D. Risk Factors

In addition to the other information contained in this Annual Report, prospective investors should carefully consider the risks described below before making any investment decision. The risks described below are not the only ones that we face. Additional risks not currently known to us or that we currently deem immaterial may also impair our business and results of operations. Our business, financial condition, results of operations and cash flow could be materially adversely affected by any of these risks, and investors could lose all or part of their investment.

Risks Relating to Our Business

A material portion of our operations and investments are located in Latin America, and we are therefore exposed to risks inherent in operating and investing in Latin America.

At December 31, 2011, approximately 48.5% of our assets were located in our Latin America segment. In addition, approximately 46.5% of our revenues for 2011 were derived from our Latin American segment operations. At December 31, 2011, 54.5% of Latin America assets and 49.0% of Latin America revenues were derived from our operations in Brazil. Our business is thus particularly sensitive to any of the risks relating to Latin America discussed in this section to the extent they arise or manifest themselves in Brazil. Our operations and investments in Latin America (including the revenues generated by these operations, their market value and the dividends and management fees expected to be received therefrom) are subject to various risks linked to the economic, political and social conditions of these countries, including risks related to the following:

- government regulation or administrative polices may change unexpectedly, including changes that modify the terms and conditions of concessions and their renewal, which could negatively affect our interests in such countries;
- the effects of inflation or currency depreciation or currency restrictions and other restraints on transfers of funds that may be imposed;
- governments may expropriate or nationalize assets or increase their participation in the economy and companies; and
- economic downturns, political instability and civil disturbances may negatively affect our operations.

Our financial condition and results of operations may be adversely affected if we do not effectively manage our exposure to foreign currency exchange rate, interest rate or financial investment risks.

We are exposed to various types of market risk in the normal course of our business, including, above all, the impact of changes in interest rates of foreign currency exchange rates. We use a variety of strategies to manage this risk, mainly through the use of financial derivatives, which themselves are suceptible to risks, including counterparty risk. Our risk management strategies may not achieve their desired effect, which could adversely affect our business, financial condition and results of operations.

For a more detailed description of our financial derivatives transactions, see “Item 11. Quantitative and Qualitative Disclosures about Market Risk” and Note 16 to our Consolidated Financial Statements.

Adverse economic conditions could reduce purchases of our products and services.

Our business is impacted by general economic conditions in each of the countries in which we operate. The current uncertainty about whether the economic recovery will continue may negatively affect the level of demand of existing and prospective customers, as our services may not be deemed critical for these customers. The principal macroeconomic factors that could have an adverse impact on consumption and, accordingly, demand for our services include access to credit, unemployment rates, consumer confidence and other general macroeconomic factors.

Existing or worsening conditions in the international financial markets may limit our ability to carry out our business plan.

The operation, expansion and upgrading of our networks, the development and distribution of our services as well as the development and implementation of new technologies or license award renewal processes, require substantial financing.

International financial markets continue to be affected by current uncertainties surrounding the pace of economic recovery, the health of the international banking system and increasing concerns regarding burgeoning public deficits in certain European countries. Worsening conditions in the international credit markets due to any of these factors may make it more difficult and more expensive to refinance our financial debt (at December 31, 2011, our net average debt scheduled to mature in the next six years was approximately €6,850 million per year) or to incur additional debt, if needed.

In addition, if our credit ratings were downgraded, our capacity to raise capital in the international capital markets could be impaired, in terms of access and cost. Although following recent downgrades in our long-term debt we have successfully tapped the capital markets in several instances, we can give no assurance regarding our ability to raise capital in the international capital markets on a timely basis or at all, or at interest rates acceptable to us.

Furthermore, market conditions may make it more difficult to renew our unused bilateral credit facilities, 24% of which as of December 31, 2011 are scheduled to mature prior to December 31, 2012. Finally, the current financial situation may also make it more difficult and costly for us to raise additional equity capital.

Risks Relating to Our Industry

We operate in a highly regulated industry, which could adversely affect our businesses, and we depend on government concessions.

