

An aerial photograph of a large crowd of runners participating in a marathon on a bridge. The runners are spread across the width of the bridge, moving away from the camera. The bridge has a blue steel structure and white lane markings. The water on either side is a deep blue-green. A semi-transparent dark blue rectangle is overlaid on the right side of the image, containing the title and logo.

# 2010 ANNUAL REPORT

*Telefonica*



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# Summary



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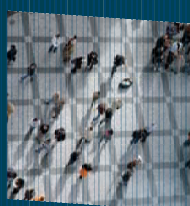
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*'Telefónica's vision is to make the possibilities offered by this new digital world real, and to be one of the leaders in this area', says the Executive Chairman, César Alierta, in his letter to shareholders.*

*Telefónica has a suitable structure in order to make the most of synergies as a global company that is already present in 25 countries. Its Board of Directors, its Management Team and its more than 285,000 Professionals guarantee the good government and management of the Company and the performance of the work plans included in the bravo! programme (strategic plan for 2010-2012).*

*In 2010, Telefónica, driven by the acquisition of the Brazilian operator Vivo, increased the scale of its operations, once again obtaining solid results, and fulfilling the commitments made in the market. Progress was possible thanks to improvements in customer experience, based on a new brand strategy; to the promotion provided by innovation in order to capture the opportunities for growth provided by the digital market; and to the improvement of operating efficiency. All this, together with a strong range of strategic alliances and our leadership in corporate sustainability, has made Telefónica the most admired company in the telecommunications industry in 2010.*

*The 2010 results demonstrate Telefónica's strength and its capacity to generate trust in the markets with a sensible risk management policy*

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## Vision

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# ...the Executive Chairman, César Alierta, in his letter to shareholders.

**César Alierta Izuel**

Executive Chairman, Telefónica, S.A.

This is the eighth  
year in a row  
in which we  
have achieved  
the objectives  
we committed

Dear shareholder,

It gives me great pleasure to offer you a brief summary of Telefónica's business activity in 2010. Here at Telefónica, we have taken advantage of this year, a year where we have seen the global economic recovery becoming more firmly established to strengthen our position in our various markets and improve our capacity for innovation. This will enable us to make the most of the opportunities offered by the Information and Communications Technology industry.

Before going into detail, I would just like to point out that 2010 was the eighth year in a row in which we have achieved the financial objectives we committed with the market. This further establishes our position as a highly predictable and reliable company.

#### Sound results

Diversification was of particular importance to our results in 2010. 83% of our accesses are now outside Spain. Telefónica Latinoamérica and Telefónica Europe accounted for 68% of our consolidated Group revenues, with Telefónica España contributing almost a third of Group revenue. This year, Latin America accounted for a larger share of our results, due both to the growth of our business in the region and the increased contribution from Brazil following the acquisition of Portugal Telecom's stake in Vivo.

The increase in our customer base and the increasing contribution of the mobile-data business have driven the growth of Telefónica's revenues, which amounted to €60.7 billion, up 7.1% on the previous year. In addition, Telefónica's operating efficiency levels continue to set the benchmark for the sector, with an increase in operating income before depreciation and amortisation (OIBDA) of 14% to €25.8 billion.

Telefónica achieved record net income of €10.2 billion in 2010, up 30.8% compared to 2009. As a result, basic earnings per share amounted to €2.25, exceeding the €2.10 target set by the company.

We have continued to invest in order to ensure the company's future growth, with investment rising at a 13.6% rate over the previous year. The company is continuing to focus its investment efforts on growth and transformation projects, boosting the development of fixed-line and mobile broadband services. The total volume of investment in the year, including spectrum acquisition, amounted to €10.8 billion. This resulted in the company achieving an operating cash flow of €14.933 billion in 2010, representing 25% of the total revenue.

#### Prioritising shareholder remuneration

In 2010 we managed to balance a number of objectives which are often difficult to combine: meeting the commitments made to the financial community; continuing to invest to facilitate future growth; maintaining a robust financial position; and increasing returns to our shareholders.



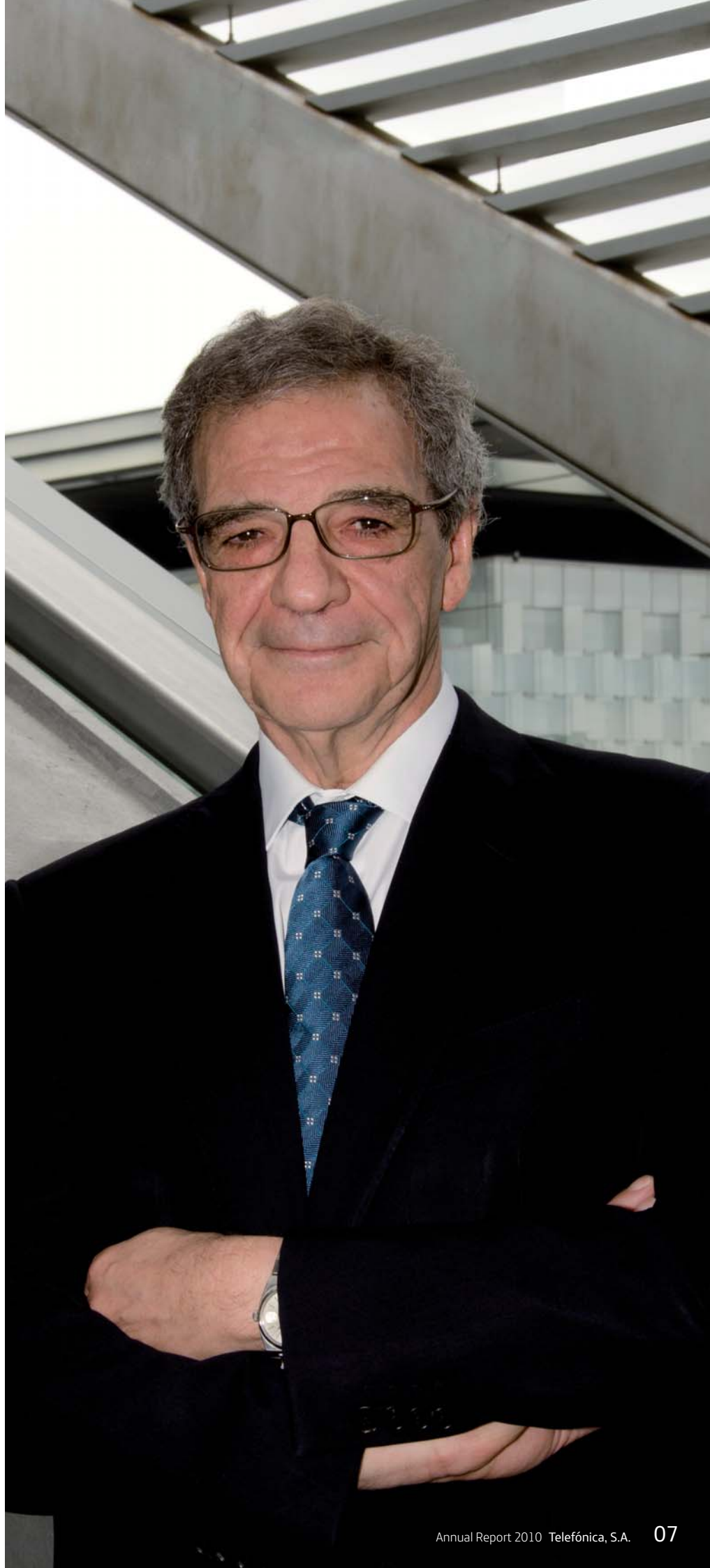
The remuneration of our shareholders remains one of our highest priorities. In 2010, Telefónica's earnings per share amounted to 8.2%, the highest of any of the 50 largest companies in the world in terms of market capitalisation.

Based on our forecasts of robust cash flow generation during the current year, we have announced a dividend of €1.60/share in 2011, an increase of 14.3% vs. the 2010 dividend. This proposal confirms the company's commitment to prioritising shareholder remuneration in the use of cash flow and progressively increasing the dividend per share, with the objective of distributing a dividend of €1.75 per share in 2012.

#### The value of our size

Size is a key factor in sectors such as telecommunications. The company's focus on increasing its customer base, and the value of our customers, has resulted in a significant increase in accesses, especially in our fixed-line and mobile broadband businesses due to the rapid adoption of smartphones and our fixed-line package offers.

Our intensive commercial activity in 2010 enabled us to increase the total number of accesses by 23 million, an increase of 8.7% to almost 288 million. Telefónica is now the fifth largest telecommunications operator in the world in terms of accesses.



## Telefónica's vision is to make the possibilities offered by this new digital world real

In 2010 we were involved in operations which have reinforced the scale and position of the company and will help us to continue to grow in the markets in which we operate:

- Taking control of Vivo through the acquisition of 50% of Brasilcel has made us the leading integrated telecommunications company in Brazil.
- We have taken a further step forward in our relationships with China Unicom through a new reciprocal investment. Once this agreement has been completed, Telefónica will have increased its shareholding in China Unicom to around 9.7%.
- Our acquisition of Tuenti makes us the leader of the benchmark social networking site in Spain, in particular among the youth segment. Jajah and Hansenet have reinforced our positions in global IP communications and the broadband business in Germany.
- We have obtained a licence to operate in the mobile market in Costa Rica and acquired spectrum -a key asset in our sector- in Germany, Brazil and Mexico.

Our size and our strategic alliances with China Unicom and Telecom Italia have positioned us as a global leader with a combined customer base of over 730 million customers; this makes us ideally positioned to take full advantage of the opportunities offered by the new digital world.

### Growth opportunities in the new digital world

The digitalisation of the world is going to go further than merely our need to communicate with each other and to always be connected. The scope of our market has increased enormously due to the most important and valuable opportunity for our industry: the digitalisation of the real economy. Many sectors such as finance, health, government, education and entertainment are demanding new digital applications and services so that they can achieve higher levels of quality, speed and ease of use, anytime, anywhere. All the experts agree, the growth prospects for this new digital world are extremely positive.

In Telefónica we are very aware of this great opportunity, which we can divide into four main pillars: an increasing number of customers; a larger number of devices with even more advanced capabilities; the proliferation of applications and services making people's lives ever easier; and a very likely explosion in traffic on new communication networks.

There are still major growth opportunities for communication services, as is shown by the forecasts of 6% annual growth in accesses worldwide from 2010 to 2013. The driver of this growth will be mobile accesses and broadband, both mobile and fixed, which are expected to grow by 46% and 9% respectively.

The growth in customers will be accompanied by a wide-range of devices connected to the Internet. These devices will be more powerful, cheaper and easier to use. And they will connect both people and machines. It has been forecast that there will be 20% average annual growth in personal devices sales over the period 2010-2013. This growth will be based on increased demand for smartphones and tablets.

These devices will also be the catalysts for new demands for applications and services; for example, to be able to pay using a mobile phone anywhere or to receive a remote medical diagnosis.

This highly likely scenario will bring with it an exponential growth in broadband data traffic, both fixed and mobile. It has been estimated that there will be twice as much data traffic in 2013 as in 2010, and that this will largely be due to the increasing amount of video online.

In short, we can conclude that Telefónica is operating in an industry with very positive growth prospects. And I can assure you that we are, and will continue, taking full advantage of this opportunity.

### **Telefónica anticipates the future**

Telefónica's vision is to make the possibilities offered by this new digital world real, and to be one of the leaders in this area. One of the steps we took in 2010 to get ahead of our competitors was the creation of seven global product and service development units, covering cloud computing, eHealth, financial services, M2M (machine-to-machine connections), video and digital home, applications and security. These units are the pillars of a globalised innovation model which is designed to capture as much of this growth in our sector as possible.

Telefónica has developed a clear strategy for capturing all the opportunities which will be generated in this new digital world. There are two basic aspects to this strategy: growth and transformation of the company. The first is based on broadband and new services. The second will enable us to grow profitably and to maximise our efficiency. We will achieve this whilst keeping the customer at the centre of everything we do and taking advantage of our scale and diversification.

Telefónica has already started to harness the growth opportunities in the sector and this will enable us to continue developing our revenue structure. As a result, the contribution of broadband to revenues will increase from the current level of 18% to 25% in 2013, and services beyond connectivity revenues will increase from 5% at present to 9% in 2013.

However, Telefónica is not just concerned about the results achieved, but also about the way in which we achieve them. For this reason, sustainability and corporate responsibility are important parts of our strategy. This is demonstrated by the fact that Telefónica is leading the Dow Jones Sustainability Index in our sector worldwide for the second year in a row.

Telefónica's future is ever more closely linked to the economic and social wellbeing of the societies in which we operate. That is why Telefónica invests significant resources in social and cultural activities, and in promoting innovation. I would like to make a special mention of the Proniño programme, of which all our shareholders and employees can be very proud. The purpose of this programme is to eradicate child labour in Latin America by facilitating access to high-quality education for children. By 2010 we had already managed to send over 211,000 children to school, and our target is to increase this to 357,000 children by 2013.

Finally, I would like to take this opportunity to share with you our pride in being recognised in 2011 as the "most admired" telecommunications company in the world by Forbes magazine.

This is the icing on the cake for a year in which our company has not only obtained solid results, but has also strengthened itself ready for the opportunities of the future. I would like to thank you all for your support and confidence in our project. We are on the right path to become the best global communications company in the digital world.



**César Alierta Izuel**  
Executive Chairman, Telefónica, S.A.



## Talent

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# ...a suitable structure...

Spain,  
Latin America  
and Europe are  
the 3 regions in  
which the Group's  
operations are  
organised

Telefónica is based on three business units (Spain, Latin America and Europe) which include the operations of 25 countries. The corporate centre provides an integral view to take full advantage of synergies

## Corporate Centre

Telefónica's Corporate Centre is responsible for its global and organisational strategies, its corporate policies, management of common activities, and coordinating the activity of business units.

## Telefónica España

The activity of Telefónica España includes fixed telephony (including pay TV), mobile telephony and Broadband. Movistar has been the only commercial brand in Spain since May 2010. In 2009 the company sold its stake in the Moroccan operator Médi Télécom.

## Telefónica Latin America

Telefónica Latin America operates in 13 countries where it offers fixed and mobile telephony, Internet, Broadband and Pay TV services: Argentina, Brazil, Chile, Colombia, Ecuador, El Salvador, Guatemala, Mexico, Nicaragua, Panama, Peru, Uruguay and Venezuela. Telefónica is also active in Puerto Rico and the USA.

Furthermore, Telefónica International Wholesale Services (TIWS) offers wholesale telecommunication services on a global scale. Amongst its international services are voice, capacity, IP interconnectivity, satellite, as well as corporate and mobile services. It has an international network of over 45,000 km of optical fibre cables.

## Telefónica Europe

Telefónica Europe offers fixed and mobile telephony and broadband services, and is operational in the UK, Ireland, Germany, the Czech Republic and Slovakia. It operates under the O2 brand in these markets.

## Alliances and other shareholdings

Telefónica has a presence in China, Italy and Portugal through its equity stakes in China Unicom, Telecom Italia and Portugal Telecom, respectively.

## Other companies

- Atento offers customer relation management services through its contact centres. It operates in Spain, Argentina, Brazil, Central America, Chile, Colombia, the USA, Morocco, Mexico, Peru, Puerto Rico, the Czech Republic, Uruguay and Venezuela.
- T Gestiona provides a full range of financial administration, HR, property, logistics and distribution, process consultancy, ERP and comprehensive back-office services. It is active in Spain, Argentina, Brazil, Chile and Peru.
- Telefónica R&D is involved in technological research and, in terms of activity and funding, it is the largest private R&D centre in Spain and the largest on the continent in the ICT sector in terms of participation in European research projects. It is operational in Spain, Brazil and Mexico.



Julio Linares, Chief Operating Officer of Telefónica, S.A.

## Telefónica's largest shareholdings

### Telefónica España

	% Stake
Telefónica de España <sup>1</sup>	100.0
Telefónica Móviles España <sup>1</sup>	100.0
Telyco	100.0
Telefónica Telecomunic. Públicas	100.0
T. Soluciones de Informática y Comunicaciones de España	100.0
Telefónica Remesas <sup>2</sup>	100.0
Tuenti <sup>3</sup>	91.4
Iberbanda	58.9

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

<sup>2</sup> Company owned through Telefónica Telecomunicaciones Públicas, S.A.

<sup>3</sup> Company owned through Telefónica Móviles España, S.A.U.

### Telefónica Europe

	% Stake
Telefónica O2 UK	100.0
Telefónica O2 Germany <sup>1</sup>	100.0
Telefónica O2 Ireland	100.0
Be	100.0
HanseNet (Germany) <sup>2</sup>	100.0
Jajah (US)	100.0
Tesco Mobile	50.0
Telefónica O2 Czech Republic <sup>1</sup>	69.4
Telefónica O2 Slovakia <sup>3</sup>	100.0

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

<sup>2</sup> Company owned through T. O2 Germany.

<sup>3</sup> Company owned through T. O2 Czech Republic.

### Telefónica Latinoamérica

	% Stake
Telesp <sup>1</sup>	88.0
Telefónica del Perú <sup>2</sup>	98.3
Telefónica de Argentina	100.0
TLD Puerto Rico	100.0
Telefónica Chile <sup>3</sup>	97.9
Telefónica Telecom	52.0
T. Intern. Wholesale Serv. (TIWS) <sup>4</sup>	100.0
Vivo Participações <sup>5</sup>	59.4
Vivo <sup>6</sup>	100.0
T. Móviles Argentina	100.0
T. Móviles Perú	100.0
T. Móviles México <sup>5</sup>	100.0
Telefónica Móviles Chile	100.0
T. Móviles El Salvador	99.1
T. Móviles Guatemala	100.0
Telcel (Venezuela)	100.0
T. Móviles Colombia	100.0
Otecel (Ecuador)	100.0
T. Móviles Panamá	100.0
T. Móviles Uruguay	100.0
Telefonía Celular Nicaragua	100.0
T. Móviles Soluciones y Aplicac. (Chile) <sup>5</sup>	100.0

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

<sup>2</sup> Latin American Cellular Holdings, B.V. owns 48.28%, Telefónica Internacional S.A. owns 49.9% and Telefónica S.A. owns 0.16%.

<sup>3</sup> Telefónica Internacional de Chile Ltda. owns 44.89% and Inversiones Telefónica Internacional Holding Ltda. owns 53%.

<sup>4</sup> Telefónica, S.A. owns 80.56% and T. Int. Wholesale Services, S.L. owns 19.44%.

<sup>5</sup> Company owned through Telefónica S.A.

<sup>6</sup> Company owned through Vivo Participações, S.A.

### Other Stakes

	% Stake
Atento Group	100.0
Telefónica de Contenidos (Spain)	100.0
Telco SpA (Italy) <sup>1</sup>	46.2
IPSE 2000 (Italy)	39.9
DTS, Distribuidora de Televisión Digital	22.0
Hispatat	13.2
Portugal Telecom <sup>2</sup>	2.0
China Unicom (Hong Kong) Limited (China)	8.4
ZON Multimedia <sup>3</sup>	5.4
BBVA	1.0
Amper	5.8

<sup>1</sup> Telefónica holds an indirect stake of the ordinary share capital (with voting rights) of Telecom Italia through Telco of approximately 10.47%. If we take into account the saving shares (azioni di risparmio), which do not have voting rights, the indirect stake of Telefónica over Telecom Italia would be 7.20%.

<sup>2</sup> In June, the Telefónica Group reduced its stake in the share capital of Portugal Telecom by 7.98%. In addition, Telefónica signed three Equity Swap contracts with different financial entities. These swaps are based on the share price of Portugal Telecom and settled by differences.

<sup>3</sup> Telefónica's Group effective stake. Telefónica Group stake would be 5.46% if we exclude the minority interests.

# ...present in 25 countries.

## Telefónica has a global positioning

In 2010 the Company maintained a high diversification and a revenue by geographic area: 31% of its revenue came from Spain; 43% from Latin America; and 25% from Europe.

### Latin America

**Population:** 526 m people

**ICT market value:**

US\$227bn\*

**Total accesses Group:** 184 m

#### Argentina

Fixed telephony: 4,622  
Data and Internet: 1,505  
Mobiles: 16,149

#### Brazil

Fixed telephony: 11,293  
Data and Internet: 3,848  
Mobiles: 60,293  
Pay TV: 486

#### Central America

Fixed telephony: 466  
Data and Internet: 3  
Mobiles: 6,404

#### Chile

Fixed telephony: 1,939  
Data and Internet: 836  
Mobiles: 8,794  
Pay TV: 341

#### Colombia

Fixed telephony: 1,587  
Data and Internet: 554  
Mobiles: 10,005  
Pay TV: 205

#### Ecuador

Mobiles: 4,220  
Fixed wireless: 95

#### Mexico

Mobiles: 19,662  
Fixed wireless: 566

#### Peru

Fixed telephony: 2,871  
Data and Internet: 885  
Mobiles: 12,507  
Pay TV: 691

#### Uruguay

Mobiles: 1,709

#### Venezuela

Mobiles: 9,515  
Fixed wireless: 966  
Pay TV: 69



Present in  
25 countries

60.737  
billion euros  
in revenue

68% of revenue  
is generated  
outside Spain

4.814 billion  
euros invested  
in R+D+I

Almost  
288 million  
accesses  
by customers

More than  
220 million  
mobile telephone  
accesses

More than  
41 million  
fixed telephone  
accesses

More than  
18 million  
data and  
Internet

2.8 million  
pay TV  
accesses

Over  
285,000  
employees

### Europe

**Population:** 164 m people  
**ICT market value:**  
US\$307bn\*  
**Total accesses Group:** 56 m

### Spain

**Population:** 46 m people  
**ICT market value:**  
US\$64bn\*  
**Total accesses Group:** 48 m

*Telefónica*

**TELECOM**  
ITALIA

China  
unicom 中国联通

A combined customer base of over 730 million customers

### Germany

Fixed telephony: 1,916  
Data and Internet: 2,915  
Mobiles: 17,049  
Pay TV: 77

### Slovakia

Mobiles: 880

### Spain

Fixed telephony: 13,280  
Data and Internet: 5,880  
Mobiles: 24,310  
Pay TV: 788

### Ireland

Mobiles: 1,696

### United Kingdom

Mobiles: 22,212  
Data and Internet: 672

### Czech Republic

Fixed telephony: 1,669  
Data and Internet: 899  
Mobiles: 4,839  
Pay TV: 788

\* Source: IDC's Black Book of January 2011.  
Figures in thousands as at 31<sup>st</sup> December 2010.

# Its Board of Directors...

The Board has been adapted to the international dimensions of the Group and to its characteristics as a global telecommunications operator

## Governing Bodies guarantee supervision and control

The Board of Directors, with the support of its Committees, performs its activities in accordance with a selection of corporate governance regulations which are principally covered in the Company Statutes, the Regulations of the General Meeting of Shareholders and the Regulations of the Board of Directors.

The Board of Directors of Telefónica is the body which supervises and controls the activities of the Company, with exclusive power over the policy and general strategies of the Company, among other decisions, including those relating to corporate governance, corporate social responsibility, compensation to directors and senior managers and returns to shareholders.

The Board of Directors of Telefónica, S.A. is supported in the Company's corporate governance by eight committees, which it charges with examining and monitoring key areas.

In accordance with its Regulations, the Board of Directors delegates day-to-day business management to the executive bodies and management team of Telefónica.

The Company provides more detailed information in the Annual Corporate Governance Report and in the Report on Compensation Policy for the Board of Directors. These documents are available at [www.telefonica.com/en/shareholders\\_investors](http://www.telefonica.com/en/shareholders_investors)

### Composition of the Board of Directors and its Committees

	Type of Chief Operating	Committee Officer	Audit and Control	Appointments, Remuneration and Good Governance	HR, Reputation and Corporate Responsibility	Regulation	Service Quality and Commercial Attention	International Issues	Innovation	Strategy
César Alierta Izuel (Executive Chairman)	●	●								
Isidro Fainé Casas (Vice-chairman)	●	●								
Vitalino Manuel Nafria 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	●					●		●		
María 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-Board Member Secretary Ramiro Sánchez de Lerín García-Ovies										
Non-Board Member Vice-Secretary María Luz Medrano Aranguren										

● Executive    ● Nominee    ● Independent    ● Other External Directors

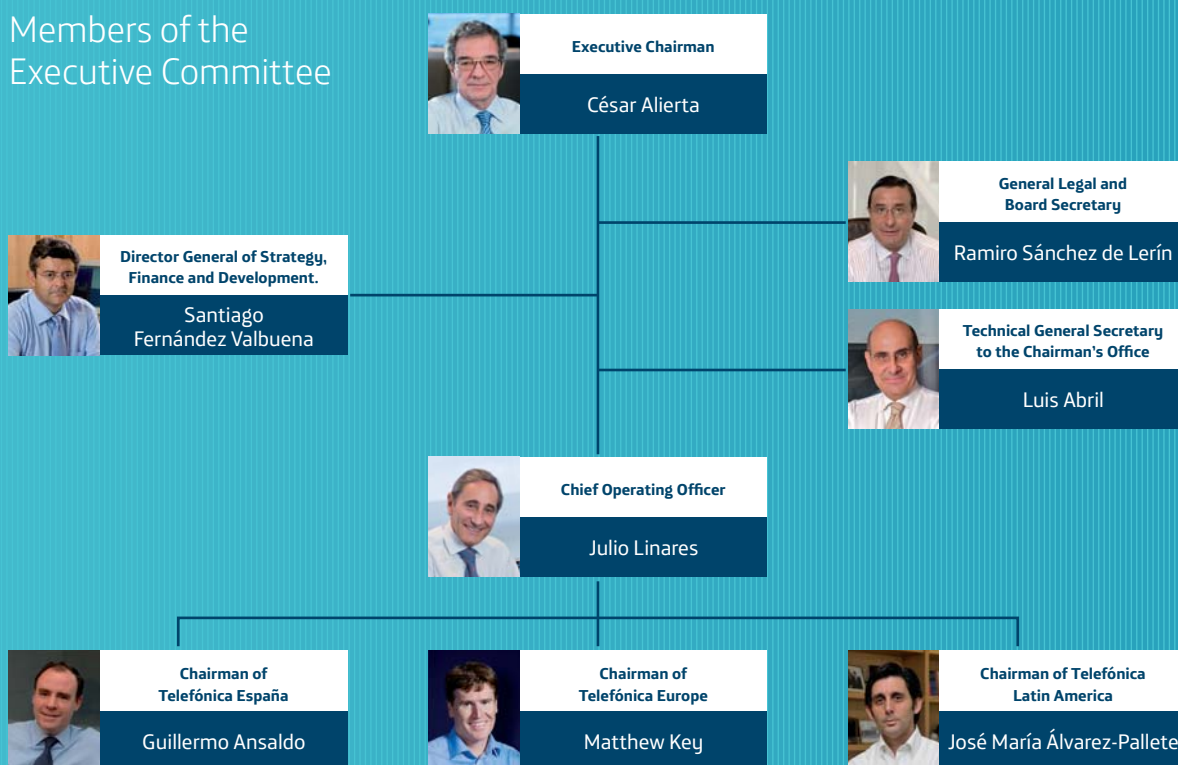
# ...its Management Team...

The Company continued to advance its organisational model in order to move towards global management, reinforce customer relationships and promote innovation and efficiency in its operations

The main management body of Telefónica S.A is the **Executive Committee**, made up of the Executive Chairman; the Chief Operating Officer; the Chairmen of the three major regional organisations

(Spain, Europe and Latin America); the General Director of Strategy, Finance and Development; and the two General Secretariats: Legal and Board, and the Technical Secretariat to the Chairman's Office.

## Members of the Executive Committee



For the daily management of the Company, Telefónica also has the **Operating Committee**, which, chaired by the Chief Operating Officer, is made up of the Chairmen of the three main regional organisations (Spain, Europe and Latin America); the Director of Innovation; and the Director of Transformation and Operations.

In 2010, as a consequence of taking control of Vivo, the territorial organisation in Latin

America reinforced its structure and established three large activity clusters: one in Brazil, to manage both the fixed and mobile businesses and guarantee the integration of Telesp with Vivo; another for the integrated countries (fixed and mobile): Chile, Colombia, Argentina, Uruguay, Peru and Ecuador; and a third for the block of countries comprising Mexico, Central America and Venezuela, predominantly for the mobile business.

# ...and its more than 285,000 professionals...

Telefónica Group has more than 133,000 employees without Atento in 25 countries, 6.4% more than in 2009

The working  
climate index  
reached 74%  
compared to 73%  
in 2010

**Staff**  
285,106 professionals  
(+10.8%) (Including Atento)

At the close of the 2010 financial year, Telefónica Group (including Atento) had a physical staff of 285,106 professionals, which means a 10.8% net increase in employment, especially in such a complex financial year in the global macroeconomic scenario.

By regions, and excluding Atento, Latin America still holds the greatest percentage of employment (51%), followed by Spain (30%) and Europe (19%).

With respect to the types of contracts, 96% of the personnel have an indefinite contract with the company, a percentage that falls to 81% when we include the Atento personnel.

Regarding gender diversity, in 2010, 36% of the personnel were women; when we include the Atento personnel, this percentage rises to 52%. In 2010, the percentage of women executives<sup>1</sup> increased to 16.8% with respect to the 15.6% of 2009, due to our equal opportunities and diversity policy.

**Social dialogue and collective agreements**  
More than 213,000 of our professionals withing the collective agreements (75%)

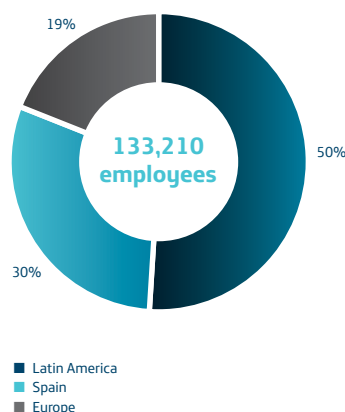
Our reference in relation to social dialogue, affiliation, participation and negotiation rights for our employees are based on our Business Principles, the Social Protocol for International Agreements and its Code of Conduct that are valid between the Union Network International (UNI) and the Company.

As proof of our dynamism in the free activity of trade unions within the Company, we can highlight the fact that more than 55% of the total staff voted in trade union elections.

In 2010, the percentage of employees with work conditions regulated by collective agreements increased by more than two percentage points, up to 75% of the total headcount, which means more than 213,000 professionals.

In Spain Telefónica Soluciones did successfully negotiate an agreement and Telefónica Móviles España obtained an extension. In the

**Percentage of employees per region**  
(Excluding Atento)



	2010	2009	Variation (%)
<b>Spain</b>			
Atento	15,175	11,952	27.0
Telefónica Group (excluding Atento)	39,704	40,108	-1.0
<b>Latin America</b>			
Atento	201,074	175,350	14.7
Telefónica Group (excluding Atento)	133,545	117,319	13.8
<b>Europe</b>			
Atento	67,529	58,031	16.4
Telefónica Group (excluding Atento)	27,171	27,964	-2.8
<b>Others</b>			
Atento	1,194	933	28.0
Telefónica Group (excluding Atento)	25,977	27,031	-3.9
<b>Others</b>			
Atento	1,982	2,052	-3.4
Telefónica Group Total (including Atento)	285,106	257,426	10.8
Telefónica Group Total (excluding Atento)	133,210	125,170	6.4

<sup>1</sup> Data adapted to allow comparison with the data from 2010, due to the recent implementation of a new model for the grading of Global Senior Executive positions, which ensures common criteria throughout the organisation.



case of Telefónica de España, in 2010 it was not possible to obtain an extension of the agreement, and so mid-way through 2011 a new negotiation process will commence. In this process, we shall have to resize the staff in order to adapt it to both, the current financial reality and the new demands of the telecommunications market.

In Spain, approximately 35,000 workers were directly related to Telefónica's core business (28,000 in fixed lines, 4,000 in mobiles and almost 3,000 in related businesses, such as Telefónica stores, phone booths, etc.). The land line business manages about 13.5 million telephone lines and 6 million ADSL lines, whereas the mobile business services more than 24 million lines. Therefore, compared to its direct competitors in Spain, Telefónica has more than twice the number of employees than the other land line, ADSL and mobile operators together.

## Working climate

### +1.3% improvement in internal working environment

In 2010, working climate and staff commitment indicator (ICC), excluding Atento, improved once again and reached 74.3%, 1.3 points above its 2009 value. In the different regions, the index for Spain reached 63% (+3% with respect to 2009); 84% in Latin America (+1% with respect to 2009); and 75% in Europe (-1% with respect to 2009). We can highlight the participation of 75% of the staff, almost 95,000 employees, in the annual working climate survey.

On the other hand, 29 companies, compared to 27 in 2009, were present in the Great Place to Work rankings. In Spain, the *Actualidad Económica* magazine considered Telefónica the best company to work for and was considered one of the Top Employers. Telefónica O2 UK confirmed its position as one of the Top Employers, coming in 16th in the Sunday Times 2010 Best Big Companies to Work For ranking. Finally, according to the Best Place to Work Institute, Telefónica is considered the second best company to work for in Latin America, and its Spanish subsidiary Atento the best in Spain.

## Global Employee Stock Purchase Plan

In 2010, we launched the Global Employee Stock Purchase Plan, which was approved by the Ordinary General Meeting of Shareholders of Telefónica, S.A. on 23 June 2009, for a maximum amount of €50 million.

Through this plan we offer the employees the possibility to purchase Telefónica, S.A. shares with the commitment by Telefónica of giving the participants a number of shares for free as long as they meet certain requirements.

This plan is part of the employee value offer, to which Telefónica is committed. We have a triple goal: to recognise the continuance and commitment of employees with the Company's project; to align the interests of the employees with those of the shareholders; and to promote the participation of our professionals in the social capital of the Company by purchasing stocks.

The registration of employees in the plan was totally voluntary. The registration period started on 26 May 2010 and at the end of it more than 40,000 Telefónica Group employees in 20 countries had signed up.

The Global Employee Stock Purchase Plan has been awarded as the Best International Share Plan by the 2010 IFS Pro Share Awards in London and the Innovation and 2010 Best Human Resources Practices prize in Mexico by the Knowledge & Management Institute.

## Development and training 13 million hours and €59 million

In 2010, Telefónica invested about 13 million hours in training, compared to the 11 million hours it provided in 2009. The total investment in training reached €59.4 million, compared to the €63.3 million in 2010 (-6.1%). On-line training has been strongly promoted within the Group, which has led to greater efficiency in the resources dedicated to training.

The work of **Universitas Telefónica** was also key in achieving this. In 2010 we consolidated our new campus in Barcelona with the attendance of more than 1,300 professionals, who evaluated their satisfaction with the courses attended at 8.9 out of 10. Universitas has three main lines of work: to contribute towards defining Telefónica's way of global leadership; to become a forum in the collaborative debate and work to provide solutions to our business problems; and to become a meeting point for Telefónica professionals.

Also in 2010, Telefónica Spain has worked in creating four Excellence Schools to promote best practices in four areas: Commercial Excellence, Excellence in Leadership, Technical Excellence and Business Excellence.



*Universitas Telefónica, Barcelona.*

# ...work plans included in the **bravo!** programme

The bravo! programme allows the implementation of the Telefónica strategy over the period 2010-2012

The bravo!  
programme  
is being  
implemented  
in the three  
business units  
within Telefónica

In March 2010, Telefónica launched the bravo! programme, a programme to implement Telefónica's vision using the four pillars of transformation, which bring together 10 common initiatives and which have been implemented in the three organisational levels of the group: Global, Regional and Local.

bravo! defines the vision as follows: "Telefónica is the Company that allows our customers and the societies in which we work to enjoy the advantages of the new digital world. With these new technologies we ensure that our customers are more and better connected, allowing them to have better, simpler and more entertaining lives. To companies, we offer more and improved tools to increase their productivity. To the public sector, we offer a greater capacity to attend more effectively to the needs of the public".

## Pillar: Customers

In 2010, for the first time we have overtaken our competitors in customer satisfaction on a worldwide scale. This result has come from the improvement of our service at contact points, from the perceived level of quality and the promotion of a culture which is aligned to the customers' vision. In addition, Telefónica has developed projects for continuous improvement of the customer experience in all geographical areas, with the aim of enhancing our emotional links with customers.

During 2010 we have worked on the identification of the levers which can have an impact on the customer satisfaction of dissatisfied customers, designing and implementing actions plans at a segment level. As a result we have achieved a major reduction (2.7 percentage points), at an aggregate level, in our percentage of dissatisfied customers to 10.29%. This reduction has taken place in our three geographical areas: Spain, Europe and Latin America.

## Bravo! awards







This sculpture, by Basque sculptor Ramón Karrera, represents a personal vision of the artist regarding the company and the field of communication.

With it Telefónica aims, on the one hand, to represent its transformation programme for 2012 (bravo! programme) and, on the other, to act visually as a recognition of the most outstanding professionals.

In 2010, 332 bravo! awards were presented throughout Telefónica's three regions.

## Bravo! Programme General Initiatives for 2010-2012

Pillars	Initiatives	Indicators
 customer	1 Building emotional engagement	▶ CSI gap
 offer	2 Traditional business growth and defense 3 Broadband leadership 4 Applications and new business development	▶ Traditional business revenues <sup>1</sup> (CAGR 08 -12) ▶ Broadband revenues <sup>2</sup> (CAGR 08 - 12) ▶ Applications and new business revenues <sup>3</sup> (CAGR 08-12)
 platforms	5 On-line company 6 IT systems as enabler 7 Best-in-class network	▶ Share of on-line transactions <sup>4</sup> ▶ Time to Market (reduction 08-12) ▶ Network CSI
 culture	8 One committed team 9 Emotional and integrated brand 10 Commitment to Society	▶ Employees satisfaction and commitment ▶ Brand consideration ▶ RepTrack

<sup>1</sup> Revenue from traditional business: Revenue from access and fixed and mobile voice (including SMS), fixed and mobile equipment, narrow band internet and M2M.

<sup>2</sup> Revenue from broadband: Revenue from BAF connectivity, retail and wholesale, equipment and data services, revenue from BAM connectivity (large and small screen).

<sup>3</sup> Income from Applications and New Business: Revenue from TV, ICT solutions, online advertising, added value services for mobile broadband, new sources of growth and other digital content services.

<sup>4</sup>  $(\text{Online new customers} + \text{online customer service transactions}) / (\text{Total new customers} + \text{Total customer service transactions})$ .

### Pillar: Offer

In 2010, Telefónica moved forward in its role as a service provider with the launch of the new organisation of seven vertical businesses (security, e-health, M2M, video, cloud computing, applications, financial services) and with the global unit of Multinationals.

Additionally, the commercial offer has been extended with the promotion of broadband, fixed and mobile, as well as innovative personal services placed in the market (SpinVox, Ring Back Tone and social network aggregators, among others), new solutions for the home with fixed-mobile solutions ("Family Solution", "UNO family"), and offers for young people.

Telefónica has always adapted itself to technological changes and continues to do so in order to generate value for its more than 1.5 million shareholders. As a result, the Company will invest up to 27 billion euros by 2013 on adapting the new fixed and mobile networks to the new requirements.

### Pillar: Platforms

During 2010, Telefónica went ahead with the deployment and expansion of new access networks (optic fibre, VDSL2, 3G); with the use of its economies-of-scale to improve efficiency (with the creation of global purchasing and roaming units); with the definition of a global IT operating model, which includes the creation of a worldwide IT unit (TGT); and with the migration towards becoming an on-line company.

Spectrum capacity has also been obtained at good prices in auctions in Brazil, Mexico and Germany and shared use agreements have been signed with other operators in Spain, Germany and the United Kingdom.

### Pillar: Culture

The cultural axis aims to implement a common culture in all countries to establish sustainable long-term relationships with all interest groups.

To this end, in this pillar three broad working lines have been defined:

- the first relates to professionals;
- the second to the brand portfolio; and
- the third to society as a whole.

For each of them, some indicators were established that in 2010 were met: 75% in the Index of Employee Satisfaction and Commitment (professionals); 1st or 2nd place in Commercial Brand Consideration in each country (brands); and 1st to 3rd place in the RepTrak ranking, also in each country, to measure the commitment to the societies in which we operate.



## Commitment

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“

*'Telefónica's vision is to make the possibilities offered by this new digital world real, and to be one of the leaders in this area', says the Executive Chairman, César Alierta, in his letter to shareholders.*

*Telefónica has a suitable structure in order to make the most of synergies as a global company that is already present in 25 countries. Its Board of Directors, its Management Team and its more than 285,000 Professionals guarantee the good government and management of the Company and the performance of the work plans included in the bravo! programme (strategic plan for 2010-2012).*

*In 2010, Telefónica, driven by the acquisition of the Brazilian operator **Vivo**, increased the **scale** of its operations, once again obtaining solid **results**, and fulfilling the **commitments** made in the market. Progress was possible thanks to improvements in customer experience, based on a new **brand strategy**; to the promotion provided by **innovation** in order to capture the opportunities for growth provided by the digital market; and to the improvement of operating **efficiency**. All this, together with a strong range of strategic **alliances** and our leadership in corporate **sustainability**, has made Telefónica the most admired company in the telecommunications industry in 2010.*

*The 2010 results demonstrate Telefónica's strength and its capacity to generate trust in the markets with a sensible risk management policy*

”

## In 2010, Telefónica, driven by the acquisition of the Brazilian operator **Vivo**,...

Telefónica gains control of Vivo after agreeing with Portugal Telecom the purchase of 50% of Brasilcel for 7.5 billion euros.

Telefónica becomes the leader operator in the telco sector in Brazil

On 28 July, 2010, Telefónica and Portugal Telecom signed an agreement for the acquisition by Telefónica of 50% of the shares of Brasilcel for a total amount of 7.5 billion euros.

As a continuation to this agreement, Telefónica acquired last 27 September 50% of the shares of Brasilcel (a company with approximately a 60% shareholding in Vivo Participações, S.A.), property of Portugal Telecom and has made a first payment, as agreed, for 4.5 billion euros.

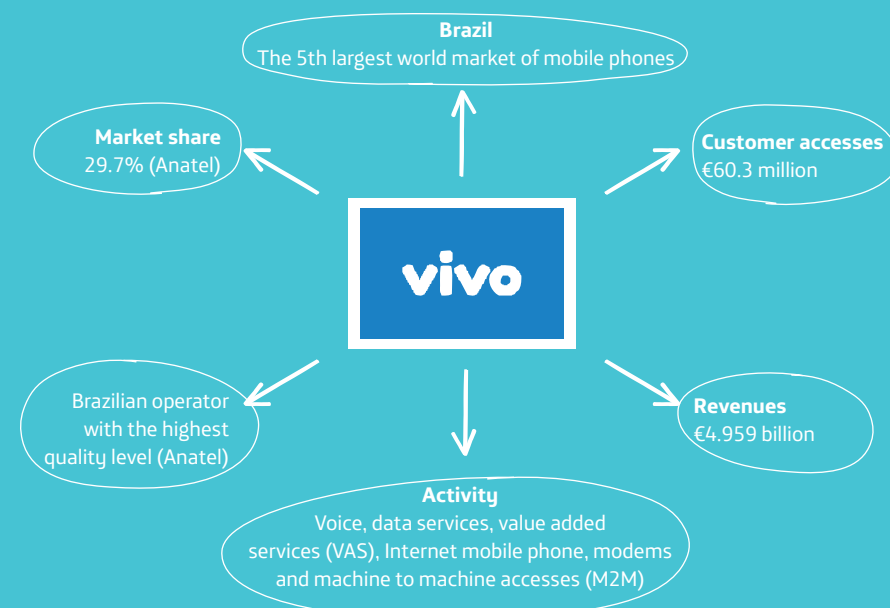
In addition, on 30 December, 2010, as planned, Telefónica S.A. paid 1 billion euros, while the payment of the remaining 2 billion euros is planned to be made next 31 October, 2011.

However, Portugal Telecom could ask this last payment to be made on 29 July, 2011. In this case the deal value, and the last price payment, would decrease by about 25 million euros.

Simultaneously with the closure of the operation last September, the agreements signed in the year 2002 between Telefónica and Portugal Telecom SG SGPS, S.A. were closed for their joint venture in Brazil (Subscription Agreement and Shareholders Agreement).

Furthermore, Telefónica has announced a takeover bid for the acquisition of voting shares in the hands of minor shareholders from Vivo Participações, S.A., which account for about 3.8% of its share capital, for an amount per share equivalent to 80% of the price agreed in the acquisition from Portugal Telecom described above and subject to regulatory approval.

### Vivo in data, 2010



On 11 February, 2011, the Brazilian stock market regulator (C.V.M.) approved the offer made by Telefónica to the voting shareholders from Vivo Participações not yet controlled by Telefónica.

On 25 March, 2011, the Board of Directors of each of the branches controlled by Telefónica, Vivo Participações and Telecomunicações de São Paulo, S.A. Telesp ("Telesp"), approved the terms and conditions of the restructuring whereby all Vivo Participações shares that do not belong to Telesp shall become their property, exchanging them for Telesp shares and thus making Vivo Participações a 100% subsidiary of Telesp. This restructuring was approved by Vivo Participações shareholders at the Extraordinary Board Meeting held on 27 April, 2011 and by Telesp shareholders at the Extraordinary Board Meeting held on the same date.

**Date of acquisition:**

Anatel approved the purchase in September 2010

[www.vivo.com.br](http://www.vivo.com.br)

## New Acquisitions

The world today is a connected society, which will be increasingly better connected; this gives Telefónica significant, new development opportunities, as telecommunication companies play a key role in the ICT ecosystem.

In this scenario, our strategy consists of continuing to capture growth through the

traditional market, broadband and new markets, and anticipating and taking advantage of new opportunities. In this way we can become the best global communications company in the digital world.

In this regard, the acquisition of digital assets, such as the companies Jajah and Tuenti, allows us to strengthen our service ecosystem.

### Tuenti, a platform for reaching new generations



The social network with the greatest traffic in Spain

**HQ:**  
Madrid (Spain)

**Operates in:**  
Spain

**Activity:**

Leader private social network in this country, particularly aimed at young people. It has 10.6 million registered users and 30 billion pages visited (Feb-March 2011). It offers games, videos, chat, application for iPhone, virtual money, geolocalisation... It also has a virtual mobile operator, Tú, and provides videoconference services.

**Date of acquisition:**  
August, 2010

[www.tuenti.com](http://www.tuenti.com)

### Jajah, one of the most innovative companies all over the world



World leader company in IP telephony and communications.

**HQ:**  
Silicon Valley (California).  
Branches in Israel.

**Operates in:**  
it provides its services in almost 200 countries to millions of people.

**Activity:**  
Considered as one of the most innovative communication companies worldwide, it

provides IP telephony solutions, including JAJAH Direct, JAJAH@call and JAJAH mobile, which are selected globally by over 10 million customers. Thanks to an open, universal telecommunications platform, services managed by JAJAH allow mobile phone operators, suppliers of landlines, wire companies, technological companies and other companies to adapt their voice solutions with a very low investment and in a very short space of time.

