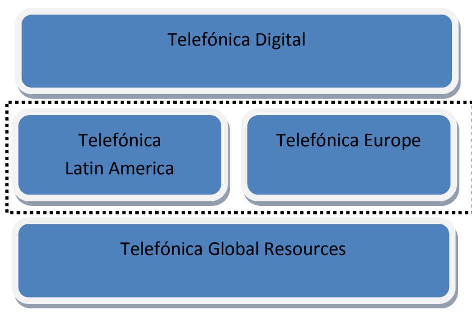
2012 Consolidated Management Report

Financial results

The Telefónica Group is one of the world's leading mobile and fixed communications services providers. Its strategy is to become a leader in the new digital world and transform the possibilities it brings into reality.

Against this backdrop and with the aim of reinforcing its growth story, actively participating in the digital world and capturing the most of the opportunities afforded by its scale and industrial alliances, in September 2011 a new organizational structure was approved. This new structure, which was fully operational in 2012, is as follows:



This new organization bolsters the Telefónica Group's place in the digital world, enabling it to tap any growth opportunities arising in this environment, drive innovation, strengthen the product and services portfolio and maximize the advantages afforded by its large customer bases in an increasingly connected world. In addition, the creation of a Global Resources operating unit aims to ensure the profitability and sustainability of the business by leveraging economies of scale and driving Telefónica's transformation into a fully global group.

Telefónica Europe's and Telefónica Latin America's objective is to shore up the results of the business and generate sustainable growth through available capacity, backed by the Global Corporation. The two differentiated segments are as follows: (i) Telefónica Europe, which now includes Telefónica Spain as well as the operations already forming part of the Telefónica Europe segment before; and (ii) Telefónica Latin America. Group's results of 2011 and 2010 have been restated to reflect this organizational structure, wothout any impact on consolidated figures.

The Telefónica Group's growth strategy for the next few years is geared towards:

- Improving the customer experience to continue increasing the number of accesses.
- Promoting growth:
  - Boosting the penetration of smartphones in all markets to accelerate the growth of mobile data, unlocking the value of its increased usage.

- Defending the competitive position in the wireline business with a focus on broadband, offering faster speeds, bundled offers and full IP voice and video services.
- Leveraging growth opportunities arising in an increasingly digital environment: e.g. video, OTT, financial services, cloud computing, eHealth and media.

• Continuing efforts to transform the Group's operating model:

- Increasing network capacity in the markets where we operate through technological advances and acquisitions of spectrum.
- Accelerating the transformation primarily through the systems area.
- Proceeding towards becoming an international digital and online service provider group.

• Maximizing economies of scale to boost efficiency.

The Telefónica Group has operations in Spain, the United Kingdom, Germany, the Czech Republic, Ireland and Slovakia in Europe, as well as Brazil, Mexico, several countries in Central America, Venezuela, Colombia, Peru, Argentina, Chile, Uruguay and Ecuador in Latin America.

Telefónica has an industrial alliance with Telecom Italia, S.p.A. and a strategic alliance with China Unicom, in which the Group holds a 5% stake. In addition, the "Partners Program" was created in 2011 in line with the objective of unlocking the value of Telefónica's scale. Three operators have signed up for this program (Bouygues, Etisalat and Sunrise). This initiative makes a host of services available to selected operators under commercial terms that allow the partners to leverage on Telefónica's scale and to cooperate in key business areas (e.g. roaming, services to multinationals, procurement, handsets, etc.)

2012 highlights

The Group's total accesses rose 3.0% year-on-year, to nearly 316 million at the 2012 year end, driven by access growth in Latin America (5.5% year-on-year).

Telefónica Latin America's revenues rose 5.5% year-on-year and 6.7% in 2012 stripping out exchange rate differences and hyperinflationary adjustments in Venezuela, underpinned by growth in the customer base. The quality of the customer base itself has also improved, with a growing weight of contract and smartphone customers.

Mobile data revenues continued to drive growth in 2012, drawing heavily from the steep rise in non-SMS data revenues.

OIBDA in 2012 amounted to 21,231 million euros, with reported growth of 5.1%, affected by the recognition of 2,671 million euros of restructuring expenses at Telefónica Spain in 2011 and the 527 million euros write-down made by the Telefónica Group against its stake in Telefónica Ireland in 2012, due to the slowdown in activities in the prevailing market uncertainty.

