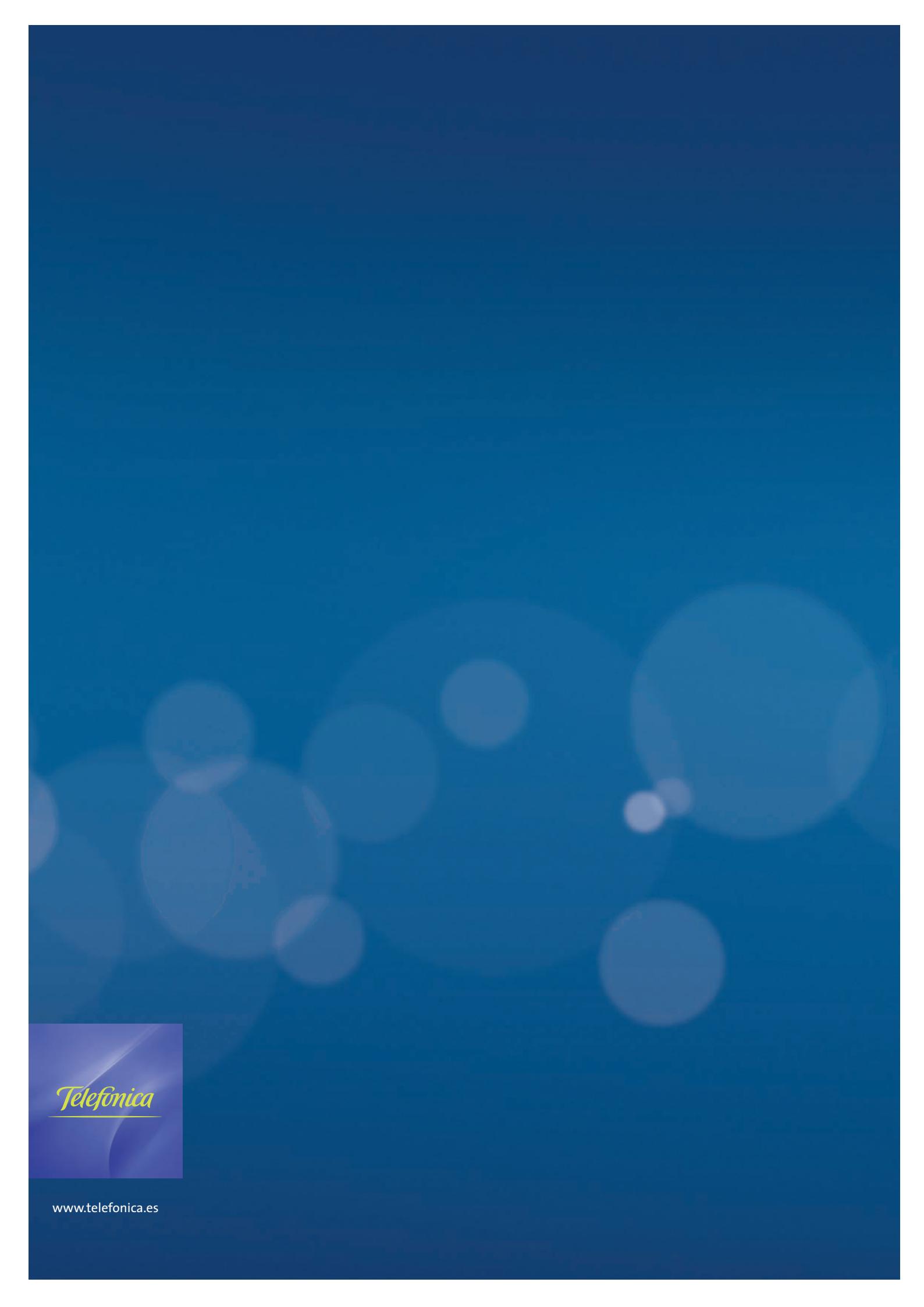
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