As a multinational telecommunications company that operates in regulated markets, we are subject to different laws and regulations in each of the jurisdictions in which we provide services. Such laws and regulations are promulgated and enforced to varying degrees by supranational regulators such as the European Union and national, state, regional and local authorities. Regulation is particularly strict in the markets of those countries in which we hold a significant market position. In this respect, regulatory authorities regularly intervene in the retail and wholesale offering and pricing of our products and services and throughout 2011 generally placed downward pressure on wholesale and retail voice rates, roaming rates, termination rates and SMS messaging rates. Additional regulations could require us to further reduce roaming prices and termination rates in mobile and/or fixed line networks, require us to offer access to our network to other operators and result in the imposition of fines if we fail to fulfill our service commitments. Such regulations and regulatory actions could place significant competitive and pricing pressure on our operations, and could have a material adverse effect on our business, financial condition, results of operations and cash flow.

We provide most of our services under licenses, authorizations and concessions and, as such, are substantially dependent upon them. Regulatory authorities may adopt further regulations or take additional actions that could adversely affect us, including revocation of or failure to renew any of our licenses, authorizations or concessions, implementation of changes to the spectrum allocated to us or the granting or new licenses, authorizations or concessions to our competitors to offer services in the relevant markets. While we pursue license renewals to the extent provided by their contractual terms, we cannot guarantee that we will always complete this process successfully or on beneficial terms for us. In many cases we must satisfy certain obligations, including, among others, minimum specified quality standards, service and coverage conditions and capital investment thresholds in order to qualify for renewal. Failure to comply with these obligations could result in the imposition of fines or even revocation or forfeiture of the license, authorization or concession.

In addition, because we hold a leading market share in many of the counties where we operate, we could face regulatory actions by antitrust or competition authorities. These authorities could prohibit us from taking further actions such as making further acquisitions or continuing to engage in particular practices or impose fines or other penalties on us, which, if significant, could result in loss of market share and harm to our financial performance and future growth.

For further information regarding the matters discussed above and other aspects of the regulatory environments in which our businesses operate, see “Item 4. Information on the Company—Business Overview—Regulation.”

We operate in highly competitive markets and the industry in which we operate is subject to rapid technological changes, which requires us to continuously adapt to such changes and to upgrade our existing networks.

We operate in markets that are highly competitive and subject to constant technological development. Therefore, we are subject to the effects of actions by competitors in these markets and rely on our ability to anticipate and adapt to constant technological changes taking place in the industry. To compete effectively with our competitors, we need to successfully market our products and services and respond to both commercial actions by competitors and other competitive factors affecting these markets, anticipating and adapting promptly to technological changes, changes in consumer preferences and general economic, political and social conditions. Failure to do so effectively could have an adverse impact on our business, results of operations and financial condition. See “Item 4. Information on the Company—Business Overview—Competition.”

New products and technologies arise constantly while the development of existing products and technologies can render obsolete the products and services we offer and the technologies we use. This can force us to investment in the development of new products, technology and services so that we can continue to compete effectively with current or future competitors. Such investments can reduce the revenue margins we obtain. In this respect, margins from traditional voice and data business are shrinking, while new sources of revenues are arising from mobile Internet. One technology that telecommunications operators, including us (in Spain and Latin America), are focused on is the new FTTx-type network, which offers broadband access using optical fiber with superior services, such as high speed Internet and HD television services. However, significant investment is required to deploy these networks, which entails fully or partially substituting the copper wire with fiber optic cables. Currently, minimal demand for the capabilities offered by these new networks to end users could make it difficult to quantify the return on investment and justify the high investment. In addition, many of these networks upgrade tasks and the ability to offer new products or services are not entirely under our control and may be affected by applicable regulations.

Spectrum capacity may become a limiting and costly factor.

Our mobile operations in a number of countries may rely on spectrum availability. Failure to obtain sufficient or adequate spectrum coverage and the costs related to obtaining this capacity could have a material adverse impact on the quality of our services, on our ability to provide new services and on our cash flow, adversely affecting our business, financial condition and results of operations. For further information regarding the matters discussed above and other aspects of the regulatory environments in which our businesses operate, see “Item 4. Information on the Company—Business Overview—Regulation—Licenses and Concessions.”