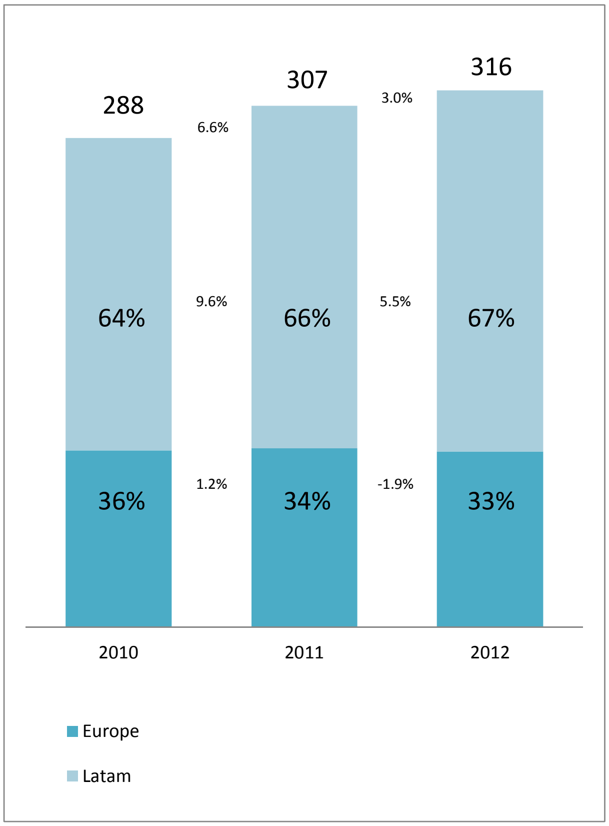
Accesses

Thousands of accesses	2010	2011	2012	%Var 10/11	%Var 11/12
Fixed telephony accesses (1) (2)	41,355.7	40,119.2	40,002.6	(3.0)%	(0.3)%
Internet and data accesses	18,611.4	19,134.2	19,402.6	2.8%	1.4%
Narrowband	1,314.1	909.2	653.2	(30.8)%	(28.2)%
Broadband (3)	17,129.6	18,066.3	18,596.2	5.5%	2.9%
Other (4)	167.8	158.7	153.1	(5.4)%	(3.5)%
Mobile Accesses (5)	220,240.5	238,748.6	247,269.5	8.4%	3.6%

Prepay (6)	151,273.9	162,246.9	165,759.7	7.3%	2.2%
Contract (7)	68,966.6	76,501.7	81,509.8	10.9%	6.5%
Pay TV (8)	2,787.4	3,309.9	3,336.2	18.7%	0.8%
Unbundled loops	2,529.2	2,928.7	3,308.8	15.8%	13.0%
Share ULL	264.0	205.0	183.5	(22.3)%	(10.5)%
Full ULL	2,265.3	2,723.7	3,125.3	20.2%	14.7%
Wholesale ADSL (9)	687.4	849.3	800.6	23.6%	(5.7)%
Other (10)	1,420.7	1,518.0	1,621.8	6.8%	6.8%
Final Client Accesses	**282,994.9**	**301,311.8**	**310,010.8**	**6.5%**	**2.9%**
Wholesale Accesses	**4,637.4**	**5,296.0**	**5,731.3**	**14.2%**	**8.2%**
Total Accesses	**287,632.3**	**306,607.8**	**315,742.1**	**6.6%**	**3.0%**

(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 and total fixed wireless included. Includes VoIP and Naked ADSL. Since the first quarter of 2012, fixed telephony accesses include 384 thousand VoIP lines in Germany and 65 thousand fixed lines in UK to homogenize these accesses to Group's criteria.
(2) It includes the reclassification in the fourth quarter of 2012 in Argentina of 157 thousand "fixed wireless" previously included in mobile contract accesses.
(3) DSL, satellite, optic fiber, cable and broadband circuits.
(4) Retail circuits other than broadband.
(5) In the first quarter of 2012, 2.0 million inactive accesses were disconnected in Spain.
(6) In the first quarter of 2012, 1.2 million inactive accesses were disconnected in Spain. In the third quarter of 2011 360 thousand inactive accesses were disconnected in Chile. In Brazil, 1.0 million inactive accesses were disconnected in the fourth quarter of 2011 and 1.6 million inactive accesses were disconnected in the second quarter of 2012.
(7) First quarter of 2012 includes the disconnection of 800 thousand inactive accesses in Spain.
(8) Includes 150 thousand clients of TVA in June 2011.
(9) Includes ULL rented by Telefónica Germany and Telefónica UK.
(10) Circuits for other operators. Includes Wholesale Line Rental (WLR) in Spain.