**Date of acquisition:**  
The National Competition Commission authorised the purchase just over a year ago.

**Amount of 100%:**  
145 million euros.

[www.jajah.com](http://www.jajah.com)  
<http://platform.jajah.com>

## ...increased the scale...

Telefónica, fifth largest operator in the world in terms of number of customer accesses: almost 288 million

## The Company has a global, regional and also a local scale

One of Telefónica's greatest strengths lies in its differential scale at the global, regional and particularly local level, making it a company that is constantly growing. Its scale is global and it is the fifth operator worldwide in terms of accesses. Its scale is also regional, as it holds significant market shares in Europe and in Latin America. However, the Company's most important aspect is its local character, as it is always first or second in the ranking in every market where it operates.

Telefónica closed the financial year 2010 with over 287 million customer accesses, a figure that represents an 8.2% increase over 2009. This growth resulted mainly from increases in mobile broadband (63.9%); in mobile telephony (+8.9%); in fixed broadband (+27.0% year-on-year, +10.9% organic); and in Pay TV (+12% reported, +8.9% organic). In terms of geographical areas, the highlights were the growth rates attained by Telefónica Latin America (year-on-year increase of 9.0%) and Telefónica Europe (organic year-on-year increase of 6.2%; 14.3% reported). On the other hand, in Spain, the number of accesses decreased by -1.7%.

### Fixed telephony 41.4 million accesses

In the mature market of fixed telephony, Telefónica ended 2010 with 41.4 million accesses.

In **Spain**, the Company's retail fixed access base stood at 13.3 million at the end of 2010 (14.2 million as at the end of December 2009), 6.5% less than in 2009. Therefore, the Company's estimated market share was around 69% in 2010.

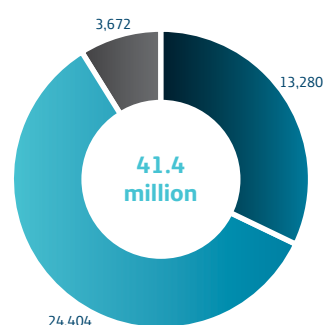
94% of the losses in retail fixed telephony accesses were offset by the net growth in wholesale accesses, thus cushioning the drop.

In **Latin America**, accesses stood at 24.4 million at the end of the year, remaining virtually stable as compared with 2009 (-0.7%).

In the **Czech Republic**, accesses stood at 1.7 million at the end of 2010, with a year-on-year drop of 5.7%, as compared to the 6.5 % drop in 2009 with respect to 2008.

### Fixed telephony accesses in 2010

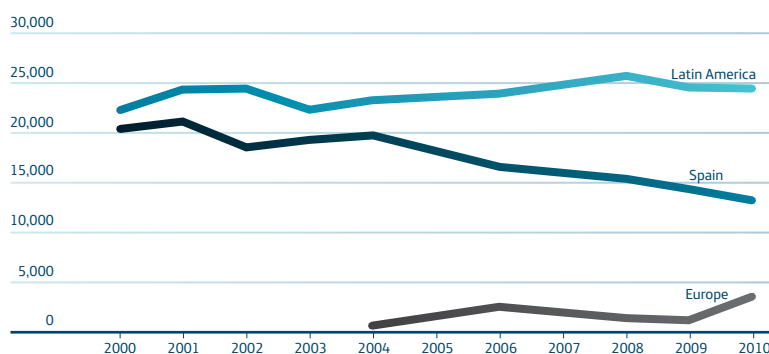
Data in thousand accesses



■ Spain  
■ Latin America  
■ Europe

### Changes in fixed telephony accesses 2000/2010

Data in thousand accesses



■ Spain  
■ Latin America  
■ Europe

\* The fixed telephony access figures for Spain in 2008 include Morocco.

## Data and Internet

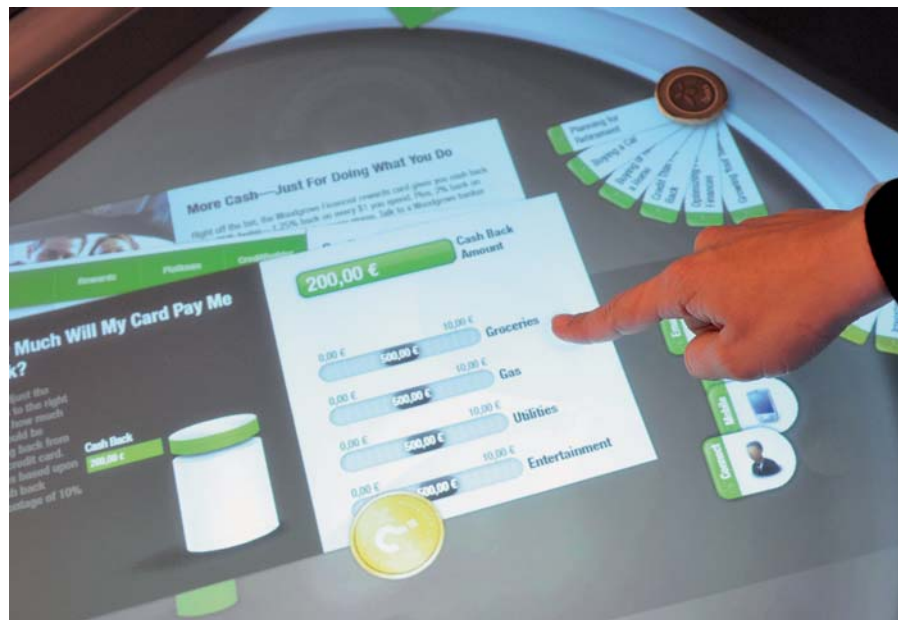
### 18.6 million accesses (+23.4% year-on-year)

Retail broadband Internet accesses stood at 17.1 million, with a year-on-year growth rate of 27.0%, after the upturn recorded in the net earnings during the fourth quarter, where Brazil, once again, stood out as a growth driver for Telefónica in these types of accesses. The adoption of packaged voice, ADSL and Pay TV service offerings remains one of the key components in the Group's strategy.

In terms of geographical areas, in **Spain**, Telefónica closed the financial year with 5.7 million accesses, up 4.5% as compared to the previous financial year, and over 5.8 million global data and Internet accesses.

In **Latin America** the number of accesses topped 7.4 million accesses (representing a 15.8% year-on-year increase, and 8.2 million global data and Internet accesses.

In **Europe**, the number of fixed retail broadband accesses and Internet reached 4.0 million accesses, after a net increase of 2.4 million in 2010 (203 thousand in organic terms), and almost 4.5 million global data and Internet accesses.

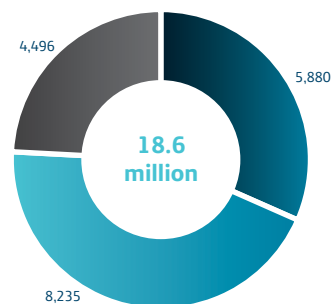


Bank office.

## Mobile

### Data and Internet accesses in 2010

Data in thousand accesses

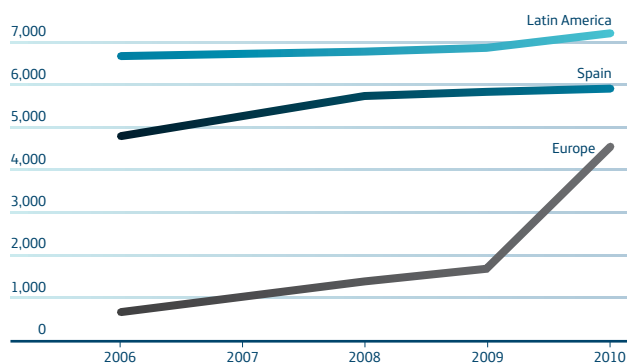


■ Spain  
■ Latin America  
■ Europe

## Progress of Pay TV

### Data and Internet accesses 2006/2010

Data in thousand accesses



■ Spain  
■ Latin America  
■ Europe



## Mobile broadband

### Mobile telephony 220.2 million accesses (+8.9% in comparable terms)

The Telefónica's mobile accesses exceeded 220 million by the end of 2010, with a net increase of approximately 18 million accesses in comparable terms during the financial year.

In the context of these figures, special mention should be made regarding the significant increase in the number of Mobile Broadband accesses, which exceeded 22 million by the end of 2010 (compared to 15 million accesses in 2009), up 48%.

**Telefónica España's** mobile base reached a total of 24.3 million mobile customers (representing a 3.3% increase as compared with the previous year). The increase in contract customers, and especially the increase in mobile broadband customers, which multiplied by 1.7 as compared to 2009, was particularly noteworthy.

In **Latin America**, mobile accesses climbed to 149.3 million, with a year-on-year growth rate of 10.8% after registering a net gain for the year of 14.6 million accesses.

In **Europe**, the Company attained a total base of 46.7 million accesses (year-on-year increase of 6.0 %) after registering a net increase of 2.8 million customers in 2010.



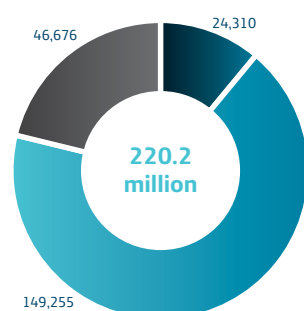
Mobile services.



Broadband accesses.

### Mobile telephony accesses in 2010

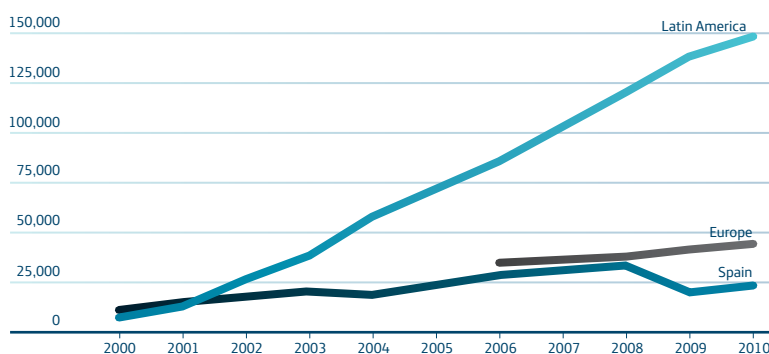
Data in thousand accesses



■ Spain  
■ Latin America  
■ Europe

### Progress of Pay TV telephony accesses 2000/2010

Data in thousand accesses



■ Spain  
■ Latin America  
■ Europe

\* The fixed telephony access figures for Spain in 2006 and 2008 include Morocco.

## Pay TV 2.8 million accesses (+12% reported)

Accesses to Pay TV reached 2.8 million at the end of 2010, which represents a 12% increase on the figure for the previous year.

**Telefónica España** added 85,000 new customers during the last financial year to its customer base, totaling 788,000 customers (a year-on-year increase of 12.1 %), with a significant climb in estimated market share, which stood at around 19% at the end of 2010.

In **Latin America**, the number of customers stood at 1.8 million (+8.7% year-on-year) after having captured 144,000 accesses over the course of the year.

**Telefónica O2 Czech Republic** totaled 129,000 customers at the end of December 2010 (-6.1% year-on-year).

## Customer satisfaction

In 2010, Telefónica's Customer Satisfaction Index (CSI) reached a record 7.13 points, a figure that came to confirm the upward trend observed over recent months.

Spain was the region with the highest perceptual CSI growth (+3.8%), consolidating its advantage over its competitors, as the gap increased up to +0.28 points. The advertising's clarity and credibility were two of the key aspects that improved the most throughout 2010, as well as the commitment to reward customer loyalty, and the increased product value and promotional clarity.

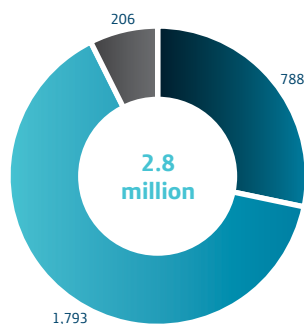
In the European region, Telefónica increased its CSI by 0.09, to reach 7.39 points, based mainly on the good running of operations in the United Kingdom, Ireland and the Czech Republic.

In Latin America, the CSI reached 7.55 points in 2010, increasing the gap over its competitors by +0.11 points. The fixed business in Brazil registered the greatest improvement compared to the previous year, recovering the leadership in the industry, and with a CSI increase of +0.83 points.

Likewise, another record was set regarding the percentage of unsatisfied customers, which at a year-to-year level decreased by -3.03 points, down to 10.29% at a global level, confirming the downward trend that has been noted during the whole year.

## Mobile in 2010

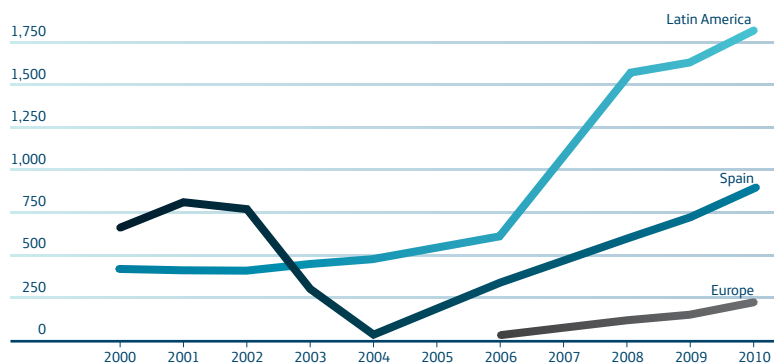
Data in thousand accesses



■ Spain  
■ Latin America  
■ Europe

## Progress of Pay TV accesses 2000/2010

Data in thousand accesses



■ Spain  
■ Latin America  
■ Europe

## ...obtaining solid results...

The sustainable growth of Telefónica's customer base has enabled the achievement of solid results

Basic Earnings  
per Share  
increased  
by 31.6%

### Shareholder remuneration 6.755 billion euros

Once again, Telefónica reaffirms its policy of increasing dividends. In 2010 the Company allocated 6.755 billion euros to shareholders remuneration; this is equivalent to 80% of the cash flow generated in the year; and 9% of the Company's stock market capitalisation<sup>1</sup>.

Shareholder return involved the payment of dividends in cash (5.872 billion euros) and acquisition of treasury shares (883 million euros). As at 31<sup>st</sup> December 2010 the Company owned derivatives on 160 million Telefónica shares, and it owned 55.2 million treasury shares, representing 1.2% of the share capital of Telefónica.

### Dividends paid in 2010 1.40 euros per share

On 11<sup>th</sup> May 2010, Telefónica distributed dividends charged to the profit and loss account for the financial year 2010 amounting to 0.65 euros gross to each of the Company's shares in circulation with dividend rights.

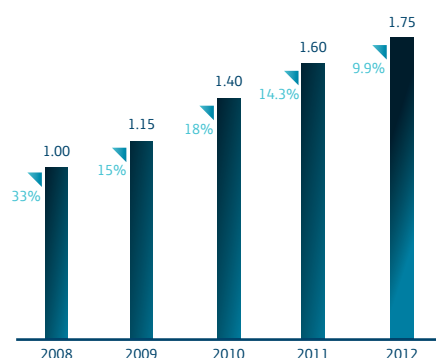
In addition, on 8<sup>th</sup> November 2010 Telefónica distributed dividends of 0.65 euros gross per share to be charged to unrestricted reserves. This last payment, together with that of 6<sup>th</sup> May 2011, confirms Telefónica's commitment to provide a shareholder return of 1.40 euros per share corresponding to 2010.

Also, for the next General Shareholders Meeting, the Board of Directors has agreed to propose the distribution of a dividend charged to unrestricted reserves for the amount of 0.77 euros per share in the second half of 2011.

### Dividend enhancement policy Objective for 2010 of 1.60 euros per share

At the Investors' Conference held on 9<sup>th</sup> October 2009, the Telefónica Group once again committed itself to a schedule of gradual increases in dividends, announcing a 21.7% increase in the dividend for 2010 to 1.40 euros per share compared to that of 2009.

### Evolution of the dividend per share



<sup>1</sup> As of 18<sup>th</sup> March 2011.

Similarly, a goal of distributing a minimum dividend of 1.75 euros per share by 2012 was set for the medium term. This commitment has been renewed several times since then, the most recent being on 23<sup>rd</sup> February 2011.

In addition, on that date, the Board of Directors of Telefónica, S.A. proposed a dividend increase to 1.60 euros per share for 2011, which represents a 14.3% increase in comparison to the dividend of 1.60 euros per share of 2010.

At the 8<sup>th</sup> Investor Day held on 13<sup>th</sup> and 14<sup>th</sup> April 2011, the Telefónica Group renewed its commitment to distribute a dividend of 1.75 euros per share in 2012, and announced the aim to establish a minimum annual remuneration of 1.75 euros per share as of 2012.

### Net profit (10.167 billion euros) and basic return per share (2.10 euros per share)

Telefónica has attained solid results, meeting for the eighth consecutive year the financial objectives committed to the market, thanks to the extensive diversification in operations, both from a geographical and a business perspective.

Thus, the strong growth experienced by Telefónica Latin America and by Telefónica Europe prove Telefónica's solidity, in spite of the unfavourable development of the business in Spain. Attention should be drawn to the increasing contribution of Latin America to the results of the Group, backed up with the support of a positive figure in operations and the increased presence in Brazil, after purchasing the stake of Portugal Telecom in Vivo last September.

The net profits attained by Telefónica in 2010 totalled 10.167 billion euros, a 30.8% increase on the amount reported in 2009, while the basic net return per share rose to 2.25 euros, a year-on-year increase of 31.6%. It is also worth noting that Telefónica has been able to place the Net Earnings per Share in



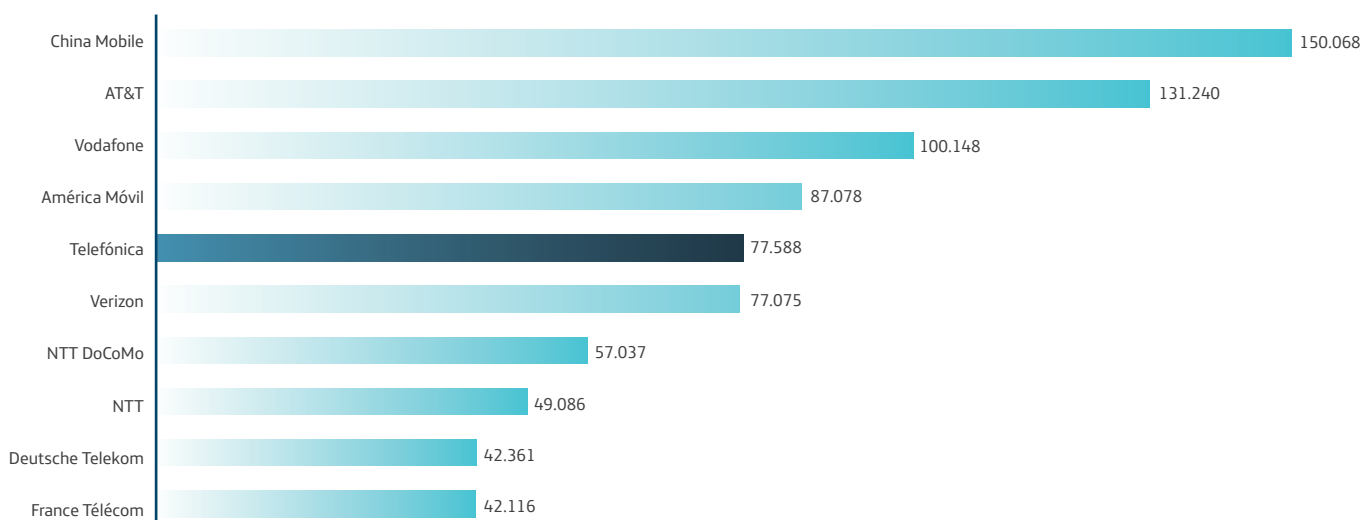
*César Alierta, Executive Chairman of Telefónica, at the 2010 General Shareholders' Meeting.*

2010 over the 2.10 euros per share target, a commitment renewed at the 7<sup>th</sup> Investor Day held in October 2009.

### Changes in share value

The main European markets have completed 2010 with general falls (Ibex-35: -17.4%; FTSE-100: -13.2%; EStoxx-50: -5.8%; and CAC-40: -3.3%) basically affected by the uncertain financial situation of the peripheral European countries (Portugal, Ireland, Italy, Greece and Spain). The only exception is the German DAX, which has risen by 16.1% in the course of the year.

### Ranking in sector according to market capitalisation



Source: Information from Bloomberg, 31<sup>st</sup> December 2010. Data in billion euro.

Ibex-35 presents the worst performance in comparison to other European markets due to the continuous concern of being affected by the sovereign debt's after the debt rescue of Greece and Ireland. As part of this, Telefónica's shares have increased by 13.1% (16.97 euros per share at the end of the year), a much better figure than the Spanish reference index.

Telefónica still benefits from the high level of its diversification, both geographically and in business areas; from its proven ability to perform in changing environments; from the Company's strong cash flow generation; and from its commitment to its shareholders. The latter is reflected in the commitment to continue increasing shareholder remuneration

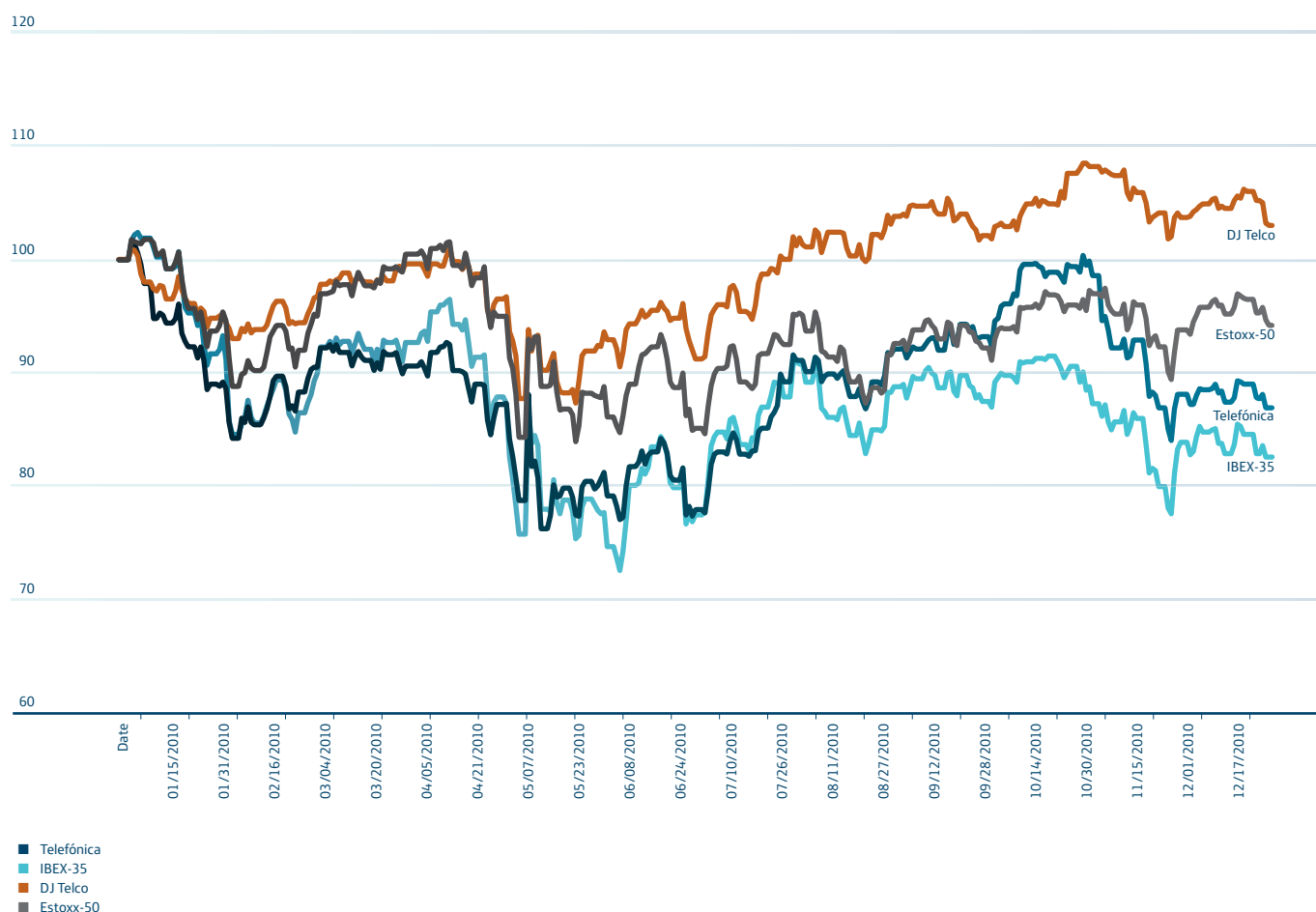
in the form of dividends. It should be highlighted that in 2010 Telefónica acquired the remaining 50% of Vivo in Brazil, thereby increasing its presence in emerging markets. With regard to the European telecommunications sector, Telefónica has registered a less impacted profitability, due to the sovereign debt's risk (DJ Telco: +3.0%; BT: +33.9%; Vodafone: +15.4%; Telecom Italia: -11.1%; France Telecom: -10.5%; KPN: -7.8%; Deutsche Telekom: -6.2%).

All this has allowed the total return of Telefónica shares in 2010 to be -6.4%, after including the dividends that were distributed throughout 2010: 0.65 on 11<sup>th</sup> May 2010 and 0.65 on 8<sup>th</sup> November 2010. Although in 2009 the total return of shares was 29.5%.

At the end of 2010, Telefónica was the world number five in the telecommunications sector in terms of stock market capitalisation, and one of the top fifty worldwide. Telefónica's stock market capitalisation at the end of 2010 stood at 77.428 billion euros.

Telefónica's average daily trading volume in the Spanish continuous market was 59.8 million shares in 2010 (48.5 million shares in 2009).

## Stock market performance





## Other information

### Number of shareholders

Telefónica had 1,428,619 shareholders as at 1<sup>st</sup> May 2010, according to the individualised records detailing private individuals and legal entities, and with the data held by the Spanish Central Securities Depository (Sociedad de Gestión de los Sistemas de Registro, Compensación y Liquidación de Valores - Iberclear).

### Stock Markets

Telefónica is listed on the Spanish Continuous Market (as part of the Ibex-35 index) and on the four Spanish stock markets (Madrid, Barcelona, Bilbao and Valencia), as well as on the stock markets of New York, London, Tokyo, Sao Paulo and Lima.

### Share capital

As a consequence of this, the share capital of Telefónica, which is fully subscribed and paid up, was calculated at 4,563,996,485 euros, consisting of 4,563,996,485 ordinary shares of the same category and series, each with a par value of one euro and being represented by account entries.

### Significant holdings

According to the information available to the Company, no private individual or legal entity exercises or might exercise control over Telefónica, either on a direct or indirect basis, whether acting alone or jointly.

As at 31<sup>st</sup> December 2010, Caja de Ahorros y Pensiones de Barcelona (La Caixa) and Banco Bilbao Vizcaya Argentaria, S.A. (BBVA), were the direct or indirect holders of 5.050% and 6.279% of the share capital of Telefónica, respectively.

Blackrock, Inc. was the holder of 3.884% of Telefónica's share capital, according to information from the Comisión Nacional del Mercado de Valores (Stock Market National Commission) on 4<sup>th</sup> February 2010.

## Telefónica's Shareholders' Office

The Shareholders' Office was created to establish transparent and fluid communications with private shareholders and to provide them with information at the same time and in the same form as it is received by institutional investors. There are three channels for this relationship:

### Free phone line for shareholders: 900 111 004.

In 2010, a total of 74,951 calls were received, an increase of 1.45% in comparison with 2009 at an average of 6,246 calls a month.

In addition to telephone queries, the Shareholders' Office dealt with a further 5,190 queries by email and post (up from 3,487 in 2009). Of the queries received in 2010, 53,576 related to economic and financial issues as follows:

- 19,268 queries about the General Shareholders' Meeting.
- 27,997 queries about stock market performance and the share price.
- 6,258 queries about results and relevant events.
- 53 queries on rights issues and special financial operations.

### On-line channel: ([www.telefonica.com/accionistaseinversores](http://www.telefonica.com/accionistaseinversores))

In 2010, there were a total of 1,439,537 page views on the Shareholders and Investors website, a 5.58% increase on the 1,363,455 the previous year. The website is available

in Spanish, English and Portuguese, and has specific sections on:

- The Company's stock market performance, including *on-line* share prices. The webpage can generate interactive charts; compare Telefónica's share price with that of other companies in the sector; calculate returns over a period selected by the user; and provide comparisons with reference indexes.
- Dividends, results and communications with the markets, relevant facts and information on Corporate Governance (composition of Governance Bodies, Articles of Association, Regulations, etc).
- Viewing and downloading documents, including annual reports, the Regulations of the General Shareholders' Meeting and the Board of Directors, the Articles of Association, and official records of information on the Company's activities.
- The Shareholders' Corner provides small shareholders with a personalised interactive area for asking questions, receiving specific information and alerts about information relevant to the Company.

### The "Acción Telefónica" magazine.

The Shareholders' Office publishes the magazine "Acción Telefónica" for Company shareholders. The magazine is published every three months. In 2010, 598,402 copies were sent to the homes of shareholders. The magazine is filled with information on results, company facts, stock market information, reports and culture.



General Shareholders' Meeting 2010.

# ...fulfilling the commitments made...

8 consecutive years fulfilling its commitments.

## A track record of leadership and reliability

### Responding to commitments

One of the main strengths of the Company is its track record in terms of fulfilling commitments taken on, regardless of the economic cycle it finds itself in. This makes Telefónica a highly predictable company, with a very low risk for investors. Strictly honouring its commitments gives Telefónica credibility and reinforces its leading role in the markets where it operates.

In the year 2010 it reached again the targets set and achieved a **net profit** of 10.167 billion euros, with an increase of 30.8% from 2009. The Company ended the last fiscal year with robust results, in a challenging environment linked to good management.

The **operating cash flow** (OIBDA-CapEx) was 14.933 billion euros (-2.7% year-on-year in terms reported), and the debt financial ratio plus commitments over OIBDA was 2.5 times in 2010, which demonstrates the financial soundness of the Company.

Despite the fact that the financial year was marked by a difficult environment due to the economic downturn, Telefónica has continued on the path of sustainable profitable growth that it has been following for the last decade.

### Compliance with Guidance 8 consecutive years

For eight consecutive years the Company has been able to meet all financial objectives previously announced for the fiscal year. The Telefónica Group obtained robust financial results in 2010, despite the complexities of the economic and operating environment, demonstrating the value of the high degree of diversification of its operations.

Revenue, OIBDA, investment and operating cash flow are just some of indicators where Telefónica managed to attain the targets set, and this clearly demonstrates its leadership and financial credibility.

Effective compliance with the financial goals for the year 2010 is evidenced as:

	Guidance			Reported with guidance criteria*			Compliance
	Revenue	OIBDA	OI	Revenue	OIBDA	OI	
2003	5%-8%	6 - 9%	18 - 21%	6%	12.5%	29.7%	✓
2004	7% - 10%	5 - 7%	15 - 18%	8.3%	6%	15.5%	✓
2005	>15%	10 - 13%	12 - 18%	17.2%	12.3%	16.1%	✓
2006	>37%	26 - 29%	26 - 30%	38.8%	28.9%	29.2%	✓
2007	8 - 10%	10 - 13%	19 - 23%	9.8%	12.8%	27.6%	✓
2008	6 - 8%	7,5 - 11%	13 - 19%	7.3%	10.6%	20.4%	✓
2009	>0%	1 - 3%	-	0.3%	1.1%	-	✓
2010	1-4%	1 - 3%	-	3.8%	1.4%	-	✓

Source: Presentation of TEF results

\* The growths given in the table are reported following the criteria established upon fixing the annual guidance, so they do not necessarily agree with the results published.

1. Revenue grows 3.8%, in the top part of the ranking announced, 1.0% - 4.0%.
2. OIBDA increases 1.4%, within the announced range of 1.0% - 3.0%.
3. The investment (CapEx), excluding spectrum, amounts to 7.646 billion euros, in line with the objective of 7.450 – 7.650 billion euros.
4. The net profit per share is 2.25 euros, above the goal of 2.10 euros.

The Telefónica Group obtained robust results in 2010, shown as a strong growth of revenue and high generation of operating cash.

## Revenues

### 60.737 billion euros

#### (+7.1% year-on-year)

The largest customer database and the growing contribution of the mobile phone business promote the growth of the **net amount of the business turnover** (revenue), that for the whole year is 60.737 billion euros, with a progression of 7.1% year-on-year.

The strong **diversification of the Group is critical** to achieve this positive evolution of its revenue. Therefore, in the year 2010 Telefónica Latin America and Telefónica Europe account for 68% of the consolidated revenue, while Telefónica España accounts for less than 31% of the Group revenue.

This diversification also explains the good behaviour of revenues in organic terms, that show a year-on-year growth for the total year of 2.4%, a value virtually in line with that recorded in the first nine months of the year. It must be highlighted that reductions in mobile interconnection rates decrease the growth 1 percentage point in organic terms.

By **regions**, Telefónica Latin America and Telefónica Europe are to be highlighted for their sustained revenue growth rate, providing 2.7 and 1.0 percentage points to the organic growth of consolidated revenue, respectively, making up for the lower contribution of Telefónica España (-1.6 p.p.). Both the revenue in the fixed sector of Telefónica España, by traditional access, and those of voice, such as the Internet and broadband fell 13.1%, 10.9% and 0.9%, respectively.

## Business profitability

### 25.777 billion euros

#### (+14.0% year-on-year)

The **operating result before amortisations and depreciations (OIBDA)** in the year 2010 amounts to 25.777 billion euros, with a year-on-year growth of 14.0%.

In organic terms, the OIBDA increases by 0.8% year-on-year, and has shown a better performance than in the first nine months of the year, with the OIBDA margin remaining virtually stable from 2009 (-0.6 p.p.) despite the greater commercial activity recorded in the year.

By **regions**, excluding the positive impact resulting from the increased value of the pre-existing share in Vivo, the OIBDA from Telefónica Latin America increases year-on-year 5.0 p.p. its contribution to OIBDA of the Group, to exceed 45% of the Company OIBDA. Therefore, together with the higher contribution from Telefónica Europe, over 60% of 2010 consolidated OIBDA is generated out of the business setting of Telefónica España, where in comparable terms the OIBDA decreases by 6.9% vs the year 2009.

## Cash generation

### 14.933 billion euros

#### (-2.7% year-on-year)

The Company continues to focus its investment effort on growth and transformation projects, promoting the development of both fixed and mobile broadband services.

The **operating flow chart (OIBDA-CapEx)** reaches 14.933 billion euros in 2010 (-2.7% year-on-year). In organic terms, excluding the acquisition of spectrum, the operating cash flow would decrease by 1.7% year-on-year. By regions, Telefónica España provided 6.499 billion euros; Telefónica Latin America 8.247 billion euros, and Telefónica Europe 942 million euros (2.321 billion, excluding the acquisition of spectrum in Germany).

The **free cash flow generated** by the Telefónica Group in 2010 amounted to 8.466 billion euros, of which 5.872 billion euros were allotted to payment of dividends, 883 million euros to the treasury shares policy, 834 million euros to the cancellations of commitments made by the Group (mainly resulting from staff reduction programmes; staff expenses in Telefónica España reached in 2010 2.658 billion euros, 15.3% more than in 2009) and 6.577 billion euros to financial investments and disinvestments made in the period.

Furthermore, the **net financial debt** has increased by 5.7 billion euros. On the other hand, a 6.343 billion euro increase in the financial debt is to be added, of which 2.366 billion euros comes from changes in the type of exchange and 3.977 billion euros from changes in the perimeter and other effects on financial accounts. As a result, the net financial debt increases 12.042 billion euros from that recorded in 2009 (43.551 billion euros), amounting at the closure of December 2010 to 55.593 billion euros.

# ...new brand strategy...

In 2010, 6 countries unified their commercial activity under the Movistar brand: Spain, Venezuela, Mexico, Ecuador, Chile, Uruguay

Telefónica  
remains  
the global  
institutional  
brand

After its approval in 2009, Telefónica started the implementation process for its new brand strategy in 2011, which has been scheduled for completion by mid-2011<sup>1</sup>. In short, the new brand strategy establishes a role-based differentiation: on the one hand, Telefónica assumes an institutional brand approach, and leads the relationships with employees, shareholders, global customers, providers, institutional audiences, and society as a whole, and on the other, Movistar, O2, and Vivo are positioned as the commercial brands of the group and are the only ones that interact with customers in the residential and SME segments in each one of their reference markets.

## Brand strategy implementation

To carry out this change, three lines of work have been established:

**1. Evolution of brand positioning and identity**, changing the Telefónica's and Movistar's strategy and identity, so that they can assume the new roles defined for them.

**Telefónica's** new role as a brand, summarised in its vision "The Power to Transform", which has its reflection in a more solid visual identity,

<sup>1</sup> Since January 2011, through the date on which this annual report was concluded, the Movistar brand unification process was completed in Argentina, Peru and Colombia. Similarly, in Germany, the United Kingdom, Ireland, Slovakia, and the Czech Republic, the Telefónica brand replaced O2 as employer brand.

## Movistar Global brand rollout campaigns



2 global campaigns  
125 TV campaigns

with the purpose of strengthening the position and reach of the institutional role that corresponds to it. This brand vision represents the creative expression of Telefónica's vision: "making the possibilities enabled by the digital world come true, and leading this whole new movement".

**Movistar's** new role as single brand for particular and business customers in 13 countries has resulted in the need to reposition the brand through a brand concept ("Life is more when you share it"), a set of values and a visual identity

that will help to develop a positive differentiation against its competitors, strengthening its links with its customers and rearranging the product and service portfolio, adapting it to the brand's new architectural reality.

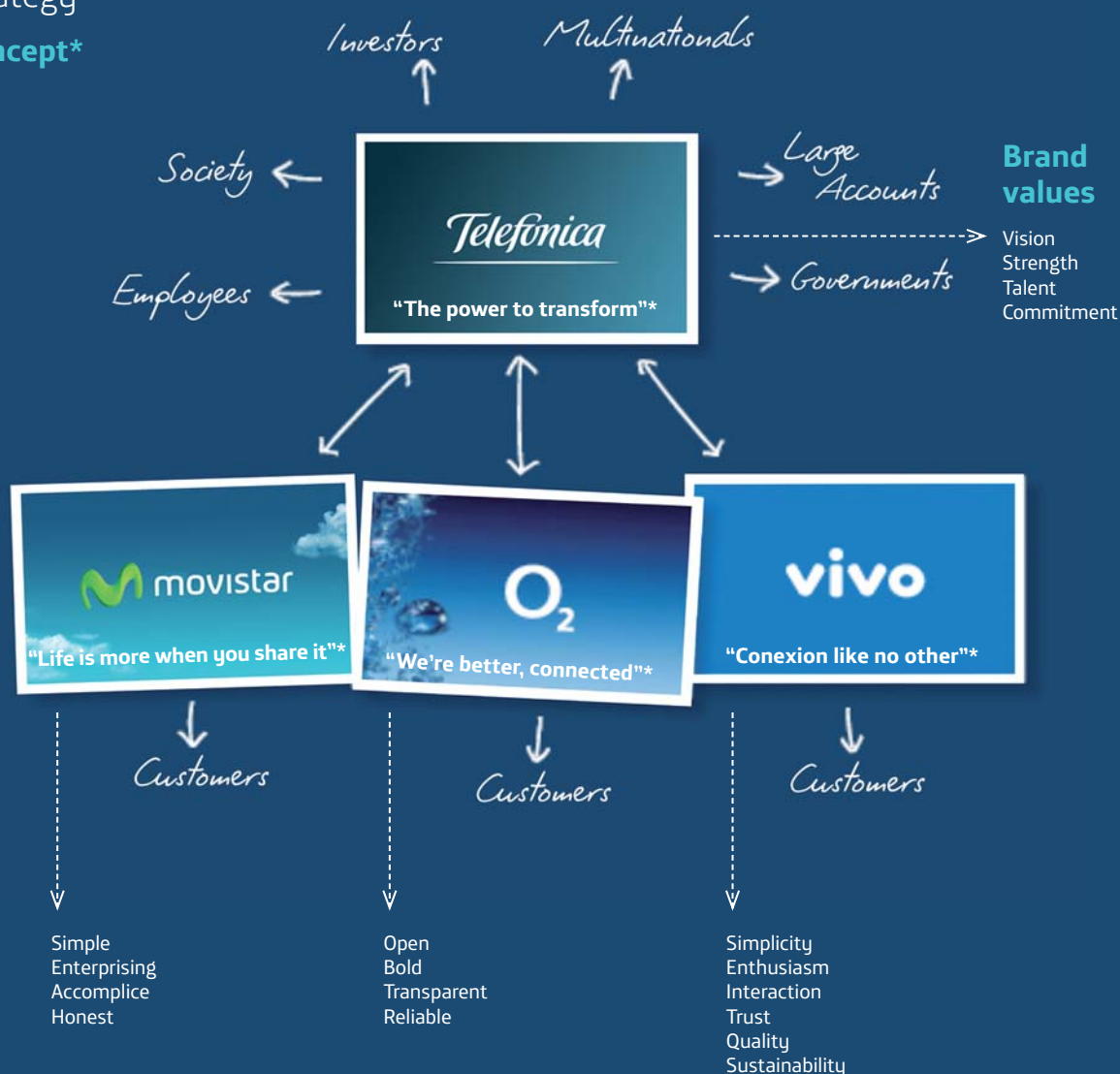
As regards **O2** and **Vivo**, they also remain as single brands for the residential and SME segments in their reference markets (Europe, and Brazil, respectively). While O2 maintains its current brand positioning and identity, throughout 2010 the Group developed Vivo's strategy to align its current positioning and

identity with its new role as a brand offering all our communications solutions in Brazil.

It is important to highlight that the commercial brands, Movistar, O2 and Vivo include the support and guarantee represented by Telefónica's brand, translated in their financial robustness, the talent of an organisation with over 285,000 employees, the fact of sharing a single business vision, and the capacity to fulfill the acquired commitments, especially as growth, economic and social driver.

## Telefónica's brand strategy

### Brand concept\*





## Movistar, O2 and Vivo are the reference brands in the markets

### Rebranding in figures

- 2 global campaigns, 25 weeks on air (launch + positioning)
- Nearly 125 TV campaigns launched with the new brand
- 500 communications briefs reviewed weekly by BG
- 5,000 stores rebranded
- 39 m invoices per cycle, with the new brand (postpaid + fixed customers)
- 10 rebranded Internet websites

2. The purpose of the commercial rebranding process has been to replace some brands with other ones (e.g.: to replace Telefónica's commercial brand with Movistar in some markets, or to adopt Telefónica as an institutional brand in the markets in which this role was being developed by Movistar or O2).

In May 2010, the rebranding process was launched in **Spain**, being the first one of the Group's countries to implement the new strategy. This project has required the joint collaboration of more than 25 areas of the Company, and has required the review of all customer experience related processes. Some of the most important processes have been the unification of all channels under a single customer experience; the integration of all call centres into a single, unified and free one; and the transfer of fidelisation programmes among all customers.

To raise customer awareness regarding the new brand architecture, two advertising campaigns were developed; one focused on informing that Telefónica's products were being integrated under the Movistar brand, and the other one to position Movistar under the brand concept "Life is more when you share it". The campaigns coincided with the rebranding of the most visible elements of the brand in the life of its customers: from stores to brochures through invoices and websites, including vehicles, buildings, products and services...

Different market studies show that consumers have understood Movistar's value proposal and that they regard positively its new positioning and identity, improving the efficiency of Company communications.

In **Latin America**, the rebranding process is being developed following a staggered process in the different markets, implementing the same actions as in Spain.

During the last quarter of 2010, Movistar's repositioning process was carried out in Mexico, Venezuela, Uruguay, Ecuador and Chile (a country where all fixed and mobile services had already been integrated under the Movistar brand in 2009).

In January 2011, Peru implemented the new Movistar in all its services. The rebranding process in the mobile businesses in Argentina, Colombia, El Salvador, Panama, Nicaragua, and Guatemala was scheduled for completion in April 2011; as well as the brand's rollout in Costa Rica.

To ensure the consistency of all Company communications, Telefónica is implementing a Brand Guardianship process in all its operations, a practice that had already been resorted to for the O2 brand. This process is new to most markets in Spain and Latin America, and entails making sure that all parts considered by the Company are aligned with the brand's strategy, both in identity and in positioning, supporting the construction of more solid brands in the mid-term.

### Movistar commercial campaigns



### 3. Creating the institutional brand.

Throughout 2010, Telefónica's new role was implemented in all Spanish and Latin America markets (except for Vivo), and Telefónica's assumption of this role before European employees has been scheduled throughout the first half of 2011.

To position Telefónica's institutional role before society, a communication strategy is being developed which includes advertising actions, the alignment of Fundación Telefónica's social initiatives under the Company's brand, or having personalities who have changed their field of activity act as brand ambassadors (Ferran Adrià has been the first one).

## Relevant Brands

As an institutional brand, Telefónica has received important accolades from some of its key stakeholders; including, but not limited to:

- **The most admired company in the telecommunications industry**, in accordance with the study published in 2011 by Fortune.

- Leading **sustainability company**, in accordance with the DJSI (2009 and 2010).
- **Best Place to Work** in different markets, as explained in the employee section of this same report.
- Integrated among the **DJ Titans 50** as one of the companies with greatest capitalisation at a global level.

Telefónica's commercial brands are also quite relevant in the different brand assessment studies published every year by prestigious publications. However, the main indicator of its success is the consideration and relevance with which our customers regard our brands, and the quality of our relationship with them (measured through the customer satisfaction indexes).

Movistar, O2 and Vivo are ranked best or second best regarded brands by customers in all countries in which we operate, except for the markets in which they rank in third position. Likewise, by supporting the Company's strategy to expand its services beyond connectivity, commercial brands are considered relevant for customers in health, finance, security, or content applications, to mention just a few.