Our business could be adversely affected if our suppliers fail to provide necessary equipment and services on a timely basis.

As a mobile and fixed telephony operator and provider of telecommunications services and products, we like other companies in the industry we depend upon a small number of major suppliers for essential products and services, mainly network infrastructure and mobile handsets. These suppliers may, among other things, extend delivery times, raise prices and limit supply due to their own shortages and business requirements. If these suppliers fail to deliver products and services on a timely basis, it could jeopardize our network deployment and expansion plans, which could adversely affect our ability to satisfy our license terms and requirements and have a material, adverse effect on our businesses, results of operations and financial condition.

We may be adversely affected by unanticipated network interruptions.

Unanticipated network interruptions as a result of system failures whether accidental or otherwise, including due to network, hardware or software failures, which affect the quality of or cause an interruption in our service, could result in customer dissatisfaction, reduced revenues and traffic and costly repairs, penalties or other measures imposed by regulatory authorities, and could harm our reputation. We attempt to mitigate these risks through a number of measures, including backup systems and protective systems such as firewalls, virus scanners and building security. However, these measures are not effective under all circumstances and cannot avert every action or event that could damage or disrupt our technical infrastructure. Although we carry business interruption insurance, our insurance policy may not provide coverage in amounts sufficient to compensate us for any losses we may incur.

The mobile industry may be harmed by concerns stemming from actual or perceived health risks associated with radio frequency emissions.

Currently, there is significant public concern regarding alleged potential effects of electromagnetic fields emitted by mobile telephones and base stations on human health. This concern has caused certain governments and administrations to take measures that have hindered the deployment of the infrastructure necessary to ensure quality of service and has affected the deployment criteria of new networks.

In May 2011, the specialized body of the World Health Organization for research on cancer (IARC) classified electromagnetic fields of mobile telephony as "possibly carcinogenic," a classification which also includes products such as coffee and pickled foods. The World Health Organization subsequently indicated, in fact sheet no. 193, published in June 2011, that to date it cannot be confirmed that the use of a mobile telephone has adverse effects on health, although it also announced that in 2012 an official assessment of this risk will be conducted, taking into account all scientific evidence available.

We have devised plans to help assure compliance with codes of good practices and relevant regulations in the various countries in which we operate. Nevertheless, this concern may affect our ability to capture or retain customers, may discourage the use of the mobile telephone and may result in the adoption of new measures by governments or any other regulatory interventions, any of which could materially and adversely affect our business, results of operations and financial condition.

Developments in the telecommunications sector have resulted, and may in the future result, in substantial write-downs of the carrying value of certain of our assets.

We review on an annual basis or more frequently where the circumstances require, the value of each of our assets and cash generating units to assess whether their carrying values can be supported by the future cash flows expected to be derived from such assets and cash generating units, considering in some cases synergies included in their acquisition costs. Changes in the regulatory, business, economic or political environment may result in the necessity of recognizing impairment charges on our goodwill, intangible assets or fixed assets.

Although the recognition of impairments of tangible, intangible and financial assets result in a non-cash charge on the income statement, such charge would adversely affect our results of operations and consequently, our ability to achieve our growth targets. For example, we have faced several corrections regarding the value of certain of our assets that have impacted our results of operations for the year in which the corrections were made. In 2011, an impairment loss was recognized on our stake in Telco, S.p.A., which, among other effects, resulted in a negative impact of €620 million, reducing the value of our stake in Telecom Italia, S.p.A. This value is evaluated at each reporting date for indications of impairment losses.

Other Risks

We are involved in disputes and litigation with regulators, competitors and third parties.

We are party to lawsuits and other legal, regulatory and antitrust proceedings in the ordinary course of our business, the final outcome of which is generally uncertain. An adverse outcome in, or any settlement of, these or other proceedings that may be asserted in the future may have a material adverse effect on our business, financial condition, results of operations and cash flow.

For a more detailed description of current legal proceedings, see "Item 8. Financial Information—Legal Proceedings."