Accesses by region



The Telefónica Group's strategy is predicated on capturing growth in its markets and especially on attracting high-value customers.

This strategy led to a 3.0% increase in total accesses, to nearly 316 million at the 2012 year end, driven primarily by contract, mobile broadband and fixed broadband customers. Accesses in Telefónica Latin America (67% of total) were particularly noteworthy, rising 5.5% compared to the December 2011 figure, despite the disconnection of inactive customers in Brazil (1.6 million accesses) and the implementation of more restrictive criteria concerning both new connections and disconnections. Total accesses in Telefónica Europe dropped 1.9% year-on-year, due to the disconnection of 2.0 million inactive mobile accesses in Spain in the first quarter of 2012.

Mobile broadband accesses stood at 52.8 million at December 2012, reflecting a solid 38% year-on-year increase and representing 21% of mobile accesses (up 5 p.p. year-on-year).

At December 31, 2012, the Telefónica Group holds significant direct and indirect stakes (of over 5% in all cases) in listed telecommunications companies other than in those in which it has control. These companies are China Unicom and Telecom Italia, S.p.A.

2012 Consolidated results

Results of operations	Year ended December 31						Percent Change			
	2012		2011		2010		2012 vs 2011		2011 vs 2010	
Millions of euros	Total	% of revenues	Total	% of revenues	Total	% of revenues	Total	%	Total	%
Revenues	62,356	100.0%	62,837	100.0%	60,737	100.0%	(481)	(0.8)%	2,100	3.5%
Other income	2,323	3.7%	2,107	3.4%	5,869	9.7%	216	10.3%	(3,762)	(64.1)%
Supplies	(18,074)	(29.0)%	(18,256)	(29.1)%	(17,606)	(29.0)%	182	(1.0)%	(650)	3.7%
Personnel expenses	(8,569)	(13.7)%	(11,080)	(17.6)%	(8,409)	(13.8)%	2,511	(22.7)%	(2,671)	31.8%
Other expenses	(16,805)	(27.0)%	(15,398)	(24.5)%	(14,814)	(24.4)%	(1,407)	9.1%	(584)	3.9%
Operating income before depreciation and amortization (OIBDA)	**21,231**	**34.0%**	**20,210**	**32.2%**	**25,777**	**42.4%**	**1,021**	**5.1%**	**(5,567)**	**(21.6)%**
Depreciation and amortization	(10,433)	(16.7)%	(10,146)	(16.1)%	(9,303)	(15.3)%	(287)	2.8%	(843)	9.1%
Operating income	**10,798**	**17.3%**	**10,064**	**16.0%**	**16,474**	**27.1%**	**734**	**7.3%**	**(6,410)**	**(38.9)%**
Share of profit (loss) of associates	(1,275)	(2.0)%	(635)	(1.0)%	76	0.1%	(640)	100.8%	(711)	n.m.
Net financial expense	(3,659)	(5.9)%	(2,941)	(4.7)%	(2,649)	(4.4)%	(718)	24.4%	(292)	11.0%
Corporate income tax	(1,461)	(2.3)%	(301)	(0.5)%	(3,829)	(6.3)%	(1,160)	n.m.	3,528	(92.1)%
Profit for the year	**4,403**	**7.1%**	**6,187**	**9.8%**	**10,072**	**16.6%**	**(1,784)**	**(28.8)%**	**(3,885)**	**(38.6)%**
Non-controlling interests	**(475)**	**(0.8)%**	**(784)**	**(1.2)%**	**95**	**0.2%**	**309**	**(39.4)%**	**(879)**	**n.m.**
Profit for the year attributable to equity holders of the parent	**3,928**	**6.3%**	**5,403**	**8.6%**	**10,167**	**16.7%**	**(1,475)**	**(27.3)%**	**(4,764)**	**(46.9)%**

n.m: non meaningful

Year ended December 31, 2012 compared with year ended December 31, 2011

The year 2012 was a key year in the transformation of Telefónica. Throughout the year, a number of initiatives were undertaken aimed at helping the Company begin growing again. Telefónica Latin America surpassed Telefónica Europe in revenues for the first time, continuing to be one of the group's two main levers of growth, along with mobile data revenues. In Telefónica Europe, there has been a recovery in sales activity in certain markets owing to the success of tariffs that have been launched, especially "Movistar Fusión" in Spain, which reflect an improvement of its competitive position across different markets, even though revenues of Telefónica Europe fell 6.5% with respect to 2011.