## Brand recognition

### Mobile telephony

Country	Total mentions	
	Percentage	Ranking
Spain	90	1
Chile	93	1
Peru	80	2
Argentina	92	1
Mexico	96	2
Uruguay	99	1
El Salvador	97	1
Guatemala	98	1
Nicaragua	99	1
Venezuela	99	1
Colombia	88	1
Ecuador	100	1
Panama	100	1
Ireland	96	2
Slovakia	89	3
Czech Republic	91	2
England	74	2
Germany	67	2

### Fixed telephony

Country	Total mentions	
	Percentage	Ranking
Spain (Telefónica + Movistar)	97	1
Chile (Movistar)	78	2
Peru	86	1
Brazil	70	1
Argentina (Broadband)	97	1
Colombia	61	1

Source: Millward Brown

## A portfolio of relevant brands



## ...provided by innovation...

In 2010, Telefónica invested 4.814 billion euros in Technological Innovation, of which, about 797 were directly allocated to R&D (representing a 15% increase as compared with 2009)

In 2010  
Telefónica  
created a new  
organisation  
with 7 vertical  
digital service  
businesses







During 2010, Telefónica transformed its Innovation model in order to adjust it better to the vision of leading the new digital environment. This transformation has been executed through the following lines of work:

### "Open Innovation" model

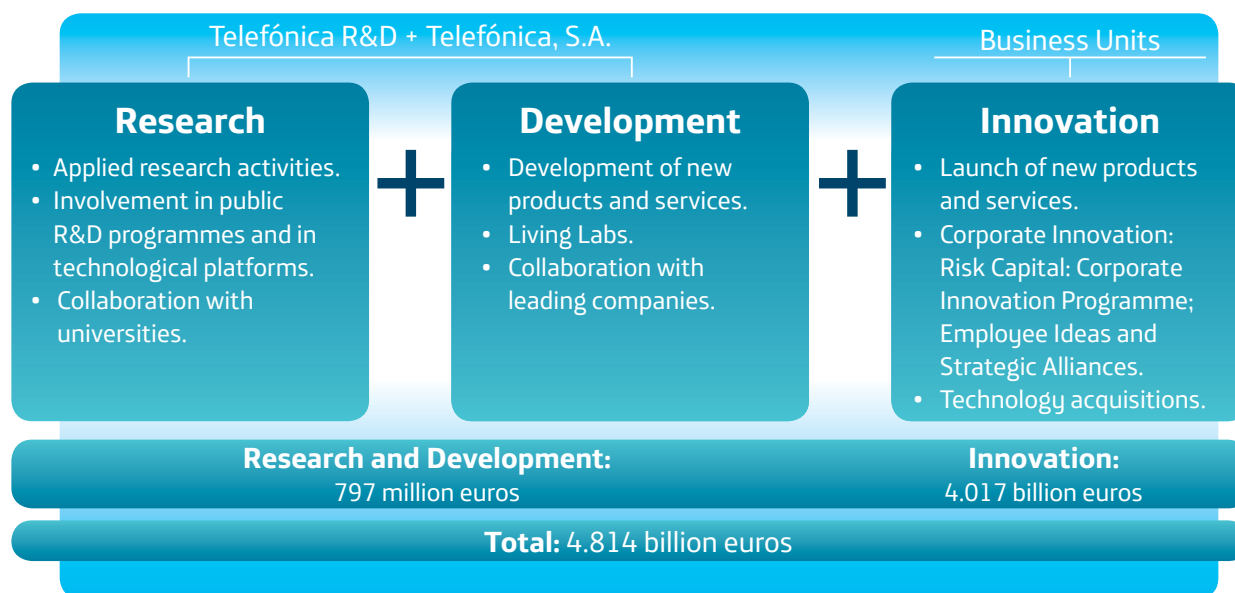
Its purpose is to develop new solutions in collaboration with third parties, digging deeper into a line of work that began in previous years. The following initiatives were the most remarkable ones:

- attracting customers to innovation processes such as LivingLabs (user experience in the development stages);
- collaborating with universities, either in projects, or through Telefónica's Professorships;
- taking part in technological programmes and platforms aimed at promoting entrepreneurial R&D at a domestic and international level;
- innovating in collaboration with each industry's leading companies;
- and taking part in Campus Party, a forum that aimed to gather restless and talented youth with the development of software and technological talent.
- opening company platforms to collaboration with third parties (BlueVia initiative);
- providing support to technology companies through MovilForum or Telefónica's risk capital fund;

### 7 vertical businesses

	Video & DH	IPTV, Videoclub, HD, Social features, Telepresence, CDN
	Apps	BlueVia, Wac X.O, App Folder, eBooks, O2 Media, RCS
	Financial Services	Handset insurance, Merchant payments & NFC, Direct to bill, m-pass, Cobranded cards
	eHealth	Movistar eHealth, Health CRM, Tele rehabilitation, Imaging, Mobile baby, Chronic management
	Security	Clean pipes, Anti fraud, Managed security, Mobile security, Data loss prevention, Identity management
	M2M	Managed connectivity, Managed devices, Asset management, Utilities, Connected car, Smart cities
	Cloud	Aplicateca, Terabox/3G, Virtual DC, Virtual Desktop

## Telefónica's investment in technological innovation



## Global innovation with a regional focus: 7 vertical businesses

During 2010, Telefónica created a new organisation with seven vertical businesses of global digital services which provide services to the different operators of the Group. Their purpose is to leverage economies of scale and adapt global developments to regional needs. The 7 vertical businesses are listed in the appended table.

## Technological Innovation R&D+I

In 2010, Telefónica assigned 4.814 billion euros to Technological Innovation, 797 of which was directly invested in R&D efforts (representing a 15% increase, compared to 2009). Telefónica R&D is responsible for the majority of applied research activities, aimed at obtaining first versions of products; the remainder, more than 80%, has been channeled through collaborating entities, to give form to one of the largest innovation networks in the worldwide ICT industry.

The R&D activities carried out during 2010 have focused on:

- future communications between individuals in a natural manner, leveraging the possibilities enabled by the Internet, Web 2.0 technologies and smartphones;
- video and multimedia services (combination of text, audio, imaging and video) with a user experience in all connected devices;
- advanced solutions in emerging ICT businesses, such as remote-health, surveillance and support platforms, and remote support for and monitoring of patients;
- machine to machine (M2M) service management, related with energy efficiency and people's mobility concepts;
- cloud computing, which make intensive use of the resources available on the web to publish, market, and distribute applications;

- analysis of user profiles, based on their use of communications, providing opportunities for services and business models (marketing campaigns, targeted advertising and personalised contextual services, turnover reduction, cross-sales, etc.);
- and evolution of the network and services into a new global infrastructure, shared by all business lines, to cut operating and maintenance costs, offering increased capabilities, contents, and the evolution of the Internet of people towards the Internet of things (intelligent spaces in homes, cars, cities, etc.).

## Innovation is a key tool to achieve growth objective

### Practical Innovation Projects in Telefónica:

The following projects were highlights during 2010:

#### Investment and funding projects

The year's highlights were the corporate venture capital programme, aimed at acquiring minority interests in innovative companies with capacities (products, services, technology) in new and adjacent business areas; and the incubation programme, aimed at developing new potentially marketable business ideas, with a relevant innovation and technology component.

#### "Disruptive Council"

Debate forum where disruptive technologies and business models, capable of changing the digital world as a whole and our industry in particular, are debated over.

#### Innovation Camp

3-day innovation camp for employees, launched by Telefónica Germany. Employees identified hundreds of ideas which were filtered by a jury of Telefónica managers; the four selected ideas have been budgeted, so that they can become a reality.

#### "Agile community"

Community of agile methodology users, provided with an Agile experience, information and knowledge exchange portal, to which all Telefónica employees are granted access.

#### Customer Experience Design (User-informed product design)

This initiative allows users to be part of the innovation, conceptualisation, and development process for new products and services, through research methods and immersion practices. Thanks to user assessments, the innovation is "customised" and new uses and ideas are generated.

#### Telefónica's Intellectual Property Management

In 2008, a patent department was created at Telefónica R&D, which is devoted to raise awareness among project managers, regarding the need to protect developments and to generate adequate standardisation methods and procedures, which allow to appropriately and timely register knowledge in patent offices. As a result of this initiative, a protected patent and product portfolio has been developed, which will allow to create value and to develop return-on-investment policies, by marketing and licensing these assets.



### Campus Party

Launched in 1997, since 2001 Telefónica has been its main sponsor. It is considered to be the largest technology, entertainment, and cultural event in the world.

Currently, Campus Party organises, besides the annual Spanish edition in Valencia, international editions in Brazil, Colombia, Mexico and El Salvador.

Other initiatives in 2010 were: Campus Party Labs (consolidating its expansion in Latin America); Campus Party Europe (with the 800 most promising minds of the EU) and "Campuses Invent and Launch" (where campus attendees present their prototypes and have chances of being awarded to register patents, protect intellectual property, and have access to marketing channels).





## Ferran Adrià

Telefónica and chef Ferran Adrià have embarked on a four-year joint project, based on the common idea that it is possible to “transform opportunities into reality” through innovation, creativity and new technologies. Within the scope of this initiative creative training courses will be organised, as well as manager and customer encounters, conferences with a special focus on innovative and technological issues. These events will take place in some of the greatest cities of the world: Miami, New York, London, Buenos Aires, Berlin, Mexico, Madrid and Barcelona, to name but a few.

The purpose is to foster the values shared with the Company: vision, passion, talent and commitment.

One of the first results to come out of this collaborative effort has been the “La cocina

en su tinta” (cuisine in its own sauce) exhibition, in the National Library, showcasing digital and interactive versions of the library's collection on gastronomy.

Likewise, Telefónica signed an alliance with Adrià to turn his restaurant, “El Bulli”, considered the best restaurant in the world between 2004 and 2009, and which will re-open in 2014, into the best creative and innovation laboratory in the world. “El Bulli” will become an international benchmark and a source of inspiration for creativity and innovation.

Through these actions, Telefónica will strengthen its brand image in strategic markets, and its relationship with key audiences. Adrià will therefore become the best ambassador for Telefónica's brand at a worldwide level.



## BlueVia

In February 2011, Telefónica launched a developer community, under the BlueVia moniker ([www.bluevia.com](http://www.bluevia.com)), which will operate in all regions where Telefónica is present.

BlueVia is an open collaboration community, whose purpose is to gather the current creative talent of the community and to provide it with the required tools, infrastructure, and platform - including API access (application programming interface), as well as with the ideas and data, to help developers identify and satisfy market demands.

With BlueVia, Telefónica becomes the first operator in the world to offer between 10% and 50% of the revenue generated by API transactions to the developers, and in addition developers retain 70% of any application sales and subscription revenue.

Developers will be able to market their ideas in countries all over the world, and to earn a portion of the revenue generated by the traffic they create through their innovative applications.



## Wayra

In early 2011, Telefónica launched Wayra, an accelerator for entrepreneurship projects based on ICT. Wayra will help talented entrepreneurs to accelerate their projects, using, also, the best mentor network in the industry, and the financial support through an innovation funding network for Latin America and Spain. A support initiative that includes three large areas: infrastructure, management support and an appropriate working environment.

For any business idea, solution, design or project which solves a need in any one of the areas of technology, or communications

services, or in any other service of the digital world in a web environment or mobile support, Wayra offers the support required to make it come true.

They analyse the proposals received, based on three assessment approaches: Innovative and disruptive nature, technological novelty and opportunity appeal.

Wayra represents an unprecedented initiative in Latin America, intended to make a difference in the economies of the countries in which it operates.

# ...improvement of operating efficiency.

Transform to become more  
Competitive and Efficient

The Company  
increased  
coverage for 3G  
networks to 63%  
and IP capacity  
by 40%

In 2010, Telefónica maintained its leadership in growth and efficiency in the sector.

Active management of efficiency is one of the most important challenges from an operational and strategic perspective: being able to offer the maximum possibilities for growth with the highest profitability.

Our global technological networks, with all-IP, global systems and Information Technology (IT) at the service of the business, and processes that are increasingly more effective and on-line, make our company the premier global telecommunications carrier in the digital era.

The best network  
in every market

Telefónica considers the network to be the key element in building its business proposal aimed at enhancing and harnessing growth in the sector. In this regard, Broadband (fixed and mobile) is still the main source of growth and as such, is a key source of revenues.

In 2010 Telefónica continued its work of streamlining the architecture and design of the new networks in accordance with this focus. As a result, this year the company increased the coverage of its 3G networks to 63% and the capacity of its IP network by 40%.

## Energy Efficiency in Networks

In 2007, Telefónica pledged to reduce by 30% the electricity consumption of our networks (measured in KWh per equivalent access) in 2015. In 2010 we have reached a reduction of around 14%.

This is due to two main factors: firstly, to the more than 40 efficiency energy projects developed in 2010; and secondly, to the consolidation of the management and government projects including the specific energy manager in each one of our companies. The best practices of energy efficiency and use of renewable energy in our networks were shared during

the First Global Energy Efficiency Workshop which took place in 2010 and which had over 300 participants.

In 2010 our electricity consumption reached around 6.38 TWh<sup>1</sup> and, thanks to the different activities we undertook in energy efficiency, we could reduce as much as 1.2% of the total electricity consumption<sup>2</sup>. Now, the challenge is to maintain the highest energy efficiency standards in our increasing network. It is worth mentioning that the incorporation of the Brazilian mobile Telco Vivo to the group in 2010 has brought a 22% increase in electricity consumption in comparison to 2009. It is our role to ensure a sustainable growth of our business, and in 2011 we will continue working in this direction, reducing our energy consumption and our CO<sub>2</sub> emissions.



<sup>1</sup> Total network and office electricity consumption (from energy data in verification process).

<sup>2</sup> Calculation based on energy efficiency projects developed by fixed and mobile operations.

The **priority lines of work in networks and technology** are as follows:

- Integrating customer's vision of fixed and mobile services from a technological perspective, by offering the best connectivity in all environments.
- Guaranteeing the offering in terms of service (speed, robustness of service, etc.) to make quality of service one of the main elements that set us apart.
- Standardising its network model to take advantage of economies of scale in purchasing equipment and contracting services.
- Sharing network infrastructure with other competitors and outsourcing processes, where these are not elements which set the company apart.
- Reinforcing automation in networks and optimising roll-out needs and resources devoted to maintenance.
- Implementing in our networks the best technology available with the highest standards of energy efficiency, using clean technologies and renewable energy.

The company's most recent initiatives in this area include: the **launch in Germany of the network pilot based on Long Term Evolution (LTE) technology**, with faster downloading; obtaining a higher spectrum capacity in Germany, Brazil and Mexico; and setting up various network-sharing agreements in various countries (Spain, United Kingdom and Germany).

## Information Technology (IT)

The aim of Telefónica's Information Technology (IT) division is to meet the requirements of the Business Units in terms of growth (net additions, retention, market share, etc.), efficiency (cost, time and quality) and quality/ sustainability of the solutions offered (development time, cost, operational impact, etc.). With this aim in mind, a **homogeneous system management model** was developed in 2010, with the following essential parts:

- Consolidating and optimising its Data Centres, equipping them with common technical architecture and management processes.
- Providing employees with better tools (common hardware and software) and exploiting scale to combine functionality and efficiency.
- Global applications, when globalisation adds value.

As an instrument for managing this model, a new IT company was created in 2009 to provide comprehensive IT services to the carriers in the Group. In 2010 the roll-out process continued, with operations opening in Madrid and Buenos Aires.

This transformation has materialised in an improvement of Telefónica's competitive capacity. Therefore, 2010 saw an 18% reduction in the time to market for new products and services.



Details of Telefónica's "mstore" (on-line store).

## Evolving towards the on-line company

In 2010, Telefónica continued to work on becoming an entirely *on-line company*, as an instrument for increasing agility and transparency. Its aim for 2009 to 2013 is to almost quadruple the percentage of customer transactions that are carried out electronically and increase the percentage of electronic negotiations carried out in the purchase processes.

## Towards the consolidation of Telefónica Global Services (TGS)

Since 2010, TGS (the company founded by Telefónica in Munich to carry out global management of purchases) has incorporated purchases of the Services, Works, Advertising and Marketing product ranges which have been added to those of Network Infrastructure, Information Systems and Market Products.

Its aims are to leverage synergies in purchases by concentrating supply and promoting global purchase synergies with its partners: China Unicom and Telecom Italia, and to streamline negotiation with suppliers, which will lead to better management (operational efficiency) and cost savings.

## ...a strong range of strategic alliances...

The boost from alliances reinforces Telefónica's leading position

Telefónica and its allies, China Unicom and Telecom Italia, have a combined customer base of over 730 million customers

### Strengthening alliances

The strategic alliances have enabled Telefónica to strengthen its leadership position, being recognised in 2010 as the most admired telecommunications company in the world.

During 2010, the strategic alliances signed by the Group were given a significant boost once again, thanks to the management of the unit created within Telefónica S.A. with the fundamental mission of optimising the management of these alliances according to a common perspective and leadership.

### China Unicom Shareholding of approximately 9.7%\*, once the agreement is completed

Telefónica has had a permanent presence in China since 2005, when Telefónica entered into a strategic alliance with the fixed carrier China Netcom Corp and acquired a 5% holding in its share capital.

In May 2008, the Chinese Government announced its intention to carry out a broad-ranging restructuring operation of the telecommunications sector. As a result of this, China Netcom Corp. merged in October 2008 with the mobile carrier China Unicom, giving rise to the fourth largest group worldwide in terms of the number of customers. On that date, César Alierta, Executive Chairman of Telefónica S.A. was elected as a member of the Board of Directors of China Unicom.

In January 2009, during the State Visit of the Chinese Premier Wen Jiabao to Spain, and in his presence of the latter and that of the President of the Spanish Government, the Executive Chairmen of Telefónica, César Alierta, and of China Unicom, Chang Xiaobing, signed a first Framework Agreement for Cooperation.

As a result of the close ties between the two companies, on 6<sup>th</sup> September 2009, **Telefónica and China Unicom announced a broad-ranging Strategic Alliance and a Share Exchange Agreement to the value of 1 billion US dollars.**

This alliance by Telefónica was given wide coverage in the international press and media, as it was the first time that a Chinese telecommunications company had acquired a holding in a foreign company.

Shortly after this agreement was signed, on 25<sup>th</sup> September 2009 China Unicom announced an agreement with the Korean operator SKT to acquire and subsequently cancel the shares it held in China Unicom. At the same time it ended its strategic alliance with this carrier.

As a result of both operations, Telefónica increased its holding in China Unicom to 8.37% of its capital, consolidating its position as the largest foreign shareholder, while China Unicom's holding in Telefónica amounted to approximately 0.9%.

In addition to these corporate transactions, both companies have been developing the Strategic Alliances resulting in major advances in technology, joint purchasing, joint provision of services to multinationals, roaming and joint training for managers in both companies.

In furtherance of the already existing strategic alliance, on January 23, 2011, Telefónica and China Unicom have agreed to enhance their Strategic Alliance, and to deepen their cooperation in areas such as procurement, mobile service platforms, services to MNCs, wholesale carriers, roaming, technology, among others, where both companies have been cooperating since the signature of their Strategic Alliance Agreement in September 2009.

Additionally, Telefónica and China Unicom have strengthened their Strategic Alliance with a new mutual investment pursuant to which the parties agreed to increase their respective stakes by acquiring the equivalent of US\$500 million in the other party through the purchase of each party's shares.

Following the completion of this additional mutual investment, Telefónica will have increased its shareholdings in China Unicom to around 9.7%\* once the agreement has been completed, whereas China Unicom's stake in Telefónica will increase to 1.37%.

Furthermore, the Board of Directors of Telefónica will propose at the next General Shareholders' Meeting the appointment of a new member of the Board of Directors representing China Unicom.

## Telecom Italia Indirect shareholding of 10.49%<sup>1</sup>

In October 2007, Telefónica joined a group of Italian institutions (Generali, Mediobanca, Intesa Sanpaolo and Benetton) to form the Telco consortium with the aim of acquiring a significant package of ordinary shares in Telecom Italia.

This investment has enabled the Group to become the majority shareholder in the aforementioned consortium and to lay the groundwork for the development of a significant programme of operational synergies with



From left to right: Fan Di'an, President of the National Art Museum of China (NAMOC); César Alierta, Executive Chairman of Telefónica; and Chang Xiaobing, Chairman of China Unicom.

a view to enhancing the mutual scale of both Companies by implementing the best commercial and operational practices.

In October last year, Telefónica and its partners Generali, Mediobanca and Itensa San Paolo agreed to renew the shareholders' agreement to extend the agreements already in place for an additional period of three years until April 2013. As a consequence of Sintonía's separation at its own request, Telco acquired control of 22.45% of the ordinary shares of Telecom Italia, thereby giving Telefónica (which owns 46.2% of the company shares) an indirect holding of 10.49% of the ordinary share capital of Telecom Italia.

In the framework of the industrial alliance with Telecom Italia, the announced 2008-2010 plan was completed at the end of 2010, achieving the objective of 1.3 billion euros in operational synergies.

Telecom Italia is the largest alliance in Europe with its 62.2 million customers and its presence in eight European countries.

<sup>1</sup> Telefónica owns an indirect shareholding of approximately 10.49% in the ordinary share capital (with voting rights) of Telecom Italia through Telco. If we add Italian preference shares (azioni di risparmio), which do not have voting rights, the indirect shareholding of Telefónica in Telecom Italia is 7.21%.

\* The real percentage depends on CU's share price when acquiring shares.



# ...leadership in corporate sustainability...

Telefónica, number 1 in the DJSI in the Telco sector for the second consecutive year

The only  
Spanish company  
considered  
“Global  
Supersector  
Leader”

Telefónica is, for the second consecutive year, the leading company in the global telecommunications sector for sustainability, leading the Dow Jones Sustainability Index (DJSI). In its annual revision, the rating agency evaluating the management of company sustainability - Sustainable Asset Management (SAM) - considering financial, environmental and social issues, has rated us with a score of 84 out of 100, which means 26 percentage points more than the average of the sector.

For DJSI, “**Corporate Sustainability is a business approach pursuing to create long-term value for shareholders by taking advantage of opportunities and effective management of the risks inherent to financial, environmental, and social development**”.



Seven key issues of our leadership should be highlighted where we have been recognised as the company with the best practices: risk and crisis management; suppliers; environmental policies; development of human resources; impact of telecommunication services; social action and commitment with interest groups, or stakeholders engagement.

Telefónica is part of this index, one of the most demanding worldwide, for over seven years, and serves as a guide to see our progress and identify improvement issues.

## Economic dimension (83 points)

In this section we have received a rating of 83 points, which means 23 percentage points more than the average in the sector. In this block the index comprises issues related to managing relations with customers; privacy; risk management; corporate administration; business and anticorruption principles, brand management and, new to this edition, innovation management.

The DJSI highlights our effort to ensure integrity through in-house rules and training our staff on business principles, the improvement of our processes to increase customer satisfaction; brand strategy; and consolidation in all countries where we operate of a single risk management model, including sustainability issues.

In the innovation section, we have created a unit to grow with digital services in *eHealth*, Financial Services, Machine to Machine (M2M), Cloud Services, Security, Applications, and Video, and Contents. We have also started to work in environmental and social innovation.

## Environmental dimension (73 points)

In issues related to the environment, the DJSI gives Telefónica a rating of 73 points, 21 points above the average. This area covers issues such as environmental policies, eco-efficiency, environmental information and climate change.



Our main improvement this year, where we achieved the highest score of the sector, was environmental management, thanks to our Global Environmental Management System, and the new ISO 14001 certifications. On the other hand, we have reached half of the goal set for 2015 - reducing energy consumption by 30% in our networks. And we continue helping other sectors to improve energy efficiency, through immotic products and services, telepresence, *virtual hosting*.

## Social dimension (90 points)

Telefónica has achieved 90 points in this area, the highest rating of the sector, 32 points above the average, considering the rating of labour markers; performance in human resources development matters; talent retention; digital inclusion; impact of telecommunication services; social action; social information; commitment with interest groups (stakeholders engagement), responsibility in the supply chain and, for the first time this year, health and occupational safety.

The main contribution to this result come from the initiatives aimed at reducing the digital gap, the evaluation of providers to assure a reliable supply chain and Fundación Telefónica programmes, particularly Proniño. The improved development of human resources must also be highlighted, with the highest score in the industry. The effort of our Company in this field involved investing in training and a Global Share Purchase Plan to recognise the commitment of our professionals.

With regard to stakeholders engagement, Telefónica is committed to social networks and dialogue about the impact of ICT in public agenda matters, such as health, education, productivity and energy efficiency.

The DJSI also highlights our positive progression on reporting matters thanks to the new scheme developed for our CR report in order to build a consistent global framework for all companies and sectors.

### World Leaders by Sector DJSI World, GLOBAL SUPERSECTOR LEADERS (2010/2011)

Name	Supersector	Country
Bayerische Motoren Werke AG (BMW)	Automotion & Accessories	Germany
Australia & New Zealand Banking Group Ltd	Banking	Australia
Xstrata PLC Basic	Raw materials	United Kingdom
AkzoNobel	Chemistry	Netherlands
Siam Cement	Bulding & Materials	Thailand
Itausa-Investimentos Itau	Financial Services	Brazil
Unilever	Food & Drink	Netherlands
Roche Holding AG	Health	Switzerland
TNT N.V.	Industrial Goods & Services	Netherlands
Swiss Re	Insurance	Switzerland
Pearson Plc.	Average	United Kingdom
Sasol	Petrol & Gas	South Korea
Philips Electronics	Personal and home articles	Netherlands
GPT Group	Fixed assets	Australia
Lotte Shopping	Retail	South Korea
Nokia Corp.	Technology	Finland
Telefónica, S.A.	Telecommunications	Spain
Air France KLM	Travel & Leisure	France
EDP Energías de Portugal	Utilitie	Portugal

Source: [http://www.sustainability-index.com/07\\_html/indexes/djsiworld\\_supersectorleaders\\_10.html](http://www.sustainability-index.com/07_html/indexes/djsiworld_supersectorleaders_10.html)

## The most admired “teleco” in the world, according to “Fortune”

**FORTUNE**

Telefónica leads the most admired telecommunications company ranking in 2011, according to the list “The World’s Most Admired Companies” drawn up by the magazine Fortune.

It is the first time that the Company has achieved this position in a ranking published for over 13 years, which includes 350 companies from 57 sectors.

With an average of 7.01 points, we moved from fourth position in 2010 and overtook Verizon, which achieved second position with 6.74, and AT&T, which finished third, with 6.56 points. The top 5 was completed by the Mexican company América Móvil and the British company Vodafone.

Of the nine parameters evaluated to rate prestige, in Telefónica we obtained the first position of five: Innovation, use of corporate assets, corporate responsibility, long-term investment, and global competition. Additionally, we are among the first three companies in the sector in other attributes: human resources management, excellence in management, financial robustness, and quality of products and services.





Strength

“

*'Telefónica's vision is to make the possibilities offered by this new digital world real, and to be one of the leaders in this area', says the Executive Chairman, César Alierta, in his letter to shareholders.*

*Telefónica has a suitable structure in order to make the most of synergies as a global company that is already present in 25 countries. Its Board of Directors, its Management Team and its more than 285,000 Professionals guarantee the good government and management of the Company and the performance of the work plans included in the bravo! programme (strategic plan for 2010-2012).*

*In 2010, Telefónica, driven by the acquisition of the Brazilian operator Vivo, increased the scale of its operations, once again obtaining solid results, and fulfilling the commitments made in the market. Progress was possible thanks to improvements in customer experience, based on a new brand strategy; to the promotion provided by innovation in order to capture the opportunities for growth provided by the digital market; and to the improvement of operating efficiency. All this, together with a strong range of strategic alliances and our leadership in corporate sustainability, has made Telefónica the most admired company in the telecommunications industry in 2010.*

*The 2010 **results** demonstrate Telefónica's strength and its capacity to generate trust in the markets with a sensible **risk management** policy.*

”

# The 2010 results

demonstrate Telefónica's strength...

## Financial Highlights

Euros of  
Net Income  
rose to  
10,167 million

- **In 2010, Telefónica Group delivered solid results, reflected in the strong top line growth (+7.1% year-on-year) and the high cash flow generation.**
- **The increased commercial activity during the year drove the total number of accesses to over 287 million at the year end (+7.2% year-on-year in organic terms):**
  - Total gross additions increased by 13.3% year-on-year, while the churn rate remained stable.
  - The focus on expanding the customer base and increasing the value of customers led to a solid advance in mobile broadband accesses (+63.9% year-on-year), which now account for 10.1% of the Group's mobile accesses, and retail fixed broadband accesses (+10.9% in organic terms).
  - The positive trend in the contract segment (+15.9% year-on-year in organic terms) boosted growth in mobile accesses (+8.9% year-on-year in organic terms). 53% of net additions in 2010 were in the contract segment, which already accounts for 31% of total mobile accesses.
- **Consolidated revenue for 2010 stood at 60,737 million euros (+7.1% year-on-year), leveraging the high diversification of the Group:**
  - Fourth quarter revenues were up 9.9% year-on-year, driven by the growing contribution from Latin America as a result of the strong performance of operations and the higher exposure to Brazil.
  - Telefónica Latinoamérica and Telefónica Europe reported solid revenue growth, accounting together for 68% of consolidated revenue for 2010.
  - Mobile data revenue rose sharply, to close to 9,300 million euros, posting a 19.3% year-on-year increase in organic terms.
  - Revenues were up 2.4% in organic terms, pushed by Telefónica Latinoamérica and Telefónica Europe, which contributed with 2.7 percentage points and 1.0 percentage points, respectively, to revenue growth, offsetting the lower contribution from Telefónica España (-1.6 percentage points).
- **Operating income before depreciation and amortization (OIBDA) stood at 25,777 million euros in 2010, posting a 14.0% year-on-year growth. Operating efficiency levels remain a sector benchmark:**
  - OIBDA was affected by the positive contribution from the revaluation of the previously-held stake in Vivo at the date of acquisition of the 50% in Brasilcel owned by Portugal Telecom (3,797 million euros in the third quarter). On the other hand, the Group recognised non-recurrent restructuring expenses of 1,262 million euros in 2010 (1,060 million euros in the fourth quarter), mainly related to personnel reorganization and firm commitments relating to the Telefónica Foundation's social activities. Excluding both impacts, consolidated OIBDA margin would reach 38.3% in 2010.

- In organic terms, which exclude the non-recurrent items mentioned above, OIBDA was up 0.8% year-on-year in 2010. The OIBDA margin remained virtually stable compared to 2009, despite the higher commercial activity registered during the year.
- **Net income amounted to 10,167 million euros, up 30.8% on 2009**, positively affected by the net impact of non-recurrent items totalling 2,164 million euros (revaluation of the stake in Vivo, restructuring expenses and reassessment of the tax assets in Colombia).
- **Telefónica Group's operating cash flow (OIBDA-CapEx) amounted to 14,933 million euros in 2010 (-2.7% year-on-year in reported terms):**
  - In organic terms which exclude spectrum acquisitions, operating cash flow dropped 1.7%, despite growth in Telefónica Latinoamérica (+6.9% year-on-year organic) and Telefónica Europe (+16.6% year-on-year in comparable terms).
- **Telefónica has met its guidance for eight years in a row.** Under the criteria applied for 2010 guidance:
  - Revenues were up 3.8%, in the high end of the range announced (1.0% - 4.0%).
  - OIBDA increased by 1.4%, within the forecast range of 1.0% - 3.0%.
  - CapEx, excluding spectrum, totalled 7,646 million euros, in line with the target of 7,450-7,650 million euros.
  - EPS stood at 2.25 euros, above the target of 2.10 euros.
- **The Group maintains its financial strenght, with a ratio of net debt + commitments to OIBDA of 2.5 times at year end.**
- **The Company announces its guidance for 2011, which reflect a strategy focused on capturing the growth in its markets while maintaining a high level of profitability. Telefónica forecasts:**
  - Revenue growth up to 2%.
  - An OIBDA margin in the upper 30s, with a limited erosion year-on-year.
  - CapEx of approximately 9 billion euros.
- **2010 Bases for Telefónica's 2011 financial targets:**
  - Consolidated revenues: 63,144 million euros.
  - OIBDA margin 38.0%.
  - Consolidated CapEx: 8,541 million euros.
- **The solid cash flow generation perspectives for 2011 allow the Company to propose the distribution of a dividend of 1.6 euros per share. This represents a 14.3% increase compared to the 2010 dividend. The proposal confirms Telefónica's commitment to prioritize shareholder remuneration in the use of cash and to gradually increase dividends per share. The Company reiterates its target of distributing a minimum dividend of 1.75 per share in 2012.**

**Organic growth:** In financial terms, it assumes constant exchange rates as of 2009 (average fx), excludes changes in the perimeter of consolidation (HanseNet since mid February 2010, Jajah in January-December 2010, Telyco Marruecos in January-December 2009, and Manx Telecom in July-December 2009) and includes 100% of Vivo since October in 2009 and 2010 and Tuenti in August-December 09. OIBDA and OI figures do not include the impact of capital gains (Manx Telecom in Q2 2010, Medi Telecom in Q4 2009 and the revaluation of our pre-existing stake in Vivo at the date of the acquisition of the 50% in Brasilcel owned by Portugal Telecom in Q3 2010), non-recurrent restructuring expenses, mainly related to personnel reorganization and firm commitments relating to the Telefónica Foundation's social activities, recorded in the second half of the year. CapEx excludes the spectrum acquisition in Germany in Q2 2010 and in Mexico in H2 2010. Figures exclude hyperinflationary accounting in Venezuela in both years. In terms of accesses, HanseNet, Medi Telecom (following its disposal in the fourth quarter of 2009), and Manx Telecom as of July 2010 are excluded. At the same time, organic net additions exclude accesses disconnections made in the second quarter of 2010.

**Comparable growth in T. Europe:** In financial terms, Organic growth: (financial figures in million euros) in financial terms, assumes constant exchange rates (average of January-December 2009) and excludes HanseNet and Jajah contributions, included in Telefónica Europe's consolidation perimeter from mid-February 2010 and January 1st, 2010, respectively. Manx Telecom results in the July-December of 2009 are excluded. OIBDA also excludes capital gain from the sale of Manx Telecom in the second quarter of 2010 and non recurrent restructuring expenses mainly related to personnel reorganization in the second half of the year of 2010 and CapEx excludes the acquisition of spectrum in Germany in May, 2010. In addition, the following non-recurrent effects are excluded: restructuring expenses, ii) Universal Service Obligation in the Czech Republic, iii) real estate gains in the Czech Republic, and iv) the proceeds from the settlement agreement with T-Mobile in the Czech Republic in 2009.

In access terms, comparisons exclude HanseNet and Manx Telecom. Net additions also exclude the disconnection of inactive mobile contract customers in the Czech Republic in the second quarter of 2010.

**Guidance criteria 2010:** 2009 adjusted figures for guidance exclude Telyco Marruecos results in T. España, Medi Telecom capital gain and write-offs. 2010 guidance assumes constant exchange rates as of 2009 (average FX in 2009) and excludes hyperinflationary accounting in Venezuela in both years. It includes 100% of Vivo since October, both 2009 and 2010, and it also includes the consolidation of HanseNet and Jajah in T. Europe. In terms of guidance calculation, OIBDA excludes non-recurrent restructuring expenses, mainly derived from personnel reorganization and firm commitments relating to the Telefónica Foundation's social activities. OIBDA also excludes the capital gain from the revaluation of our pre-existing stake in Vivo. Group CapEx includes 50% of Vivo in the fourth quarter 2009 and excludes Real Estate Efficiency Program of T. España and spectrum licenses.

**Guidance criteria 2011:** 2010 adjusted figures for guidance include full consolidation of Vivo, Hansenet and Tuenti in the whole year (12 months) and excludes Manx Telecom's results in January-June 2010. 2010 adjusted OIBDA excludes the capital gain from the revaluation of Telefónica's pre-existing stake in Vivo at the date of the acquisition of the 50% in Brasilcel owned by Portugal Telecom, non-recurrent restructuring expenses registered in the second half of 2010, and the capital gain derived from the disposal of Manx Telecom.

2011 guidance assumes constant exchange rates as of 2010 (average FX in 2010) and excludes hyperinflationary accounting in Venezuela in both years. At the OIBDA level guidance for 2011 excludes write-offs (impairments of subsidiaries), capital gains/losses from companies disposals and significant exceptionals mainly related with restructuring costs. Results from the operation in Costa Rica are excluded from guidance calculation. Group CapEx excludes Real Estate Efficiency Program of T. España, the Real State commitments associated to the new Telefónica premises in Barcelona and spectrum licenses.

## Telefónica Group Selected Financial Data

	January -December		% Chg		
	2010	2009	Reported	Organic	Guidance Criteria
Unaudited figures (Euros in millions)					
Revenues	60,737	56,731	7.1	2.4	3.8
Telefónica España	18,711	19,703	(5.0)	(4.8)	
Telefónica Latinoamérica	26,041	22,983	13.3	6.7	
Telefónica Europe	15,255	13,533	12.7	4.4	
OIBDA	25,777	22,603	14.0	0.8	1.4
Telefónica España	8,520	9,757	(12.7)	(8.5)	
Telefónica Latinoamérica	13,782	9,143	50.7	9.1	
Telefónica Europe	4,014	3,910	2.6	3.8	
OIBDA margin	42.4%	39.8%	2.6 p.p.	(0.6 p.p.)	
Telefónica España	45.5%	49.5%	(4.0 p.p.)	(1.9 p.p.)	
Telefónica Latinoamérica	52.9%	39.8%	13.1 p.p.	0.9 p.p.	
Telefónica Europe	26.3%	28.9%	(2.6 p.p.)	(0.2 p.p.)	
Operating Income (OI)	16,474	13,647	20.7	4.5	
Telefónica España	6,511	7,617	(14.5)	(9.2)	
Telefónica Latinoamérica	9,721	5,350	81.7	21.2	
Telefónica Europe	923	1,015	(9.1)	15.1	
Net income	10,167	7,776	30.8		
Basic earnings per share (euros)	2.25	1.71	31.6		
OpCF (OIBDA-CapEx)	14,933	15,346	(2.7)	(1.7)	
Telefónica España	6,499	7,893	(17.7)	(12.6)	
Telefónica Latinoamérica	8,247	5,693	44.9	6.9	
Telefónica Europe	942	2,183	(56.8)	14.6	

Reconciliation included in the excel spreadsheets.

### Notes:

- OIBDA and OI are presented before brand fees and management fees.
- OIBDA margin calculated as OIBDA over revenues.
- 2009 and 2010 reported figures include the hyperinflationary adjustments in Venezuela in both years.
- **Organic criteria:** Figures in million euros. In financial terms, it assumes constant exchange rates as of 2009 (average fx), excludes changes in the perimeter of consolidation (HanseNet since mid February 2010, Jajah in January-December 2010, Telyco Marruecos in January-December 2009, and Manx Telecom in July-December 2009) and includes 100% of Vivo since October in 2009 and 2010 and Tuenti in August-December 09. OIBDA and OI figures do not include the impact of capital gains (61 from Manx Telecom in Q2 2010, 220 from Medi Telecom in Q4 2009 and 3,797 from the revaluation of the pre-existing stake in VIVO at the date of the acquisition of the 50% in Brasilcel owned by Portugal Telecom in Q3 2010), non-recurrent restructuring expenses (1,262), mainly related to personnel reorganization (658) and firm commitments relating to the Telefónica Foundation's social activities (400) in the second half of the year. Figures exclude hyperinflationary accounting in Venezuela in both years. CapEx excludes the spectrum acquisition in Germany in Q2 2010 and in Mexico in the second half of 2010.
- **Guidance criteria:** Figures in million euros. 2009 adjusted figures for guidance exclude Telyco Marruecos results in T. España, Medi Telecom capital gain (220 in the fourth quarter of 2009) and write-offs. 2010 guidance assumes constant exchange rates as of 2009 (average FX) and excludes hyperinflationary accounting in Venezuela in both years. It includes 100% of Vivo since October, both 2009 and 2010, and it also includes the consolidation of HanseNet and Jajah in T. Europe. In terms of guidance calculation, OIBDA excludes non-recurrent restructuring expenses (1,262), mainly related to personnel reorganization (658) and firm commitments relating to the Telefónica Foundation's social activities (400) in the second half of the year. OIBDA also excludes the capital gain from the revaluation of the pre-existing stake in VIVO. Group CapEx includes 50% of Vivo in the fourth quarter 2009 and excludes Real Estate Efficiency Program of T. España and spectrum licenses.



## Market Size

Data in thousands accesses

**Argentina**

Fixed Telephony: 4,622  
 Internet & Data: 1,505  
 Mobile: 16,149

**Brazil**

Fixed Telephony: 11,293  
 Internet & Data: 3,848  
 Mobile: 60,293  
 Pay TV: 486

**Central America**

Fixed Telephony: 466  
 Internet & Data: 3  
 Mobile: 6,404

**Chile**

Fixed Telephony: 1,939  
 Internet & Data: 836  
 Mobile: 8,794  
 Pay TV: 341

**Colombia**

Fixed Telephony: 1,587  
 Internet & Data: 554  
 Mobile: 10,005  
 Pay TV: 205

**Ecuador**

Mobile Accesses: 4,220  
 Fixed Wireless: 95

**Mexico**

Mobile: 19,662  
 Fixed Wireless: 566

**Peru**

Fixed Telephony: 2,871  
 Internet & Data: 885  
 Mobile: 12,507  
 Pay TV: 691

**Uruguay**

Mobile: 1,709

**Venezuela**

Mobile: 9,515  
 Fixed Wireless: 966  
 Pay TV: 69

**Germany**

Fixed Telephony: 1,916  
 Internet & Data: 2,915  
 Mobile: 17,049  
 Pay TV: 77

**Slovakia**

Mobile: 880

**Spain**

Fixed Telephony: 13,280  
 Internet & Data: 5,880  
 Mobile: 24,310  
 Pay TV: 68

**Ireland**

Mobile: 1,696

**United Kingdom**

Mobile: 22,212  
 Internet & Data: 672

**Czech Republic**

Fixed Telephony: 1,669  
 Internet & Data: 899  
 Mobile: 4,839  
 Pay TV: 129

## Telefónica Group Accesses

	December		
	2010	2009	% Chg
Unaudited figures (thousands)			
Final Clients Accesses	282,994.9	260,510.2	8.6
Fixed telephony accesses <sup>1</sup>	41,355.7	40,606.0	1.8
Internet and data accesses	18,611.4	15,082.5	23.4
Narrowband	1,314.1	1,427.5	(7.9)
Broadband <sup>2</sup>	17,129.6	13,492.6	27.0
Other <sup>3</sup>	167.8	162.4	3.3
Mobile accesses	220,240.5	202,332.5	8.9
Prepay	151,273.9	142,806.6	5.9
Contract	68,966.6	59,525.9	15.9
Pay TV	2,787.4	2,489.2	12.0
Wholesale Accesses	4,637.4	4,095.3	13.2
Unbundled loops	2,529.2	2,206.0	14.7
Shared ULL	264.0	447.7	(41.0)
Full ULL	2,265.3	1,758.3	28.8
Wholesale ADSL <sup>4</sup>	687.4	463.4	48.4
Other <sup>5</sup>	1,420.7	1,426.0	(0.4)
Total Accesses	287,632.3	264,605.5	8.7

### Notes:

- Year-on year changes are affected by the disconnection of inactive customers in December 2009 and in the second quarter of 2010, as well as the inclusion of the customers of HanseNet since March 2010 and the exclusion of the customers of Manx since July 1st, 2010.

<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 and total fixed wireless included. Includes VoIP and Naked ADSL.

<sup>2</sup> ADSL, satellite, optical fibre, cable modem and broadband circuits.

<sup>3</sup> Retail circuits other than broadband.

<sup>4</sup> Includes ULL rented by T. O2 Germany.

<sup>5</sup> Circuits for other operators. Includes Wholesale Line Rental (WLR) in Spain.

## Consolidated Results

Telefónica obtained solid results in 2010, meeting the guidance committed with the market for eight years in a row, thanks to the Company's high-class diversification, both in terms of geographies and businesses.

The strong growth posted by Telefónica Latinoamérica and Telefónica Europe drove Telefónica's solid performance, offsetting the lower contribution of the business in Spain. It is noteworthy the growing contribution of the Latin America business to the Group's results, supported by the positive performance in operations and the greater exposure to Brazil, following the acquisition of Portugal Telecom's stake in Vivo last September.

It should be noticed that Vivo is fully consolidated in the Group since October 2010 (prior to that date, the results of Vivo were proportionally consolidated), affecting therefore to year-on-year comparisons in reported terms as from the fourth quarter of the year.

The Company's focus on growing its customer base and increasing the value of customers led to a solid advance in the number of accesses, especially in the broadband businesses (both wireline and mobile). In addition, it is noteworthy the higher proportion of the contract segment in the mobile business, thanks to active migration policies and to the rapid adoption of smartphones. Bundled offers in the wireline business showed also steady growth, reflecting the commercial priorities set for the year.

The intense commercial activity recorded throughout the year by the Group's businesses across markets pushed total accesses up by 7.2% year-on-year in organic terms (+8.7% in reported terms), to 287.6 million. By region, of particular note are the expansion of the customer base at Telefónica Latinoamérica (+9.0% year-on-year) and Telefónica Europe (+6.2% year-on-year organic; +14.3% reported).

The increased commercial drive resulted in a year-on-year growth in gross additions of 13.3%. At the same time, customer loyalty programmes and the commitment to improving quality kept the **churn** rate stable year-on-year at 2.3% in 2010. As a result, the Company registered 19.2 million organic **net additions** during the year (1.5 times the net additions recorded in 2009), adding 5.7 million new accesses in the fourth quarter (+36.0% compared to the third quarter; +13.1% year-on-year).

By access type:

- **Mobile accesses** at the Telefónica Group stood at 220.2 million at the end of 2010, a year-on-year growth of 8.9% (both in organic and reported terms). Organic net additions reached 18.2 million in 2010 (1.3 times those recorded in 2009). Fourth-quarter net additions amounted to 5.4 million. Brazil posted the greatest growth in customer base, with 8.5 million net additions in 2010 (2.6 million in the fourth quarter).

The focus on high-value customers has been reflected in a significant increase in contract net additions compared to 2009: 53% of organic net additions corresponded to this segment, compared to 38% in 2009. This has left a total of 69.0 million contract customers (+15.9% year-on-year in organic terms), which represents over 31% of the Group's total mobile accesses (+3 percentage points year-on-year organic).

The strong adoption of mobile broadband services, together with the launch of new and more segmented price schemes has allowed the Group to increase its number of **mobile broadband accesses** to more than 22.2 million by the end of 2010 (+63.9% year-on-year). This represents a penetration over the total mobile access base of 10.1%, 3.4 percentage points higher than at December 2009. All these accesses have a data rate attached and therefore are active users of the service.

- **Retail fixed broadband accesses** reached a total of 17.1 million (+27.0% year-on-year in reported terms, +10.9% organic). Net additions picked up in the fourth quarter to reach 422 thousand accesses. In 2010, net additions stood at 3.6 million accesses (1.5 million in organic terms). Brazil was once again the driver of the Group's growth in this type of access, with Telesp registering 681 thousand net additions, a record-high figure in the Company's history.

Bundled voice, broadband, and television services remain key to Group strategy and especially to churn control. In Spain, 89% of retail fixed broadband accesses are bundled as part of either a dual or triple play offer, while in Latin America the figure stands at 86%.

- The number of **pay-TV accesses** stood at 2.8 million in 2010, an 8.9% increase in organic terms on December 2009 (+12.0% reported).
- **Fixed telephony accesses** totalled 41.4 million, down 2.7% year-on-year in organic terms, although the rate of decrease was slower in the fourth quarter than in previous periods. In reported terms, the number of accesses rose 1.8%.

The increased customer base and the growing contribution from the mobile data business drove growth in **revenues**, which totalled 60,737 million euros in 2010, up 7.1% year-on-year (+9.9% in the fourth quarter). Foreign exchange rates added 2.2 percentage points despite the sharp devaluation in the Venezuelan bolivar, while changes in the consolidated perimeter accounted for 2.5 percentage points of the growth for the year.

The Group's high-class diversification is a key factor behind the strong revenue trends. In 2010, Telefónica Latinoamérica and Telefónica Europe accounted for 68% of consolidated revenues, whereas Telefónica España's contribution stood below 31%.

This diversification is also behind the positive performance of revenues in organic terms, which grew 2.4% year-on-year in 2010. This figure is roughly in line with the growth rate recorded in the first nine months of the year. It is worth to mention that cuts in mobile termination rates dragged 1.0 percentage point to organic revenue growth. By region, it is noteworthy the sustained momentum in the year-on-year revenue growth at Telefónica Latinoamérica and Telefónica Europe. These regions account for 2.7 percentage points and 1.0 percentage points of the organic growth in consolidated revenues respectively, and offset the lower contribution from Telefónica España (-1.6 percentage points).

**Consolidated operating expenses** amounted to 40,375 million euros in 2010, a 13.8% year-on-year growth in reported terms. These expenses were negatively affected by non-recurrent restructuring expenses recorded in the second half of 2010 (1,262 million euros). These costs were mainly related to personnel reorganization (658 million euros) and firm commitments relating to the Telefónica Foundation's social activities (400 million euros; of this total, 280 million euros are recorded in Telefónica S.A. and the rest is registered in Telefónica Latinoamérica). In organic terms, expenses were up 3.7% year-on-year in 2010, although the rate of growth slowed in the last quarter. Breakdown by component:

- **Supply costs** amounted to 17,606 million euros in 2010, decreasing 0.1% year-on-year in organic terms (+5.3% reported), as lower mobile interconnection costs at Telefónica España offset the increased handset costs in the three regions.
- **Personnel expenses** amounted to 8,409 million euros in 2010, up 9.3% year-on-year in organic terms (+24.1% reported). This figure was affected by personnel reorganisation costs recorded in the second half of the year.

The average number of employees in 2010 was 269,047 (13,896 employees more than at December 2009), mainly due to the larger workforce at Atento. Excluding Atento, Telefónica Group's average workforce rose 2% year-on-year to 128,012.

- **Subcontract expenses** amounted to 12,228 million euros in 2010, up 7.9% on 2009 in organic terms (+23.3% reported). This performance is largely due to the higher commercial efforts in the three regions and increased network management expenses at Telefónica Latinoamérica. Subcontract expenses also include firm commitments relating to social activities of the Telefónica Foundation.

In addition, it is important to highlight the value of the scale of the Group, reflected in the positive contribution to results from global projects launched in 2010. Indeed, the centralisation of certain Group processes had a positive effect on 2010 results, impacting revenues by 242 million euros and OIBDA by 200 million euros.

**Gain on sales of fixed assets** totalled 4,150 million in 2010, primarily explained by the positive impact of the revaluation of the previously held stake in Vivo at the date of acquisition of the 50% in Brasilcel owned by Portugal Telecom (3,797 million euros in the third quarter).

**Operating income before depreciation and amortization (OIBDA)** for 2010 stood at 25,777 million euros, a year-on-year growth of 14.0%, strongly affected by the gain on sales of fixed assets abovementioned recorded in the third quarter of the year, and despite the negative impact of non-recurrent restructuring expenses (1,262 million euros) also mentioned previously. Foreign exchange rates contributed with 1.2 percentage points to this growth, while changes in the consolidated perimeter represented 1.6 percentage points. The OIBDA margin stood at 42.4% for 2010 (+2.6 percentage points year-on-year). Stripping out the above mentioned impacts, the OIBDA margin would reach 38.3% in 2010.

In organic terms, which exclude the aforementioned non-recurrent restructuring expenses, OIBDA rose 0.8% year-on-year, an improved performance compared to the first nine months of 2010. The OIBDA margin was virtually stable compared to the prior year (-0.6 percentage points), despite the higher commercial activity in 2010.

By region and excluding the positive impact of the revaluation of the previously held stake in Vivo already mentioned, Telefónica Latinoamérica increased its contribution to the Group's OIBDA up by 5.0 percentage points year-on-year, to exceed 45% of the Group figure. Consequently, together with the higher contribution from Telefónica Europe, in 2010 over 60% of consolidated OIBDA was generated outside Telefónica España.

**Depreciation and amortization** amounted to 9,303 million euros in 2010, up 3.9% in reported terms (-2.8% organic). In the fourth quarter, this caption included amortization associated to the purchase price allocation of Vivo (84 million euros).

As a result, **operating income (OI)** totalled 16,474 million euros in 2010, up 20.7% year-on-year in reported terms. In organic terms and excluding the non-recurrent expenses mentioned above, OI rose 4.5% year-on-year.

**Profits from associates** amounted to 76 million euros in 2010, up 59.8% year-on-year. This increase is mainly due to the improved results contributed by the associate Telco, S.p.A.

**Net Financial Results** up to December 2010 amounted to 2,649 million euros (-19.9% year-on-year). Year-on-year performance of Venezuela's impact yielded a lower expense of 521 million euros. Stripping out this effect year-on-year performance is explained mainly by:

- Changes in the foreign exchange gains and losses up to December 2010 with respect to the same period last year yielded a lower expense of 172 million euros.

- Interest rate drops during the year, changes of the actual value of commitments derived mainly from the pre-retirement plans and other financial operations have yielded a lower expense of 410 million euros. On the other hand, changes in the Group's debt volume have yielded a higher expense of 254 million euros. Both effects have yielded a lower expense of 156 million euros.

- The 191 million euro expense corresponding to the transfer of the interest in BBVA at fair value from equity to financial results. This interest continues to be recognized as an available-for-sale financial asset.

Interest related net financial expenses up to December 2010 (excluding the 191 million expense mentioned before) amounted to 2,458 million euros, a cost of 4.9% over total average net debt of 49,999 million euros.

**Free cash flow** generated by the Telefónica Group up to the end of December 2010 amounted to 8,466 million euros, of which 5,872 million euros were assigned to Telefónica S.A. dividend payment, 883 million euros were devoted to the acquisition of Telefónica treasury shares and 834 million euros to commitment cancellations derived mainly from the pre-retirements plans. In addition, there was a net payment of 6,577 million euros due to financial investments and divestments in the period mainly explained by the purchase of the 50% stake in Brasilcel owned by Portugal Telecom and to a lesser extent the HanseNet purchase. As a result, net financial debt increased by 5,700 million euros. In addition, net debt increased by an additional 6,343 million euros of which 2,366 million euros are due to foreign exchange impact, and 3,977 million euros are due to changes in the consolidation perimeter and other effects on financial accounts. All this has led to an increase of 12,042 million euros with respect to the net financial debt at the end of 2009 (43,551 million euros), leaving the final figure in December 2010 at 55,593 million euros.

**The leverage ratio**, net debt over OIBDA (including accumulated 100% of Vivo's OIBDA to December 2010, excluding results on the sale of fixed assets and adjusted by firm commitments relating to the Telefónica Foundation's social activities), stands at 2.4 times at December 2010.

During 2010, the **financing activity** of Telefonica Group, excluding short term Commercial Paper Programmes activity, rose to 15,800 million equivalent euros, with the main objective of partly financing in advance 2011 debt at Telefónica, S.A. level and finance the acquisition of 50% of Brasilcel. On July 28, 2010, Telefónica, S.A. entered into a syndicated facility agreement with several domestic and international financial entities in an aggregate amount of up to 8,000 million euros. This Facility Agreement is divided into two tranches: the first, a three-year term loan facility, in an aggregate amount of up to 5,000 million euros and a second, a five-year revolving credit facility, in an aggregate amount of up to 3,000 million euros.

It is also worth highlighting the financing activity of the company during 2010 in the bond markets:

- Two bond issuances in the euro market, a 5 year bond issue for an amount of 1,400 million raised in March and a 7 year 1,000 million raised in September;
- In the US, Telefonica has issued an American dollar denominated bond for an amount of 3,500 million dollars raised in April, distributed in three tranches: 3 year 1,200 million dollars, 5 year 900 million dollars and a 10 year tranche of 1,400 million dollars;
- A 19 year bond issuance for an amount of 400 million Sterling Pounds in October.

It is to mention the loan facility for telecom equipment purchases for an amount of nearly 500 million dollars with the guaranty of the Swedish Export Credit Agency (EKN) signed in February.

Telefonica S.A. and its holding companies have continued active during 2010 under its various Commercial Paper Programmes (Domestic and European), for an outstanding balance of 1,654 million euros at December.

Regarding Latin America, Telefonica's subsidiaries have tapped the capital markets up to December for an amount above 1,900 million equivalent euros, mainly for refinancing 2010 maturities. To highlight the Mexican peso bond issuance launched in July in two tranches, a 10 year 2,000 million and a 4 year 4,000 million bond issue, as well the Telefónica Moviles Chile issuance for an amount of 300 million dollars maturing in 5 years.

At the end of December, bonds and debentures represented 63%, on the consolidated financial debt breakdown, while debt with financial institutions reached a 37% weight.

**Corporate income taxes** for 2010 stood at 3,829 million euros, impacted by the reassessment of the tax assets in Colombia, amounting to 864 million euros and recorded in the fourth quarter of 2010. It is worth to mention that in the third quarter of 2010, this caption also included 321 million euros of fiscal effects relating to the revaluation of the Company's previously-held stake in Vivo at the date of acquisition of the 50% in Brasilcel owned by Portugal Telecom. On the positive side, income tax expense for 2010 has decreased in the amount of 138 million euros due to tax credits generated in México and Terra Brazil, which are based on the expected taxable income to be generated by the companies.

**Profit attributable to minority interests** increased the net income figure by 95 million euros in 2010, reversing the trend observed both until September 2010 (-153 million euros) and compared to 2009 (-161 million euros), primarily due to minority interests in the losses Telefónica Telecom, which increased after the aforementioned reassessment. This more than offset the share of minority interests in the profits of Vivo, Telesp and Telefónica O2 Czech Republic.

The result of all the above was **consolidated net income** of 10,167 million euros for 2010, 30.8% higher year-on-year. The main drivers behind this performance were:

- the positive net impact from the revaluation of the previously held stake in Vivo at the date of acquisition of the 50% in Brasilcel owned by Portugal Telecom (3,476 million euros);
- non-recurrent restructuring expenses registered in the second half of 2010 (862 million euros, net of taxes and minority interests);

- the write-down of tax credits in Colombia (450 million euros, net of minority interests).

As a result, **basic earnings per share** stood at 2.25 euros (+31.6% year-on-year).

**CapEx**, excluding spectrum acquisitions, reached 8,228 million euros, up 13.6% on 2009 figure (+5.9% in organic terms). The Company continues to focus its investments on growth and transformation projects (77% of total investment, excluding spectrum acquisitions), fostering the development of broadband services (both fixed and mobile).

Taking into account the spectrum acquisitions in Germany in May and the acquisition of additional spectrum and licenses in Mexico, CapEx for 2010 amounted to 10,844 million euros.

As a result, **operating cash flow (OIBDA-CapEx)** totalled 14,933 million euros in 2010 (-2.7% year-on-year). In organic growth terms and stripping out spectrum acquisitions, operating cash flow dropped 1.7% year-on-year.

#### Definitions

*Organic growth: In financial terms, it assumes constant exchange rates as of 2009 (average fx), excludes changes in the perimeter of consolidation (HanseNet since mid February 2010, Jajah in January-December 2010, Telyco Marruecos in January-December 2009, and Manx Telecom in July-December 2009) and includes 100% of Vivo since October in 2009 and 2010 and Tuenti in August-December 09. OIBDA and OI figures do not include the impact of capital gains (Manx Telecom in Q2 2010, Medi Telecom in Q4 2009 and the revaluation of our pre-existing stake in Vivo at the date of the acquisition of the 50% in Brasilcel owned by Portugal Telecom in Q3 2010), non-recurrent restructuring expenses, mainly related to personnel reorganization and firm commitments relating to the Telefónica Foundation's social activities, recorded in the second half of the year. CapEx excludes the spectrum acquisition in Germany in Q2 2010 and in Mexico in H2 2010. Figures exclude hyperinflationary accounting in Venezuela in both years. In terms of accesses, HanseNet, Medi Telecom (following its disposal in the fourth quarter of 2009), and Manx Telecom as of July 2010 are excluded. At the same time, organic net additions exclude accesses disconnections made in the second quarter of 2010.*

**Average total Net Debt:** Average balance at December 2010 of the items shown in the "Net financial debt and commitments" table.



## Financial Data

Telefónica Group  
Consolidated Income Statement

	January - December			October - December		
	2010	2009	% Chg	2010	2009	% Chg
Unaudited figures (Euros in millions)						
Revenues	60,737	56,731	7.1	16,457	14,976	9.9
Internal exp capitalized in fixed assets	737	720	2.3	218	237	(8.1)
Operating expenses	(40,375)	(35,489)	13.8	(11,740)	(9,654)	21.6
Supplies	(17,606)	(16,717)	5.3	(4,910)	(4,560)	7.7
Personnel expenses	(8,409)	(6,775)	24.1	(2,444)	(1,770)	38.0
Subcontracts	(12,228)	(9,921)	23.3	(3,771)	(2,734)	37.9
Bad Debt Provisions	(853)	(874)	(2.3)	(249)	(210)	19.0
Taxes	(1,279)	(1,203)	6.3	(367)	(380)	(3.6)
Other net operating income (expense)	494	435	13.5	276	221	24.6
Gain (loss) on sale of fixed assets	4,150	248	n.s.	206	230	n.s.
Impairment of goodwill and other assets	35	(42)	c.s.	(6)	(32)	c.s.
Operating income before D&A (OIBDA)	25,777	22,603	14.0	5,410	5,978	(9.5)
OIBDA margin	42.4%	39.8%	2.6 p.p.	32.9%	39.9%	(7.0 p.p.)
Depreciation and amortization	(9,303)	(8,956)	3.9	(2,559)	(2,293)	11.6
Operating income (OI)	16,474	13,647	20.7	2,851	3,685	(22.6)
Profit from associated companies	76	47	59.8	8	0	n.s.
Net financial income (expense)	(2,649)	(3,307)	(19.9)	(675)	(1,034)	(34.7)
Income before taxes	13,901	10,387	33.8	2,183	2,651	(17.7)
Income taxes	(3,829)	(2,450)	56.2	(1,099)	(161)	n.s.
Income from continuing operations	10,072	7,937	26.9	1,084	2,490	(56.5)
Income (Loss) from discontinued ops.	-	-	-	-	-	-
Non-controlling interests	95	(161)	c.s.	248	(50)	c.s.
Net income	10,167	7,776	30.8	1,333	2,440	(45.4)
Weighted average number of ordinary shares outstanding during the period (millions)	4,522	4,553	(0.7)	4,512	4,554	(0.9)
Basic earnings per share (euros)	2.25	1.71	31.6	0.30	0.54	(44.9)

## Notes:

- HanseNet and Jajah have been included in T. Europe's consolidation perimeter since mid February 2010 and since January 2010 respectively, and the perimeter of consolidation of T. España excludes Telyco Morocco since January, 2010 and includes Tuenti since August of 2010. The perimeter of consolidation of T. Latinoamérica includes 100% of Vivo since October 2010.
- For the basic earnings per share calculation purposes, the weighted average number of ordinary shares outstanding during the period have been obtained applying IAS rule 33 "Earnings per share". Thereby, there are not been taken into account as outstanding shares the weighted average number of shares held as treasury stock during the period.
- Figures in million euros. OIBDA, OIBDA margin and Operating Income are affected by the positive impact from the revaluation of the pre-existing stake in Vivo at the date of the acquisition of the 50% in Brasilcel owned by Portugal Telecom (3,797 in the third quarter of 2010). Additionally, OIBDA includes a capital gain of 61 from the sale of Manx Telecom in the second quarter of 2010, 220 from the sale of Medi Telecom in the fourth quarter of 2009, and is impacted by 1,262 of non-recurrent restructuring expenses in the second half of the year, mainly related to personnel reorganization (658) and firm commitments relating to the Telefónica Foundation's social activities (400).
- 2009 and 2010 reported figures include the hyperinflationary adjustments in Venezuela in both years.

## Telefónica Group Results By Regional Business Units

	Revenues			OIBDA			OIBDA Margin		
	January - December			January - December			January - December		
	2010	2009	% Chg	2010	2009	% Chg	2010	2009	% Chg
Unaudited figures (Euros in millions)									
Telefónica España <sup>1 2</sup>	18,711	19,703	(5.0)	8,520	9,757	(12.7)	45.5%	49.5%	(4.0 p.p.)
Telefónica Latinoamérica <sup>1 2</sup>	26,041	22,983	13.3	13,782	9,143	50.7	52.9%	39.8%	13.1 p.p.
Telefónica Europe <sup>1 2</sup>	15,255	13,533	12.7	4,014	3,910	2.6	26.3%	28.9%	(2.6 p.p.)
Other companies and eliminations	730	512	42.7	(539)	(207)	160.3	n.m.	n.m.	n.m.
<b>Total Group<sup>1 2</sup></b>	<b>60,737</b>	<b>56,731</b>	<b>7.1</b>	<b>25,777</b>	<b>22,603</b>	<b>14.0</b>	<b>42.4%</b>	<b>39.8%</b>	<b>2.6 p.p.</b>

	Operating Income			CapEx			OpCF (OIBDA-CapEx)		
	January - December			January - December			January - December		
	2010	2009	% Chg	2010	2009	% Chg	2010	2009	% Chg
Unaudited figures (Euros in millions)									
Telefónica España <sup>1 2</sup>	6,511	7,617	(14.5)	2,021	1,863	8.4	6,499	7,893	(17.7)
Telefónica Latinoamérica <sup>2 3</sup>	9,721	5,350	81.7	5,535	3,450	60.5	8,247	5,693	44.9
Telefónica Europe <sup>1 4</sup>	923	1,015	(9.1)	3,072	1,728	77.8	942	2,183	(56.8)
Other companies and eliminations	(681)	(335)	103.0	216	216	0.0	(755)	(423)	78.5
<b>Total Group<sup>1 2 3 4</sup></b>	<b>16,474</b>	<b>13,647</b>	<b>20.7</b>	<b>10,844</b>	<b>7,257</b>	<b>49.4</b>	<b>14,933</b>	<b>15,346</b>	<b>(2.7)</b>

<sup>1</sup> Since January 2010, the perimeter of consolidation of T. España excludes Telyco Marruecos and includes Tuenti since August of 2010. The perimeter of consolidation of T. Latinoamérica includes 100% of Vivo since October 2010. HanseNet and Jajah have been included in T. Europe's consolidation perimeter since mid February 2010 and January 2010, respectively.

<sup>2</sup> Figures in million euros. OIBDA, OIBDA margin, Operating Income and OpCF are affected by the positive impact from the revaluation of the pre-existing stake in Vivo at the date of the acquisition of the 50% in Brasilcel owned by Portugal Telecom (3,797 in the third quarter of 2010). Additionally, OIBDA includes a capital gain of 61 from the sale of Manx Telecom in the second quarter of 2010, 220 from the sale of Medi Telecom in the fourth quarter of 2009, and is impacted by 1,262 of non-recurrent restructuring expenses in the second half of the year, mainly related to personnel reorganization (658) and firm commitments relating to the Telefónica Foundation's social activities (400).

<sup>3</sup> CapEx includes 1,237 million euros from the acquisition of spectrum in Mexico in 2010.

<sup>4</sup> CapEx includes 1,379 million euros from the acquisition of spectrum in Germany in the second quarter of 2010.

### Notes:

- OIBDA and OI are presented before brand fees and management fees.
- OIBDA margin calculated as OIBDA over revenues.
- 2009 and 2010 reported figures include the hyperinflationary adjustments in Venezuela in both years.

## Telefónica Group

### Consolidated Statement of Financial Position

	December 2010	December 2009	% Chg
Unaudited figures (Euros in millions)			
<b>Non-current assets</b>	<b>108,721</b>	<b>84,311</b>	<b>29.0</b>
Intangible assets	25,026	15,846	57.9
Goodwill	29,582	19,566	51.2
Property, plant and equipment and Investment properties	35,802	32,003	11.9
Non-current financial assets and investments in associates	12,618	10,925	15.5
Deferred tax assets	5,693	5,971	(4.7)
<b>Current assets</b>	<b>21,054</b>	<b>23,830</b>	<b>(11.7)</b>
Inventories	1,028	934	10.1
Trade and other receivables	12,426	10,622	17.0
Current tax receivable	1,331	1,246	6.8
Current financial assets	1,574	1,906	(17.4)
Cash and cash equivalents	4,220	9,113	(53.7)
Non-current assets classified as held for sale	475	9	n.m.
<b>Total Assets = Total Equity and Liabilities</b>	<b>129,775</b>	<b>108,141</b>	<b>20.0</b>
<b>Equity</b>	<b>31,684</b>	<b>24,274</b>	<b>30.5</b>
Equity attributable to equity holders of the parent	24,452	21,734	12.5
Non-controlling interests	7,232	2,540	n.m.
<b>Non-current liabilities</b>	<b>64,599</b>	<b>56,931</b>	<b>13.5</b>
Non-current financial debt	51,356	47,607	7.9
Deferred tax liabilities	6,074	3,082	97.1
Non-current provisions	4,865	4,993	(2.6)
Other non-current liabilities	2,304	1,249	84.5
<b>Current liabilities</b>	<b>33,492</b>	<b>26,936</b>	<b>24.3</b>
Current financial debt	9,744	9,184	6.1
Trade and other payables	9,314	7,365	26.5
Current tax payables	2,822	2,766	2.0
Current provisions and other liabilities	11,612	7,621	52.4
<b>Financial Data</b>			
Net financial Debt <sup>1</sup>	55,593	43,551	27.7

<sup>1</sup> Figures in million euros. Includes: Long term financial debt + other long term liabilities (1,718) + Short term financial debt + short-term provisions and other liabilities (1,977) - non-current financial assets and investments in associates (3,408) - temporary financial investment included in current financial assets - cash and cash equivalents.

Note:

2009 and 2010 reported figures include the hyperinflationary adjustments in Venezuela in both years.

## Telefónica Group

### Free Cash Flow and Change in Debt

		January - December		
		2010	2009	% Chg
Unaudited figures (Euros in millions)				
I	Cash flow from operations	21,313	21,178	0.6
II	Net interest payment <sup>1</sup>	(2,018)	(2,070)	
III	Payment for income tax	(2,616)	(2,942)	
A=I+II+III	Net cash provided by operating activities	16,679	16,165	3.2
B	Payment for investment in fixed and intangible assets <sup>2</sup>	(8,670)	(7,592)	
C=A+B	Net free cash flow after CapEx	8,010	8,573	(6.6)
D	Net Cash received from sale of Real Estate	41	241	
E	Net payment for financial investment	(6,618)	(1,419)	
F	Net payment for operations with minority shareholders and treasury stock <sup>3</sup>	(7,132)	(5,785)	
G=C+D+E+F	Free cash flow after dividends	(5,700)	1,610	c.s.
H	Effects of exchange rate changes on net financial debt	2,366	1,226	
I	Effects on net financial debt of changes in consolid. and others	3,977	1,203	
J	Net financial debt at beginning of period	43,551	42,733	
K=J+G+H+I	Net financial debt at end of period	55,593	43,551	27.7

<sup>1</sup> Including cash received from dividends paid by subsidiaries that are not fully consolidated.

<sup>2</sup> Includes 1,379 million euros from the acquisition of spectrum in Germany in the second quarter of 2010 and 276 million euros from the acquisition of spectrum in Mexico.

<sup>3</sup> Dividends paid by Telefónica S.A., operations with treasury stock and operations with minority shareholders from subsidiaries that are fully consolidated.

Note:

2009 and 2010 reported figures include the hyperinflationary adjustments in Venezuela in both years.

## Reconciliations of Cash Flow and OIBDA Minus Capex

	January - December		
	2010	2009	% Chg
Unaudited figures (Euros in millions)			
OIBDA	25,777	22,603	14.0
- CapEx accrued during the period	(10,844)	(7,257)	
- Payments related to cancellation of commitments	(834)	(793)	
- Net interest payment	(2,018)	(2,070)	
- Payment for tax	(2,616)	(2,942)	
- Results from the sale of fixed assets	(4,150)	(248)	
- Investment In working capital and other deferred income and expenses	2,694	(719)	
= Net Free Cash Flow after CapEx	8,010	8,573	(6.6)
+ Net Cash received from sale of Real Estate	41	241	
- Net payment for financial investment	(6,618)	(1,419)	
- Net payment for operation with minority shareholders and treasury stock	(7,132)	(5,785)	
= Free Cash Flow after dividends	(5,700)	1,610	c.s.

	January - December		
	2010	2009	% Chg
Unaudited figures (Euros in millions)			
Net Free Cash Flow after CapEx	8,010	8,573	(6.6)
+ Payments related to cancellation of commitments	834	793	
- Operations with minority shareholders	(378)	(269)	
= Free Cash Flow	8,466	9,097	(6.9)
Weighted average number of ordinary shares outstanding during the period (millions)	4,522	4,553	
Free Cash Flow per share (euros)	1.87	2.00	(6.3)

### Notes:

- 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 accommodate strategic flexibility.  
The differences with the caption "Net Free Cash Flow after CapEx" included in the table presented above, are related to "Free Cash Flow" being calculated before payments related to commitments (workforce reductions and guarantees) and after operations with minority shareholders, due to cash recirculation within the Group.
- 2009 and 2010 reported figures include the hyperinflationary adjustments in Venezuela in both years.

## Net Financial Debt and Commitments

December 2010

Unaudited figures (Euros in millions)	
Long-term debt <sup>1</sup>	53,074
Short term debt including current maturities <sup>2</sup>	11,721
Cash and cash equivalents	(4,220)
Short and Long-term financial investments <sup>3</sup>	(4,982)
<b>A Net Financial Debt</b>	<b>55,593</b>
Guarantees to IPSE 2000	0
<b>B Commitments related to guarantees</b>	<b>0</b>
Gross commitments related to workforce reduction <sup>4</sup>	3,556
Value of associated Long-term assets <sup>5</sup>	(803)
Taxes receivable <sup>6</sup>	(1,043)
<b>C Net commitments related to workforce reduction</b>	<b>1,710</b>
<b>A+B+C Total Debt + Commitments</b>	<b>57,303</b>
<b>Net Financial Debt / OIBDA<sup>7</sup></b>	<b>2.4x</b>
<b>Total Net Debt + Commitments/ OIBDA<sup>7</sup></b>	<b>2.5x</b>

1 Includes "long-term financial debt" and 1,718 million euros of "other long-term debt".

2 Includes "short-term financial debt" and 1,977 million euros of "short-term provisions and other liabilities" for the pending payment commitment with Portugal Telecom from the acquisition of Brasilcel.

3 Includes "Current financial assets" and 3,408 million euros recorded under the caption of "Non-current financial assets and investments in associates".

4 Mainly in Spain. This amount is detailed in the captions "Long-term provisions" and "Short-term provisions and other liabilities" of the Statement of Financial Position, 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".

5 Amount included in the caption "Non-current financial assets and investments in associates" of the Statement of Financial Position. Mostly related to investments in fixed income securities and long-term deposits that cover the materialization of technical reserves of the Group insurance companies.

6 Net present value of tax benefits arising from the future payments related to workforce reduction commitments.

7 Calculated based on December 2010 OIBDA, and excluding results on the sale of fixed assets and firm commitments relating to the Telefónica Foundation's social activities. It includes 100% of Vivo's OIBDA for the full year 2010.

Note:

2010 reported figures include the hyperinflationary adjustments in Venezuela.

## Debt Structure by Currency

	December 2010				
	EUR	LATAM	GBP	CZK	USD
Unaudited figures					
Debt structure by currency	73%	15%	7%	3%	3%

## Credit Ratings

	Long-Term	Short-Term	Perspective	Date of last rating change
Unaudited figures				
Moody's	Baa1	P-2	Stable	07/29/2010
JCR	A	-	Stable	12/17/2008
S&P	A-	A-2	Negative	08/06/2010
Fitch/IBCA	A-	F-2	Stable	11/25/2008



## Telefónica Group Exchanges Rates Applied

	P&L and CapEx <sup>1</sup>		Statement of Financial Position <sup>2</sup>	
	Jan - Dec 2010	Jan - Dec 2009	December 2010	December 2009
USA (US Dollar/Euro)	1.324	1.390	1.336	1.441
United Kingdom (Sterling/Euro)	0.857	0.891	0.861	0.888
Argentina (Argentinean Peso/Euro)	5.180	5.174	5.313	5.474
Brazil (Brazilian Real/Euro)	2.328	2.757	2.226	2.508
Czech Republic (Czech Crown/Euro)	25.291	26.435	25.060	26.465
Chile (Chilean Peso/Euro)	674.363	775.795	625.356	730.460
Colombia (Colombian Peso/Euro)	2,509.215	2,985.075	2,557.460	2,941.176
Guatemala (Quetzal/Euro)	10.660	11.331	10.708	12.035
Mexico (Mexican Peso/Euro)	16.711	18.778	16.502	18.812
Nicaragua (Cordoba/Euro)	28.271	28.258	29.239	30.023
Peru (Peruvian Nuevo Sol/Euro)	3.738	4.186	3.754	4.165
Uruguay (Uruguayan Peso/Euro)	26.537	31.303	26.850	28.275
Venezuela (Bolivar Fuerte/Euro) (3)	5.746	3.097	5.746	3.097

<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/December/10 and 31/December/09.

<sup>3</sup> After considering Venezuela as an hyperinflationary country, P&L and CapEx from the operations in the country are to be accounted at the closing exchange rate Bolivar Fuerte/Euro.

## Results by regional business units

### Telefónica España<sup>1</sup>

Fiscal Year  
closes with  
47.6 millions  
of accesses

Against the backdrop of an adverse economic environment, austerity measures and strong price oriented competition, Telefónica España recorded a high level of commercial activity in 2010. Thus, aligned with the management priorities set for the year, the Company sustains its solid market leadership, especially in terms of revenue and profitability.

It is worth highlighting the 926 thousand net additions registered for the full year (not considering the disconnections in May following the process of identifying inactive prepay customers), that more than six fold the comparable figure recorded in 2009. It is also noteworthy the higher level of commercial activity recorded in both the wireline and wireless businesses, with an overall 10.5% year-on-year growth in gross additions in 2010, which coupled with continued churn management, drove total accesses to 47.6 million by year end. Net additions in the fourth quarter totalled 227 thousand (+4.9% year-on-year).

In the wireline business it should be noted the growth posted by **retail fixed broadband Internet accesses** in 2010 (+4.5% year-on-year) and the significant increase of **Pay TV** customers (12.1% year-on-year). On the other hand, it is remarkable the lower **retail fixed line** losses (-920 thousand in 2010), which decreased 18.3% year-on-year.

Additionally, in the **mobile business**, growth in the contract segment remained solid (+6.9% year-on-year). It should be highlighted the increase in the mobile broadband customer base, which reached 4.8 million by year end, 1.7 times higher than at the end of 2009.

As for reported economic-financial results, against the backdrop of lower consumption and increased price pressure, the loss of higher-margin revenue and increased commercial efforts relative to 2009 had a direct impact on OIBDA. In addition, operating expenses in 2010, and OIBDA by extension, reflect the TV tax introduced in the year (107 million euros) as well as non-recurrent restructuring expenses, mainly related to personnel reorganization plans, booked in the fourth quarter of the year (202 million euros). Another factor worth recalling is the 220 million euros capital gain on the disposal of Medi Telecom booked in the fourth quarter of 2009.

**Revenue** totalled 18,711 million euros in 2010, down 5.0% year-on-year in reported terms, impacted primarily by the trading environment, lower revenue related to Universal Service (95 million in 2010 vs. 223 million in 2009), the exit of Telyco Marruecos from the consolidation perimeter (57 million in 2009) and revenue from the sale of applications rights (101 million in 2010 vs. 48 million in 2009).

<sup>1</sup> Figures in millions of euros. Since January 2010, T. España's consolidation perimeter does not include Telyco Marruecos (wireline business) and since August 2010 includes Tuenti (mobile business). Comparable terms exclude the impact from changes in the consolidation perimeter, and thus includes Tuenti in the period August-December 2009 and excludes the impact of the following: Universal Service: +95 in revenue (wireline) and +31 in OIBDA in 2010; +223 in revenue (wireline) and +68 in OIBDA in 2009; +38 in revenue (wireline) and +13 in OIBDA in the fourth quarter of 2010; +148 in revenue (wireline) and +47 in OIBDA in the fourth quarter of 2009; property capital gains: +6 in OIBDA in the fourth quarter of 2009; capital gain on the sale of Medi Telecom: +220 in OIBDA in the fourth quarter of 2009; exit of Telyco Marruecos from the consolidation perimeter: +57 in revenue and +4 in OIBDA in 2009; +9 in revenue and +2 in OIBDA in the fourth quarter of 2009; non-recurrent restructuring expenses mainly related to personnel reorganization plans: -202 in OIBDA in the fourth quarter of 2010; revision of estimates made prior to 2009 related to personnel commitments: +90 in OIBDA in 2009; TV tax: -107 in OIBDA in 2010; -24 in OIBDA in the fourth quarter of 2010; sale of application rights: +101 in revenue and OIBDA (+51 in wireline; +51 in mobile) in 2010; +48 in revenue and OIBDA in 2009 (mobile); +49 in revenue and OIBDA in the fourth quarter of 2010 (+25 in wireline; +25 in mobile) and recovery of bad debts: +20 in OIBDA in 2010.

Reported revenue declined 7.5% year-on-year in the fourth quarter of 2010, affected by lower revenue related to Universal Service (38 million in 2010 vs. 148 million in 2009) and higher revenue from the sale of application rights (49 million in 2010). The economic impact of the full consolidation of Tuenti on Telefónica España's wireless business in 2010 is not material.

In comparable terms, revenue declined 4.4% year-on-year in 2010 (-6.4% in the fourth quarter). This evolution is primarily explained by lower consumption across businesses and strong competition, with a direct impact on ARPU's. Against this backdrop, it is worth highlighting the healthy performance of IT revenue in 2010 in the wireline business (+9.0% year-on-year in comparable terms). On the other hand, in the wireless business it is especially noteworthy the performance of connectivity revenue (+54.3% year-on-year), which is cementing its status as a key revenue driver.

**Operating expenses** amounted to 10,489 million euros in 2010, a slight increase of 0.8% year-on-year in reported terms. In the fourth quarter operating expenses grew 3.0% year-on-year, reflecting impact from the non-recurrent restructuring expenses, mainly related to personnel reorganization plans, above-mentioned. In comparable terms, operating expenses decreased 1.5% in 2010 (-2.1% in the quarter), thanks to the efficiency measures implemented.

A breakdown by component is as follows:

- Despite the higher commercial effort along the year, **subcontract expenses** totalled 3,017 million euros in 2010, decreasing 2.8% year-on-year in reported terms (-3.6% in the quarter). In comparable terms, excluding the restructuring projects booked in the fourth quarter of 2010, the year-on-year drop in operating expenses widens to 3.7% (-7.1% in the quarter).

- **Personnel expenses** amounted to 2,658 million euros in 2010 and increased 15.3% year-on-year in reported terms (+35.5% in the quarter). This trend is affected by the revision of estimates made prior to 2009 related with personnel commitments (+90 million euros in the second quarter of 2009) and, particularly in the fourth quarter of 2010, by restructuring expenses mainly related to personnel reorganization already mentioned, and the negative impact of a higher-than-estimated rate of CPI. In comparable terms, personnel expenses would increase 3.7% year-on-year for the full year (+6.4% in the quarter).
- **Supplies** reached 4,185 million euros in 2010 and decreased 2.5% year-on-year in reported terms and 1.4% in comparable terms (-1.2% in comparable terms in the quarter), reflecting lower interconnection costs due to mobile termination rate cuts, which offset higher expenses on mobile handsets.
- **Taxes** increased 1.0% year-on-year in 2010 in reported terms to 496 million euros, adversely affected by the recognition of the TV tax (107 million euros in 2010), which more than offset lower expenses associated with the Universal Service. In comparable terms, taxes declined 3.2% year-on-year in 2010 (-4.5% in the quarter).
- **Bad debt provisions** (133 million euros in 2010), accounted for 0.7% of reported revenue by year end, and had a significant year-on-year reduction of 36.8% in reported terms, reflecting the improvements made on bad debt recoveries. In comparable terms, the year-on-year decline was 27.5% (-43.6% in the quarter).

As a result, **operating income before depreciation and amortization (OIBDA)** amounted to 8,520 million euros in 2010 (-12.7% year-on-year in reported terms), standing the OIBDA margin at 45.5% (-4.0 percentage points year-on-year).

In comparable terms, OIBDA decreased 6.9% year-on-year (-10.2% in the quarter). The Company maintained a high operational efficiency as reflected by the comparable OIBDA margin, which stood at 46.9% for the full year, limiting its year-on-year decline to 1.2 percentage points.

**CapEx** totalled 2,021 million euros in 2010, up 8.4% year-on-year, driven by the Company's strategic focus on the development of growing services, particularly fixed and mobile broadband.

**Operating cash flow (OIBDA-CapEx)** amounted to 6,499 million euros in 2010, a year-on-year decline of 10.7% in comparable terms (-17.7% in reported terms).

## Commercial Activity and Revenue Performance by Business Unit

### Wireline Business

In the fourth quarter of 2010, the wireline access market recorded a slight improvement that contributed to the fact that the Company registered 20 thousand net additions in the quarter of **total wireline accesses** (retail wireline telephony accesses, wholesale line rental -AMLT-, fully undundled loops, and naked wholesale ADSL). As a result, total wireline accesses reached 16.0 million at year end, and remained virtually stable year-on-year in 2010 (-0.4% on 2009), posting a much better performance than in 2009 (-2.4% year-on-year). The Company's estimated market share stood at around 83% at year end.

It is also worth highlighting the significant year-on-year reduction in net losses of **retail wireline telephony accesses** in both the quarter (-27.3%; 205 thousand lines) and the full year (-18.3% year-on-year; -920 thousand lines). The loss of retail accesses in the full year was virtually fully offset (in its 94%) by net additions in wholesale accesses, which continue to generate revenue for the Company. As a result, retail wireline accesses, impacted by loops unbundling, declined 6.5% on 2009 to 13.3 million, implying an estimated market share of around 69%.

The number of preselected lines continued to fall (-73 thousand in the fourth quarter; -375 thousand in 2010) to stand around 682 thousand at year end.

Telefónica España held on to its solid leadership position in the **wireline broadband Internet access** market, with more than 5.7 million accesses at year end (+4.5% year-on-year), implying an estimated market share of over 53%. Net additions for the full year stood at 245 thousand, growing 6.6% year-on-year (50 thousand net additions in the quarter, pretty much in line with the previous quarter).

Net additions of wholesale indirect broadband accesses, boosted by the introduction of new modalities as well as price reductions, reached 202 thousand in 2010, bringing total accesses to 561 thousand at year end (+56.4% year-on-year). Net additions in the quarter were 53 thousand.

Total unbundled loops stood at almost 2.5 million at year end, (+15.0% year-on-year), of which 11% were shared loops, while the remainders were full unbundled loops (including 602 thousand naked shared loops). It should be noted the slowdown in the pace of growth reflected in the net additions for the full year (323 thousand loops), which were 29.1% below the 2009 figure (106 thousand in the quarter; -20.3% year-on-year). Shared loops decreased by 184 thousand accesses in 2010 (-33 thousand in the quarter), while full unbundled loops rose by 507 thousands (138 thousand in the quarter), of which 34% were naked shared loops.

**Pay TV** accesses recorded a positive performance in 2010, with 85 thousand net additions (15 thousand in the quarter), driving the customer base to over 788 thousand accesses (+12.1% year-on-year), and leaving an estimated market share of almost 19%.

On the other hand, the total number of Dúo and Trío packages accounted for 89% of the Company's retail broadband Internet accesses by year end.

**Revenue** declined 6.3% year-on-year in reported terms to 11,397 million euros in 2010 (-9.8% in the quarter). In comparable terms, revenue fell 5.3% year-on-year in 2010, primarily driven by the performance in access and voice revenue in an adverse economic environment. In the fourth quarter comparable revenue fell 7.2% year-on-year, mainly driven by the lower contribution of voice revenue and a slowdown in data and IT revenues.

By component:

- **Traditional access revenue** fell 13.1% year-on-year in reported terms in 2010, due to lower revenue related to Universal Service (95 million euros in 2010 vs. 223 million euros in 2009). In comparable terms, the year-on-year decline was 9.2% due to lower accesses (-6.5% year-on-year) and lower average revenue per line. The pace of decline eased in the fourth quarter (-9.0% year-on-year in comparable terms), improving quarter-on-quarter.
- **Voice service revenue** declined 10.9% year-on-year in 2010 (-13.1% in the quarter), affected by lower traffic, particularly international and fixed-to-mobile, and the growing weight of traffic under flat-rates.
- **Internet and broadband revenue** dropped 0.9% year-on-year in 2010 (-2.1% in the quarter):

- Retail broadband revenue fell 4.3% year-on-year in the full year, reflecting the decline in effective ARPU (-8.7% year-on-year). Revenue performance in the quarter (-7.6% year-on-year) reflected higher promotional activity amid strong competition.

- Wholesale broadband revenue posted an outstanding 29.0% year-on-year increase (+40.5% in the quarter), underpinned by growth in unbundled loops and wholesale ADSL accesses.

- Revenue from **data services** grew 4.9% year-on-year in 2010 and remained virtually stable in the quarter (-0.2% year-on-year). Stripping out revenues coming from the wireless business of Telefónica España, data revenue would have fallen 1.4% year-on-year.

- Revenue from **IT services** rose 19.0% year-on-year (+19.6% in the quarter), positively affected by the sale of applications rights (+51 million euros). In comparable terms, revenue growth was 9.0% year-on-year for the full year (+3.9% in the fourth quarter).

### Wireless Business

At the end of 2010 the estimated penetration in the Spanish mobile telephony market stood at 125%.

Telefónica maintained a strong commercial activity throughout 2010, up 7.1% year-on-year. However, it is worth to mention that the Company adapted its commercial strategy through 2009, leading to a strong push from the third quarter of 2009 onwards that explains the slowdown in year-on-year growth in the fourth quarter of 2010.

Gross additions in 2010 rose sharply, up 14.9% year-on-year (+6.6% in the quarter), being especially remarkable the higher growth recorded in the contract segment (+24.5% in 2010).

The **churn** rate was 2.3% in the year, very similar to 2009 rate (2.4% in the quarter). Nevertheless, contract churn remained well below the blended rate (1.4% in 2010) and was virtually stable year-on-year.

As a result, net additions posted healthy growth in 2010 (1.4 times the 2009 figure in comparable terms) amounting to 884 thousand accesses (not considering the disconnections in May following the identification of inactive prepaid customers).

The Company's focus on the contract segment drove net additions in this segment over one million accesses in the full year (roughly 1.4 times the 2009 figure), with 288 net additions in the quarter. As a result, the contract segment continued to post solid growth in 2010 (+6.9% year-on-year), accounting for over 67% of the Company's total mobile accesses, 2.3 percentage points more than in 2009.

It is worth noting the fact that this strategy, focused on the customer value, enabled Telefónica to sustain its leadership in the Spanish mobile telephony market, being the operator presenting the widest gap between revenue and access share.

As a result, the Company's **mobile telephony customer base** ended 2010 at 24.3 million accesses, up 3.3% on December 2009 figure.

**Traffic** fell by 0.8% year-on-year in both the full year and the quarter, reflecting a lower usage from customers in the current environment, and the different promotional campaigns of 2009 and 2010.

**Total ARPU** stood at 25.4 euros in 2010, down 7.3% year-on-year (-8.3% year-on-year in the quarter).

**Voice ARPU** declined 9.5% year-on-year in 2010 to 20.0 euros (-10.7% year-on-year in the quarter), driven by mobile termination rate cuts (-19.2% year-on-year following the cuts implemented in October and April 2010), lower usage by customers in the current environment and increased price-oriented competition. Outgoing voice ARPU posted a better performance, dropping 7.4% year-on-year in 2010 (-9.4% in the quarter).

**Data ARPU** recorded a positive performance standing at 5.5 euros in 2010, up 1.6% year-on-year (+0.7% in the quarter), on the back of a higher contribution from connectivity revenue and despite lower revenue from SMS. Data ARPU accounted for 21.4% of total ARPU in 2010 (+1.9 percentage points year-on-year).

Regarding data revenue, it is especially noteworthy the significant growth posted by connectivity revenue (+54.3% year-on-year in 2010; +44.2% in the quarter), boosted by strong demand for mobile broadband. As a result, mobile broadband customers reached over 4.8 million by year end (1.7 times the year end 2009 figure), accounting for almost 20% of the Company's mobile accesses (+8 percentage points vs. 2009).

Connectivity revenue growth led data revenue to account for 21% of mobile service revenue in 2010, with non-P2P SMS revenue representing 67% of data revenue.

**Revenue** totalled 8,550 million euros in 2010, a year-on-year decline of 4.6% in reported terms (-6.1% in the quarter). In comparable terms, revenue fell 4.7% year-on-year in the full year, and 7.3% in the quarter. By component:

- **Mobile service revenue** stood 7,270 million euros in 2010, declining 7.1% year-on-year in reported terms (-7.8% in the quarter). Lower mobile termination rates accounted for 3.1 percentage points of this decline. In comparable terms, mobile service revenue dropped 7.2% year-on-year in 2010 (-9.1% in the quarter).
- **Customer revenue** (6,226 million euros) declined 5.3% year-on-year in 2010 (-8.4% in the quarter), driven by lower usage and a downtrend in prices against a backdrop of intense competition.
- **Interconnection revenue** (792 million euros) decreased 20.9% year-on-year in 2010 (-17.8% in the last quarter) impacted by lower mobile termination rates.
- **Roaming-in revenue** fell 8.6% year-on-year in 2010, to 140 million euros (-0.7% year-on-year in the quarter).
- **Revenue from handset sales** grew by 12.6% year-on-year to 1,280 million euros in 2010 (+1.9% in the quarter).