In view of the sale of the Atento Group in the fourth quarter of 2012, the results of that business area were deconsolidated from the Telefónica Group as from the end of November 2012. This had an impact on the year-on-year comparison of Telefónica's economic results in reporting terms.

OIBDA was also impacted by the 527 million euros write-down the Telefónica Group made against its stake in Telefónica Ireland.

Revenues: Revenues for 2012 stood at 62,356 million euros, which represented a decrease of 0.8% on the 2011 figure. This decrease was due to less favorable conditions in some markets, and the prevailing economic situation, in which competition is steeper and regulatory changes have had adverse impacts. The exchange rate differences and the effect of hyperinflation in Venezuela contributed 0.1 p.p. to change in revenues; when stripping out this impact, the fall was 0.9% in 2012.

The Company's strong diversification continues to be a key differential for the Group in the current market situation, as reflected by the revenues structure. In this regard, revenues showed solid growth in Telefónica Latin America (up 5.5% year-on-year) and accounted for 49% of consolidated revenues (up

2.9 p.p. compared to 2011), outperforming those of Telefónica Europe (48% of the Group's total and down 6.5% year-on-year). Telefónica Spain's contribution to consolidated revenues decreased to 24%.

The decline in revenue compared to the year-ago figure was caused by the lower average revenue per access for the Group, mainly due to lower average revenue per mobile access in Spain and the UK, and the overall fall in average revenue per fixed access in the Group, which undermined the growth in accesses. Revenues were hit hard by cuts to interconnection rates, which had a drag of approximately 1.1 p.p. on overall revenue growth.

In terms of services, mobile data revenue continued to be the largest growth driver in 2012 (up 12.8% year-on-year), accounting for over 34% of mobile service revenues in the period (31% in 2011). Non-SMS data revenue climbed 24.1% year-on-year, raising its share of total data revenue by 5 p.p. to 57%.

Other income: Other income comprises the gains on disposals of assets, 782 million euros in 2012 (down 5.0% year-on-year). In 2012, other income primarily reflects: i) sales of non-strategic towers, with an impact of 643 million euros on Other income (and OIBDA), primarily in Brazil, Mexico, Chile, Spain and Peru; ii) the sale of software applications (gains of 39 million euros; 18 million euros recognized in Telefónica Spain); and iii) the fourth-quarter sales of the Atento Group (gains of 61 million euros), Rumbo (gains of 27 million euros) and Hispasat (partial sale, gains of 26 million euros). In 2011, this caption mainly reflected: i) the positive impact derived from the partial reduction of the Group's economic exposure in Portugal Telecom (184 million euros); and ii) the sale of non-strategic towers (541 million euros).

Total expenses, which include supplies, personnel expenses and other expenses (mainly external services and taxes other than corporate income tax) stood at 43,448 million euros, down 2.9% on the 2011 figure. These expenses were affected by exchange rate differences and hyperinflation adjustments (0.3 p.p.); when stripping out this impact, expenses were down 3.2%. The year-on-year variation reported is also affected by the provision for restructuring expenses in Spain, made in the third quarter of 2011 (2,671 million euros). The year-on-year reduction in expenses is primarily explained by the absence of similar restructuring charges in 2012 and lower commercial expenditure, especially in Spain, as a result of a new commercial model in place from the end of 2011.

- **Supply costs** amounted to 18,074 million euros in 2012, down 1.0% on 2011, reflecting the lower mobile interconnection costs and lower handset consumption in Spain resulting from the new policy doing away with subsidies and the lower volume of handset upgrades.

- **Personnel expenses** were 8,569 million euros, down 22.7% on 2011. The year-on-year variation was affected by the provision for personnel restructuring in Spain, mentioned above. When stripping out the impact of this provision, which amounted to 2,671 million euros, personnel expenses were 1.9% higher than in 2011, reflecting the adjustments for inflation in certain Latin American countries.

  The average headcount was 272,598 employees, 13,547 less than the 2011 average. The decrease mainly reflects the sale of Atento in the fourth quarter of 2012. When stripping out the Atento business, Telefónica's average headcount was 131,468 employees, 2,480 less than in 2011.