## Telefónica España Accesses

	2009	2010				
	December	March	June	September	December	% Chg
Unaudited figures (thousands)						
<b>Final Clients Accesses</b>	<b>44,164.2</b>	<b>44,181.1</b>	<b>44,113.8</b>	<b>44,231.5</b>	<b>44,257.4</b>	<b>0.2</b>
Fixed telephony accesses <sup>1</sup>	14,200.1	13,922.5	13,663.9	13,485.0	13,279.7	(6.5)
Naked ADSL	14.7	30.3	37.0	39.1	38.1	158.2
Internet and data accesses	5,722.5	5,797.8	5,823.0	5,849.5	5,879.8	2.7
Narrowband	219.5	194.8	179.6	155.2	136.1	(38.0)
Broadband <sup>2</sup>	5,476.8	5,578.6	5,620.3	5,672.1	5,722.3	4.5
Other <sup>3</sup>	26.2	24.4	23.2	22.2	21.4	(18.2)
Mobile accesses	23,538.6	23,727.8	23,879.1	24,123.6	24,309.6	3.3
Prepay <sup>4</sup>	8,204.5	8,197.2	8,095.6	8,022.3	7,919.8	(3.5)
Contract	15,334.1	15,530.6	15,783.5	16,101.3	16,389.7	6.9
Pay TV	703.0	733.0	747.8	773.4	788.2	12.1
<b>Wholesale Accesses</b>	<b>2,614.0</b>	<b>2,844.3</b>	<b>3,004.1</b>	<b>3,132.5</b>	<b>3,333.8</b>	<b>27.5</b>
WLR <sup>5</sup>	97.4	161.3	205.1	250.5	294.5	n.m.
Unbundled loops	2,153.8	2,260.5	2,331.8	2,371.5	2,477.1	15.0
Shared ULL	447.7	380.1	324.8	296.7	264.0	(41.0)
Full ULL <sup>6</sup>	1,706.1	1,880.5	2,007.0	2,074.8	2,213.1	29.7
Wholesale ADSL	359.0	419.0	464.4	508.0	561.3	56.4
Other <sup>7</sup>	3.7	3.3	2.8	2.5	0.9	(76.6)
<b>Total Accesses</b>	<b>46,778.2</b>	<b>47,025.4</b>	<b>47,117.9</b>	<b>47,364.0</b>	<b>47,591.2</b>	<b>1.7</b>

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

2 ADSL, satellite, optical fibre and broadband circuits.

3 Leased lines.

4 715 thousand inactive prepay accesses were disconnected in December 2009 and 113 thousand in May 2010.

5 Wholesale Line Rental.

6 Includes naked shared loops.

7 Wholesale circuits.



## Telefónica España

### Consolidated Income Statement

	January - December			October - December		
	2010	2009	% Chg	2010	2009	% Chg
Unaudited figures (Euros in millions)						
Revenues	18,711	19,703	(5.0)	4,670	5,048	(7.5)
Internal exp capitalized in fixed assets	238	218	9.4	62	70	(11.2)
Operating expenses	(10,489)	(10,402)	0.8	(2,910)	(2,825)	3.0
Supplies	(4,185)	(4,293)	(2.5)	(1,137)	(1,158)	(1.8)
Personnel expenses	(2,658)	(2,304)	15.3	(813)	(600)	35.5
Subcontracts	(3,017)	(3,102)	(2.8)	(804)	(834)	(3.6)
Bad debt provision	(133)	(211)	(36.8)	(26)	(45)	(43.6)
Taxes	(496)	(491)	1.0	(131)	(187)	(29.9)
Other net operating income (expense)	50	25	98.0	23	1	n.s.
Gain (loss) on sale of fixed assets	14	222	n.s.	5	226	(97.6)
Impairment of goodwill and other assets	(4)	(9)	(53.9)	0	(4)	c.s.
<b>Operating income before D&amp;A (OIBDA)</b>	<b>8,520</b>	<b>9,757</b>	<b>(12.7)</b>	<b>1,850</b>	<b>2,517</b>	<b>(26.5)</b>
<b>OIBDA margin</b>	<b>45.5%</b>	<b>49.5%</b>	<b>(4.0 p.p.)</b>	<b>39.6%</b>	<b>49.8%</b>	<b>(10.2 p.p.)</b>
Depreciation and amortization	(2,009)	(2,140)	(6.1)	(531)	(542)	(2.0)
<b>Operating income (OI)</b>	<b>6,511</b>	<b>7,617</b>	<b>(14.5)</b>	<b>1,319</b>	<b>1,975</b>	<b>(33.2)</b>

#### Notes:

- OIBDA and OI before brand fees.
- Figures in million euros. Since January 2010, T. España's consolidation perimeter does not include Telyco Marruecos and since August 2010 includes Tuenti. In comparable terms revenues of T. España would decline by 4.4%, OIBDA would decrease by 6.9% and OpCF would drop 10.7% in the year. Comparable terms exclude the impact from changes in the consolidation perimeter, and thus include Tuenti in Aug-Dec 2009 and exclude the impact from following effects: Universal Service (+95 in revenue and +31 in OIBDA in 2010; +223 in revenue and +68 in OIBDA in 2009; +38 in revenue and +13 in OIBDA in the fourth quarter 2010; +148 in revenue and +47 in OIBDA in the fourth quarter 2009), property capital gains (+6 in OIBDA in the fourth quarter of 2009); capital gain on the sale of Medi Telecom (+220 in OIBDA in the fourth quarter of 2009); the exit of the consolidation perimeter of Telyco Marruecos (+57 in revenue and +4 in OIBDA in 2009; +9 in revenue and +2 in OIBDA in the fourth quarter of 2009); non-recurrent restructuring expenses mainly related to personnel reorganization (-202 in OIBDA in the fourth quarter of 2010); revision of estimates made prior to 2009 related to personnel commitments (+90 in OIBDA in 2009); TV tax (-107 in OIBDA in 2010; -24 in OIBDA in the fourth quarter of 2010), sale of application rights (+101 in revenue and OIBDA in 2010; +48 in revenue and OIBDA in 2009; +49 in revenue and OIBDA in the fourth quarter of 2010); and recovery of bad debts (+20 in OIBDA in 2010).

## Telefónica España: Wireline Business Selected Revenues Data

	January - December			October - December		
	2010	2009	% Chg	2010	2009	% Chg
Unaudited figures (Euros in millions)						
Traditional Access <sup>1</sup>	2,426	2,792	(13.1)	601	767	(21.6)
Traditional Voice Services	3,548	3,983	(10.9)	848	975	(13.1)
Traffic <sup>2</sup>	1,975	2,209	(10.6)	467	535	(12.6)
Interconnection <sup>3</sup>	808	911	(11.3)	185	220	(15.9)
Handsets sales and others <sup>4</sup>	766	864	(11.3)	195	220	(11.3)
Internet Broadband Services	2,933	2,960	(0.9)	726	741	(2.1)
Narrowband	17	33	(47.4)	3	6	(44.3)
Broadband	2,915	2,928	(0.4)	723	736	(1.8)
Retail <sup>5</sup>	2,480	2,590	(4.3)	596	646	(7.6)
Wholesale <sup>6</sup>	435	337	29.0	126	90	40.5
Data Services	1,358	1,294	4.9	348	349	(0.2)
IT Services	604	508	19.0	187	156	19.6
Subsidiaries and eliminations	528	630	(16.2)	149	181	(17.8)
Revenues	11,397	12,167	(6.3)	2,859	3,170	(9.8)

<sup>1</sup> Monthly and connection fees (PSTN, Public Use Telephony, ISDN and Corporate Services) and Telephone booths surcharges and WLR access.

<sup>2</sup> Local, domestic long distance, fixed to mobile and international traffic, Intelligent Network Services, Special Valued Services, Information Services (118xy), bonus 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.

### Notes:

- Since 1 January 2010, T. España's consolidation perimeter (wireline) does not include Telyco Marruecos.
- Figures in million euros. Associated to the recognition of the Universal Service, 95 million euros are included in traditional accesses in 2010 (38 in the fourth quarter) and 223 in 2009 (148 in the fourth quarter).
- IT services include a positive impact of 51 million euros from the sale of applications in 2010 (25 in the fourth quarter).

## Telefónica España: Wireless Business Selected Revenues Data

	January - December			October - December		
	2010	2009	% Chg	2010	2009	% Chg
Unaudited figures (Euros in millions)						
Service Revenues	7,270	7,828	(7.1)	1,751	1,898	(7.8)
Customer Revenues	6,226	6,571	(5.3)	1,499	1,636	(8.4)
Interconnection	792	1,001	(20.9)	182	221	(17.8)
Roaming - In	140	153	(8.6)	27	27	(0.7)
Other	113	103	9.4	44	14	n.s.
Handset revenues	1,280	1,137	12.6	387	380	1.9
Revenues	8,550	8,965	(4.6)	2,138	2,278	(6.1)

### Note:

- Figures in million euros. Service revenues include a positive impact of 51 from the sale of applications in 2010 (25 in the fourth quarter) and 48 in 2009, and include Twenti since August of 2010.

## Telefónica España: Wireless Business Selected Operating Data

	2009	2010				
	Q4	Q1	Q2	Q3	Q4	% Chg
Unaudited figures						
Traffic (Million minutes)	10,495	10,051	10,562	10,675	10,412	(0.8)
ARPU (EUR) <sup>1</sup>	26.7	25.6	25.6	26.2	24.5	(8.3)
Prepay <sup>1</sup>	11.9	11.4	11.6	12.2	10.6	(11.6)
Contract	35.3	33.1	32.9	33.2	31.2	(11.4)
Data ARPU (EUR) <sup>1</sup>	5.6	5.3	5.2	5.6	5.7	0.7
% non-P2P SMS over data revenues	60.7%	65.3%	65.8%	67.8%	67.8%	7.1 p.p.

<sup>1</sup> Change in ARPU affected by 715 thousand disconnections of inactive customers in December 2009 and 113 thousand in May 2010.

### Notes:

- ARPU calculated as monthly quarterly average.
- Traffic is defined as minutes used by the company customers, both outbound and inbound. On-net traffic is only included once (outbound), and promotional traffic is included. Traffic not associated to the Company's mobile customers (roaming-in, MVNOs, interconnection of third parties and other business lines) is excluded. Traffic volume non rounded.

## Telefónica España: Wireless Business Cumulative Selected Operating Data

	2009	2010				
	Jan-Dec	Jan-Mar	Jan-Jun	Jan-Sept	Jan-Dec	% Chg
Unaudited figures						
Traffic (Million minutes)	42,039	10,051	20,613	31,288	41,700	(0.8)
ARPU (EUR) <sup>1</sup>	27.5	25.6	25.6	25.8	25.4	(7.3)
Prepay <sup>1</sup>	12.6	11.4	11.5	11.7	11.4	(9.1)
Contract	36.5	33.1	33.0	33.1	32.6	(10.7)
Data ARPU (EUR) <sup>1</sup>	5.4	5.3	5.3	5.4	5.5	1.6
% non-P2P SMS over data revenues	60.6%	65.3%	65.4%	66.2%	66.6%	6.0 p.p.

<sup>1</sup> Change in ARPU affected by 715 thousand disconnections of inactive customers in December 2009 and 113 thousand in May 2010.

### Notes:

- ARPU calculated as monthly quarterly average of each period.
- Traffic is defined as minutes used by the company customers, both outbound and inbound. On-net traffic is only included once (outbound), and promotional traffic is included. Traffic not associated to the Company's mobile customers (roaming-in, MVNOs, interconnection of third parties and other business lines) is excluded. Traffic volume non rounded.

## Results by regional business units

### Telefónica Latinoamérica<sup>1</sup>

## Telefónica strengthened its position in Latin America

In 2010 Latin America registered strong economic growth, further strengthening the bases of a young social structure with a growing middle class in an increasingly stable institutional framework.

At the same time, Brazil has strengthened its position not only as a regional leader but also as a major player on the global stage. Telefónica reinforced its benchmark position in this key market in 2010, after increasing its stake in Vivo in the third quarter.

In 2010 Telefónica Latinoamérica delivered a strong operating performance, while maintaining high levels of efficiency.

Thanks to its differential asset portfolio in the region, the Company reported net additions of 15.2 million **accesses** in 2010 (4.6 million in the fourth quarter), to reach a total of 183.7 million accesses at the end of December (+9.0% year-on-year). This performance was underpinned by the growth of its mobile and broadband businesses and the stability of traditional wireline accesses.

Highlights of key trends in the **mobile business** in 2010 include:

- The estimated penetration rate in Latin America stood at 99% at the end of December 2010, a year-on-year increase of 10 percentage points.

- Telefónica managed 149.3 million mobile **accesses** in the region, up 10.8% year-on-year.
- **Net additions** in 2010 reached 14.6 million (+28.7% year-on-year) and 4.5 million accesses in the fourth quarter.
- Particularly noteworthy was the **quality of the growth**, the result of an acquisition policy focused on customer value and a clear commitment to migration from prepay to contract as a value driver. Thus, contract net additions accounted for 46% of the total in 2010 (19% in 2009) and were 3.1 times the figure reported in 2009. As a result, the contract customer base advanced by 28.9% year-on-year, representing 20% of the total customer base at year end (+3 percentage points year-on-year).
- The focus on a quality customer base, combined with the success of customer loyalty policies was reflected in a stable **churn**, which stood at 2.5% in 2010.
- **Traffic** in 2010 rose 22.4% year-on-year to 189,358 million minutes, driven by outgoing traffic (+27.2% in the year), on the back of initiatives aimed at encouraging usage and boosting the community effect.
- **Data** revenue remained a key growth lever in 2010, rising 43.4% year-on-year in organic terms and accounting for 23% of mobile service revenues (+4 percentage points year-on-year in organic terms).

<sup>1</sup> **Organic growth:** it assumes constant exchange rates as of 2009 (average fx), excludes changes in the perimeter of consolidation, includes 100% of Vivo since October in 2009. OIBDA figures do not include the revaluation of our pre-existing stake in Vivo (3,797 million euros in 2010), non-recurrent restructuring expenses (410 million euros in the fourth quarter 2010), mainly related to personnel reorganization and firm commitments relating to the Telefónica Foundation's social activities. Figures exclude hyperinflationary accounting in Venezuela in both years. CapEx excludes the spectrum acquisition in Mexico in 2010 (1,237 million euros).

- **ARPU** remained virtually stable (-0.2% year-on-year in constant currency), despite the strong growth in the customer base. This reflects the strong performance of outgoing ARPU, which rose 3.0% year-on-year in constant currency in 2010.

In the **wireline business**, in 2010 the Company continued to focus on improving quality indicators and customer satisfaction levels while maintaining its focus on bundles, reporting positive operating results:

- Telefónica's wireline **accesses** in Latin America totalled 34.5 million at the end of December, posting positive growth for the first time in six quarters (+1.8% vs. 2009).
- The focus on **bundling** and broadband is reflected in the fact that 66% of wireline accesses had signed up for some form of bundled offer as of the end of December 2010. Furthermore, 86% of broadband accesses are also under a double or triple play offers (+4 percentage points y-o-y).
- **Broadband accesses** rose again with net additions at record levels thanks to Telesp, the acceleration of growth in Colombia and the consolidation of growth in Argentina and Peru. As a result, broadband accesses stood at 7.4 million at the end of December, up 15.8% year-on-year, with growth continuing to accelerate versus previous quarters (+13.9% in the third quarter, +8.9% in the second quarter and +7.0% in the first). Total net additions in 2010 exceeded one million accesses (259 thousand in the fourth quarter), 2.8 times more than in 2009. The strong growth in broadband accesses drives the transformation process of the fixed business, and thus broadband accesses account for 30% of the Company's traditional accesses at year end (+4 percentage points year-on-year).

- In **pay TV** the customer base stood at 1.8 million at the end of December 2010 (+8.7% year-on-year), with growth picking up sharply in the fourth quarter (+3.6% year-on-year through September). Net additions in the year totalled 144 thousand accesses (39.5 thousand in the quarter).
- In the **traditional business** the Company continued to gear its efforts towards maintaining a stable customer base. Thus, fixed accesses totalled 24.4 million at the end of 2010, virtually unchanged from a year earlier (-0.7%), after registering a steady improvement over the year (-2.6% in September, -3.5% up to June).

As for Telefónica Latinoamérica's financial results, it should be noted that year-on-year comparisons from the fourth quarter of 2010 reflect the full consolidation of Vivo since October 2010 (previously this company's results were proportionately consolidated) following the acquisition of 50% of Brasilcel from Portugal Telecom on 27 September 2010.

In addition, 2010 OIBDA is affected by the positive contribution from the revaluation of our previously held stake in Vivo at the date of the acquisition of the 50% in Brasilcel owned by Portugal Telecom (3,797 million euros booked in the third quarter). On the other hand, the OIBDA is affected by non-recurrent restructuring expenses booked in the fourth quarter of 2010 (410 million euros), mainly related to personnel reorganization (159 million euros) and firm commitments linked to Telefónica Foundation's social activities (120 million euros).

It is also important to note that the year-on-year comparison in euros with 2009 is sharply distorted by the devaluation of the Venezuelan bolivar at the beginning of 2010.

**Revenue** in 2010 totalled 26,041 million euros, with solid year-on-year growth in organic terms of 6.7%, in line with the first nine months.

In terms of contributions by country, Brazil remained the biggest contributor in the region in 2010, generating 42.7% of revenue, a figure that rises to 47.1% assuming the full consolidation of Vivo in the entire year. The next largest contributors were Argentina (11.8% of revenue), Venezuela (8.9%), Chile (8.4%), Peru (7.5%) and Mexico (7.0%).

**Operating expenses** reached 16,965 million euros in 2010, up 7.6% year-on-year in organic terms that exclude non-recurrent restructuring expenses already mentioned:

- Supply costs increased 3.6% in organic terms to 6,801 million euros in 2010, and continued to reflect the impact of higher interconnection expenses and handset sales due to the increase in traffic and commercial activity, although growth slowed markedly versus the first half (+8.1% organic). The increase in reported terms was 9.9% in 2010.

- Subcontract expenses amounted to 6,549 million euros in 2010, up 11.8% year-on-year in organic terms. This growth is mainly explained by the higher commercial activity and the increased focus on contract, and the higher network and system expenses. In reported terms the increase was 28.6% affected by non-recurrent restructuring expenses related with firm commitments linked to Telefónica Foundation's social activities.
- Personnel expenses through December stood at 2,411 million euros, up 18.2% year-on-year in organic terms (+34.7% in reported terms), still affected by higher inflation in some countries in the region and by the non recurrent impacts from personnel reorganization in 2009 and 2010.

#### Operating income before depreciation and amortization (OIBDA)

reached 13,782 million euros in 2010 (+50.7% year-on-year in reported terms). In organic terms that exclude the impact from non-recurrent restructuring expenses in the fourth quarter, OIBDA was up 9.1% year-on-year.

**CapEx** in 2010 totalled 5,535 million euros (+12.7% year-on-year in organic terms), mainly related to mobile broadband expansion, as well as the enhancement of fixed broadband service. **Operating cash flow (OIBDA-CapEx)** amounted to 8,247 million euros (+6.9% year-on-year in organic terms that exclude the impact from non-recurrent restructuring expenses in the fourth quarter).

Telefónica Latinoamérica's strategy continues to focus on delivering customer satisfaction as a key growth lever. The Company's ability to deliver such a strong financial performance reflects its capacity to capture the full value of its assets taking a coordinated, regional approach to all its operations.

Within this goal of capturing the value of its assets and encompassed by the regional transformation process, the Company has developed a number of initiatives in different countries such as the sale of non-strategic assets, leading to positive results in 2010 (242 million euros in OIBDA).

It is also worth highlighting that the initiative "Open Telefónica", focused on finding new opportunities, continues to boost results derived from third party access to the Company's services platform and know-how and from assignments of rights of use (139 million euro contribution to revenue and 180 million euros to OIBDA in 2010; 117 and 140 million euros in 2009, respectively).

At the same time, the Company is constantly exploring new types of supplier relationships and innovative improvements to critical processes, taking a medium- to long-term approach. These take the form of specific initiatives that have a positive impact on synergy generation, and by extension, on the results of Telefónica Latinoamérica (61 million euros in OIBDA in 2010; 217 million euros in 2009).

## Brazil

In 2010, Brazil consolidated its position as a leading economic player, with high growth rates and an increasingly stable social structure with a growing middle class.

In this context, Telefónica has bolstered its position in the country after increasing its stake in Vivo, the leading mobile operator, and is the benchmark telco player in a sector that remains showing intense dynamism.

Telefónica managed 76.0 million **accesses** in Brazil at the end of 2010 (+13.4% year-on-year increase), after posting net additions of 9.0 million accesses (+44.6% year-on-year growth). As a result, the Company consolidated its position as market leader in accesses, underlining Vivo's leadership in the mobile market while posting a marked improvement in the operating results of Telesp.

In the mobile business, Vivo ended 2010 with 60.3 million accesses, up 16.5% year-on-year, maintaining its market leadership after posting net additions of 8.5 million accesses.

In the wireline business, Telesp consolidated its competitive and operating improvement in 2010, with quality levels that are a benchmark in the market. As a result, net additions in 2010 totalled 446 thousand accesses (98 thousand in the fourth quarter), underscoring the trends seen in previous quarters.

It should be noted that financial results from the fourth quarter of 2010 reflect the full consolidation of Vivo since October 2010 (previously this company's results were proportionately consolidated) after the acquisition of 50% of Brasilcel from Portugal Telecom on 27 September 2010.

Telefónica's **revenues** in Brazil totalled 11,119 million euros in 2010, a year-on-year increase of 12.1% in local currency and of 3.6% in organic terms, with organic growth rate accelerating to 5.6% in the fourth quarter, thanks to the strong performance of the mobile business.

#### Operating income before depreciation and amortization (OIBDA)

in 2010 amounted to 4,074 million euros (+9.6% year-on-year in reported terms). It should be noted that fourth-quarter OIBDA evolution is affected by non-recurrent restructuring expenses related to personnel reorganization and revenues from the assignment of rights of use of non-core assets. The OIBDA margin stood at 36.6% in 2010 in reported terms (-0.8 percentage points year-on-year) and at 39.7% in the fourth quarter.

In 2010 **CapEx** totalled 1,797 million euros (+12.5% year-on-year organic), leaving an **Operating cash flow (OIBDA-CapEx)** of 2,277 million euros.



## VIVO

The Brazilian mobile market continued to show strong performance in 2010, with accesses topping the 200-million mark in December (+16.7% year-on-year growth). This meant penetration surpassed 100% for the first time to reach 105% as of December (+14 percentage points year-on-year), consolidating Brazil's status as the fifth largest market in the world in terms of mobile phone users and one of the fastest growing markets.

In this context, it should be noted that Vivo began to be managed under Telefónica's integrated management model in the fourth quarter of 2010, already obtaining the first tangible benefits. At the same time, the Company continued to bolster its competitive position thanks to quality, customer satisfaction and brand recognition levels that remain the market benchmark in Brazil.

Vivo continues to lead the market in terms of accesses, revenue and profitability. According to data from Anatel, Vivo's market share at year end 2010 stood at 29.7%, leading the way in higher value segments where it attained a market share in the contract segment of 35.2%, up 3.0 percentage points year-on-year, despite strong competition.

The Company managed 60.3 million **accesses** at the end of 2010, up 16.5% year-on-year, after adding 8.5 million accesses in the year and 2.6 million in the fourth quarter.

Particularly noteworthy was the improvement in the quality of the customer base growth, with a larger increase in the contract customer base (+29.1% year-on-year). Contract net additions in 2010 represented 33% of the total and were 2.3 times higher than in 2009. As a result, the contract segment now accounts for 21% of total accesses, up 2 percentage points year-on-year.

The high level of net additions reflect the strong performance of gross additions (+24.5% year-on-year) and **churn** contention, which stood at 2.7% both in the full year and in the quarter, virtually stable versus 2009 (+0.1 percentage points year-on-year).

In terms of **traffic**, Vivo's networks managed a total of 77,463 million minutes in 2010, up 48.6% year-on-year (+11.6% in the quarter), driven by the sharp growth in on-net traffic.

**ARPU** continued to improve over the year, declining by 6.0% year-on-year in local currency in 2010 and by 3.0% in the fourth quarter, recording positive sequential growth for the third consecutive quarter.

**Revenues** amounted to 4,959 million euros in 2010, up 9.3%, year-on-year in organic terms, with growth accelerating in the fourth quarter to 11.4%. Mobile service revenues continued to perform well, rising 11.4% in the year, and accelerating in the fourth quarter to 14.8%, both year-on-year in organic terms.

**Data revenues** advanced 62.3% year-on-year in organic terms in 2010 (+53.5% year-on-year in the fourth quarter), and accounted for 19% of mobile service revenues in 2010 (+6 percentage points year-on-year). Particularly noteworthy was the positive performance of non-P2P SMS data revenues, accounting for 64% of data revenue (+2 percentage points versus 2009). Vivo consolidated its status as a sector benchmark and continued to tap market potential, delivering a particularly strong performance in mobile broadband.

**Operating income before depreciation and amortization (OIBDA)** amounted to 1,611 million euros in 2010, affected by non-recurrent restructuring expenses related to personnel reorganization (28 million euros) in the fourth quarter. Despite this effect, year-on-year growth in OIBDA in local currency and excluding changes in perimeter ramped up over the year to 13.1%, reaching a 19.7% in the fourth quarter.

The OIBDA margin stood at 32.5% in 2010 (+1.2 percentage points year-on-year), after reaching 34.2% in the fourth quarter (+2.4 percentage points year-on-year), setting a benchmark for the Brazilian market.

In 2010, **Operating cash flow (OIBDA-CapEx)** reached 863 million euros, as **CapEx** in 2010 totalled 748 million euros (+16.3% year-on-year in organic terms). Vivo continues to roll out its 3G network at a faster pace than its competitors, standing its 3G coverage at 75% over total population at the end of 2010.

## TELESP

Telesp achieved significant operating and commercial improvements in 2010, a year during which the Company reoriented its management focus and repositioned its commercial offer, attaining significant improvements in quality and customer loyalty levels. Thus, in 2010, two landmark achievements are especially noteworthy: the Company reported positive net additions of traditional lines for the first time since 2004 and in the broadband business, attained net additions of 681 thousand accesses, its highest ever figure which led to an upturn in its market share.

As a result, Telesp reached 15.7 million **accesses** at the end of 2010 (+2.9% year-on-year). Net additions stood at 446 thousand accesses in the year (98 thousand in the quarter), cementing the positive trend in yearly access growth that started in the third quarter.

In the traditional wireline business the Company managed 11.3 million accesses, having achieved 39 thousand net additions in the year thanks to an outstanding reduction in the number of claims and higher customer satisfaction levels derived from the sustained improvement in quality indicators.

As of December 2010, **broadband accesses** totalled 3.3 million (+25.8% year-on-year; +21.7% up to September). 2010 has been a historic year for the Company, recording 180 thousand net additions in the fourth quarter. Churn contention and strong gross additions reflect the significant improvement in Telesp's positioning in the market.

This performance underlines the acceleration in the transformation process of the Company. Broadband accesses represented 29% of traditional accesses in December 2010, up 6.0 percentage points year-on-year, despite the increase in traditional accesses.

In **Pay TV**, the Company managed 486 thousand accesses at the end of 2010, stable year-on-year thanks to a strong fourth-quarter performance, with net additions of 21 thousand accesses after five quarters of access net losses. This reflects the Company's successful repositioning of its offering.

At the same time, financial results are gradually reflecting the improvements at the operating level. Thus, full-year **revenues** totalled 6,843 million euros, stable year-on-year (+0.2% in local currency), with improved trends in the second half of the year (+0.5% in the fourth quarter in local currency).

Internet, pay TV and content revenues in 2010 advanced 2.2% year-on-year in local currency (+8.4% in the fourth quarter), accounting for 15% of total revenue in 2010. In 2010, broadband revenues advanced a noteworthy 7.4% year-on-year in local currency, with a marked acceleration in the fourth quarter (+20.2% year-on-year versus +3.3% up to September). Also noteworthy is the 9.9% year-on-year growth in local currency of Data and IT revenue in 2010, which also accelerated in the fourth quarter (+14.0% year-on-year).

Meanwhile, traditional telephony revenues remained under pressure, falling 1.4% year-on-year in local currency in 2010, mainly due to lower local traffic and public telephony revenue.

**Operating expenses** rose 6.0% in 2010 in local currency. In the fourth quarter of 2010 non-recurrent restructuring expenses related to personnel reorganization (32 million euros) were booked. Excluding this effect, as well as the positive non-recurrent impact recorded in the second quarter of 2009 arising from the revision of the provision for contingencies, the performance of expenses was mainly explained by the higher commercial activity, the increased weighting of new businesses, the growth in wireless traffic (SMP) and the efforts to improve the customer relationship model.

The bad debt provision also reflects Telesp's increasing focus on quality, representing 2.1% of total revenues in the year and 1.5% in the fourth quarter (-1.1 percentage points year-on-year in both periods).

As a result, **operating income before depreciation and amortization (OIBDA)** in 2010 amounted to 2,419 million euros (-7.5% year-on-year in local currency), leading to an OIBDA margin of 35.4% (-3.0 percentage points year-on-year). In the fourth quarter OIBDA advanced 2.5% year-on-year in local currency, leaving an OIBDA margin of 38.7% (+0.7 percentage points year-on-year).

2010 OIBDA and OIBDA margin year-on-year evolution were also affected by the positive impact registered in the fourth quarter of 2010 from the assignment of rights of use of non-strategic assets (100 million euros).

In 2010, **CapEx** stood at 1,049 million euros (+9.9% year-on-year in local currency), mainly devoted to new businesses development.

**Operating cash flow (OIBDA-CapEx)** amounted to 1,370 million euros in 2010 (-17.6% year-on-year in local currency).

## Argentina

Growth in the Argentine telecommunications market remained strong in 2010. In this context, Telefónica consolidated its leadership with a strategy focused on increasing customer value. In the wireline business, this was reflected on the promotion of bundles and improved quality through a differential broadband offering, and in the mobile business, on leveraging the community effect, prepay to contract migrations and the growth of mobile broadband.

Telefónica Argentina managed 22.3 million **accesses** at the end of 2010 (+1.8% year-on-year), fuelled by the growth in fixed broadband accesses (+16.3% year-on-year) and the stable fixed telephony accesses (+0.3% year-on-year).

**Revenues** in 2010 totalled 3,073 million euros, up 17.9% year-on-year in local currency (+19.7% in the fourth quarter), underpinned by solid revenue growth at the mobile business and internet and broadband and the stable revenue growth of the traditional telephony business.

**Operating income before depreciation and amortization (OIBDA)** reached 1,082 million euros in 2010, recording a 9.8% year-on-year growth in local currency (-0.4% in the fourth quarter), leading to an OIBDA margin of 34.3% (-2.4 percentage points year-on-year). It should be noted that non-recurrent restructuring expenses mainly related to personnel reorganization were booked in the wireline business in the fourth quarter of 2010 (40 million euros).

**CapEx** totalled 398 million euros in 2010 (+25.2% year-on-year in local currency), with **operating cash flow (OIBDA-CapEx)** of 684 million euros, up 2.5% year-on-year in local currency.

### T. Móviles Argentina

The estimated penetration rate of the Argentine mobile market stood at 129% at the end of 2010, up 8 percentage points year-on-year.

Telefónica managed 16.1 million mobile **accesses** in Argentina at year end (+1.4% year-on-year), after posting 217 thousand net additions in the year and despite the disconnection of 264 thousand inactive prepay accesses in the fourth quarter. It should be highlighted the strong performance posted by the contract segment, up 11.2% year-on-year to account for 36% of the total customer base (+3 percentage points year-on-year).

Gross additions posted a solid performance in 2010 (+1.6% year-on-year), while **churn** stood at 2.2% (+0.3 percentage points compared with 2009), as a result of the more selective commercial policies applied by the Company. However, it is worth highlighting the positive year-on-year evolution of contract churn.

**Traffic** carried in 2010 totalled 17,550 million minutes and posted a strong growth (+12.8% year-on-year; +10.8% in the fourth quarter) due to the sharp rise in on-net traffic (+23.4% versus 2009).

**ARPU** increased 6.7% year-on-year in local currency in 2010, with an acceleration of its growth trend to 8.4% year-on-year in the fourth quarter, driven by higher customer voice consumption and growing data usage.

**Revenues** in 2010 totalled 1,979 million euros (+20.6% year-on-year in local currency), with the positive growth trend consolidated in the fourth quarter (+23.1% year-on-year in local currency). This strong performance was driven by the solid growth in mobile service revenue in the quarter (+25.5% year-on-year in local currency; +21.4% in the full year).

The Company has developed a mobile broadband offering with a strong take-up, becoming a key growth driver. Thus, data revenues amounted to 35% of mobile service revenue in the year (+5 percentage points year-on-year), after posting 42.4% year-on-year growth in local currency (+30.4% in the quarter). Non-P2P SMS revenue grew 50.8% year-on-year and amounted to 27% of total data revenue.

**Operating income before depreciation and amortization (OIBDA)** reached 707 million euros in 2010, up 16.8% year-on-year in local currency (+15.0% in the final quarter), mainly driven by the strong revenue performance. The OIBDA margin stood at 35.7% in 2010 (-1.2 percentage points year-on-year) and at 37.4% in the fourth quarter (-2.9 percentage points year-on-year).

**CapEx** totalled 191 million euros in 2010, up 35.6% year-on-year in local currency, and was focused on expanding the capacity and coverage of the 3G network. **Operating cash flow (OIBDA-CapEx)** stood at 516 million euros in 2010, up 11.1% year-on-year in local currency.

### Telefónica de Argentina

Telefónica de Argentina managed 6.1 million **accesses** at the end of 2010, up 2.9% year-on-year, due to the strong growth in fixed broadband accesses (+16.3% year-on-year) and stable wireline accesses (+0.3% year-on-year).

In the **broadband** business Telefónica de Argentina consolidated its differential position in the market, based on quality and benchmark service. At the end of 2010 the Company managed 1.4 million accesses, recording 201 thousand net additions in the year (+28.8% year-on-year) and 48 thousand in the quarter. It is worth mentioning the Company's bundling strategy, as 72% of broadband accesses were bundled at the end of 2010 (+5 percentage points year-on-year).

At the end of December **traditional fixed accesses** stood at 4.6 million, with 14 thousand net additions, reflecting the Company's bundling strategy. Thus, 72% of these accesses were bundled on traffic packages (+3 percentage points year-on-year).

**Revenues** totalled 1,187 million euros in 2010, a year-on-year increase of 13.5% in local currency, with similar growth in the quarter (+14.0% year-on-year). This performance was driven by the strong growth in internet and content revenues (+29.2% year-on-year in local currency in 2010) and in data and IT revenues (+16.9% year-on-year in local currency), which account for 24% and 17% of total revenues respectively. Also noteworthy is the strong performance of traditional revenues (+6.3% year-on-year in local currency in 2010) due to the clear strategic focus on bundling.

In 2010 **operating expenses** advanced 20.3% year-on-year in local currency (+36.3% in the quarter), affected by the widespread increase in prices, the impact of the salary agreement reached in the previous quarter and non-recurrent restructuring expenses associated to personnel reorganization (40 million euros in the fourth quarter of 2010). Bad debt provisions stood at 1.3% of revenues in 2010 (-0.1 percentage points year-on-year).

**Operating income before depreciation and amortization (OIBDA)** reached 375 million euros in 2010, a 1.3% year-on-year fall in local currency, affected by the non-recurrent restructuring expenses mentioned earlier, and leaving an OIBDA margin of 28.4% (-3.9 percentage points year-on-year).

**CapEx** totalled 207 million euros in 2010 (+16.9% year-on-year in local currency), leaving **operating cash flow (OIBDA-CapEx)** of 168 million euros (-17.3% year-on-year in local currency).

## Chile

At the end of 2010 Telefónica Chile maintained its market leadership in Chile, promoting all its services under the Movistar brand. This has become a competitive advantage for the Company, providing an integrated and global service to its customers.

Telefónica managed 11.9 million **accesses** at the end of December 2010, up by a solid 11.8% year-on-year, driven by the strong growth of mobile accesses (+16.9% year-on-year), with a robust performance of mobile broadband and the contract segment (+25.2% year-on-year), and the focus on fixed broadband (+4.9% year-on-year) and pay TV expansion (+19.7% year-on-year). Additionally, traditional accesses slightly improved its trend, with the year-on-year decline continuing to ease in the fourth quarter (-4.4% compared with -4.7% in the third quarter).

It is worth noting the reduction in termination rates introduced in the tariff decrees of 2009 (On 23 January 2009 regulated mobile termination rates and on 7 May wireline termination rates) as these changes continue to affect the year-on-year comparison for the twelve-month period, with no impact on the fourth-quarter comparison.

On the other hand, the collection of insurance claims to cover the effects of the earthquake in the first quarter of the year was booked in the third and fourth quarter. These indemnities mitigate the negative impact of the earthquake on operating results and CapEx in 2010.

**Revenues** in 2010 amounted to 2,197 million euros, up 4.3% year-on-year in local currency, posting a strong acceleration in the fourth quarter (+9.5%). Excluding the impact of the termination rate cuts, revenues rose 5.0% year-on-year in local currency in 2010.

**Operating income before depreciation and amortization (OIBDA)** in 2010 reached 1,092 million euros, up 24.5% year-on-year in local currency (+43.8% in the fourth quarter). It should be noted that non-recurrent restructuring expenses related to personnel reorganization were booked in the fourth quarter (12 million euros). The OIBDA margin stood at 49.7% in 2010.

**CapEx** in 2010 totalled 516 million euros (+29.3% year-on-year in local currency), leaving **operating cash flow (OIBDA-CapEx)** of 576 million euros, a year-on-year increase of 20.4% in local currency.

### T. Móviles Chile

The penetration of the Chilean mobile market stood at an estimated 126% at the end of 2010, up 20 percentage points year-on-year.

Telefónica is focused on boosting the contract segment and the mobile broadband business, while offering a segmented service portfolio based on customer needs.

Telefónica Móviles Chile managed 8.8 million **accesses** at the end of 2010, up 16.9% year-on-year, consolidating the acceleration of the growth trend seen in prior quarters. The contract segment remains a key growth lever (+25.2% year-on-year), accounting for 30% of the customer base (+2 percentage points year-on-year).

Net additions reached 1.3 million in 2010, two fold the 2009 figure, with a solid fourth-quarter performance (503 thousand net additions; +86.9% year-on-year). Especially noteworthy was the performance of contract net additions (526 thousand), which were three times higher than in 2009 and amounted to 41% of total net additions in the year (26% in 2009). This positive performance was driven by steady growth in gross additions and the positive trend in churn. Movistar is the sector benchmark on this metric with a **churn** rate in 2010 of 1.3% (-0.3 percentage points year-on-year) and of 1.2% in fourth quarter (-0.2 p.p. percentage points year-on-year).

**Traffic** in 2010 reached 11,791 million minutes, up 12.1% year-on-year, mainly driven by the strong performance of on-net traffic (+14.0% year-on-year).

**ARPU** declined 1.8% year-on-year in local currency (-3.2% in the fourth quarter) despite the strong growth of the customer base.

**Revenues** totalled 1,266 million euros in 2010, up 9.0% year-on-year in local currency (+12.5% in the quarter), driven by the strong increase in mobile service revenues (+11.2% year-on-year in 2010; +14.2% in the fourth quarter).

Particularly noteworthy was the performance of **data revenues**, which advanced 46.9% year-on-year in local currency, accelerating its growth trend in the fourth quarter to 57.9%. Thus, data revenues account now for 16% of mobile service revenues, 4 percentage points higher compared to 2009. Non-P2P SMS revenue accounts for 66% of total data revenues, increasing its contribution by 13 percentage points year-on-year.

**Operating income before depreciation and amortization (OIBDA)** amounted to 610 million euros, a strong 19.2% year-on-year increase in local currency (+18.1% in the quarter). In the fourth quarter of 2010 non-recurrent restructuring expenses related to personnel reorganization were booked (3 million euros). As a result, the OIBDA margin stood at 48.2% in 2010 and 52.3% in the quarter, up 4.2 percentage points and 2.4 percentage points year-on-year respectively.

**CapEx** in 2010 amounted to 294 million euros (+38.2% year-on-year in local currency), while **operating cash flow (OIBDA-CapEx)** rose 5.8% year-on-year in local currency to 317 million euros.

### Telefónica Chile

Telefónica de Chile managed 3.1 million **accesses** at the end of 2010, with a stable access base compared with 2009 thanks to broadband (+4.9% year-on-year) and pay TV (+19.7% year-on-year) growth and the slowdown in the decline in traditional accesses.

The broadband customer base stood at 821 thousand accesses at the end of December 2010, with 38 thousand net additions in the year (6 thousand net additions in the fourth quarter), with almost the entire access base bundled.

Pay TV accesses totalled 341 thousand in December, driven by the launch of the high-definition service and the reshuffling of channels and value added services that allowed to reach 56 thousand net additions in 2010, three fold the 2009 net additions.

**Revenues** in 2010 totalled 1,038 million euros, up 1.1% year-on-year in local currency on the back of the steady improvement over the year, which continued in the fourth quarter (+8.2% year-on-year in local currency).

Internet, Pay TV and content revenues grew 10.0% year-on-year in local currency, with growth accelerating in the fourth quarter (+13.3%), and accounted for 28% of total revenue in 2010 (+2 percentage points year-on-year). Revenue from the traditional business fell 6.3% in local currency, though the year-on-year decline continued to ease (-1.1% in the fourth quarter).

The Company maintained its disciplined costs management, translated into **operating expenses** contention, down 1.2% year-on-year in local currency in 2010. This performance was achieved despite the impact in the fourth quarter of non-recurrent restructuring expenses related to personnel reorganization (9 million euros). Particularly noteworthy is the 0.8 percentage point year-on-year decline in the bad debt provision to 3.7% of revenues.

**Operating income before depreciation and amortization (OIBDA)** amounted to 476 million euros, a 27.2% year-on-year increase in local currency (+63.1% in the quarter). As a result, the OIBDA margin stood at 45.9% in 2010.

OIBDA growth was driven by strong revenue increase and improved cost efficiency. In addition, OIBDA includes gains from the sale of non-core assets (15 million euros) and the collection of insurance claims associated with the earthquake that shook Chile in the first quarter of the year.

**CapEx** in 2010 amounted to 222 million euros (+19.2% year-on-year in local currency). This drove **operating cash flow (OIBDA-CapEx)** 35.1% higher year-on-year in local currency to 254 million euros.

## Peru

Telefónica maintained its leadership position in the Peruvian market, managing 17.0 million **accesses** at year end 2010 (+6.5% year-on-year growth), on the back of the positive trend in fixed broadband accesses (+10.8% year-on-year) and mobile accesses (+9.2% year-on-year).

**Revenues** totalled 1,960 million euros in 2010, up 2.0% year-on-year in local currency (+3.0% in the fourth quarter), underpinned by strong trend of mobile service revenues and fixed broadband revenues.

**Operating income before depreciation and amortization (OIBDA)** reached 812 million euros in 2010, up 1.8% year-on-year in local currency (+4.1% in the fourth quarter), thanks to the progressive improvement in the mobile business throughout the year. It should be highlighted that OIBDA evolution, on the one hand, included negative impact in the fourth

quarter of non-recurrent restructuring expenses related to personnel reorganization (23 million euros), and on the other hand, included revenues from the sale of non-core assets (39 million euros in the year).

The OIBDA margin stood at 41.4% in 2010, virtually flat year-on-year (-0.1% percentage points), rising to 43.4% in the fourth quarter (+0.5 percentage points compared to 2009).

**CapEx** totalled 295 million euros in 2010 (-2.7% year-on-year in local currency), with **operating cash flow (OIBDA-CapEx)** at 517 million euros (+4.6% year-on-year in local currency).

### T. Móviles Perú

The Peruvian mobile market shows a significant growth potential, with estimated penetration of just 67% at year end 2010 (+2 percentage points year-on-year).

At December 2010, Telefónica Móviles Perú managed 12.5 million mobile **accesses**, (+9.2% year-on-year), underpinned by the excellent performance in the contract segment where accesses almost doubled year-on-year. Contract accesses accounted for 19% of the total customer base (+8 percentage points year-on-year) reflecting the efforts to migrate high value prepaid customers to the contract segment.

Mobile net additions surpassed one million in 2010 (365 thousand in the fourth quarter), posting a year-on-year growth of 24.0%. This performance was driven by growth in gross additions (+9.6% year-on-year) and the lower **churn** rate in 2010 (-0.1 percentage point year-on-year) standing at 3.0%, due to substantial improvement in the contract churn rate (-0.6 percentage points year-on-year).

**Traffic** in 2010 increased 19.2% to 13,662 million minutes, posting strong growth in the fourth quarter (+27.6% year-on-year), driven by the positive performance of outgoing traffic (+19.7% year-on-year in 2010; +29.1% in the fourth quarter).

In 2010, **ARPU** grew slightly (+0.3% year-on-year on 2009 in local currency), after posting in the fourth quarter a 2.1% year-on-year growth, reflecting the Company's strategic focus on increasing the unit value of its customer base.

**Revenues** in 2010 rose 6.4% in local currency to 1,001 million euros (+11.9% in the fourth quarter), consolidating the improved trend showed throughout the year. Revenue growth was underpinned by the healthy performance in mobile service revenues, which increased 9.7% year-on-year in 2010 in local currency (+15.3% in the fourth quarter).

Data revenues continued posting a strong performance, growing 10.5% year-on-year in local currency (+15.3% in the fourth quarter) to account for 11% of mobile service revenues in 2010. Non-P2P SMS revenues stood out, accounting for 58% of data revenue in 2010 (+4 percentage points year-on-year), after posting a year-on-year growth of 18.2% (+7.1% in the fourth quarter).

**Operating income before depreciation and amortization (OIBDA)** totalled 411 million euros in 2010 (up 12.3% year-on-year in local currency), driven by the 15.0% growth recorded in the fourth quarter. As a result, the 2010 OIBDA margin stood at 41.0% (+2.1 percentage points year-on-year), while in the fourth quarter the OIBDA margin was 42.2% (+1.1 percentage points).

**CapEx** amounted to 134 million euros in 2010, 5.5% lower than in 2009 in local currency. As a result, **operating cash flow (OIBDA-CapEx)** totalled 277 million euros in 2010, posting a strong growth of 23.6% year-on-year in local currency.

### Telefónica del Perú<sup>2</sup>

Telefónica del Perú managed 4.4 million **accesses** at year end 2010 (-0.2% year-on-year), with the bundled service offering remaining the Company's key growth driver.

<sup>2</sup> Wireline telephony accesses include all Telefónica's fixed wireless accesses in Peru, both those managed by the wireline business and those managed by the wireless business. However, earnings from fixed wireless accesses are included in the results of the Peruvian wireless business.



**Fixed broadband accesses** stood at 851 thousand at year end 2010 (+10.8% year-on-year), after recording 83 thousand net additions (+18.8% year-on-year). Pay TV reached 691 thousand accesses (+0.6%), virtually stable year-on-year despite the backdrop of intense competition.

Traditional wireline accesses reached 2.9 million at the end of 2010 (-3.4% year-on-year), affected by fixed-mobile substitution and line losses in the fixed wireless business.

The success of service bundling strategy is reflected in the number of bundled accesses: at year end 2010, 54% of traditional wireline accesses were bundled (+2 percentage points year-on-year), while 72% of fixed broadband accesses had either a Duo or Trio package (+8 percentage points).

**Revenues** totalled 1,097 million euros in 2010 (-2.6% year-on-year in local currency; -4.3% in the fourth quarter). This trend reflects lower revenues from traditional telephony services due to lower interconnection revenues (affected by cuts in the fixed network termination rates in force since September 2009) and the impact of new regulatory measures (reduction in fixed-mobile rates, the mobile virtual area in force since September 2010 and the application of the new productivity factor in the last quarter of 2010). On the other hand, Internet, TV and content revenues increased 6.9% year-on-year in 2010 in local currency (+1.3% in the fourth quarter), accounting for 36% of total revenue (+3 percentage points year-on-year).