- **Other expenses** rose 9.1% year-on-year to 16,805 million euros. This increase was primarily driven by the increase in external services caused by higher customer service costs, and network and systems costs as well as the 527 million euros write-down of the Telefónica Group made against its stake in Telefónica Ireland and by the capital loss (97 million euros) generated on the sale of China Unicom shares.

OIBDA stood at 21,231 million euros, up 5.1% from 2011. When stripping out the negative impact of exchange rate differences and hyperinflationary adjustments (0.3 p.p.), OIBDA grew by 5.4%. The **OIBDA**

margin for 2012 was 34.0%, posting a year-on-year erosion of revenues that was not offset by cost savings.

In terms of geographic segments, Telefónica Latin America had the largest contribution to consolidated OIBDA (52.3%, down 1.6 p.p. compared to December 2011). Telefónica Europe accounts for less than 50%.

Depreciation and amortization rose by 2.8% year-on-year, to 10,433 million euros. This variation was primarily due to amortization of new spectrum licenses acquired in Germany, Brazil, Colombia, Mexico and Venezuela, and to the overall increase in fixed assets. Total depreciation and amortization charges derived from purchase price allocation processes stood at 962 million euros in 2012 (down 14.1% year-on-year).

Operating income in 2012 amounted to 10,798 million euros, a reported increase of 7.3%, helped by a 5.1% increase in OIBDA and hurt partially by a 2.8% increase in depreciation and amortization.

The **share of profit (loss) of associates** in 2012 reflects a loss of 1,275 million euros (vs. a loss of 635 million euros in 2011), primarily due to the write-down of Telco, S.p.A.'s investment in Telecom Italia and the recovery of all the operating synergies considered at the time of this investment, with a net impact of -1,355 million euros in 2012 and -662 million euros in 2011.

Net financial expense in 2012 totaled 3,659 million euros, 24.4% more than in 2011. This increase is due to two effects: first, an increase in average cost of net debt primarily due to the increase in average net debt (up 3.3% to a total of 58,187 million euros), the rise in credit spreads and the need to enhance liquidity (with very low returns compared to the cost of the debt) as a result of the financial market crises; and, secondly, to the increase in net exchange differences caused by the decline in estimated value of the Venezuelan bolivar. In spite of the increase in credit costs, the Group's average cost of gross financial debt held steady at 4.7%. Stripping out net exchange rate differences, such expenses implied an average cost of net debt of 5.37% in 2012.

Corporate income tax in 2012 amounted to 1,461 million euros, implying an effect tax rate of 24.9% over the 5,864 million euros of profit before tax, lower than statutory rates, mainly due to the recognition of tax credits in several countries.

Profit attributable to non-controlling interests reduced net profit by 475 million euros in 2012, and primarily reflects the share of Telefónica Brazil, Telefónica Czech Republic and Telefónica Germany's profits attributable to non-controlling interests. The year-on-year variation (a decrease of 39.5%) was due to reversal in the fourth quarter of 2011 of deferred tax liabilities recognized on the Vivo purchase price allocation (1,288 million euros) as a result of the change in the tax value of certain assets acquired.

In all, the **consolidated profit** of 2012 amounted to 3,928 million euros (down 27.3% year on year).

Year ended December 31, 2011 compared with year ended December 31, 2010

Consolidated results in 2011 reflect the impact of consolidation of 100% of Vivo since October 1, 2010 (50% prior to that date).

Revenues: Revenues rose 3.5% in 2011, to 62,837 million euros. The full consolidation of Vivo had an impact of 2,396 million euros. Exchange rates and the impact of hyperinflation in Venezuela subtracted -0.7 p.p. from revenue growth in the year. Excluding both impacts, revenues are in line with those of the prior year, with Latin America as the region with the highest contribution to revenues (46%) as well as to its growth.

Overall revenue growth was driven by the growth of accesses, as average revenue per access for the Group declined due to decreases in average revenue per mobile access in Europe and widespread decreases in the fixed line voice business. Excluding the impact of declines in interconnection tariffs, revenue growth was slightly more than 1 p.p. higher.

Other income: Other income totaled 2,107 million euros and reflects gains on disposals of non-strategic assets in the year, mainly in Latin America, in the amount of 541 million euros, and the positive impact derived from the partial reduction of the Group's economic exposure from its stake in Portugal Telecom (184 million euros). The variation in other income compared to 2010 is primarily due to the 2010 recognition of a capital gain of 3,797 million euros arising from the remeasurement of the previously held investment in Brasilcel. Other income in 2010 also reflects gains on disposals of non-strategic assets and the sale of Manx, for 260 million euros and 61 million euros, respectively. Other income in 2011 also reflects the impact of lower ancillary income.

Total expenses, which include supplies, personnel expenses and other expenses (mainly external services and taxes other than corporate income tax), were 44,734 million euros in 2011, up 9.6% compared to 2010. The increase reflects the impact of full consolidation of Vivo from October 2010, which amounted to 1,574 million euros, and the increase in personnel expenses due to the recognition in 2011 of 2,671 million euros of restructuring costs related to the labor force reduction plan approved by the Group in Spain. In 2010, personnel expenses included 658 million euros of costs from the restructuring of workforces of several Group companies. Also in 2010, 400 million euros of firm commitments were recognized in relation to Telefónica Foundation's social program.

Excluding the aforementioned effects, total expenses slightly exceeded revenue growth due to:

- **Supply and external services** related to stronger commercial activity following the increasing adoption of smartphones in all regions, which implies higher handset costs in Latin America due to greater levels of commercial activity and to higher spending on 3G network deployment. However, total supplies were offset by lower mobile interconnection expenses.

- **Personnel expenses** related to the increased headcount levels in Brazil and wage growth linked to higher inflation in some of the region's markets.

- Increase in **other expenses** caused by higher customer service costs, higher commercial expenses due to increased commercial activity and higher spending on 3G network deployment.

As a result of the above, OIBDA in 2011 decreased approximately 22% to 20,210 million euros from 25,777 million euros in 2010.

Depreciation and amortization increased by 9.1% in 2011, reflecting both the full consolidation of Vivo and the amortization of assets in Vivo's purchase price allocation (336 million euros in 2011 compared to 84 million euros in 2010).

Operating income fell by approximately 39% to 10,064 million euros in 2011 from 16,474 million euros in 2010. Excluding foreign exchange rate effects and the consideration of Venezuela as a hyperinflationary economy, operating income would have decreased by 38% in the year.

The **share of profit (loss) of associates** reflects a loss of 635 million euros in 2011, compared to a profit of 76 million euros in 2010. The variation is due to the impact of the valuation adjustment made by Telco, S.p.A. to its stake in Telecom Italia, coupled with the impact of operational synergies considered in the investment made in this company and the deconsolidation of Portugal Telecom.

Net financial expenses for 2011 increased by 11% year-on-year to 2,941 million euros, primarily a result of the 13% rise in average financial debt, to a total of 56,351 million euros. This implied an average cost of debt of 5.22% which, adjusting for exchange rate differences, fell to below 5% (4.91%). Net financial debt increased by 711 million euros in the year to 56,304 million euros at December 31, 2011. Foreign exchange gains and losses for the year ended December 31, 2011 increased financial expenses by 29 million euros.

Corporate income tax in 2011 totaled 301 million euros (3,829 million euros in 2010), on a profit before tax of 6,488 million euros. In 2011, deferred tax liabilities recognized in the Vivo purchase price allocation of 1,288 million euros (952 million euros in profit for the year attributable to equity holders of the parent) were reversed as a result of the change in the tax value of certain assets upon the merger of Telesp and Vivo in October 2011, as they became tax deductible under Brazilian tax regulations.

Profit attributable to non-controlling interests reduced net profit by 784 million euros in 2011. This was mainly due to non-controlling interests' share in the profits of Telefónica Brazil (864 million euros), which was affected by the exchange of Telesp shares for Vivo Participaçoes, and Telefónica Czech Republic shares (95 million euros). These impacts more than offset the non-controlling interests' share of losses of Telefónica Telecom in Colombia.

As a result of all of the factors noted above, **consolidated net profit** for 2011 declined 46.9% to 5,403 million euros compared with 10,167 million euros in 2010.

Segment results

Some of the figures in the table below are compared at a constant exchange rate in order to analyse yearly performance excluding the effect of exchange rate variation. For Financial Results comparison has been made using previous year average exchange rate to convert the figure. In these cases a comment of "excluding foreign exchange rate effect" has been indicated.

Some figures have been compared in local currency, taking the financial magnitudes in the relevant local currency as they were registered in the corresponding periods.