**Operating expenses** grew 6.7% year-on-year in local currency in 2010, affected by non-recurrent restructuring expenses related to personnel reorganization (23 million euros) booked in the fourth quarter, higher bad debt provisions and the reversal of provisions in 2009 (8 million euros).

Bad debt provisions in 2010 accounted for 5.3% of total revenues (+2.6 percentage points year-on-year), showing a better performance in the fourth quarter (4.5% of revenues; +1.2 percentage points year-on-year).

**Operating income before depreciation and amortization (OIBDA)** amounted to 401 million euros in 2010, down 7.0% year-on-year in local currency (-4.3% year-on-year in the fourth quarter), mainly affected by the non-recurrent expenses previously-mentioned, and on the other hand, by the sale of non-core assets (39 million euros in 2010). The OIBDA margin stood at 36.6% in 2010 (-1.7 percentage points on 2009) and at 38.5% in the fourth quarter (stable year-on-year).

**CapEx** amounted to 161 million euros in 2010, virtually stable year-on-year (-0.3% in local currency). Thus **operating cash flow (OIBDA-CapEx)** totalled 240 million, down 11.1% on 2009 in local currency.

## Colombia

Telefónica consolidated its competitive position in the Colombian market in 2010, achieving overall operational improvements underpinned by changes in its commercial approach and in the management of the Company. This operational improvement was also reflected in its financial results, with a remarkable improvement versus 2009 and year-on-year growth in revenues, OIBDA and OpCF.

Telefónica managed 12.4 million **accesses** in Colombia at the end of 2010, up 10.7% year-on-year, driven by a strong growth in mobile and fixed broadband accesses (+11.6% and 30.4% year-on-year respectively), the sharp increase in pay TV accesses (+61.4% year-on-year) and the marked slowdown in the decline of traditional accesses (-3.2% year-on-year).

**Revenues** totalled 1,529 million euros in 2010 (+1.3% year-on-year in local currency), reversing the decline recorded in the first nine months of the year thanks to the 9.9% growth posted in the fourth quarter.

**Operating income before depreciation and amortization (OIBDA)** amounted to 484 million euros in 2010, up 2.6% year-on-year in local currency. OIBDA in the fourth quarter (-36.2% year-on-year) was affected, on the one hand, by non-recurrent restructuring expenses (85 million euros), mainly related to personnel reorganization, bad debts provisions and third-party claims, and on the other hand, by revenues from the assignment of rights of use and sale of non-core assets (71 million euros in the year).

The reported OIBDA margin stood at 31.7% in 2010 (+0.4 percentage points year-on-year) and at 22.1% in the quarter.

**CapEx** in 2010 amounted to 334 million euros (-11.0% year-on-year in local currency), while **operating cash flow (OIBDA-CapEx)** rose 55.4% year-on-year in local currency to 150 million euros.

### T. Móviles Colombia

The Colombian mobile market reached an estimated penetration of 98% by year end 2010, up 5 percentage points year-on-year, in a context where competition was rational, with commercial policies focused on customer value.

Telefónica Móviles Colombia ended 2010 having further consolidated the operational and financial improvements achieved since the beginning of the year. The customer base totalled 10.0 million **accesses** in December 2010 (+11.6% year-on-year), driven by the increase in contract customers (+32.0% year-on-year). It is worth pointing out the positive performance of mobile broadband, further consolidating its position as a key growth driver.



The commercial offering repositioning, which has been strengthened over the year, is reflected in the growth of gross additions (+50.3% year-on-year) and churn contention. Blended **churn** fell by 0.5 percentage points in the year to 3.2%, with positive performances in both prepay and contract segments. In the fourth quarter churn stood at 2.8%, stable compared to 2009.

As a result, net additions in 2010 amounted to 1.0 million accesses (284 thousand in the quarter) compared with the net loss reported in 2009. This positive trend was accompanied by strong growth in the contract segment, which accounted for 54% of net additions in the year, reflecting the Company's focus on high value customers.

The growth in **traffic** continues to reflect the Company's overall operating improvement and rose 18.7% year-on-year in 2010 to 16,226 million minutes (+16.2% in the fourth quarter), driven by the sharp growth in outgoing traffic (+22.8% in 2010).

As a result, and despite the sharp growth in accesses, **ARPU** in 2010 rose 2.0% year-on-year in local currency, with a strong increase in the fourth quarter (3.1% year-on-year), reflecting the strategic focus on acquisition and retention of high value customers.

**Revenues** in 2010 increased 7.1% year-on-year in local currency to 872 million euros, on the back of a marked acceleration in the second half of the year, especially in the fourth quarter (+18.6% year-on-year in local currency). Mobile service revenues showed a positive evolution rising 5.7% year-on-year in local currency in 2010, with growth accelerating to 15.8% in the fourth quarter.

Data revenues consolidated their role as a growth lever, rising 93.6% year-on-year in local currency (+104.8% in the quarter) to account for 16% of mobile service revenues (+7 percentage points year-on-year). To highlight the good performance of non-P2P SMS data revenues, accounting for 81% of data revenue (+4 percentage points versus 2009).

**Operating income before depreciation and amortization (OIBDA)** totalled 237 million euros in 2010, a year-on-year increase of 2.8% in local currency. OIBDA evolution throughout the year is impacted, on the one hand, by the sale of non-strategic assets (26 million euros) and, on the other hand, by non-recurrent restructuring expenses (65 million euros) mainly related to personnel reorganization, bad debt provisions and third-party claims booked in the fourth quarter. The OIBDA margin stood at 27.2% in 2010 (-1.1 percentage points year-on-year).

**CapEx** in 2010 amounted to 156 million euros, down 20.4% year-on-year in local currency, while **operating cash flow (OIBDA-CapEx)** stood at 81 million euros (2.3 times higher than 2009 in local currency terms).

#### Telefónica Telecom

Telefónica Telecom recorded significant commercial and operating improvements in 2010. Both the broadband and TV businesses maintained positive trends while traditional business showed signs of stabilization.

The focus on more segmented tariffs and maximising customer satisfaction, along with the steady upgrade in the speed of the broadband service and the gradual increase of bundles, are the key levers of the Company's strategy.

Telefónica Telecom managed 2.3 million **accesses** at the end of 2010 (+6.8% year-on-year), recording 150 thousand net additions in 2010.

**Broadband accesses** totalled 548 thousand at the end of 2010 (+30.4% year-on-year), with the pace of growth accelerating versus the first nine months of the year (+22.3% through September). Net additions in the year reached 128 thousand accesses (19 thousand in the fourth quarter).

Pay TV accesses reached 205 thousand (+61.4% year-on-year), with net additions of 78 thousand accesses in the year (versus a net loss in 2009) and of 21 thousand in the fourth quarter.

In the traditional business, the Company reached over 1.6 million accesses (-3.2% year-on-year), with a net loss in the full year of 53 thousand accesses, significantly lower than the 2009 figure.

This reflects the positive and sustained performance over the year of gross additions and the stability of churn across all businesses.

It should be noted that 79% of wireline accesses are bundled at the end of 2010 (+7 percentage points year-on-year), and all broadband accesses are marketed as part of either a Duo or Trio package.

Financial results continue to reflect improved operating trends again this quarter. **Revenues** amounted to 700 million euros in 2010 (-4.2% year-on-year in local currency), after posting year-on-year positive growth for second quarter in a row (+1.9% in local currency in the fourth quarter).

Internet, TV and content revenues showed positive trend in 2010, rising 10.3% year-on-year in local currency (+15.9% in the quarter) and now account for 23% of total revenues (+3 percentage points year-on-year). Meanwhile, in 2010, data and IT revenues rose 9.1% year-on-year in local currency (-0.5% in the fourth quarter).

**Operating expenses** in 2010 grew 5.9% year-on-year in local currency, affected by non-recurrent restructuring expenses (20 million euros) mainly related to personnel reorganization, bad debt provisions and third-party claims booked in the fourth quarter of 2010.

As a result, **operating income before depreciation and amortization (OIBDA)** showed a significant improvement, totalling 249 million euros (+2.9% year-on-year in local currency; -8.2% in the fourth quarter). In addition to non-recurrent impacts mentioned previously, 2010 OIBDA evolution reflects the positive impact of the assignment of rights of use of non-core assets (45 million euros in the year). The OIBDA margin stood at 35.5% in 2010 (+2.5 percentage points year-on-year) and at 34.1% in the quarter (-3.6 percentage points).

**CapEx** in 2010 amounted to 178 million euros (-0.7% year-on-year in local currency), while **operating cash flow (OIBDA-CapEx)** totalled 70 million euros (+13.3% year-on-year in local currency).

## Mexico

Estimated penetration in the Mexican mobile market reached 82% by year end 2010, up 7 percentage points year-on-year.

At year end 2010, Telefónica Móviles México managed 20.2 million **accesses**, up 14.1% from December 2009. Mobile accesses stood at 19.7 million (+13.0% year-on-year), boosted mainly by growth in the contract segment (+49.3% year-on-year), which reflects the Company's strategic efforts to migrate its value prepay customers over to this segment. The Company's estimated share of the mobile market surpassed 21.3% (+0.4 percentage points on December 2009), thereby consolidating the improvement in its competitive position and extending the market share gain registered in recent years.

**Net additions** reached 2.3 million in 2010 (+9.2% year-on-year) and 901 thousands in the fourth quarter. It is worth mentioning the positive evolution of prepay net additions in the fourth quarter, broadly flat year-on-year.

It should be noticed that since the end of the third quarter of 2010 the Company has taken a new commercial approach in the prepay segment aimed at boosting usage per customer. This has led to changes in the promotional policy and the introduction of new pricing plan, which have resulted in some operational improvements although they have not yet an impact on revenues.

On the other hand, as part of the Company's strategic focus on customer value as the lever for sustainable growth, commercial activity in the contract segment was strong again in the fourth quarter leading total contract net additions in 2010 to triple versus 2009. As a result, the contract segment now accounts for 8% of Telefónica Móviles México's customer base (+2 percentage points compared to year end 2009) and 23% of net additions for the year (vs. 8% in 2009).

The **churn** rate was 2.1% (1.9% in the fourth quarter), below the 2009 rate (-0.1 percentage points year-on-year) and maintaining its position as a benchmark in the market.

**Traffic** was broadly flat in 2010 (+0.2% year-on-year), affected by the introduction of a 3% special tax (IEPS) on production and services and a 1 percentage point increase in VAT, which was transferred to customers, as well as changes made to the Company's commercial offering in the first half of the year. Nevertheless, the pace of decline in traffic eased in the fourth quarter (-7.1% year-on-year vs. -7.7% in the third quarter), evidencing the initial results of the changes introduced to reposition the Company's commercial offer in the prepay segment.

**ARPU** fell by 10.8% year-on-year in local currency in 2010 (-15.2% year-on-year in the last quarter).

**Revenue** totalled 1,832 million euros in 2010, a year-on-year increase of 5.0% in local currency (-3.8% in the fourth quarter). Mobile service revenue rose 4.1% in 2010 in local currency (-2.2% in the fourth quarter), driven by a strong revenue performance in the contract segment which offset the weak performance in the prepay segment.

Data revenue continued to post sharp growth (+14.2% year-on-year in local currency in 2010; +8.3% in the fourth quarter). As a result, 22% of mobile service revenues now come from the data business (+2 percentage points on 2009), with a remarkable 45.9% year-on-year growth in non-P2P SMS revenue (+39.3% in the fourth quarter). Regarding this point, following the recent acquisition of new spectrum, it is worth highlighting the positive take-up of the mobile broadband offer already in place.

**Operating income before depreciation and amortization (OIBDA)** reached 623 million euros in 2010, down 1.7% year-on-year in local currency (-19.6% in the fourth quarter). The OIBDA performance is driven by the commercial reshuffling, which has led to higher commercial activity, the increased proportion of contract customers and the evolution of prepay revenues. The OIBDA margin stood at 34.0% in 2010 (32.5% in the fourth quarter), 2.3 percentage points below the 2009 margin.

**CapEx** totalled 1,580 million euros in 2010, reflecting the cost of the licence for use of the 1900 MHz and 1700 MHz frequencies awarded to Telefónica and the renewal of its 800 MHz licences for a total of 1,237 million euros. **Operating cash flow (OIBDA-CapEx)** in 2010 (-957 million euros) was affected by the investment in spectrum.

Stripping out the cost of the licences, CapEx would have increased by 19.4% year-on-year in 2010 in local currency, reflecting an intensification of the rollout of the mobile broadband network, while operating cash flow would have fallen by 18.5% in local currency terms.

## Venezuela

For a better understanding of the evolution of Telefónica Móviles Venezuela's financial results in euros, it should be noticed that in early January 2010 the Venezuelan government devalued the bolivar fuerte. Therefore in 2010, the conversion of Telefónica Móviles Venezuela's financial results is delivered at an exchange rate of 4.3 bolivar fuerte per dollar, which implies a year-on-year devaluation of 50%. It must be borne in mind that the Company's financial results reflect a hyperinflation adjustment for both 2009 and 2010.

For comparative purposes and to facilitate the interpretation of year-on-year changes with respect to 2009 in local currency of the headings affected by the hyperinflation adjustment are reported excluding the impact of this adjustment (changes in organic terms).

Estimated market penetration in Venezuela reached 101% by the end of 2010, unchanged from year end 2009.

In the current environment, Telefónica Móviles Venezuela's strategy is focused on innovation and maximising customer value, both in acquisition and retention policies. To this end, the Company keeps a benchmark offer in the market, leading broadband, television, and mobile telephony services with a highly-segmented approach. This strategy is translating into high levels of customer satisfaction in terms of service quality ratios.

At year end 2010, the Company managed over 10.6 million **accesses** (11.8 million at year end 2009), of which 9.5 million were mobile accesses (10.5 million at year end 2009). The year-on-year performance was shaped by market dynamics, the strategic focus on customer value and the limited availability of handsets. Thus, it is worth highlighting the growth in the contract customer base (+20.9% year-on-year), with this segment already accounting for 8% of total accesses (+2 percentage points versus 2009).

The **churn** rate in the mobile business stood at 2.6% in 2010 (+0.2 percentage points year-on-year), with the performance in the contract segment standing out (-0.1 percentage point year-on-year to 1.0%). The churn rate rose 0.4 percentage points year-on-year in the fourth quarter to 3.0%, impacted by the performance of the prepaid segment.

**Traffic** managed by the Company totalled 14,195 million minutes in 2010 (-5.1% year-on-year), due to the lower access base, albeit performing slightly better in the last quarter (-4.4% year-on-year).

**ARPU** continued to post a positive performance, reflecting the continuous focus on increasing customer value, rising 26.3% year-on-year in organic terms in 2010 and accelerating to 28.4% year-on-year in organic terms in the fourth quarter.

**Revenue** continued to perform well in 2010, with high growth rates, posting a 15.0% year-on-year increase in organic terms to reach 2,318 million euros (+17.8% in the last quarter). Notably, mobile services revenues continued to post healthy growth, rising 21.3% in organic terms in 2010 (+19.4% in the last quarter), while revenue from handset sales continued to be affected by the economic environment and the limited availability of handsets (-17.7% year-on-year in organic terms in 2010).

In the data business, Telefónica Móviles Venezuela is cementing its position as a benchmark company, offering new products and innovative services. The strategic focus on the mobile broadband segment is paying off. Thus, in 2010, data revenue registered organic growth of 47.4% year-on-year (+41.9% in the last quarter) to account for 33% of mobile service revenues.

**Operating income before depreciation and amortization (OIBDA)** totalled 1,087 million euros in 2010, up 10.4% year-on-year in organic terms (+21.2% in the fourth quarter), extending the increasing growth momentum evidenced throughout the year. The Company continues posting high operating efficiency, registering an OIBDA margin of 46.9% in 2010 (47.1% in the fourth quarter), reflecting its ability to adapt to the high-inflation environment.

The Company maintains its significant investment effort, so that **CapEx** increased by 18.7% year-on-year in organic terms to 293 million euros in 2010. **Operating cash flow (OIBDA-CapEx)** amounted to 794 million euros, with a 7.7% year-on-year growth in organic terms.

## Central America

Mobile penetration in Telefónica's Central American markets is estimated at 98% as of December 2010, up 8 percentage points year-on-year. It is worth highlighting the penetration rate in El Salvador and Panama, which exceed 100%.

At the end of December 2010, Telefónica managed 6.9 million total **accesses** (+9.7% year-on-year), of which 6.4 million were mobile accesses (+10.3% year-on-year), consolidating the acceleration in year-on-year access growth noted since the end of 2009, with strong performance of mobile broadband accesses. The Company has consolidated the improvement in its competitive positioning during last quarter.

Mobile net additions totalled 597 thousand in 2010, nearly six times the net additions reported in 2009, with strong performances in both the prepaid and contract segments. This improvement was achieved thanks to the increase in commercial activity arising from a differentiated offer and the positive performance of **churn** (2.7%), which was virtually unchanged year-on-year (-0.1 percentage points), notwithstanding the disconnections relating to the CDMA network switch-off in El Salvador and Guatemala. Mobile net additions totalled 237 thousand in the fourth quarter (+57.3% year-on-year), driven by an excellent performance in prepaid additions and a 0.3 percentage point improvement in churn. Stripping out the disconnections relating to the CDMA network switch-off in El Salvador and Guatemala, blended churn would have declined 0.3 percentage points year-on-year.

**Revenues** in 2010 totalled 562 million euros (-4.7% year-on-year in constant euros; -13.6% in the quarter), mainly affected by the new regulatory measures in El Salvador, which had a significant impact on interconnection revenues and customer fees.

**Operating income before depreciation and amortization (OIBDA)** totalled 189 million euros in 2010 (-24.8% year-on-year in constant euros; -25.3% in the quarter) affected by higher commercial expenses due to increased commercial activity associated with the distribution channel expansion and higher call center expenses to enhance customer relations service. Therefore, the OIBDA margin in 2010 stood at 33.6% (-9.0 percentage points year-on-year), with an improved performance in the fourth quarter (37.3%, -6.1 percentage points year-on-year).

**CapEx** in 2010 amounted to 105 million euros (+16.3% year-on-year in constant euros), largely due to investment focused on increasing network coverage in Guatemala, El Salvador and Nicaragua. As a result **operating cash flow (OIBDA-CapEx)** totalled 84 million euros (-47.8% year-on-year in constant euros).

## Ecuador

Estimated penetration of the Ecuadorean mobile market stood at 106% at the end of 2010, an increase of 13 percentage points year-on-year.

Telefónica managed a total of 4.3 million **accesses** in Ecuador at year end 2010 (+13.4% year-on-year). Mobile accesses increased by 13.4% on December 2009 to 4.2 million, thanks to the excellent performance of the contract segment (+24.7% year-on-year) and mobile broadband accesses. Net additions in the mobile business reached 498 thousand accesses in 2010.

The Company's focus on customer value is reflected in the growth of the contract segment, where net additions were 2.3 times the 2009 figure (accounting for 26% of total 2010 net additions) and in the 0.4 percentage point improvement in contract **churn** compared to 2009. The blended churn stood at 2.6% (+0.2 percentage points year-on-year).

**Traffic** also performed well, rising 14.0% year-on-year to 4,268 million minutes in 2010 (+3.0% year-on-year in the quarter), driven by higher on-net traffic.

**ARPU** decreased 4.6% year-on-year in local currency, affected by the higher weight of on-net traffic with lower unitary prices and by the sharp growth in the customer base. However, ARPU performed better in the last quarter of the year (-1.4% year-on-year).

**Revenue** rose 11.8% in local currency to 396 million in 2010 (+6.5% year-on-year in the fourth quarter), underpinned by healthy growth in mobile service revenues, which rose 10.8% year-on-year (+11.1% year-on-year in the last quarter).

Data revenue remains a key growth driver, posting a 36.4% growth in local currency in 2010 (+37.0% in the fourth quarter) and accounts for 25% of mobile service revenues (+5 percentage points year-on-year). Growth in non-P2P SMS data revenues fared especially well (+86.6% year-on-year in local currency in 2010), accounting for 53% of 2010 data revenues (+14 percentage points year-on-year).

**Operating income before depreciation and amortization (OIBDA)** rose 15.6% year-on-year in local currency to 121 million euros (+32.3% in the fourth quarter). OIBDA margin in 2010 stood at 30.7% (+1.0 percentage points year-on-year), while in the fourth-quarter margin rose 6.7 percentage points year-on-year to 32.8%.

**CapEx** totalled 60 million euros in 2010 (-31.0% year-on-year in local currency), while **operating cash flow (OIBDA-CapEx)** amounted to 61 million euros (3.4 times higher than 2009, in local currency).

## Telefónica Latinoamérica Accesses

	2009	2010				
	December	March	June	September	December	% Chg
Unaudited figures (Thousands)						
Final Clients Accesses	168,531.1	172,265.3	176,044.0	179,102.5	183,686.9	9.0
Fixed telephony accesses <sup>1</sup>	24,578.3	24,459.1	24,514.9	24,456.5	24,403.6	(0.7)
Internet and data accesses	7,605.2	7,733.8	7,911.5	8,102.7	8,235.1	8.3
Narrowband <sup>2</sup>	1,070.6	983.6	881.6	808.0	674.8	(37.0)
Broadband <sup>3,4</sup>	6,426.8	6,641.5	6,916.0	7,183.0	7,442.3	15.8
Other <sup>5</sup>	107.8	108.7	113.9	111.7	118.0	9.4
Mobile accesses	134,698.9	138,377.4	141,882.2	144,790.1	149,255.4	10.8
Prepay	111,503.6	113,517.7	115,102.4	116,267.5	119,359.1	7.0
Contract	23,195.4	24,859.7	26,779.8	28,522.6	29,896.3	28.9
Pay TV	1,648.6	1,695.0	1,735.4	1,753.2	1,792.7	8.7
Wholesale Accesses	56.1	55.8	58.8	56.1	55.9	(0.4)
Total Accesses	168,587.2	172,321.1	176,102.8	179,158.5	183,742.8	9.0

<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. Total "fixed wireless" accesses included.

<sup>2</sup> Includes narrowband ISP of Terra Brasil and Terra Colombia.

<sup>3</sup> Includes broadband ISP of Terra Brasil and Terra México.

<sup>4</sup> Includes ADSL, optical fiber, cable modem and broadband circuits.

<sup>5</sup> Retail circuits other than broadband.

Note:

December 2009 includes the disconnection of inactive customers in Colombia, Peru and Guatemala.

## Telefónica Latinoamérica Consolidated Income Statement

	January - December			October - December		
	2010	2009	% Chg	2010	2009	% Chg
Unaudited figures (Euros in millions)						
Revenues	26,041	22,983	13.3	7,606	6,334	20.1
Internal exp capitalized in fixed assets	147	112	31.5	48	31	55.2
Operating expenses	(16,965)	(14,274)	18.9	(5,178)	(4,016)	28.9
Supplies	(6,801)	(6,188)	9.9	(1,951)	(1,777)	9.8
Personnel expenses	(2,411)	(1,789)	34.7	(810)	(497)	63.0
Subcontracts	(6,549)	(5,092)	28.6	(2,044)	(1,429)	43.0
Bad debt provision	(512)	(564)	(9.2)	(167)	(140)	19.0
Taxes	(691)	(640)	8.0	(206)	(173)	19.3
Other net operating income (expense)	474	308	54.0	280	171	64.4
Gain (loss) on sale of fixed assets	4,079	15	n.m.	199	7	n.m.
Impairment of goodwill and other assets	5	(2)	c.s.	(1)	3	c.s.
Operating income before D&A (OIBDA)	13,782	9,143	50.7	2,955	2,529	16.9
OIBDA Margin	52.9%	39.8%	13.1 p.p.	38.9%	39.9%	(1.1 p.p.)
Depreciation and amortization	(4,061)	(3,793)	7.1	(1,181)	(1,014)	16.5
Operating income (OI)	9,721	5,350	81.7	1,774	1,515	17.1

Notes:

• OIBDA and OI before management and brand fees

• 2009 and 2010 reported figures include the hyperinflationary adjustments in Venezuela in both years.

• T. Latinoamérica reported figures include 100% of Vivo since October 2010.

• Figures in million euros. OIBDA, OIBDA margin and Operating Income are affected by the positive impact from the revaluation of the pre-existing stake in Vivo at the fair value at the date of the acquisition of the 50% in Brasilcel owned by Portugal Telecom (3,797 in the third quarter of 2010) and by non-recurrent restructuring expenses mainly related to personnel reorganization and firm commitments relating to the Telefónica Foundation's social activities of 410 in the fourth quarter of 2010.

## Telefónica Latinoamérica Accesses by Countries (I)

	2009		2010			
	December	March	June	September	December	% Chg
Unaudited figures (Thousands)						
<b>Brazil</b>						
Final Clients Accesses	66,925.7	69,185.5	71,353.9	73,243.2	75,919.6	13.4
Fixed telephony accesses <sup>1</sup>	11,253.8	11,193.2	11,256.8	11,299.3	11,292.6	0.3
Internet and data accesses	3,440.2	3,573.4	3,651.0	3,764.0	3,848.2	11.9
Narrowband	723.1	689.4	595.8	547.0	446.2	(38.3)
Broadband <sup>2</sup>	2,638.4	2,801.4	2,974.2	3,138.9	3,319.2	25.8
Other <sup>3</sup>	78.7	82.6	81.0	78.1	82.8	5.2
Mobile accesses	51,744.4	53,949.1	55,977.3	57,714.4	60,292.5	16.5
Prepay	41,960.7	43,435.9	44,626.1	45,641.8	47,658.6	13.6
Contract	9,783.7	10,513.2	11,351.2	12,072.6	12,633.9	29.1
Pay TV	487.2	469.8	468.8	465.5	486.3	(0.2)
Wholesale Accesses	34.2	33.6	34.1	33.8	33.9	(0.8)
Total Accesses	66,959.8	69,219.1	71,388.1	73,277.0	75,953.5	13.4
<b>Argentina</b>						
Final Clients Accesses	21,890.7	22,157.2	22,384.3	22,501.9	22,275.8	1.8
Fixed telephony accesses <sup>1</sup>	4,607.7	4,608.9	4,612.1	4,620.9	4,621.5	0.3
Fixed wireless	36.2	38.0	36.1	38.8	35.5	(2.0)
Internet and data accesses	1,351.0	1,365.5	1,408.2	1,468.4	1,505.4	11.4
Narrowband	112.7	89.1	83.9	76.5	65.7	(41.7)
Broadband <sup>2</sup>	1,238.3	1,276.4	1,324.4	1,391.9	1,439.7	16.3
Mobile accesses	15,931.9	16,182.8	16,364.0	16,412.6	16,148.9	1.4
Prepay	10,736.8	10,867.3	10,911.8	10,793.3	10,370.4	(3.4)
Contract	5,195.2	5,315.5	5,452.1	5,619.3	5,778.5	11.2
Wholesale Accesses	9.3	9.8	12.6	12.8	13.0	39.4
Total Accesses	21,900.0	22,167.0	22,396.9	22,514.8	22,288.8	1.8
<b>Chile</b>						
Final Clients Accesses	10,645.0	10,847.4	11,077.5	11,397.8	11,910.5	11.9
Fixed telephony accesses <sup>1</sup>	2,028.0	1,990.9	1,966.9	1,952.8	1,939.3	(4.4)
Internet and data accesses	807.2	800.0	811.0	830.6	836.0	3.6
Narrowband	15.9	8.5	7.6	7.0	6.6	(58.2)
Broadband <sup>2</sup>	783.2	783.5	795.3	815.7	821.5	4.9
Other <sup>3</sup>	8.1	8.0	8.0	7.9	7.9	(3.1)
Mobile accesses	7,524.7	7,759.6	7,992.7	8,290.8	8,794.0	16.9
Prepay	5,435.9	5,531.7	5,640.0	5,805.3	6,179.3	13.7
Contract	2,088.8	2,228.0	2,352.7	2,485.4	2,614.7	25.2
Pay TV	285.1	296.9	306.9	323.6	341.2	19.7
Wholesale Accesses	8.9	8.6	8.4	5.7	5.3	(40.4)
Total Accesses	10,653.8	10,856.1	11,085.8	11,403.5	11,915.8	11.8

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

2 Includes ADSL, cable modem and broadband circuits.

3 Retail circuits other than broadband.



## Telefónica Latinoamérica Accesses by Countries (II)

	2009		2010			
	December	March	June	September	December	% Chg
Unaudited figures (Thousands)						
<b>Peru</b>						
Final Clients Accesses	15,916.3	16,162.6	16,304.7	16,611.5	16,954.3	6.5
Fixed telephony accesses <sup>1</sup>	2,971.2	2,945.3	2,915.0	2,895.4	2,871.2	(3.4)
Fixed wireless	582.7	555.8	539.7	535.6	537.8	(7.7)
Internet and data accesses	800.6	824.0	860.0	863.1	885.4	10.6
Narrowband	16.9	15.0	16.5	15.9	15.4	(9.1)
Broadband <sup>2</sup>	768.0	792.2	825.3	828.4	850.8	10.8
Other <sup>3</sup>	15.6	16.8	18.2	18.8	19.2	23.1
Mobile accesses	11,458.2	11,681.1	11,805.4	12,141.9	12,507.1	9.2
Prepay	10,214.2	10,151.5	9,873.8	9,880.8	10,104.4	(1.1)
Contract	1,244.1	1,529.6	1,931.6	2,261.1	2,402.7	93.1
Pay TV <sup>4</sup>	686.3	712.3	724.3	711.1	690.6	0.6
Wholesale Accesses	0.5	0.5	0.5	0.5	0.5	(10.2)
Total Accesses	15,916.8	16,163.1	16,305.2	16,611.9	16,954.8	6.5
<b>Colombia<sup>5</sup></b>						
Final Clients Accesses	11,159.9	11,528.0	11,835.4	12,062.9	12,350.3	10.7
Fixed telephony accesses <sup>1</sup>	1,639.8	1,628.2	1,627.1	1,623.7	1,586.9	(3.2)
Internet and data accesses	428.4	464.9	499.7	534.5	553.6	29.2
Narrowband	5.9	4.9	4.6	5.3	5.6	(4.4)
Broadband <sup>2</sup>	420.3	460.0	495.0	529.2	548.0	30.4
Other <sup>3</sup>	2.2	0.0	0.0	0.0	0.0	n.s.
Mobile accesses	8,964.6	9,287.5	9,537.6	9,720.1	10,004.5	11.6
Prepay	7,203.2	7,369.0	7,497.1	7,520.5	7,679.1	6.6
Contract	1,761.4	1,918.5	2,040.5	2,199.6	2,325.5	32.0
Pay TV	127.2	147.4	171.0	184.7	205.3	61.4
Wholesale Accesses	3.3	3.3	3.3	3.3	3.3	0.0
Total Accesses	11,163.2	11,531.3	11,838.7	12,066.2	12,353.6	10.7
<b>Mexico</b>						
Mobile accesses	17,400.5	17,813.2	18,256.9	18,760.5	19,661.6	13.0
Prepay	16,328.3	16,617.3	16,904.4	17,289.7	18,061.3	10.6
Contract	1,072.1	1,195.9	1,352.5	1,470.8	1,600.2	49.3
Fixed Wireless	334.3	381.1	430.6	496.0	565.5	69.1
Total Accesses	17,734.8	18,194.3	18,687.5	19,256.5	20,227.1	14.1
<b>Venezuela</b>						
Mobile accesses	10,531.4	10,254.6	10,265.4	9,851.0	9,514.7	(9.7)
Prepay	9,891.1	9,601.7	9,596.1	9,137.0	8,740.3	(11.6)
Contract	640.3	652.9	669.3	714.0	774.4	20.9
Fixed Wireless	1,214.3	1,170.8	1,175.8	1,023.4	966.2	(20.4)
Pay TV	62.8	68.7	64.4	68.3	69.3	10.4
Total Accesses	11,808.5	11,494.0	11,505.6	10,942.7	10,550.2	(10.7)

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

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

3 Retail circuits other than broadband.

4 67 thousand inactive Pay TV accesses were disconnected in December 2009 in Peru.

5 376 thousand fixed telephony accesses, 25 thousand broadband accesses and 5 thousand Pay TV accesses in Colombia, all of them inactive, were disconnected in December 2009.

## Telefónica Latinoamérica Accesses by Countries (III)

	2009 December	March	2010 June	September	December	% Chg
Unaudited figures (Thousands)						
<b>CENTRAL AMERICA<sup>1</sup></b>						
Fixed telephony accesses <sup>2</sup>	444.5	453.2	441.5	451.0	465.7	4.8
Fixed Wireless	331.9	223.1	224.9	238.4	301.7	(9.1)
Internet and data accesses	14.7	12.7	11.6	10.9	3.0	(79.8)
Broadband <sup>3</sup>	12.6	11.4	10.4	9.5	0.5	(95.9)
Other <sup>4</sup>	2.1	1.2	1.2	1.3	2.4	14.6
Mobile accesses	5,806.5	5,969.2	6,044.0	6,166.6	6,403.7	10.3
Prepay <sup>5</sup>	5,385.2	5,473.2	5,454.1	5,550.5	5,776.0	7.3
Contract	421.3	496.0	589.9	616.2	627.7	49.0
<b>Total Accesses</b>	<b>6,265.8</b>	<b>6,435.1</b>	<b>6,497.2</b>	<b>6,628.5</b>	<b>6,872.4</b>	<b>9.7</b>
<b>Ecuador</b>						
Mobile accesses	3,721.8	3,846.7	3,981.1	4,060.7	4,219.8	13.4
Prepay	3,193.9	3,299.4	3,405.8	3,448.7	3,561.6	11.5
Contract	527.9	547.3	575.3	612.1	658.2	24.7
Fixed Wireless	84.7	87.5	89.0	94.0	94.8	11.9
<b>Total Accesses</b>	<b>3,806.4</b>	<b>3,934.2</b>	<b>4,070.1</b>	<b>4,154.8</b>	<b>4,314.6</b>	<b>13.4</b>
<b>Uruguay</b>						
Mobile accesses	1,614.9	1,633.5	1,657.8	1,671.5	1,708.5	5.8
Prepay	1,154.3	1,170.7	1,193.0	1,199.9	1,228.1	6.4
Contract	460.6	462.8	464.8	471.6	480.4	4.3
<b>Total Accesses</b>	<b>1,614.9</b>	<b>1,633.5</b>	<b>1,657.8</b>	<b>1,671.5</b>	<b>1,708.5</b>	<b>5.8</b>

<sup>1</sup> Includes Guatemala, Panama, El Salvador and Nicaragua.

<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. Total "fixed wireless" accesses included.

<sup>3</sup> Includes optical fiber, cable modem and broadband circuits.

<sup>4</sup> Retail circuits other than broadband.

<sup>5</sup> 116 thousand inactive mobile accesses were disconnected in Guatemala in December 2009.

## Telefónica Latinoamérica

### Selected Mobile Business Operating Data by Country

	2009	2010				
	Q4	Q1	Q2	Q3	Q4	% Chg Local Cur
Unaudited figures						
<b>Brazil</b>						
Traffic (Million minutes)	18,181	18,345	18,639	20,196	20,283	11.6
ARPU (EUR)	10.4	10.1	11.1	11.3	11.3	(3.0)
<b>Argentina</b>						
Traffic (Million minutes)	4,253	4,052	4,271	4,515	4,713	10.8
ARPU (EUR)	8.5	8.5	9.2	9.5	9.6	8.4
<b>Chile</b>						
Traffic (Million minutes)	2,799	2,822	2,859	3,025	3,085	10.2
ARPU (EUR)	11.0	11.5	12.0	12.4	12.5	(3.2)
<b>Peru</b>						
Traffic (Million minutes)	3,042	3,072	3,208	3,502	3,881	27.6
ARPU (EUR)	5.6	5.7	6.3	6.3	6.3	2.1
<b>Colombia</b>						
Traffic (Million minutes)	3,703	3,779	3,995	4,148	4,303	16.2
ARPU (EUR)	6.2	6.7	7.1	7.6	7.4	3.1
<b>Mexico</b>						
Traffic (Million minutes)	6,208	6,298	5,745	5,426	5,764	(7.1)
ARPU (EUR)	6.7	6.8	7.5	6.8	6.6	(15.2)
<b>Venezuela</b>						
Traffic (Million minutes)	3,758	3,560	3,519	3,523	3,593	(4.4)
ARPU (EUR) <sup>1</sup>	22.2	12.9	14.1	14.6	15.5	28.4
<b>Central America<sup>2</sup></b>						
Traffic (Million minutes)	1,766	1,802	1,906	2,107	2,220	25.7
ARPU (EUR) (3)	6.5	6.6	7.1	6.6	6.4	(9.5)
<b>Ecuador</b>						
Traffic (Million minutes)	1,071	1,035	1,067	1,063	1,103	3.0
ARPU (EUR)	6.3	6.3	7.0	7.0	6.8	(1.4)
<b>Uruguay</b>						
Traffic (Million minutes)	718	691	706	742	797	11.0
ARPU (EUR)	9.4	9.9	10.5	9.8	10.0	(3.4)

#### Notes:

- ARPU calculated as a monthly quarterly average.
- Traffic is defined as minutes used by the company customers, both outbound and inbound. On-net traffic is only included once (outbound), and promotional traffic is included. Traffic not associated to the Company's mobile customers (roaming-in, MVNOs, interconnection of third parties and other business lines) is excluded. Traffic volume non rounded.

1 For comparative purpose and in order to facilitate the interpretation of the year-on-year change versus 2009 results, the variation in local currency of the ARPU in Venezuela is reported excluding the impact of the hyperinflation adjustment.

2 Includes Guatemala, Panama, El Salvador and Nicaragua.

3 Changes in ARPU affected by the disconnection of inactive clients in Guatemala in December 2009.

## Telefónica Latinoamérica

### Cumulative Selected Mobile Business Operating Data by Country

	2009		2010			
	Jan-Dec	Jan-Mar	Jan-Jun	Jan-Sept	Jan-Dec	% Chg Local Cur
Unaudited figures						
<b>Brazil</b>						
Traffic (Million minutes)	52,134	18,345	36,984	57,180	77,463	48.6
ARPU (EUR)	9.9	10.1	10.6	10.9	11.0	(6.0)
<b>Argentina</b>						
Traffic (Million minutes)	15,562	4,052	8,323	12,837	17,550	12.8
ARPU (EUR)	8.6	8.5	8.8	9.0	9.2	6.7
<b>Chile</b>						
Traffic (Million minutes)	10,521	2,822	5,681	8,706	11,791	12.1
ARPU (EUR)	10.7	11.5	11.8	12.0	12.1	(1.8)
<b>Peru</b>						
Traffic (Million minutes)	11,460	3,072	6,280	9,781	13,662	19.2
ARPU (EUR)	5.5	5.7	6.0	6.1	6.2	0.3
<b>Colombia</b>						
Traffic (Million minutes)	13,665	3,779	7,774	11,923	16,226	18.7
ARPU (EUR)	5.9	6.7	6.9	7.1	7.2	2.0
<b>Mexico</b>						
Traffic (Million minutes)	23,186	6,298	12,043	17,468	23,232	0.2
ARPU (EUR)	6.9	6.8	7.2	7.0	6.9	(10.8)
<b>Venezuela</b>						
Traffic (Million minutes)	14,951	3,560	7,078	10,602	14,195	(5.1)
ARPU (EUR) <sup>1</sup>	21.2	12.9	13.5	13.9	14.3	26.3
<b>Central America<sup>2</sup></b>						
Traffic (Million minutes)	6,868	1,802	3,709	5,815	8,035	17.0
ARPU (EUR) <sup>3</sup>	6.9	6.6	6.9	6.8	6.7	(7.5)
<b>Ecuador</b>						
Traffic (Million minutes)	3,744	1,035	2,102	3,165	4,268	14.0
ARPU (EUR)	6.8	6.3	6.7	6.8	6.8	(4.6)
<b>Uruguay</b>						
Traffic (Million minutes)	2,646	691	1,397	2,139	2,936	11.0
ARPU (EUR)	8.7	9.9	10.2	10.1	10.1	(1.5)

## Notes:

- ARPU calculated as a monthly quarterly average for each period.
  - Traffic is defined as minutes used by the company customers, both outbound and inbound. On-net traffic is only included once (outbound), and promotional traffic is included. Traffic not associated to the Company's mobile customers (roaming-in, MVNOs, interconnection of third parties and other business lines) is excluded. Traffic volume non rounded.
- 1 For comparative purpose and in order to facilitate the interpretation of the year-on-year change versus 2009 results, the variation in local currency of the ARPU in Venezuela is reported excluding the impact of the hyperinflation adjustment.
  - 2 Includes Guatemala, Panama, El Salvador and Nicaragua.
  - 3 Changes in ARPU affected by the disconnection of inactive clients in Guatemala in December 2009.

## Telefónica Latinoamérica Selected Financial Data (I)

	January - December				October - December			
	2010	2009	% Chg	% Chg Local Cur	2010	2009	% Chg	% Chg Local Cur
Unaudited figures (Euros in millions)								
<b>Brazil<sup>1</sup></b>								
Revenues	11,119	8,376	32.8	12.1	3,578	2,305	55.3	39.4
OIBDA	4,074	3,139	29.8	9.6	1,420	845	68.1	51.5
OIBDA margin	36.6%	37.5%	(0.8 p.p.)		39.7%	36.7%	3.0 p.p.	
CapEx	1,797	1,228	46.4	23.6	893	438	103.9	79.7
OpCF (OIBDA-CapEx)	2,277	1,911	19.1	0.6	527	407	29.6	19.4
<b>Vivo<sup>1</sup></b>								
Revenues	4,959	3,036	63.4	37.9	2,110	851	147.9	122.8
Service revenues	4,649	2,792	66.5	40.3	1,990	776	156.4	129.5
OIBDA	1,611	949	69.8	43.4	723	271	166.4	139.2
OIBDA margin	32.5%	31.2%	1.2 p.p.		34.2%	31.9%	2.4 p.p.	
CapEx	748	422	77.3	49.8	429	129	232.4	197.0
OpCF (OIBDA-CapEx)	863	527	63.8	38.3	294	142	106.7	86.0
<b>Telesp</b>								
Revenues	6,843	5,766	18.7	0.2	1,758	1,568	12.1	0.5
OIBDA	2,419	2,209	9.5	(7.5)	680	596	14.1	2.5
OIBDA margin	35.4%	38.3%	(3.0 p.p.)		38.7%	38.0%	0.7 p.p.	
CapEx	1,049	806	30.2	9.9	464	309	50.2	31.6
OpCF (OIBDA-CapEx)	1,370	1,403	(2.4)	(17.6)	216	287	(24.7)	(30.9)
<b>Argentina</b>								
Revenues	3,073	2,609	17.8	17.9	824	661	24.7	19.7
OIBDA	1,082	986	9.7	9.8	268	260	3.0	(0.4)
OIBDA margin <sup>2</sup>	34.3%	36.8%	(2.4 p.p.)		31.8%	38.3%	(6.6 p.p.)	
CapEx	398	319	25.1	25.2	168	125	34.2	31.2
OpCF (OIBDA-CapEx)	684	668	2.4	2.5	100	135	(26.0)	(28.0)
<b>T. Móviles Argentina</b>								
Revenues	1,979	1,643	20.4	20.6	546	426	28.1	23.1
Service revenues	1,845	1,522	21.3	21.4	508	389	30.8	25.5
OIBDA	707	606	16.7	16.8	204	172	18.9	15.0
OIBDA margin	35.7%	36.9%	(1.2 p.p.)		37.4%	40.3%	(2.9 p.p.)	
CapEx	191	141	35.4	35.6	89	54	64.9	60.5
OpCF (OIBDA-CapEx)	516	465	11.0	11.1	115	118	(2.2)	(5.2)
<b>Telefónica de Argentina</b>								
Revenues	1,187	1,047	13.3	13.5	302	254	19.0	14.0
OIBDA	375	380	(1.4)	(1.3)	63	88	(28.2)	(29.8)
OIBDA margin <sup>2</sup>	28.4%	32.3%	(3.9 p.p.)		18.9%	30.7%	(11.8 p.p.)	
CapEx	207	178	16.8	16.9	79	71	10.7	8.8
OpCF (OIBDA-CapEx)	168	203	(17.4)	(17.3)	(15)	17	c.s.	c.s.
<b>Chile</b>								
Revenues	2,197	1,831	20.0	4.3	614	480	28.0	9.5
OIBDA	1,092	763	43.2	24.5	374	224	67.2	43.8
OIBDA margin	49.7%	41.7%	8.1 p.p.		60.8%	46.6%	14.2 p.p.	
CapEx	516	347	48.8	29.3	268	121	121.2	92.1
OpCF (OIBDA-CapEx)	576	416	38.5	20.4	106	103	3.4	(13.5)
<b>T. Móviles Chile</b>								
Revenues	1,266	1,010	25.4	9.0	356	271	31.6	12.5
Service revenues	1,175	918	27.9	11.2	325	243	33.7	14.2
OIBDA	610	445	37.2	19.2	186	135	37.9	18.1
OIBDA margin	48.2%	44.1%	4.2 p.p.		52.3%	49.9%	2.4 p.p.	
CapEx	294	185	59.0	38.2	146	50	192.7	155.1
OpCF (OIBDA-CapEx)	317	260	21.7	5.8	40	85	(53.0)	(62.1)
<b>Telefónica Chile</b>								
Revenues	1,038	893	16.3	1.1	288	228	26.4	8.2
OIBDA	476	326	46.3	27.2	181	96	88.9	63.1
OIBDA margin	45.9%	36.5%	9.4 p.p.		63.0%	42.2%	20.8 p.p.	
CapEx	222	162	37.1	19.2	121	71	70.8	48.0
OpCF (OIBDA-CapEx)	254	163	55.4	35.1	60	25	140.2	106.9

Note:

OIBDA is presented before management and brand fees.

<sup>1</sup> Includes 100% of Vivo since October 2010.

<sup>2</sup> Margin over revenues includes fixed to mobile interconnection.

## Telefónica Latinoamérica Selected Financial Data (II)

	January - December				October - December			
	2010	2009	% Chg	% Chg Local Cur	2010	2009	% Chg	% Chg Local Cur
Unaudited figures (Euros in millions)								
<b>Peru</b>								
Revenues	1,960	1,716	14.2	2.0	494	430	15.0	3.0
OIBDA	812	712	14.0	1.8	214	184	16.4	4.1
OIBDA margin	41.4%	41.5%	(0.1 p.p.)		43.4%	42.9%	0.5 p.p.	
CapEx	295	271	8.9	(2.7)	120	144	(17.2)	(25.7)
OpCF (OIBDA-CapEx)	517	442	17.1	4.6	95	40	138.2	107.7
<b>T. Móviles Perú</b>								
Revenues	1,001	840	19.2	6.4	266	213	25.1	11.9
Service revenues	854	695	22.8	9.7	229	177	28.9	15.3
OIBDA	411	327	25.8	12.3	112	87	28.5	15.0
OIBDA margin	41.0%	38.9%	2.1 p.p.		42.2%	41.1%	1.1 p.p.	
CapEx	134	127	5.8	(5.5)	54	76	(28.4)	(35.7)
OpCF (OIBDA-CapEx)	277	200	38.4	23.6	58	12	n.s.	n.s.
<b>Telefónica del Perú</b>								
Revenues	1,097	1,006	9.0	(2.6)	265	248	6.8	(4.3)
OIBDA	401	386	4.1	(7.0)	102	95	6.9	(4.3)
OIBDA margin	36.6%	38.3%	(1.7 p.p.)		38.5%	38.4%	0.0 p.p.	
CapEx	161	144	11.7	(0.3)	65	69	(4.9)	(14.8)
OpCF (OIBDA-CapEx)	240	241	(0.4)	(11.1)	36	27	37.5	21.9
<b>Colombia</b>								
Revenues	1,529	1,269	20.5	1.3	396	315	25.9	9.9
OIBDA	484	397	22.1	2.6	87	120	(26.9)	(36.2)
OIBDA margin	31.7%	31.3%	0.4 p.p.		22.1%	38.0%	(15.9 p.p.)	
CapEx	334	316	5.9	(11.0)	129	152	(15.2)	(27.7)
OpCF (OIBDA-CapEx)	150	81	84.9	55.4	(41)	(32)	27.7	2.4
<b>T. Móviles Colombia</b>								
Revenues	872	685	27.4	7.1	234	172	36.0	18.6
Service revenues	814	647	25.8	5.7	217	163	32.7	15.8
OIBDA	237	194	22.3	2.8	29	62	(54.1)	(59.6)
OIBDA margin	27.2%	28.3%	(1.1 p.p.)		12.3%	36.3%	(24.0 p.p.)	
CapEx	156	165	(5.3)	(20.4)	60	88	(31.5)	(41.6)
OpCF (OIBDA-CapEx)	81	29	179.4	134.9	(32)	(26)	23.6	0.7
<b>Telefónica Telecom</b>								
Revenues	700	615	14.0	(4.2)	177	152	16.7	1.9
OIBDA	249	203	22.4	2.9	60	57	5.6	(8.2)
OIBDA margin	35.5%	33.0%	2.5 p.p.		34.1%	37.7%	(3.6 p.p.)	
CapEx	178	151	18.2	(0.7)	68	64	7.1	(8.3)
OpCF (OIBDA-CapEx)	70	52	34.8	13.3	(8)	(7)	20.6	(9.2)
<b>Mexico (T. Móviles México)</b>								
Revenues	1,832	1,552	18.0	5.0	458	416	10.1	(3.8)
Service revenues	1,651	1,412	17.0	4.1	416	371	12.1	(2.2)
OIBDA	623	564	10.5	(1.7)	149	162	(8.1)	(19.6)
OIBDA margin	34.0%	36.3%	(2.3 p.p.)		32.5%	38.9%	(6.5 p.p.)	
CapEx <sup>1</sup>	1,580	251	n.s.	n.s.	386	119	n.s.	n.s.
OpCF (OIBDA-CapEx) <sup>1</sup>	(957)	313	c.s.	c.s.	(237)	43	c.s.	c.s.
<b>Venezuela (T. Móviles Venezuela)<sup>2</sup></b>								
Revenues	2,318	3,773	(38.6)	15.0	710	1,129	(37.1)	17.8
Service revenues	2,073	2,841	(27.0)	21.3	623	642	(3.0)	19.4
OIBDA	1,087	1,818	(40.2)	10.4	334	508	(34.2)	21.2
OIBDA margin	46.9%	48.2%	(1.3 p.p.)		47.1%	45.0%	2.1 p.p.	
CapEx	293	423	(30.7)	18.7	132	230	(42.8)	(5.1)
OpCF (OIBDA-CapEx)	794	1,395	(43.1)	7.7	203	277	(26.9)	51.4
<b>Central America<sup>3</sup></b>								
Revenues	562	565	(0.5)	(4.7)	140	149	(5.8)	(13.6)
Service revenues	522	540	(3.2)	0.0	128	142	(10.0)	(9.1)
OIBDA	189	241	(21.5)	(24.8)	52	65	(19.0)	(25.3)
OIBDA margin	33.6%	42.6%	(9.0 p.p.)		37.3%	43.4%	(6.1 p.p.)	
CapEx	105	86	21.7	16.3	50	60	(16.5)	(22.0)
OpCF (OIBDA-CapEx)	84	154	(45.7)	(47.8)	2	5	(52.4)	(69.5)

Note:

- OIBDA is presented before management and brand fees.

- 1 CapEx includes 1,237 million euros from the acquisition of spectrum in Mexico in 2010. In organic terms, which exclude spectrum, CapEx would grow 19.4% and OpCF would drop 18.5% year on year in 2010.
- 2 2009 and 2010 reported figures include the hyperinflationary adjustments in Venezuela in both years. For comparison purposes and to facilitate the interpretation of the year-on-year changes vs. 2009, variations in local currency of the headings affected by the hyperinflation adjustments are reported excluding the impact of this adjustment.
- 3 Includes Guatemala, Panama, El Salvador and Nicaragua.



## Telefónica Latinoamérica Selected Financial Data (III)

	January - December				October - December			
	2010	2009	% Chg	% Chg Local Cur	2010	2009	% Chg	% Chg Local Cur
Unaudited figures (Euros in millions)								
<b>ECUADOR (T. Móviles Ecuador)</b>								
Revenues	396	337	17.5	11.8	102	88	15.3	6.5
Service revenues	345	296	16.3	10.8	89	74	20.7	11.1
OIBDA	121	100	21.4	15.6	33	23	44.8	32.3
OIBDA margin	30.7%	29.7%	1.0 p.p.		32.8%	26.1%	6.7 p.p.	
CapEx	60	83	(27.5)	(31.0)	27	51	(47.3)	(50.0)
OpCF (OIBDA-CapEx)	61	17	n.s.	n.s.	6	(28)	c.s.	c.s.
<b>URUGUAY (T. Móviles Uruguay)</b>								
Revenues	217	175	24.3	5.4	54	49	9.5	(0.9)
Service revenues	206	163	26.3	7.1	51	46	11.0	0.3
OIBDA	95	69	39.0	17.8	26	24	10.6	(1.4)
OIBDA margin	43.8%	39.2%	4.6 p.p.		48.9%	48.4%	0.5 p.p.	
CapEx	29	24	19.6	1.4	17	11	59.0	38.4
OpCF (OIBDA-CapEx)	66	44	49.6	26.8	9	13	(28.2)	(33.8)

Note:  
OIBDA is presented before management and brand fees.

## Results by Regional Business Units

### Telefónica Europe<sup>1</sup>

Mobile  
Broadband  
accesses have  
gone up  
by 45'6%

During 2010 Telefónica Europe delivered strong financial and operating performance built on the continued expansion of its customer base and the fast growth of mobile data revenues.

At the end of December 2010, Telefónica Europe's total customer base reached 56.3 million (+14.3% year-on-year, +6.2% in organic terms), with ongoing growth in the mobile contract segment complemented by internet and data accesses.

Mobile net additions for the year reached 2.8 million in organic terms and excluding the disconnection of 111 thousand inactive customers in the Czech Republic. As a result, total mobile customer base growth accelerated to 6.0% year-on-year in organic terms, reaching 46.7 million at the end of December 2010. Supported by the increased adoption of smartphones, the acquisition and retention of high value customers has improved the mobile customer mix in 2010, with the contract base growing 8.2% year-on-year in organic terms. Contract net additions reached 1.8 million in 2010, in organic terms and excluding Czech Republic disconnections, accounting for 65% of total net additions. In the fourth quarter, mobile net additions reached 737 thousand (+33.0% year-on-year in organic terms), of which 72% correspond to the contract segment. As a result, contract customers represent 49% of the total base (+1 percentage point year-on-year).

It is worth noting that mobile broadband customers increased 45.6% year-on-year in 2010, resulting in a customer base of nearly 10 million or 21% of the total mobile base (15% in 2009).

Telefónica Europe's **wireline retail broadband accesses** reached 4.0 million at year end, adding 2.4 million lines in 2010 (203 thousand in organic terms).

**Revenues** reached 15,255 million euros in the year, a growth of 12.7% year-on-year (+15.5% in the fourth quarter). HanseNet and Jajah contributed 807 million euros to revenues in the year (225 million euros in the fourth quarter).

It should be highlighted the fact that organic revenue growth accelerated during the year to 4.4% year-on-year (+3.7% year-on-year up to September). This trend is also reflected when excluding the impact from mobile termination rate cuts, with organic revenue growth in 2010 at 6.7% year-on-year (+6.4% year-on-year in the first nine months), driven by the good performance of UK and Germany, that more than offset the results in Czech Republic and Ireland, both impacted by a difficult economic climate.

Mobile broadband adoption stepped up in the year, leading to non-P2P SMS data revenue growth in the year of 26.4% in organic terms in 2010 to account for 36% of total data revenues (31% in 2009).

<sup>1</sup> Organic growth: (financial figures in million euros) in financial terms, assumes constant exchange rates (average of January-December 2009) and excludes HanseNet and Jajah contributions, included in Telefónica Europe's consolidation perimeter from mid-February 2010 and January 1st, 2010, respectively. Manx Telecom results in the July-December of 2009 are excluded. OIBDA also excludes capital gain from the sale of Manx Telecom (61) in the second quarter of 2010 and non-recurrent restructuring expenses mainly related to personnel reorganization in the second half of the year of 2010 (202 recorded in the third quarter and 118 in the fourth quarter) and CapEx excludes the acquisition of spectrum in Germany in May, 2010 (1,379). In access terms, comparisons exclude HanseNet and Manx Telecom. Net additions also exclude the disconnection of 111 thousand inactive mobile contract customers in the Czech Republic in the second quarter of 2010. Comparable growth: (financial figures in million euros) organic growth excluding additional non-recurrent effects: i) restructuring expenses (2010: 29, 2009: 44), ii) Universal Service Obligation in the Czech Republic (2010: 1, 2009: 7), iii) real estate gains in the Czech Republic (13 in 2009), and iv) the proceeds from the settlement agreement with T-Mobile in the Czech Republic in 2009 (39).

**Operating expenses** stood at 11,507 million euros in 2010, increasing 16.8% year-on-year. The year-on-year evolution is impacted by non-recurring restructuring expenses mainly related to personnel reorganization in the second half of the year (202 million euros recorded in the third quarter and 118 million euros in the fourth quarter). In organic terms, operating expenses would have increased 3.7% year-on-year in 2010.

As a result, **operating income before depreciation and amortization (OIBDA)** amounted to 4,014 million euros in 2010 and grew 2.6% year-on-year (+5.1% in the fourth quarter), with HanseNet and Jajah contributing 71 million euros in the year. OIBDA growth in the year in comparable terms would have reached 4.9%, reflecting the Company's efforts in efficiency.

Reported OIBDA margin was 26.3% in the year, remaining virtually flat year-on-year in comparable terms (+0.1 percentage points). In the fourth quarter, OIBDA margin was 27.0% (+1.5 percentage points year-on-year in comparable terms).

**CapEx** amounted to 3,072 million euros in the year, mainly impacted by the spectrum investment made in Germany (1,379 million euros). In organic terms, CapEx would decline 9.9% year-on-year in the year, the main driver being the completion of the German network rollout in 2009.

**Operating cash flow (OIBDA-CapEx)** was 942 million euros in the year (2,321 million euros excluding the acquisition of spectrum in Germany). Operating cash flow grew 16.6% year-on-year in comparable terms.

## Telefónica O2 UK

Telefónica O2 UK delivered strong results in 2010 in a highly competitive environment, driven by benchmark contract churn and strong momentum delivered by providing its customers with the best user experience.

The strong results were underpinned by the growth of mobile broadband and customers upgrading to smartphones. Penetration of mobile broadband has increased along with the associated demand for mobile data, leading to growing revenues from devices and data usage. The Company has further advanced in its goal to profitably monetise the mobile data opportunity with the introduction of data caps in the fourth quarter of the year and is also continuously looking to leverage customer insight with innovative new products, such as "O2 Media" and "O2 Money".

The Company's total **mobile customer base** (excluding Tesco Mobile) reached 22.2 million at the end of 2010 (+4.3% year-on-year), driven by a robust 9.8% year-on-year increase in the contract segment. Mobile net additions stood at 912 thousand in 2010, with 254 thousand in the fourth quarter.

This evolution was driven by the strong performance of contract net additions throughout the year, which reached 940 thousand in 2010 and 202 thousand in the fourth quarter (79% of total net additions in the quarter), reflecting rapid smartphone adoption and continued strength in a competitive market. At the end of 2010, contract customers represented 47% of the base (+2.4 percentage points year-on-year).

**Churn** totalled 2.7% in 2010 (+0.1 percentage points year-on-year) and 2.9% in the fourth quarter (+0.3 percentage points year-on-year). Contract churn remained market leading at 1.1% for the whole year and in the fourth quarter.

Mobile **traffic** volume carried in the UK grew by 8.0% year-on-year to 58,143 million minutes in 2010 (+6.3% year-on-year in the fourth quarter) due to the higher contract base and increased usage per customer in the prepaid segment.

**Total ARPU** for the year was down 2.1% year-on-year in local currency to 25.1 euros, and virtually flat year-on-year in the fourth quarter (-0.3%), however, growth rate improved 1.7 percentage points quarter-on-quarter. Excluding mobile termination rate cuts, ARPU would increase 1.2% year-on-year in local currency in 2010, and with a positive performance in the fourth quarter (+0.5% year-on-year in local currency), improving versus the slight year-on-year decline recorded in the previous quarter.

Voice ARPU declined 6.5% year-on-year in local currency to 15.0 euros in 2010 (-3.3% year-on-year in the fourth quarter).

Data ARPU increased 5.3% year-on-year in local currency to 10.1 euros in 2010 and by 4.3% in the fourth quarter, an improved performance over the previous quarter, driven by the increased demand for data from smartphone users.

Telefónica O2 UK's wireline **retail broadband Internet accesses** reached 0.7 million lines at the end of December 2010 (+13.5% year-on-year).

**Revenue** growth accelerated in the fourth quarter to 9.0% year-on-year in local currency (+8.5% and +6.0% year-on-year in the third and second quarter, respectively) to reach 7,201 million euros in 2010 (+6.5% year-on-year in local currency). This strong performance was driven by sustained positive trends in mobile service revenues and higher handset sales, coming from the increased adoption of smartphones.

Mobile service revenues stood at 6,513 million euros in 2010, with a solid 5.6% year-on-year increase in local currency, which ramped up to 7.9% year-on-year in local currency in the fourth quarter. Excluding the impact of mobile termination rate cuts, 2010 mobile service revenues would grow 9.2% year-on-year in local currency, and increased 8.7% year-on-year in the fourth quarter (+0.3 percentage points quarter-on-quarter). This performance reflects the higher proportion of contract customers in the base and the increased number of smartphone users.

The continued growth of non-P2P SMS data revenues should be highlighted, with growth of 31.7% year-on-year in local currency in 2010. As a result, total data revenues as a proportion of mobile service revenues stood at 40% in 2010, almost a 2 percentage points increase year-on-year.

**Operating income before depreciation and amortization (OIBDA)** increased 4.9% year-on-year in local currency to 1,830 million euros in 2010. OIBDA decreased 3.8% year-on-year in local currency in the fourth quarter, as non-recurrent restructuring expenses of 72 million euros were recorded in the quarter, mainly related to personnel and shops, following the ongoing reorganisation of the business. This will allow the Company increased focus on capturing new opportunities and further enhance customer service. Excluding restructuring expenses registered in 2010 and 28 million euros in 2009, OIBDA growth for 2010 in local currency would reach 7.2% year-on-year, and 11.0% year-on-year in the fourth quarter, which is a significant improvement over the previous quarter, where higher commercial expenses were registered following the launch of iPhone 4.

OIBDA margin reached 25.4% for the year (-0.4 percentage points year-on-year), and remained stable over the previous year (+0.2 percentage points) excluding non-recurrent restructuring expenses, despite higher commercial expenses derived from the increased demand for mobile broadband connections. In the fourth quarter, OIBDA margin stood at 24.7% (-3.4 percentage points year-on-year; +0.5 percentage points year-on-year excluding restructuring expenses).

**CapEx** increased 14.7% year-on-year in local currency in 2010 to reach 717 million euros, as the Company continued to further enhance its mobile network capacity and coverage, including the recent refarming of the 900MHz spectrum, to give its customers the best user experience.

**Operating cash flow (OIBDA-CapEx)** reached 1,113 million euros in 2010, resulting in a 0.5% year-on-year decline in local currency. Excluding non-recurrent restructuring expenses in both years, operating cash flow would grow 3.2% year-on-year in local currency.

## Telefónica O2 Germany

In 2010 Telefónica O2 Germany maintained a solid commercial and financial momentum across key areas in a competitive market compounded by a steep reduction in mobile termination rates in the month of December.

The Company continued to deliver growth in the mobile business, in particular a strong performance of the contract segment, driven by improved customer service and notable growth in demand for smartphones. After the successful spectrum auction, the LTE network rollout is progressing in line with expectations, as is the ongoing transformation to an integrated business model following the acquisition of HanseNet.

As a result, Telefónica O2 Germany strengthened its position in the German market, adding 6.0 million accesses (including HanseNet) in 2010 to reach a **total access base** of 23.1 million. The total **mobile customer base** reached 17.0 million lines, up 9.9% year-on-year. Net additions stood at 1.5 million in the year (+17.8% year-on-year) and at 421 thousand in the fourth quarter, a significant improvement over the same period in 2009, when a significant number of prepay customers were disconnected from the base.

The contract segment added 554 thousand customers in 2010 with 228 thousand customers being added in the fourth quarter, 2.6 times the figure recorded in the previous quarter. The strong performance in the contract segment reflected the increased demand for tariffs such as "O2 Blue" and "O2 o", as well as for the iPhone, particularly through "My Handy". The prepay segment continued its positive momentum mainly through partner channels, with 988 thousand customers added in 2010 (193 thousand in the fourth quarter). As a result, the contract segment made up 48% of the total customer base at the end of the year (versus 50% in 2009).

**Churn** declined to 2.1% in 2010 (0.2 percentage points year-on-year improvement) and reached 2.3% in the fourth quarter of the year (1.0 percentage point improvement), reflecting improved customer satisfaction levels. Contract churn in 2010 was stable compared to the previous year at 1.8%, and 0.2 percentage points year-on-year better at 1.9% in the fourth quarter. This was the result of Company's active policy of retaining customers and the enhanced portfolio of products and services.

In terms of usage, **traffic** in 2010 grew 9.8% year-on-year to 25,543 million minutes (+10.2% year-on-year in the fourth quarter), driven by the higher customer base and increased usage of voice packages from prepaid customers.

Total **ARPU** for 2010 declined 5.5% year-on-year to 14.8 euros (-5.0% year-on-year in the fourth quarter). Excluding the impact from mobile termination rate cuts (close to a 62% reduction in the last two years, up to December 2010), total ARPU would decrease 4.6% year-on-year in 2010, showing a significant quarter-on-quarter improvement (-2.8% year-on-year in the fourth quarter versus -4.3% year-on-year in the third quarter).

Voice ARPU in 2010 decreased 10.4% year-on-year to 9.8 euros (-11.5% in the fourth quarter), primarily due to mobile termination rate cuts, continued usage optimisation from customers and an increased number of non-voice accesses, partially compensated by a favourable change in the customer mix.

Data ARPU increased 6.1% year-on-year in 2010 to 5.0 euros, and showed a better performance in the fourth quarter (+9.2% year-on-year compared to +5.4% in the third quarter), which reflects the growing usage of data services on smartphones and tablets.

Telefónica O2 Germany's wireline business continued to gain traction with 84 thousand **retail broadband internet** net additions in the fourth quarter, significantly higher than in the previous quarter (32 thousand), reaching 2.5 million accesses at the end of December, 2010. This was mainly due to HanseNet's competitive product portfolio and new opportunities arising from our integrated distribution model. Wholesale broadband accesses declined 15.2%

year-on-year to 1.1 million lines at year end due to the internalisation of former HanseNet lines. However, in organic terms, wholesale broadband accesses increased by 15.3% year-on-year.

Telefónica O2 Germany delivered strong **revenue** performance in 2010 totalling 4,826 million euros, a 28.9% year-on-year growth (+31.6% year-on-year in the fourth quarter). On an organic basis, revenues increased 7.9% year-on-year in 2010 and 9.8% in the fourth quarter, ramping up 5.1 percentage points over the previous quarter, mainly driven by strong performance of mobile service revenues and the robust demand for smartphones, particularly through "My Handy" product, which does not allocate handset subsidies into mobile service revenues.

Mobile service revenue increased 2.5% year-on-year in 2010 to reach 2,932 million euros (+2.6% year-on-year in the fourth quarter). Excluding the impact from mobile termination rate cuts, year-on-year growth would accelerate from 3.6% in the third quarter to 4.9% in the fourth quarter, achieving a year-on-year growth of 3.8% in 2010. The main growth drivers were the increase in the customer base and continued growth in non-P2P SMS data revenues (+31.4% year-on-year in 2010 to reach 42% of total data revenues, versus 37% in 2009). Total mobile data revenues amounted to 970 million euros in 2010 (+15.4% year-on-year), accounting for 33% of mobile service revenues.

**Operating income before depreciation and amortization (OIBDA)** totalled 944 million euros in 2010, a 2.8% year-on-year growth (+23.2% year-on-year in the fourth quarter). In organic terms, which exclude non-recurrent restructuring expenses related to personnel reorganization in 2010 (202 million euros in the third quarter), and also if they were excluded in 2009 (9 million euros), OIBDA would have grown by 10.1% year-on-year in 2010 and by 11.6% year-on-year in the fourth quarter, which is a 2.1 percentage points improvement over the third quarter. This was mainly attributable to the end of national roaming arrangements in 2009, revenue growth as well as cost savings from the Company's continued commitment to efficiencies, despite being partially offset by increased commercial expenses relating to growth in smartphone sales during the fourth quarter.

As a result, OIBDA margin for 2010 was 19.6% (-5.0 percentage points year-on-year) and 23.6% in the fourth quarter (-1.6 percentage points year-on-year). If HanseNet and non-recurrent restructuring expenses in both years were excluded, OIBDA margin would have reached 25.3% in 2010 (+0.5 percentage points year-on-year) and 25.8% in the fourth quarter (+0.4 percentage points year-on-year). The OIBDA margin was negatively impacted by the consolidation of HanseNet in 1.9 percentage points in 2010.

**CapEx** totalled 2,057 million euros in 2010, a 2.6 times increase over the previous year due to the investment in spectrum (1,379 million euros). In organic terms, which exclude the spectrum investment, CapEx in 2010 decreased by 27.9% year-on-year due to completion of network rollout in 2009.

LTE technology started to be introduced in the mobile network in the fourth quarter, initially with trial periods in "white spots" before commencing the commercial launch in the second quarter of 2011. The cost of the network rollout will be mitigated with 99% of sites using the Company's existing infrastructure.

**Operating cash flow (OIBDA-CapEx)** for 2010 totalled -1,113 million euros due to the investment in spectrum and non-recurrent restructuring expenses. In organic terms, and excluding the above-mentioned factors, operating cash flow would have been 3.4 fold higher than the previous year.

## Telefónica O2 Ireland

The performance of Telefónica O2 Ireland in 2010 was impacted by a difficult economic environment, intense competition and mobile termination rate cuts. Despite these challenges, the Company continued posting growth in the mobile contract segment whilst giving its customers the best user experience.

The total **mobile customer base** stood at 1.7 million at the end of December 2010 (-1.1% year-on-year), with a notably strong 5.4% year-on-year increase in the contract segment, representing 43% of the total base (+3 percentage points year-on-year). Contract net additions in 2010 reached 38 thousand (7 thousand in the fourth quarter) driven by prepay to contract migrations as well as mobile broadband uptake.

**Churn** improved 0.3 percentage points in the year to 2.3% while remaining stable in the fourth quarter at 2.6% despite intensifying competition.

In terms of usage, **traffic** grew by 1.3% year-on-year to 4,732 million minutes in 2010, showing a better performance in the fourth quarter (+3.0% year-on-year) mainly explained by a higher contract base and the popularity of value for money products which offer free minutes.

Telefónica O2 Ireland's total **ARPU** declined 6.6% year-on-year in 2010 to 37.0 euros (-7.3% in the fourth quarter). Excluding mobile termination rate cuts, ARPU would decline 4.4% in 2010 and 4.0% in the fourth quarter.

Voice ARPU dropped 11.0% year-on-year in 2010 (-11.9% year-on-year in the fourth quarter), impacted by mobile termination rate cuts, customers optimising their usage and reduced roaming out activity.

Data ARPU grew 3.9% year-on-year in 2010 to 12.3 euros (+3.2% in the fourth quarter), mainly due to the continued growth in mobile broadband.

In 2010, **revenues** totalled 848 million euros, a year-on-year decline of 6.3% (-9.2% year-on-year in the fourth quarter). Mobile service revenues for the year declined 7.5% year-on-year to 779 million euros (-7.7% year-on-year in the fourth quarter). Excluding the impact of mobile termination rate cuts, mobile service revenues would have declined by 5.4% in 2010 (-4.6% year-on-year in the fourth quarter).

Total **data revenues** in 2010 grew 3.5% year-on-year to represent 32% of service revenues, compared to 29% in 2009, with non-P2P SMS data revenue growth of 7.9% year-on-year.

**Operating income before depreciation and amortization (OIBDA)** totalled 275 million euros and dropped 9.0% year-on-year in 2010 (-5.8% in the fourth quarter). Reported OIBDA includes non-recurrent restructuring expenses of 12 million euros in 2010 and 1 million euros in 2009. Excluding the impact of restructuring expenses, OIBDA would have declined 5.4% year-on-year in 2010 (-1.6% year-on-year in the fourth quarter). It is important to highlight the favourable trend, compared to the third and second quarter (-4.6% and -10.6% respectively, excluding restructuring expenses), as the lower revenue was mitigated by disciplined cost saving initiatives.

As a result, reported OIBDA margin reached 32.4% in 2010 vs. 33.4% in 2009 (+0.3 percentage points year-on-year excluding restructuring expenses) and 35.6% in the fourth quarter (+2.8 percentage points year-on-year excluding non-recurrent restructuring expenses).

The efficient CapEx management achieved by Telefónica O2 Ireland (-4.1% year-on-year to 60 million euros in 2010), and the already mentioned evolution of the OIBDA resulted in an operating cash flow (OIBDA-CapEx) decrease of 10.3% year-on-year in 2010 (-5.7% year-on-year excluding non-recurrent restructuring expenses) to 214 million euros.

## Telefónica O2 Czech Republic

Despite a challenging economic environment, Telefónica O2 Czech Republic maintained its solid commercial momentum in 2010, with an increased mobile contract and retail fixed broadband customer base as well as a stabilisation of fixed line losses.

At the end of December, the total number of **accesses** for Telefónica O2 Czech Republic, including Slovakia, stood at 8.5 million, an increase of 2.2% year-on-year.

The **mobile customer base** in the Czech Republic reached 4.8 million at the end of 2010 (-2.1% year-on-year), impacted by the disconnection of 111 thousand inactive customers in the second quarter of 2010. Contract customers increased by 1.7% year-on-year to reach 2.9 million at year end, with 49 thousand net additions for the full year (45 thousand in the fourth quarter). This performance was driven by continuous uptake of "O2 Neon" tariffs, prepay to contract migrations and positive contribution of mobile broadband growth. As a result, the contract customer mix increased by 2.3 percentage points year-on-year to represent 59% of the total base.

**Fixed telephony accesses** continued to post improvement with a net loss of 17 thousand accesses in the fourth quarter (-14.4% year-on-year; -26.6% quarter-on-quarter) driven by the solid uptake of "naked" accesses and VoIP lines for the corporate segment. Thus, fixed telephony accesses reached 1.7 million at the end of 2010 (-5.7% year-on-year).

The Company's wireline **retail broadband Internet accesses** stood at 753 thousand at year end (+10.2% year-on-year), with 70 thousand net additions in 2010 (17 thousand net additions in the fourth quarter). **Pay TV customers** reached 129 thousand by year end (-6.1% year-on-year).



In 2010, Telefónica O2 Slovakia recorded 328 thousand net additions (+44.0% year-on-year) to reach 880 thousand customers (+59.2% year-on-year). In the fourth quarter of 2010, healthy commercial momentum continued with a record quarterly of 99 thousand net additions (+10.6% year-on-year). It should be highlighted that the contract customer base increased by 71.0% year-on-year to account for 38% of the total base at the end of 2010 (+2.6 percentage points year-on-year).

Mobile **churn** in the Czech Republic stood at 2.4% in 2010 (+0.3 percentage points year-on-year), with a better performance in the fourth quarter (2.2%; -0.2 percentage points year-on-year; flat quarter-on-quarter).

In the Czech Republic, **traffic** carried in 2010 increased year-on-year by 6.8% to 8,790 million minutes (+3.7% in the fourth quarter). This was driven by a higher contract base as well as the success of propositions such as "O2 Neon".

Total mobile **ARPU** in the Czech Republic (18.5 euros in 2010) declined 8.1% during the year in local currency (-6.0% year-on-year in the fourth quarter), being impacted by mobile termination rate cuts. Excluding these cuts, ARPU performance would have improved throughout the year (from -6.6% in the first quarter to -1.9% in the fourth quarter) as result of continuous stabilisation in customer spend.

Voice ARPU declined 9.4% year-on-year in local currency in 2010 (-8.8% year-on-year in the fourth quarter), mainly due to mobile termination rate cuts, better value for money propositions, and reduced roaming rates.

Data ARPU totalled 4.8 euros, a decline of 4.1% year-on-year in local currency, showing an improvement in the fourth quarter of the year (+2.7% year-on-year in local currency) driven by the continued uptake of the mobile broadband propositions.

**Revenues** for 2010 were 2,197 million euros, a year-on-year decline of 6.8% in constant currency (-6.7% in the fourth quarter). The impact of Universal Service Obligation was 2 million euros in 2010 and 14 million euros in 2009.

Telefónica O2 Czech Republic's fixed revenues declined 8.8% year-on-year in local currency to reach 954 million euros in 2010, mainly due to lower government related ICT revenues and the above mentioned Universal Service Obligation.

Mobile service revenues in the Czech Republic declined 8.2% year-on-year in local currency to 1,078 million euros in 2010 (-7.8% in the fourth quarter), with mobile termination rate cuts, more customers opting for semi-flat tariffs, such as "O2 Neon", and lower incoming traffic all having an adverse effect. Excluding the impact of mobile termination rate cuts, service revenues would have declined 4.0% year-on-year in local currency in 2010. Revenues from Telefónica O2 Slovakia increased 50.5% year-on-year in 2010 (+42.6% year-on-year in the fourth quarter).

**Operating income before depreciation and amortization (OIBDA)** decreased 13.4% year-on-year in constant currency in 2010 to reach 953 million euros (-8.9% in the fourth quarter). This was impacted by a number of non-recurring items during the year: i) Universal Service Obligation (1 million euros in 2010; 7 million euros in 2009), ii) restructuring expenses (18 million euros in 2010; 6 million euros in 2009), iii) real estate gains in 2009 (13 million euros), and iv) the proceeds from the settlement agreement with T-Mobile in 2009 (39 million euros). Excluding these factors, OIBDA would have declined by 6.7% year-on-year in constant currency in 2010 with the OIBDA margin remaining relatively stable year-on-year (-0.2 percentage points).

In reported terms, OIBDA margin stood at 43.4% in 2010 and reached 44.3% in the fourth quarter (-0.8 percentage points year-on-year, excluding non-recurring effects) due to the strong Christmas campaign focused on mobile broadband.

**CapEx** in 2010 declined year-on-year by 12.5% in constant currency to 224 million euros.

Combined with the above mentioned OIBDA evolution, **operating cash flow (OIBDA-CapEx)** reached 729 million euros in 2010 (-13.7% year-on-year in constant currency; -4.7% if the above mentioned non recurrent factors were excluded from the calculation).

## Telefónica Europe Accesses

	2009	2010				
	December	March	June	September	December	% Chg
Unaudited figures (Thousands)						
Final Clients Accesses	47,814.9	52,769.9	53,355.5	54,080.0	55,050.6	15.1
Fixed telephony accesses <sup>1</sup>	1,827.5	3,620.8	3,564.7	3,533.5	3,672.4	100.9
Internet and data accesses	1,754.7	4,364.0	4,382.4	4,409.4	4,496.4	156.2
Narrowband	137.3	559.4	537.9	528.6	503.2	n.s.
Broadband	1,589.1	3,776.0	3,815.5	3,852.8	3,964.9	149.5
Other <sup>2</sup>	28.3	28.5	29.0	28.0	28.3	(0.0)
Mobile accesses	44,095.0	44,599.5	45,217.0	45,938.5	46,675.5	5.9
Prepay <sup>3</sup>	23,098.5	23,167.9	23,430.4	23,787.9	23,994.9	3.9
Contract <sup>4</sup>	20,996.5	21,431.6	21,786.6	22,150.6	22,680.6	8.0
Pay TV	137.6	185.6	191.4	198.6	206.4	50.0
Wholesale Accesses <sup>5</sup>	1,425.2	1,152.5	1,186.1	1,216.2	1,247.7	(12.5)
Total Accesses	49,240.1	53,922.4	54,541.6	55,296.3	56,298.3	14.3

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

2 Retail circuits other than broadband.

3 December 2009 includes the disconnection of inactive mobile prepay customers in Germany.

4 June 2010 includes the disconnection of inactive mobile contract customers in Czech Republic.

5 Includes Unbundled Lines by T. O2 Germany.

### Notes:

- Accesses include Manx Telecom customers until June 2010.
- Starting March 2010, T. Europe includes accesses from HanseNet.

## Telefónica Europe Consolidated Income Statement

	January - December			October - December		
	2010	2009	% Chg	2010	2009	% Chg
Unaudited figures (Thousands)						
Revenues	15,255	13,533	12.7	4,017	3,477	15.5
Internal exp capitalized in fixed assets	198	213	(7.1)	61	56	10.2
Operating expenses	(11,507)	(9,856)	16.8	(2,993)	(2,505)	19.5
Supplies	(6,648)	(6,189)	7.4	(1,792)	(1,597)	12.2
Personnel expenses	(1,625)	(1,304)	24.6	(351)	(301)	16.4
Subcontracts	(3,040)	(2,244)	35.5	(798)	(573)	39.1
Bad debt provision	(175)	(100)	74.3	(47)	(28)	72.1
Taxes	(19)	(17)	11.4	(5)	(5)	1.3
Other net operating income (expense)	3	5	(43.1)	(4)	2	c.s.
Gain (loss) on sale of fixed assets	66	16	n.s.	4	2	70.7
Impairment of goodwill and other assets	(1)	(1)	(18.0)	(0)	0	c.s.
Operating income before D&A (OIBDA)	4,014	3,910	2.6	1,085	1,032	5.1
OIBDA Margin	26.3%	28.9%	(2.6 p.p.)	27.0%	29.7%	(2.7 p.p.)
Depreciation and amortization	(3,091)	(2,895)	6.7	(814)	(707)	15.1
Operating income (OI)	923	1,015	(9.1)	271	325	(16.7)

### Notes:

- OIBDA and OI before management and brand fees.
- HanseNet and Jajah have been included in T. Europe's consolidation perimeter since mid February 2010 and since January 2010 respectively, and Manx Telecom has been excluded from the consolidation perimeter since July, 2010.
- Figures in million euros. OIBDA includes a capital gain of 61 from the sale of Manx Telecom in the second quarter of 2010 and is affected by non-recurrent restructuring expenses mainly related to personnel reorganization in the second half of the year (202 recorded in the third quarter and 118 in the fourth quarter).
- Figures in millions of euros. In comparable terms, OIBDA of T. Europe would increase 4.9% and OpCF would gain 16.6%. Comparable terms assume constant exchange rates of the same period in 2009 (average fx) and exclude HanseNet (since mid February 2010), Jajah (January-December 2010) and Manx Telecom (July-December 2009). OIBDA also excludes capital gain from the sale of Manx Telecom (61 in the second quarter of 2010). Additionally, it excludes 1) non recurrent restructuring expenses mainly related to personnel reorganization in the second half of the year (202 recorded in the third quarter and 118 in the fourth quarter), additional restructuring expenses (2010: 29, 2009: 44); 2) Universal Service Obligation in the Czech Republic (2010:1, 2009: 7); 3) real estate gains in the Czech Republic (13 in 2009) and 4) the proceeds from the settlement agreement with T-Mobile in the Czech Republic in 2009 (39). CapEx excludes the acquisition of spectrum in Germany in the second quarter of 2010 (1,379).

## Telefónica Europe Accesses by Countries

	2009 December	March	2010 June	September	December	% Chg
Unaudited figures (Thousands)						
<b>Telefónica O2 UK</b>						
Final Clients Accesses	21,890.8	21,987.9	22,255.6	22,620.9	22,883.1	4.5
Internet and data accesses	591.5	632.4	650.0	663.8	671.6	13.5
Broadband	591.5	632.4	650.0	663.8	671.6	13.5
Mobile accesses	21,299.3	21,355.5	21,605.6	21,957.1	22,211.5	4.3
Prepay	11,740.3	11,602.0	11,544.6	11,659.6	11,712.3	(0.2)
Contract	9,558.9	9,753.5	10,061.0	10,297.4	10,499.2	9.8
<b>Total Accesses</b>	<b>21,890.8</b>	<b>21,987.9</b>	<b>22,255.6</b>	<b>22,620.9</b>	<b>22,883.1</b>	<b>4.5</b>
<b>Telefónica O2 Germany</b>						
Final Clients Accesses	15,792.5	20,571.4	20,934.3	21,344.5	21,957.5	39.0
Fixed telephony accesses	0.0	1,826.3	1,779.4	1,797.3	1,916.4	n.s.
Internet and data accesses	285.1	2,832.5	2,824.7	2,851.2	2,914.7	n.s.
Narrowband	0.0	428.0	411.4	406.2	385.7	n.s.
Broadband	285.1	2,404.5	2,413.3	2,445.1	2,529.1	n.s.
Mobile accesses	15,507.4	15,864.7	16,272.1	16,628.0	17,049.2	9.9
Prepay <sup>1</sup>	7,807.0	8,009.9	8,336.0	8,602.5	8,795.2	12.7
Contract	7,700.4	7,854.8	7,936.0	8,025.5	8,254.0	7.2
Pay TV	0.0	47.9	58.2	68.0	77.2	n.s.
Wholesale Accesses <sup>2</sup>	1,316.8	1,040.1	1,072.6	1,098.6	1,116.5	(15.2)
<b>Total Accesses</b>	<b>17,109.3</b>	<b>21,611.5</b>	<b>22,006.9</b>	<b>22,443.0</b>	<b>23,074.0</b>	<b>34.9</b>
<b>Telefónica O2 Ireland</b>						
Mobile accesses	1,714.3	1,705.6	1,710.8	1,716.2	1,695.8	(1.1)
Prepay	1,022.5	1,003.8	997.6	993.6	966.5	(5.5)
Contract	691.8	701.8	713.1	722.7	729.4	5.4
<b>Total Accesses</b>	<b>1,714.3</b>	<b>1,705.6</b>	<b>1,710.8</b>	<b>1,716.2</b>	<b>1,695.8</b>	<b>(1.1)</b>
<b>Telefónica O2 Czech Republic</b>						
Final Clients Accesses	7,701.5	7,696.4	7,558.5	7,559.1	7,535.8	(2.2)
Fixed telephony accesses <sup>3</sup>	1,770.6	1,737.5	1,708.3	1,685.8	1,669.2	(5.7)
Naked ADSL	62.1	89.8	114.8	138.8	163.7	163.8
VoIP	16.9	23.4	28.5	33.1	38.6	128.7
Internet and data accesses	848.7	868.4	874.8	886.5	898.8	5.9
Narrowband	137.3	131.4	126.5	122.4	117.5	(14.4)
Broadband	683.1	708.4	719.3	736.1	753.0	10.2
Other <sup>4</sup>	28.3	28.5	29.0	28.0	28.3	(0.0)
Mobile accesses	4,944.6	4,952.7	4,842.2	4,856.2	4,838.6	(2.1)
Prepay	2,130.2	2,094.8	2,060.4	2,037.6	1,975.0	(7.3)
Contract <sup>5</sup>	2,814.4	2,857.9	2,781.8	2,818.6	2,863.6	1.7
Pay TV	137.6	137.7	133.2	130.6	129.2	(6.1)
Wholesale Accesses	108.4	112.4	113.5	117.7	131.2	21.0
<b>Total Accesses</b>	<b>7,810.0</b>	<b>7,808.8</b>	<b>7,672.0</b>	<b>7,676.7</b>	<b>7,667.0</b>	<b>(1.8)</b>
<b>Telefónica O2 Slovakia</b>						
Mobile accesses	552.9	645.7	708.6	781.1	880.4	59.2
Prepay	357.2	418.1	450.6	494.6	545.9	52.8
Contract	195.6	227.6	257.9	286.4	334.5	71.0
<b>Total Accesses</b>	<b>552.9</b>	<b>645.7</b>	<b>708.6</b>	<b>781.1</b>	<b>880.4</b>	<b>59.2</b>

1 450 thousand inactive prepay accesses were disconnected in December 2009.

2 Includes Unbundled Lines by T. O2 Germany.

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

4 Retail circuits other than broadband.

5 111 thousand inactive contract customers were disconnected in June 2010.

**Note:**

Starting March 2010, T. O2 Germany includes accesses from HanseNet.

## Telefónica Europe Selected Operating Mobile Business Data by Countries

	2009	2010				
	Q4	Q1	Q2	Q3	Q4	% Chg Local Cur
Unaudited figures						
<b>Telefónica O2 UK</b>						
Traffic (Million minutes)	14,176	14,155	14,346	14,565	15,076	6.3
ARPU (EUR)	24.0	24.0	25.3	26.1	25.2	(0.3)
Prepay	11.7	11.3	11.7	12.0	12.0	(2.6)
Contract	39.1	39.4	41.0	42.1	40.0	(3.0)
Data ARPU (EUR)	9.5	9.6	10.1	10.4	10.4	4.3
% non-P2PSMS over data revenues	29.4%	30.7%	33.7%	33.1%	33.5%	4.1 p.p.
<b>Telefónica O2 Germany</b>						
Traffic (Million minutes)	6,108	6,223	6,299	6,292	6,729	10.2
ARPU (EUR) <sup>1</sup>	15.3	14.8	14.8	15.0	14.5	(5.0)
Prepay <sup>1</sup>	5.8	5.7	6.0	6.2	6.6	12.5
Contract	25.2	24.2	23.9	24.3	23.0	(8.5)
Data ARPU (EUR) <sup>1</sup>	4.8	5.0	4.7	4.9	5.2	9.2
% non-P2PSMS over data revenues	40.7%	40.9%	39.4%	43.5%	43.6%	2.9 p.p.
<b>Telefónica O2 Ireland</b>						
Traffic (Million minutes)	1,177	1,166	1,181	1,172	1,213	3.0
ARPU (EUR)	39.5	37.4	36.9	37.2	36.6	(7.3)
Prepay	26.5	21.8	27.0	24.3	24.3	(8.1)
Contract	58.8	60.1	50.9	55.1	53.1	(9.8)
Data ARPU (EUR)	12.1	12.0	12.1	12.5	12.5	3.2
% non-P2PSMS over data revenues	38.3%	38.3%	39.5%	37.4%	37.7%	(0.5 p.p.)
<b>Telefónica O2 Czech Republic<sup>2</sup></b>						
Traffic (Million minutes)	2,153	2,127	2,260	2,170	2,233	3.7
ARPU (EUR) <sup>3</sup>	19.1	17.8	18.6	19.0	18.8	(6.0)
Prepay	8.7	7.6	8.2	8.2	8.6	(5.4)
Contract <sup>3</sup>	27.1	25.3	26.3	26.9	26.0	(8.5)
Data ARPU (EUR) <sup>3</sup>	4.6	4.5	4.6	4.9	5.0	2.7
% non-P2PSMS over data revenues	43.9%	45.0%	43.8%	45.1%	44.8%	0.9 p.p.

<sup>1</sup> Change in ARPU affected by 450 thousand disconnections of inactive customers in Germany in December 2009.

<sup>2</sup> KPIs for Mobile business in Czech Republic do not include Slovakia.

<sup>3</sup> Change in ARPU affected by 111 thousand disconnections of inactive customers in Czech Republic in June 2010.

### Notes:

- ARPU calculated as monthly quarterly average.
- Traffic is defined as minutes used by the company customers, both outbound and inbound. On-net traffic is only included once (outbound), and promotional traffic is included. Traffic not associated to the Company's mobile customers (roaming-in, MVNOs, interconnection of third parties and other business lines) is excluded. Traffic volume non rounded.

## Telefónica Europe

### Cumulative Selected Operating Mobile Business Data by Countries

	2009		2010			
	Jan-Dec	Jan-Mar	Jan-Jun	Jan-Sept	Jan-Dec	% Chg Local Cur
Unaudited figures						
<b>Telefónica O2 UK</b>						
Traffic (Million minutes)	53,856	14,155	28,502	43,067	58,143	8.0
ARPU (EUR)	24.7	24.0	24.6	25.1	25.1	(2.1)
Prepay	12.3	11.3	11.5	11.7	11.8	(8.2)
Contract	40.8	39.4	40.2	40.9	40.6	(4.2)
Data ARPU (EUR)	9.3	9.6	9.9	10.0	10.1	5.3
% non-P2PSMS over data revenues	27.4%	30.7%	32.2%	32.5%	32.8%	5.4 p.p.
<b>Telefónica O2 Germany</b>						
Traffic (Million minutes)	23,257	6,223	12,522	18,814	25,543	9.8
ARPU (EUR) <sup>1</sup>	15.6	14.8	14.8	14.9	14.8	(5.5)
Prepay <sup>1</sup>	5.7	5.7	5.8	6.0	6.1	7.8
Contract	26.1	24.2	24.0	24.1	23.8	(8.8)
Data ARPU (EUR) <sup>1</sup>	4.7	5.0	4.9	4.9	5.0	6.1
% non-P2PSMS over data revenues	36.7%	40.9%	40.2%	41.3%	41.9%	5.2 p.p.
<b>Telefónica O2 Ireland</b>						
Traffic (Million minutes)	4,672	1,166	2,347	3,519	4,732	1.3
ARPU (EUR)	39.6	37.4	37.1	37.1	37.0	(6.6)
Prepay	25.5	21.8	24.3	24.3	24.3	(4.5)
Contract	62.0	60.1	55.5	55.3	54.7	(11.6)
Data ARPU (EUR)	11.8	12.0	12.0	12.2	12.3	3.9
% non-P2PSMS over data revenues	36.7%	38.3%	38.9%	38.4%	38.2%	1.5 p.p.
<b>Telefónica O2 Czech Republic<sup>2</sup></b>						
Traffic (Million minutes)	8,232	2,127	4,387	6,558	8,790	6.8
ARPU (EUR) <sup>3</sup>	19.3	17.8	18.2	18.5	18.5	(8.1)
Prepay	8.5	7.6	7.9	8.0	8.1	(7.8)
Contract <sup>3</sup>	28.2	25.3	25.8	26.2	26.1	(11.4)
Data ARPU (EUR) <sup>3</sup>	4.7	4.5	4.6	4.7	4.8	(4.1)
% non-P2PSMS over data revenues	44.6%	45.0%	44.4%	44.6%	44.7%	0.1 p.p.

<sup>1</sup> Change in ARPU affected by 450 thousand disconnections of inactive customers in Germany in December 2009.

<sup>2</sup> KPIs for Mobile business in Czech Republic do not include Slovakia.

<sup>3</sup> Change in ARPU affected by 111 thousand disconnections of inactive customers in Czech Republic in June 2010.

#### Notes:

- ARPU calculated as monthly quarterly average of each period.
- Traffic is defined as minutes used by the company customers, both outbound and inbound. On-net traffic is only included once (outbound), and promotional traffic is included. Traffic not associated to the Company's mobile customers (roaming-in, MVNOs, interconnection of third parties and other business lines) is excluded. Traffic volume non rounded.



## Telefónica Europe Selected Financial Data

	January - December				October - December			
	2010	2009	% Chg	% Chg Local Cur	2010	2009	% Chg	% Chg Local Cur
Unaudited figures (Euros in millions)								
<b>Telefónica O2 UK</b>								
Revenues	7,201	6,512	10.6	6.5	1,884	1,642	14.8	9.0
Service revenues	6,513	5,936	9.7	5.6	1,667	1,467	13.6	7.9
OIBDA <sup>1</sup>	1,830	1,680	9.0	4.9	466	461	1.1	(3.8)
OIBDA margin <sup>1</sup>	25.4%	25.8%	(0.4 p.p.)		24.7%	28.1%	(3.4 p.p.)	
CapEx	717	602	19.1	14.7	211	177	18.8	13.2
OpCF (OIBDA-CapEx) <sup>1</sup>	1,113	1,078	3.3	(0.5)	255	284	(10.0)	(14.4)
<b>Telefónica O2 Germany</b>								
Revenues <sup>2</sup>	4,826	3,746	28.9	28.9	1,314	998	31.6	31.6
Service revenues	2,932	2,861	2.5	2.5	749	729	2.6	2.6
OIBDA <sup>2</sup>	944	918	2.8	2.8	310	252	23.2	23.2
OIBDA margin <sup>2</sup>	19.6%	24.5%	(5.0 p.p.)		23.6%	25.2%	(1.6 p.p.)	
CapEx <sup>3</sup>	2,057	796	n.s.	n.s.	223	250	(10.7)	(10.7)
OpCF (OIBDA-CapEx) <sup>2,3</sup>	(1,113)	122	c.s.	c.s.	87	2	n.s.	n.s.
<b>Telefónica O2 Ireland</b>								
Revenues	848	905	(6.3)	(6.3)	207	228	(9.2)	(9.2)
Service revenues	779	842	(7.5)	(7.5)	191	207	(7.7)	(7.7)
OIBDA <sup>4</sup>	275	302	(9.0)	(9.0)	74	78	(5.8)	(5.8)
OIBDA margin <sup>4</sup>	32.4%	33.4%	(1.0 p.p.)		35.6%	34.3%	1.3 p.p.	
CapEx	60	63	(4.1)	(4.1)	19	25	(24.9)	(24.9)
OpCF (OIBDA-CapEx) <sup>4</sup>	214	239	(10.3)	(10.3)	55	53	3.1	3.1
<b>Telefónica O2 Czech Republic<sup>5</sup></b>								
Revenues	2,197	2,260	(2.8)	n.c.	563	579	(2.7)	n.c.
Service revenues	1,078	1,123	(4.0)	n.c.	270	280	(3.6)	n.c.
OIBDA	953	1,053	(9.5)	n.c.	250	262	(4.7)	n.c.
OIBDA margin	43.4%	46.6%	(3.2 p.p.)		44.3%	45.3%	(1.0 p.p.)	
CapEx	224	245	(8.8)	n.c.	78	75	3.4	n.c.
OpCF (OIBDA-CapEx)	729	807	(9.7)	n.c.	172	187	(8.0)	n.c.

### Notes:

- OIBDA before management and brand fee.
- HanseNet has been included in T. O2 Germany's consolidation perimeter since mid February 2010.

- 1 OIBDA is affected by non-recurrent restructuring expenses mainly related to personnel reorganization of 72 million euros in T.O2 UK in the fourth quarter of 2010. Excluding this restructuring expenses and 28 million euros in 2009, OIBDA growth for 2010 reached 7.2% year-on-year in local currency.
- 2 OIBDA is affected by non-recurrent restructuring expenses related to personnel reorganization of 202 million euros in T.O2 Germany in the third quarter of 2010. Excluding HanseNet and non-recurrent restructuring expenses related to personnel reorganization in Germany in the third quarter of 2010 and in 2009 (9 million euros), revenues of T.O2 Germany would increase 7.9% and OIBDA would grow 10.1% in the year 2010.
- 3 CapEx includes 1,379 million euros from the acquisition of spectrum in Germany in the second quarter of 2010. In organic terms, which exclude spectrum, CapEx would fall 27.9% and excluding non-recurrent restructuring costs in Germany related to personnel reorganization in the third quarter of 2010, OpCF would have a 3.4 fold increase year-on-year in 2010.
- 4 OIBDA is affected by non-recurrent restructuring expenses of 12 million euros in T.O2 Ireland in 2010.
- 5 Includes Slovakia, except in service revenues.

## Results by Regional Business Units

### Other Companies

Offshoring  
business  
represent 6'7%  
of the total  
revenues

#### Atento Group<sup>1</sup>

In 2010 Atento continued to follow its strategy of revenue growth and diversification, maintaining the focus on the profitability of the business. As a result, while the Company continued to gradually expand its customer base and range of products, and to increase sales from non-Telefónica customers, it improved its competitive position within the CRM BPO sector, consolidating its position as a leading player in terms of revenues and profitability.

In 2010 **revenues** for Atento totalled 1,663 million euros, up 25.9% year-on-year after the fourth quarter posted year-on-year growth of 29.4%. In organic terms, revenues grew 15.7% y-o-y in 2010, which gradually accelerated along the year.

Multi-sector customer growth (outside the Telefónica Group) generated 50% of revenues in 2010 (49% in 2009), up 27.3% year-on-year in 2010.

By region, the Brazilian business, which accounted for more than half the revenue growth, both in reported and organic terms, contributed 54% of Atento revenues in 2010. The Americas region, which registered double-digit growth in 2010, decreased its contribution to the Company's revenues to 30%, down from 34% in 2009. EMEA region, which accounted for 16% of Atento revenues, also registered double-digit growth in 2010.

The offshored business, whose main source markets are Spain and Mexico and main target markets are Central America, Colombia and Morocco, accounted for 6.7% of revenues in 2010.

**Operating income before depreciation and amortization (OIBDA)** at Atento in 2010 amounted to 190 million euros, up 23.3% year-on-year. This figure was impacted by the restructuring expenses reported in the second and fourth quarter of the year. OIBDA in the fourth quarter rose 22.5% year-on-year. In organic terms, OIBDA growth accelerated to 15.2% in 2010, compared with 11.7% in the first nine months of the year.

The **OIBDA margin** stood at 11.4% in 2010, 1.0 percentage points higher than in the first nine months of 2010 and virtually in line with the margin posted in 2009 (-0.2 percentage points in reported terms; -0.1 p.p. in organic terms). Excluding the restructuring expenses mentioned above, the OIBDA margin in 2010 would be slightly higher than in 2009 (+0.2 percentage points). The OIBDA margin stood at 14.1% in the fourth quarter (14.9% in the same quarter of 2009).

**CapEx** reached 88 million euros in 2010, a year-on-year decline of 4.2% (-12.1% in organic terms). CapEx was focused on revenue growth after investments were directed toward the construction of new customer service positions and equipment acquisition as well as renewed equipment in Brazil and Mexico.

*Note:*

*The Americas includes Mexico, Argentina, Peru, Venezuela, Colombia, Chile, Central America, Puerto Rico, and the US. EMEA includes Spain, Czech Republic and Morocco. Given its high business volume, Brazil is considered a region.*

<sup>1</sup> Organic growth assumes 2009 average exchange rates for the period and excludes hyperinflationary adjustments in Venezuela in both 2009 and 2010.

<sup>2</sup> CRM BPO: Customer Relationship Management; Business Process Outsourcing.

As a result, **operating cash flow (OIBDA-CapEx)** totalled 102 million euros in 2010, a remarkable year-on-year growth of 64.0% in reported terms and 56.3% in organic terms, explained mainly by the increasing volume of business and by maintaining efficiency levels.

Atento had 151,896 employees at the end of 2010, up 14.8% year-on-year.

## Atento Group Consolidated Income Statement

	January - December			October - December		
	2010	2009	% Chg	2010	2009	% Chg
Unaudited figures (Euros in millions)						
Revenues	1,663	1,321	25.9	454	351	29.4
Internal exp capitalized in fixed assets	-	-	-	-	-	-
Operating expenses	(1,475)	(1,167)	26.3	(392)	(299)	31.0
Supplies	(97)	(77)	25.7	(30)	(14)	116.3
Personnel expenses	(1,151)	(896)	28.4	(303)	(228)	33.1
Subcontracts	(220)	(189)	16.1	(56)	(56)	0.2
Bad debt provision	(1)	(0)	n.s.	(1)	(0)	n.s.
Taxes	(6)	(4)	36.8	(2)	(1)	57.4
Other net operating income (expense)	2	(0)	c.s.	2	0	n.s.
Gain (loss) on sale of fixed assets	(0)	0	c.s.	(0)	0	c.s.
Operating income before D&A (OIBDA)	190	154	23.3	64	52	22.5
OIBDA margin	11.4%	11.6%	(0.2 p.p.)	14.1%	14.9%	(0.8 p.p.)
Depreciation and amortization	(45)	(32)	38.6	(12)	(9)	42.3
Operating income (OI)	145	122	19.2	52	44	18.5

Note:

- 2009 and 2010 reported figures include the hyperinflationary adjustments in Venezuela in both years.

## Addenda

### Key Holdings of the Telefónica Group detailed by regional business units

#### Telefónica España

	% Stake
Telefónica de España <sup>1</sup>	100.0
Telefónica Móviles España <sup>1</sup>	100.0
Telyco	100.0
Telefónica Telecomunic. Públicas	100.0
T. Soluciones de Informática y Comunicaciones de España	100.0
Telefónica Remesas <sup>2</sup>	100.0
Tuenti <sup>3</sup>	91.4
Iberbanda	58.9

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

<sup>2</sup> Company owned through Telefónica Telecomunicaciones Públicas, S.A.

<sup>3</sup> Company owned through Telefónica Móviles España, S.A.U.

#### Telefónica Europe

	% Stake
Telefónica O2 UK	100.0
Telefónica O2 Germany <sup>1</sup>	100.0
Telefónica O2 Ireland	100.0
Be	100.0
HanseNet (Germany) <sup>2</sup>	100.0
Jajah (US)	100.0
Tesco Mobile	50.0
Telefónica O2 Czech Republic <sup>1</sup>	69.4
Telefónica O2 Slovakia <sup>3</sup>	100.0

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

<sup>2</sup> Company owned through T. O2 Germany.

<sup>3</sup> Company owned through T. O2 Czech Republic.

#### Telefónica Latinoamérica

	% Stake
Telesp <sup>1</sup>	88.0
Telefónica del Perú <sup>2</sup>	98.3
Telefónica de Argentina	100.0
TLD Puerto Rico	100.0
Telefónica Chile <sup>3</sup>	97.9
Telefónica Telecom	52.0
T. Intern. Wholesale Serv. (TIWS) <sup>4</sup>	100.0
Vivo Participações <sup>5</sup>	59.4
Vivo <sup>5</sup>	100.0
T. Móviles Argentina	100.0
T. Móviles Perú	100.0
T. Móviles México <sup>5</sup>	100.0
Telefónica Móviles Chile	100.0
T. Móviles El Salvador	99.1
T. Móviles Guatemala	100.0
Telcel (Venezuela)	100.0
T. Móviles Colombia	100.0
Otecel (Ecuador)	100.0
T. Móviles Panamá	100.0
T. Móviles Uruguay	100.0
Telefonía Celular Nicaragua	100.0
T. Móviles Soluciones y Aplicac. (Chile) <sup>5</sup>	100.0

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

<sup>2</sup> Latin American Cellular Holdings, B.V. owns 48.28%, Telefónica Internacional S.A. owns 49.9% and Telefónica S.A. owns 0.16%.

<sup>3</sup> Telefónica Internacional de Chile Ltda. owns 44.89% and Inversiones Telefónica Internacional Holding Ltda. owns 53%.

<sup>4</sup> Telefónica, S.A. owns 80.56% and T. Int. Wholesale Services, S.L. owns 19.44%.

<sup>5</sup> Company owned through Telefónica S.A.

<sup>6</sup> Company owned through Vivo Participações, S.A.

#### Other Stakes

	% Stake
Atento Group	100.0
Telefónica de Contenidos (Spain)	100.0
Telco SpA (Italy) <sup>1</sup>	46.2
IPSE 2000 (Italy)	39.9
DTS, Distribuidora de Televisión Digital	22.0
Hispatat	13.2
Portugal Telecom <sup>2</sup>	2.0
China Unicom (Hong Kong) Limited (China)	8.4
ZON Multimedia <sup>3</sup>	5.4
BBVA	1.0
Amper	5.8

<sup>1</sup> Telefónica holds an indirect stake of the ordinary share capital (with voting rights) of Telecom Italia through Telco of approximately 10.47%. If we take into account the saving shares (azioni di risparmio), which do not have voting rights, the indirect stake of Telefónica over Telecom Italia would be 7.20%.

<sup>2</sup> In June, the Telefónica Group reduced its stake in the share capital of Portugal Telecom by 7.98%. In addition, Telefónica signed three Equity Swap contracts with different financial entities. These swaps are based on the share price of Portugal Telecom and settled by differences.

<sup>3</sup> Telefónica's Group effective stake. Telefónica Group stake would be 5.46% if we exclude the minority interests.

## Significant Events

- On 23 January 2011 and in furtherance of their already existing strategic alliance, Telefónica, S.A. and China Unicom entered into the Enhanced Strategic Alliance Agreement in which both companies agreed to strengthen and deepen their strategic cooperation in certain business areas and through which, upon the terms and conditions set out thereof, each party has agreed to invest the equivalent of USD 500 million in ordinary shares of the other party. Following completion of the transaction, Telefónica will own approximately a 9.7% of China Unicom's voting share capital, assuming current price of the shares, and China Unicom will own approximately 1.37% of Telefónica's voting share capital. Furthermore, in view of China Unicom's interest in Telefónica's share capital, Telefónica undertakes, to the extent permitted under the applicable laws and its by-laws, to propose at its next General Shareholders' Meeting the appointment of a director nominated by China Unicom.
- On 28 December 2010, Telefónica, through its subsidiary Telefónica de Contenidos, S.A.U., completed the acquisition of the 22% stake in the company that brings together the pay-TV service of Prisa Group (DTS Distribuidora de Televisión Digital, S.A.). Telefónica's total investment in the aforementioned acquisition was approximately four hundred eighty-eight million euros (488 million euro), of which 228 million euro were covered by the cancellation of the outstanding amount of the subordinated loan existing between Telefónica de Contenidos, S.A.U. (creditor) and Sogetel, S.A. (actually known as Prisa Televisión, S.A.U., debtor).
- On 28 July 2010, Telefónica and Portugal Telecom signed an agreement for the acquisition by Telefónica of 50% of the share capital of Brasilcel for a total of 7,500 million euros. Further to the agreement signed on 28 July, on 27 September 2010 Telefónica acquired 50% of the share capital of Brasilcel (the owner of approximately 60% of Vivo Participações, S.A.) from Portugal Telecom. As set out in the contract, the Company settled the first payment instalment of 4,500 million euros. In addition, on 30 December 2010, Telefónica S.A. made a scheduled payment of 1,000 million euros while the payment of the remaining 2,000 million euros is scheduled for 31 October 2011. Nevertheless, Portugal Telecom may request that this latter payment be made on 29 July 2011, in which case the purchase price (specifically, the last instalment thereof) would be reduced by approximately 25 million euros.

Upon completion of the deal, the contracts signed between Telefónica and Portugal Telecom SG SGPS, S.A. in 2002 in connection with their joint venture in Brazil (Subscription Agreement and Shareholders Agreement) were rescinded.

Additionally, Telefónica announced a tender offer for the voting shares held by non-controlling interests of Vivo Participações, S.A. representing, approximately, 3.8% of its capital stock, for an amount equivalent to 80% of the price agreed in the Portugal Telecom acquisition described previously. This offer was approved by the Brazilian market regulator (C.V.M.) on February 11, 2011.

## Changes to the consolidation perimeter

In 2010 the following changes in the consolidation perimeter took place:

- Telefónica Group, through its 100%-owned subsidiary, Telefónica Europe Plc, acquired 100% of the leading communications innovator JAJAH Inc., for the value of 145 million euros in January 2010. The company has been incorporated in Telefónica's Group consolidation perimeter under the full consolidation method.
- On 3 December 2009 TELEFÓNICA, through its subsidiary Telefónica Deutschland GmbH ("Telefónica Deutschland"), signed definitive agreements for the acquisition of the German telecommunications operator HanseNet Telekommunikation GmbH ("HanseNet"). On 16 February 2010, the Telefónica Group completed the acquisition of 100% of the share capital of HanseNet Telekommunikation GmbH. The initial amount paid for this acquisition was approximately 913 million euros, which included 638 million euros refinanced debt that was finally reduced by 40 million euros once the transaction was completed. The company has been incorporated in Telefónica's Group consolidation perimeter under the full consolidation method.
- In April 2010, Teleinformática y Comunicaciones, S.A. (Telyco) disposed of its subsidiary, Telyco Marruecos, S.A. This company, which had been fully consolidated in the Telefónica Group, was removed from the consolidation perimeter.
- In June 2010, the British company Manx Telecom Limited was sold for approximately 164 million euros. This sale generated a benefit of 61 million euros. This company, which had been fully consolidated in the Telefónica Group, was removed from the consolidation perimeter.
- In June 2010, the Telefónica Group reduced its interest in the share capital of Portugal Telecom by 7.98%. In addition, Telefónica signed three "Equity Swaps" contracts with different financial entities. These swaps are based on the share price of Portugal Telecom and are settled by differences, thereby obtaining the same economic returns. The company was removed from the consolidation perimeter as of 30 June 2010.
- Telefónica Móviles España, S.A.U., a 100% subsidiary of Telefónica, S.A., acquired approximately 91.2% of the Spanish company Tuenti Technologies, S.L. in August. Afterwards, a capital increase took place and the Telefónica Group increase its stake to 91.4%. The company has been incorporated in Telefónica's Group financial statements under the full consolidation method.
- On 27 September 2010, Telefónica, S.A. acquired fifty percent (50%) of the share capital of Brasilcel, N.V. (a Dutch company holding an approximately sixty per cent (60%) interest in the Brazilian company Vivo Participações, S.A.) from Portugal Telecom SGPS, S.A. Vivo has been incorporated in Telefónica's Group consolidation financial statements under the full consolidation method since September 2010.



## Disclaimer

This document contains statements that constitute forward looking statements about Telefónica Group (going forward, "the Company" or Telefónica) including financial projections and estimates and their underlying assumptions, statements regarding plans, objectives and expectations which refer to the intent, belief or current prospects of the customer base, estimates regarding, among others, future growth in the different business lines and the global business, market share, financial results and other aspects of the activity and situation relating to the Company.

The forward-looking statements in this document can be identified, in some instances, by the use of words such as "expects", "anticipates", "intends", "believes", and similar language or the negative thereof or by forward-looking nature of discussions of strategy, plans or intentions.

Such forward-looking statements, by their nature, are not guarantees of future performance and involve risks and uncertainties, and other important factors that could cause actual developments or results to differ from those expressed in our forward looking statements. These risks and uncertainties include those discussed or identified in fuller disclosure documents filed by Telefónica with the relevant Securities Markets Regulators, and in particular, with the Spanish Market Regulator.

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## Telefónica's Group operates under a proactive Risk Management Policy

### Derivative Financial Instruments and Risk Management Policies

The Telefónica Group is exposed to various financial market risks as a result of: (i) its ordinary business activity, (ii) debt incurred to finance its business, (iii) its investments in companies, and (iv) other financial instruments related to the above commitments.

The main market risks affecting Group companies are as follows:

1. Exchange rate risk  
Exchange rate risk arises primarily from (i) Telefónica's international presence, through its investments and businesses in countries that use currencies other than the euro (primarily in Latin America, but also in the United Kingdom and the Czech Republic), and (ii) debt denominated in currencies other than that of the country where the business is conducted or the home country of the company incurring such debt.
2. Interest rate risk  
Interest rate risk arises primarily from changes in interest rates affecting (i) financial expenses on floating rate debt (or short-term debt likely to be renewed), due to changes in interest rates and (ii) the value of long-term liabilities at fixed interest rates.

#### 3. Share price risk

Share price risk arises primarily from changes in the value of the equity investments that may be bought, sold or otherwise involved in transactions, from changes in the value of derivatives associated with such investments, from changes in the value of treasury shares and from equity derivatives.

The Telefónica Group is also exposed to liquidity risk if a mismatch arises between its financing needs (including operating and financial expense, investment, debt redemptions and dividend commitments) and its sources of finance (including revenues, divestments, credit lines from financial institutions and capital market transactions). The cost of finance could also be affected by movements in the credit spreads (over benchmark rates) demanded by lenders.

Finally, the Telefónica Group is exposed to "country risk" (which overlaps with market and liquidity risks). This refers to the possible decline in the value of assets, cash flows generated or cash flows returned to the parent company as a result of political, economic or social instability in the countries where the Telefónica Group operates, especially in Latin America.

The Telefónica Group actively manages these risks through the use of derivatives (primarily on exchange rates, interest rates and share prices) and by incurring debt in local currencies, where appropriate, with a view to stabilizing cash flows, the income statement and investments. In this way, it attempts to protect the Telefónica Group's solvency, facilitate financial planning and take advantage of investment opportunities.

*Note: The notes that are referred to this part are included in the 2010 Financial Report of Telefónica, S.A.*

The Telefónica Group manages its exchange rate risk and interest rate risk in terms of net debt and net financial debt as calculated by them. The Telefónica Group believes that these parameters are more appropriate to understanding its debt position. Net debt and net financial debt take into account the impact of the Group's cash balance and cash equivalents including derivatives positions with a positive value linked to liabilities. Neither net debt nor net financial debt as calculated by the Telefónica Group should be considered an alternative to gross financial debt (the sum of current and non-current interest-bearing debt) as a measure of liquidity.

### Exchange rate risk

The fundamental objective of the exchange rate risk management policy is that, in event of depreciation in foreign currencies relative to the euro, any potential losses in the value of the cash flows generated by the businesses in such currencies, caused by depreciation in exchange rates of a foreign currency relative to the euro, are offset (to some extent) by savings from the reduction in the euro value of debt denominated in such currencies. The degree of exchange rate hedging employed varies depending on the type of investment.

At December 31, 2010, net debt in Latin American currencies was equivalent to approximately 8,463 million euros. However, the Latin American currencies in which this debt is denominated is not distributed in proportion to the cash flows generated in each currency. The future effectiveness of the strategy described above as a hedge of exchange rate risks therefore depends on which currencies depreciate relative to euro.

The Telefónica Group aims to protect itself against declines in Latin American currencies relative to the euro affecting asset values through the use of dollar-denominated debt, incurred either in Spain (where such debt is associated with an investment as long as it is considered to be an effective hedge) or in the country itself, where the market for local currency financing or hedges may be inadequate or non-existent. At December 31, 2010, the Telefónica Group's net debt denominated in dollars was equivalent to 1,518 million euros, of which 1,126 million euros was related to assets in Latin America and the remaining 392 million euros was related to its investment in China Unicom.

At December 31, 2010, pound sterling-denominated net debt was approximately 2.4 times the value of 2010 OIBDA from the "Telefónica Europe" business unit in the United Kingdom. The Telefónica Group's aim is to maintain the same proportion of pound sterling-denominated net debt to OIBDA as the Telefónica Group's net debt to OIBDA ratio, on a consolidated basis, to reduce its sensitivity to changes in the pound sterling to euro exchange rate. Pound sterling-denominated net debt at December 31, 2010, was equivalent to 4,025 million euros, higher than the 3,799 million euros at December 31, 2009.

To protect the investment in the Czech Republic, the Telefónica Group has net debt denominated in Czech crowns, which at December 31, 2010 was equivalent to 1,568 million euros, almost 36% of the original cost of the investment (compared to 59% of the initial cost of the investment in 2009), a decrease from approximately 2,513 million euros at December 31, 2009. The coverage percentage has been reduced in order to incorporate the management criterion adopted for the pound sterling. Consequently, the ratio of net debt in Czech crowns to OIBDA is 1.6 in consolidated terms and 2.3 in proportional terms, currently very close to the net debt to OIBDA ratio for the Telefónica Group in 2010.

The Telefónica Group also manages exchange rate risk by seeking to minimize the negative impact of any remaining exchange rate exposure on the income statement, regardless of whether there are open positions. Such open position exposure can arise for any of three reasons: (i) a thin market for local derivatives or difficulty in sourcing local currency finance which makes it impossible to arrange a low-cost hedge (as in Argentina and Venezuela), (ii) financing through intra-group loans, where the accounting treatment of exchange rate risk is different from that for financing through capital contributions, and (iii) as the result of a deliberate policy decision, to avoid the high cost of hedges that are not warranted by expectations or high risk of depreciation.

In 2010, exchange rate management resulted in negative exchange rate differences totaling 112 million euros, compared to 540 million euros in negative differences in 2009.

The following table illustrates the sensitivity of the income statement and equity to changes in exchange rates, where: (i) to calculate the impact on the income statement, the exchange rate position affecting the income statement at the end of 2010 was considered constant during 2011; (ii) to calculate the impact on equity, only monetary items have been considered, namely debt and derivatives such as hedges of net investment and loans to subsidiaries associated with the investment, whose composition is considered constant in 2011 and identical to that existing at the end of 2010. In both cases, Latin American currencies are assumed to depreciate against the US dollar, and the rest of the currencies against the euro by 10%.

Currency	Change	Impact on the consolidated income statement	Impact on consolidated equity
Millions of euros			
All currencies vs EUR	10%	105	67
USD	10%	1	206
European currencies vs EUR	10%	-	(417)
Latin American currencies vs USD	10%	104	278
All currencies vs EUR	(10)%	(105)	(67)
USD	(10)%	(1)	(206)
European currencies vs EUR	(10)%	-	417
Latin American currencies vs USD	(10)%	(104)	(278)

The Group's monetary position in Venezuela at December 31, 2010 is a net creditor position of 401 million Venezuela bolivars (equivalent to approximately 70 million euros). This leads to a higher financial expense in the amount of 109 million euros.

### Interest rate risk

The Telefónica Group's financial expenses are exposed to changes in interest rates. In 2010, the rates applied to the largest amount of short-term debt were mainly based on the Euribor, the Czech crown Pribor, the Brazilian SELIC, the US dollar Libor and the Colombian UVR. In nominal terms, at December 31, 2010, 64.9% of the Telefónica Group's net debt (or 70.0% of long-term net debt) was at rates fixed for a period longer than one year, compared to 52.6% of net debt (50% of long-term net debt) in 2009. Of the remaining 35.1% (net debt at floating or fixed rates maturing in less than one year), the interest rate on 18 percentage points was set for a period of more than one year (7% of long-term net debt), compared to 24 percentage points on debt at floating or fixed rates maturing in less than one year (10.7% of long-term net debt) at December 31, 2009. This decrease in 2010 from 2009 is due to our decision to cancel or not renew an amount equivalent to 491 million euros of caps and floors in euros, US dollars and pounds sterling, following the policy implemented in 2009 in anticipation of a fall in interest rates.

In addition, early retirement liabilities were discounted to present value over the year, using the curve on the swap rate markets. The decrease in interest rates has increased the market value of these liabilities. However, this increase was nearly completely offset by the increase in the value of the hedges on these positions.

Net financial expenses decreased 20% to 2,649 million euros in 2010, from 3,307 million euros in 2009, mainly due to the impact of Venezuela. Stripping out exchange-rate effects, net financial expense for 2010 totaled 2,537 million euros, an 8% decrease from the 2,767 million euros recorded in 2009.

To illustrate the sensitivity of financial expenses to variability in short-term interest rates, a 100 basis points increase in interest rates in all currencies in which there are financial positions at December 31, 2010 has been assumed, and a 100 basis points decrease in interest rates in all currencies except the dollar and the pound sterling, to avoid negative rates. The constant position equivalent to that prevailing at the end of 2010 has also been assumed.

To illustrate the sensitivity of equity to variability in interest rates, a 100 basis points increase in interest rates in all currencies and in all curve periods where Telefónica has a financial position at December 31, 2010, and a 100 basis points decrease in all currencies and in all periods, have been assumed. In addition, only positions with cash flow hedges have been considered, given that they are the only positions where the change in fair value due to interest rate movements is recorded in equity.

In both cases, only transactions with external counterparties have been considered.

Millions of euros Change in basis points (bp) (*)	Impact on consolidated income statement	Impact on consolidated equity
Millions of euros		
+100bp	(222)	575
-100bp	209	(626)

\* Impact on results of 100 bp change in interest rates in all currencies, except the pound sterling and the dollar.

### Share price risk

The Telefónica Group is exposed to 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.

According to the Telefónica, S.A. share option plan, Performance Share Plan (PSP) -(see Note 20)- the shares to be delivered to employees under such plan may be either the parent company treasury shares, acquired by them or any of its Group companies; or newly-issued shares. The possibility of delivering shares to employees in the future, in accordance with relative total shareholders' return, implies a risk since there could be an obligation to hand over a maximum number of shares at the end of each phase, whose acquisition (in the event of acquisition in the market) in the future could imply a higher cash outflow than required on the start date of each phase if the share price is above the corresponding price on the phase

start date. In the event that new shares are issued for delivery to the beneficiaries of the plan, there would be a dilutive effect for ordinary shareholders as a result of the higher number of shares delivered under such plan outstanding.

To reduce the risk to the company associated with variations in share price under this plan, Telefónica has acquired derivatives that replicate the risk profile of some of the shares deliverable under the plan as explained in Note 20.

During 2010, an incentive plan for Group employees to purchase Telefónica shares, approved at the Ordinary General Shareholders' Meeting of 2009, was initiated. The cost of this plan will not exceed 50 million euros, as agreed in the aforementioned Ordinary General Shareholders' Meeting (see Note 20 for further details).

In addition, the Group may use part of the 55,188,046 treasury shares of Telefónica, S.A. held at December 31, 2010 to cover shares deliverable under the PSP. The net asset value of the treasury shares could increase or decrease depending on variations in Telefónica, S.A.'s share price.

### Liquidity risk

The Telefónica Group seeks to match the schedule for its debt maturity payments to its capacity to generate cash flows to meet these maturities, while allowing for some flexibility. In practice, this has been translated into two key principles:

1. The Telefónica Group's average maturity of net financial debt is intended to stay above 6 years, or be restored above that threshold in a reasonable period of time if it eventually falls below it. This principle is considered as a guideline when managing debt and access to credit markets, but not a rigid requirement. When calculating the average maturity for the net financial debt and part of the undrawn credit lines can be considered as offsetting the shorter debt maturities, and extension options on some financing facilities may be considered as exercised, for calculation purposes.

2. The Telefónica Group must be able to pay all commitments over the next 12 months without accessing new borrowing or accessing the capital markets (although drawing upon firm credit lines arranged with banks), assuming budget projections are met.

As of December 31, 2010, the average maturity of its 55,593 million euros of net financial debt was 5.72 years.

At December 31, 2010, gross financial debt scheduled maturities in 2011 amounted to approximately 11,350 million euros (including the net position of derivative financial instruments, as well as the amount of deferred payment for the acquisition of Brasilcel, for a present value of 1,977 million euros (Note 2)), which is lower than the amount of funds available, calculated as the sum of: a) current financial assets and cash at December 31, 2010 (5,423 million euros excluding derivative financial instruments), b) annual cash generation projected for 2011; and c) undrawn credit lines arranged with banks whose original maturity is over one year (an aggregate of more than 7,142 million euros at December 31, 2010), providing flexibility to the Telefónica Group with regard to accessing capital or credit markets in the next 12 months. For a further description of the Telefónica Group's liquidity and capital resources in 2010, see Note 13.2 Financial Liabilities and Appendix III.

### Country risk

The Telefónica Group 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 the Telefónica Group's Latin American companies such that any potential asset impairment would be accompanied by a reduction in liabilities; and,
2. Repatriating funds generated in Latin America that are not required for the pursuit of new, profitable business development opportunities in the region.

Regarding the first point, at December 31, 2010, the Telefónica Group's Latin American companies had net financial debt not guaranteed by the parent company of 6,834 million euros, which represents 13% of consolidated net financial debt.

Regarding the repatriation of funds to Spain, it has received 3,279 million euros from the Group's Latin America companies in 2010, of which 1,282 million euros was from dividends, 722 million euros from intra-group loans (payments of interest and repayments of principal), 1,231 million euros from financial investments, and 44 million euros from capital reductions. These amounts were equally offset by additional amounts invested in its Latin American companies, mainly in Chile (869 million euros) and in Mexico (269 million euros). As a result of the foregoing, net funds repatriated to Spain from the Group's Latin America companies amounted to the equivalent of 2,125 million euros in 2010.

In this regard, it is worth noting that since February 2003, Venezuela has had an exchange control mechanism in place, managed as indicated above by the Currency Administration Commission (CADIVI). The body has issued a number of regulations ("providencias") governing the modalities of currency sales in Venezuela at official exchange rates. Foreign companies which are duly registered as foreign investors are entitled to request approval to acquire currencies at the official exchange rate by the CADIVI, in line with regulation number 029, article 2, section c) "Remittance of earnings, profits, income, interest and dividends from international investment." Telcel, a Telefónica Group subsidiary in Venezuela, obtained the aforementioned requested approval on 295 million Venezuelan bolivars in 2006, 473 million Venezuelan bolivars in 2007 and 785 million Venezuelan bolivars in 2008. At December 31, 2010, payment of the dividends approved by the company in the amount of 1,152 million Venezuelan bolivars is pending approval.

### Credit risk

The Telefónica Group trades in derivatives with creditworthy counterparties. Therefore, Telefónica, S.A. trades with credit entities whose "senior debt" ratings are of at least "A". In Spain, where most of the Group's derivatives portfolio is held, there are netting agreements with financial institutions, with debtor or creditor positions offset in case of bankruptcy, limiting the risk to the net position. For other subsidiaries, particularly those in Latin America, assuming a stable sovereign rating provides a ceiling which is below "A," trades are with local financial entities whose rating by local standards is considered to be of high creditworthiness.

Meanwhile, with credit risk arising from cash and cash equivalents, the Telefónica Group places its cash surpluses in high quality and highly liquid money-market assets. These placements are regulated by a general framework, revised annually 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 (long-term debt rating); (ii) the maximum tenor 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 2010 was limited to 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 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, Telefónica'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 ratio in its operations. Particular attention is given to those clients that could cause a material impact on the Group's financial statements for which, depending on the segment and type of relation, hedging instruments or collateral may be required to mitigate exposure to credit risk.

All Group companies adopt policies, procedures, authorization guidelines, and homogeneous management practices, in consideration of the particularities of each market and best international practices, and incorporating this commercial credit risk management model into the Group's decision making processes, both from a strategic and day to day operating perspective.

The Telefónica Group's maximum exposure to credit risk is initially represented by the carrying amounts of the assets (see Notes 11 and 13) and the guarantees given by the Telefónica Group.

Several Telefónica Group companies provide operating guarantees granted by external counterparties, which are offered during their normal commercial activity, in bids for licenses, permits and concessions, and spectrum acquisitions. At December 31, 2010, these guarantees amounted to approximately 2,062 million euros (see Note 21.d).

Furthermore, in relation to the public offering announced in order to acquire the ordinary shares in Vivo Participações, S.A. that are not held by Brasilcel, described in Note 5, Telefónica has provided the guarantees normally required in this type of transaction, totaling an amount of 818 million euros at December 31, 2010.

### Capital management

Telefónica's corporate finance department, which is in charge of Telefónica's capital management, takes into consideration several factors when determining Telefónica's capital structure, with the aim of ensuring sustainability of the business and maximizing the value to shareholders.

Telefónica monitors its cost of capital with a goal of optimizing its capital structure. In order to do this, Telefónica monitors the financial markets and updates to standard industry approaches for calculating weighted average cost of capital, or WACC. Telefónica also uses a leverage ratio not exceeding the 2.5x OIBDA limit in the medium term (excluding items of a non-recurring or exceptional nature), enabling to obtain and maintain the desired credit rating over the medium term, and with which the Telefónica Group can match the potential cash flow generation with the alternative uses that could arise at all times.

These general principles are refined by other considerations and the application of specific variables, such as country risk in the broadest sense, or the volatility in cash flow generation, when determining the Telefónica Group's financial structure.

### Derivatives policy

During 2010, the Group continued to use derivative financial instruments to limit interest and exchange rate risk on otherwise unhedged positions, and to adapt its debt structure to market conditions.



At December 31, 2010, the nominal value of outstanding derivatives with external counterparties amounted to 140,272 million euros equivalent, a 6.6% increase from December 31, 2009 (131,614 million euros equivalent). 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 example, a foreign currency loan can be hedged into floating rate, and then each interest rate period can be fixed using a fixed rate hedge, or FRA (forward rate agreement). Even using such techniques to reduce the position, it is still necessary to take extreme care in the use of derivatives to avoid potential problems arising through error or a failure to understand the real position and its associated risks.

The Telefónica 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 accounting rules 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, which are 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 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 Telefónica 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 liquidity in 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.

In certain cases, 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, the aim is 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 (of the Telefónica Group companies as well as those of the banks).

**4 Ability to measure the derivative's fair value using the valuation systems available to the Telefónica Group.**

The Telefónica Group 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.**

The Telefónica Group considers the sale of options when: i) there is an underlying exposure (on the consolidated statement of financial position 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, the Group would swap part of its debt from floating rate to a lower fixed rate, having received a premium.

**6 Hedge accounting.**

The main risks that may qualify for hedge accounting are as follows:

- Variations in market interest rates (either money-market rates, credit spreads or both) that affect the value of the underlying asset or the measurement of the cash flows;

- Variations in exchange rates that change the value of the underlying asset in the company's functional currency and affect the measurement of the cash flow in the functional currency;
- Variations in the volatility of any financial variable, asset or liability that affect either the valuation or the measurement of cash flows on debt or investments with embedded options, whether or not these options are separable; and
- Variations in the valuation of any financial asset, particularly shares of companies included in the portfolio of "Available-for-sale financial assets".

#### Regarding the underlying:

- Hedges can cover all or part of the value of the underlying;
- The risk to be hedged can be for the whole period of the transaction or for only part of the period; and
- The underlying may be a highly probable future transaction, or a contractual underlying (loan, foreign currency payment, investment, financial asset, etc.) or a combination of both that defines an underlying with a longer term.

This may on occasion mean that the hedging instruments have longer terms than the related contractual underlying. This happens when the Group enters into long-term swaps, caps or collars to protect ourselves against interest rate rises that may raise the financial expense of its promissory notes, commercial paper and some floating rate loans which mature earlier than their hedges. These floating rate financing programs are highly likely to be renewed and Telefónica commits to this by defining the underlying asset in a more general way as a floating rate financing program whose term coincides with the maturity of the hedge.

#### Hedges can be of three types:

- Fair value hedges.
- Cash flow hedges. Such hedges can be set at any value of the risk to be hedged (interest rates, exchange rates, etc.) or for a defined range (interest rates between 2% and 4%, above 4%, etc.). In this last case, the hedging instrument used is options and only the intrinsic value of the option is recognized as an effective hedge. Changes in the time value of options are recognized in the income statement. To prevent excessive swings in the income statement from changes in time value, the hedging ratio (amount of options for hedging relative to the amount of options not treated as hedges) is assigned dynamically, as permitted by the standard.
- Hedges of net investment in consolidated foreign subsidiaries. Generally such hedges are arranged by the parent company and the other Telefónica's holding companies. Wherever possible, these hedges are implemented through real debt in foreign currency. Often, however, this is not always possible as many Latin American currencies are non-convertible, making it impossible for non-resident companies to issue local currency debt. It may also be that the debt market in the currency concerned is too thin to accommodate the required hedge (for example, the Czech crown and pounds sterling), or that an acquisition is made in cash with no need for market financing. In these circumstances derivatives, either forwards or cross-currency swaps are used to hedge the net investment.

Hedges can comprise a combination of different derivatives.

Management of accounting hedges is not static, and the hedging relationship may change before maturity. Hedging relationships may change to allow appropriate management that serves the Group's stated principles of stabilizing cash flows, stabilizing net financial income/expense and protecting share capital. The designation of hedges may therefore be cancelled, before maturity, because of a change in the underlying, a change in perceived risk on the underlying or a change in market view. Derivatives included in these hedges may be reassigned to new hedges where they meet the effectiveness test and the new hedge is well documented. To gauge the efficiency of transactions defined as accounting hedges, the Group analyzes the extent to which the changes in the fair value or in the cash flows attributable to the hedged item would offset the changes in fair value or cash flows attributable to the hedged risk using a linear regression model.

The main guiding principles for risk management are laid down by Telefónica's Finance Department and implemented by company chief financial officer (who is responsible for balancing the interests of each company and those of the Telefónica Group). The Corporate Finance Department may allow exceptions to this policy where these 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 Telefónica Group as a result of mergers or acquisitions may also need time to adapt.

The breakdown of the financial results recognized in 2010, 2009 and 2008 is as follows:

	2010	2009	2008
Millions of euros			
Interest income	454	528	589
Dividends received	40	45	67
Other financial income	266	151	217
Interest expenses	(2,514)	(3,036)	(3,333)
Ineffective portion of cash flow hedges	(16)	(17)	(71)
Accretion of provisions and other liabilities	(145)	(254)	(453)
Changes in fair value of financial assets at fair value through profit or loss	25	124	341
Changes in fair value of financial liabilities at fair value through profit or loss	(39)	(132)	(115)
Transfer from equity to profit and loss from cash flow hedges	(73)	77	(50)
Transfer from equity to profit and loss from available-for-sale assets	(202)	4	142
(Gain)/loss on fair value hedges	168	(427)	912
Loss/(gain) on adjustment to items hedged by fair value hedges	(211)	439	(883)
Other expenses	(290)	(269)	(184)
<b>Net finance costs excluding foreign exchange differences</b>	<b>(2,537)</b>	<b>(2,767)</b>	<b>(2,821)</b>

The breakdown of Telefónica's derivatives at December 31, 2010, their fair value at year-end and the expected maturity schedule are as set forth in the table below:

		Maturity (notional amount)*				
Derivatives	Fair value: at 12/31/10**	2011	2012	2013	Subsequent years	Total
Millions of euros						
Interest rate hedges	(355)	(5,850)	60	(2,083)	7,202	(671)
Cash flow hedges	266	(3,504)	556	(438)	8,487	5,101
Fair value hedges	(621)	(2,346)	(496)	(1,645)	(1,285)	(5,772)
Exchange rate hedges	(405)	1,329	113	579	4,323	6,344
Cash flow hedges	(404)	1,206	113	579	4,323	6,221
Fair value hedges	(1)	123	-	-	-	123
Interest and exchange rate hedges	(31)	253	272	1,162	2,595	4,282
Cash flow hedges	(87)	191	246	1,148	2,252	3,837
Fair value hedges	56	62	26	14	343	445
Hedge of net investment in foreign operations	(234)	(2,221)	(118)	(160)	(1,030)	(3,529)
Derivatives not designated as hedges	(411)	4,839	318	(289)	(428)	4,440
Interest rate	(245)	4,231	426	(427)	(1,316)	2,914
Exchange rate	(168)	528	(107)	138	888	1,447
Interest and exchange rate	2	80	(1)	-	-	79

\* For hedges, the positive amount is in terms of fixed "payment."

For foreign currency hedges, a positive amount means payment in functional vs. foreign currency.

\*\* Positive amounts indicate payables.

Note: The notes that are referred to this part are included in the 2010 Financial Report of Telefónica, S.A.

The breakdown of Telefónica's derivatives at December 31, 2009, their fair value at year-end and the expected maturity schedule are as set forth in the table below:

Derivatives	Fair value: at 12/31/09**	Maturity (notional amount)*				Total
		2010	2011	2012	Subsequent years	
Millions of euros						
Interest rate hedges	(282)	3,044	(103)	163	(2,520)	584
Cash flow hedges	147	1,769	1,143	659	3,024	6,595
Fair value hedges	(429)	1,275	(1,246)	(496)	(5,544)	(6,011)
Exchange rate hedges	1,055	1,792	788	112	4,900	7,592
Cash flow hedges	1,055	1,797	788	112	4,900	7,597
Fair value hedges	-	(5)	-	-	-	(5)
Interest and exchange rate hedges	157	14	(419)	(314)	(281)	(1,000)
Cash flow hedges	152	51	(426)	(171)	(360)	(906)
Fair value hedges	5	(37)	7	(143)	79	(94)
Hedge of net investment in foreign operations	(276)	(2,555)	(958)	(113)	(868)	(4,494)
Derivatives not designated as hedges	(612)	6,110	341	388	(744)	6,095
Interest rate	(299)	5,532	413	483	(1,770)	4,658
Exchange rate	(270)	738	(9)	(28)	1,026	1,727
Interest and exchange rate	(43)	(160)	(63)	(67)	-	(290)

The Company also has debt assigned to the investment of 944 million US dollars, 2,643 million pounds sterling and 302 million Czech crowns (data in equivalent euros).

\* For hedges, the positive amount is in terms of fixed "payment."

For foreign currency hedges, a positive amount means payment in functional vs. foreign currency.

\*\* Positive amounts indicate payables.

A list of derivative products entered into at December 31, 2010 and 2009 is provided in Appendix III.









Telefónica, S.A.  
Annual Report 2010

This report is available on the Telefónica website at: [www.telefonica.com](http://www.telefonica.com)

Shareholders may also request copies of this report from the Shareholders' Office by using the free phone number 900 111 004 (in Spain) or by sending an e-mail to: [accion.telefonica@telefonica.es](mailto:accion.telefonica@telefonica.es)

Likewise, the mandatory information that must be provided under prevailing legislation is also available to shareholders and the general public.

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