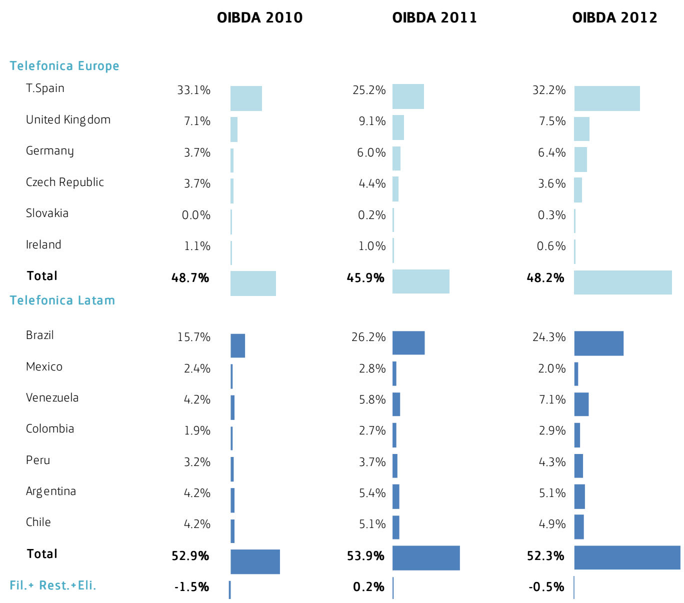
							Var 10/11		Var 11/12	
Millions of euros	2010	% Total	2011	% Total	2012	% Total	Reported	Ex fx (*)	Reported	Ex fx (*)
Revenues	**60,737**		**62,837**		**62,356**		**3.5%**	**4.2%**	**(0.8)%**	**(0.9)%**
Telefónica Europe	33,726	55.5%	32,066	51.0%	29,995	48.1%	(4.9)%	(4.8)%	(6.5)%	(7.8)%
Telefónica Latin America	25,476	41.9%	28,941	46.1%	30,520	48.9%	13.6%	15.2%	5.5%	6.7%
OIBDA	**25,777**		**20,210**		**21,231**		**(21.6)%**	**(21.2)%**	**5.1%**	**5.4%**
Telefónica Europe	12,541	48.7%	9,278	45.9%	10,244	48.3%	(26.0)%	(26.1)%	10.4%	9.5%
Telefónica Latin America	13,630	52.9%	10,890	53.9%	11,103	52.3%	(20.1)%	(19.3)%	2.0%	3.1%
OIBDA Margin	**42.4%**		**32.2%**		**34.0%**					
Telefónica Europe	37.2%		28.9%		34.2%					
Telefónica Latin America	53.5%		37.6%		36.4%					
Operating income	**16,474**		**10,064**		**10,798**		**(38.9)%**	**(38.1)%**	**7.3%**	**8.8%**
Telefónica Europe	7,455	45.3%	4,197	41.7%	5,233	48.5%	(43.7)%	(43.8)%	24.7%	23.9%
Telefónica Latin America	9,686	58.8%	6,120	60.8%	6,015	55.7%	(36.8)%	(35.3)%	(1.7)%	0.7%
Net income	**10,167**		**5,403**		**3,928**					

(*) Excluding foreign exchange rate effects and the consideration of Venezuela being considered a hyperinflationary economy

Revenues and OIBDA Contribution by Country

We include below some charts showing the Revenues and OIBDA contribution by main countries, and segments, to total Consolidated Group Revenues and OIBDA for 2010, 2011 and 2012. By way of explanation, Telefónica Spain revenues in 2012 contribute by 24.0% to total Group revenues in 2012 (that are 100%).

	Revenues 2010	Revenues 2011	Revenues 2012
Telefonica Europe			
T.Spain	30.8%	27.5%	24.0%
United Kingdom	11.9%	11.0%	11.3%
Germany	7.9%	8.0%	8.4%
Czech Republic	3.4%	3.2%	2.9%
Slovakia	0.2%	0.3%	0.3%
Ireland	1.4%	1.2%	1.0%
Total	**55.5%**	**51.0%**	**48.1%**
Telefonica Latam			
Brazil	18.3%	22.8%	21.8%
Mexico	3.0%	2.5%	2.6%
Venezuela	3.8%	4.3%	5.4%
Colombia	2.5%	2.5%	2.8%
Peru	3.2%	3.2%	3.8%
Argentina	5.1%	5.1%	5.9%
Chile	3.6%	3.7%	4.1%
Total	**41.9%**	**46.1%**	**48.9%**
Fil.+ Rest.+Eli.	**2.5%**	**2.9%**	**3.0%**



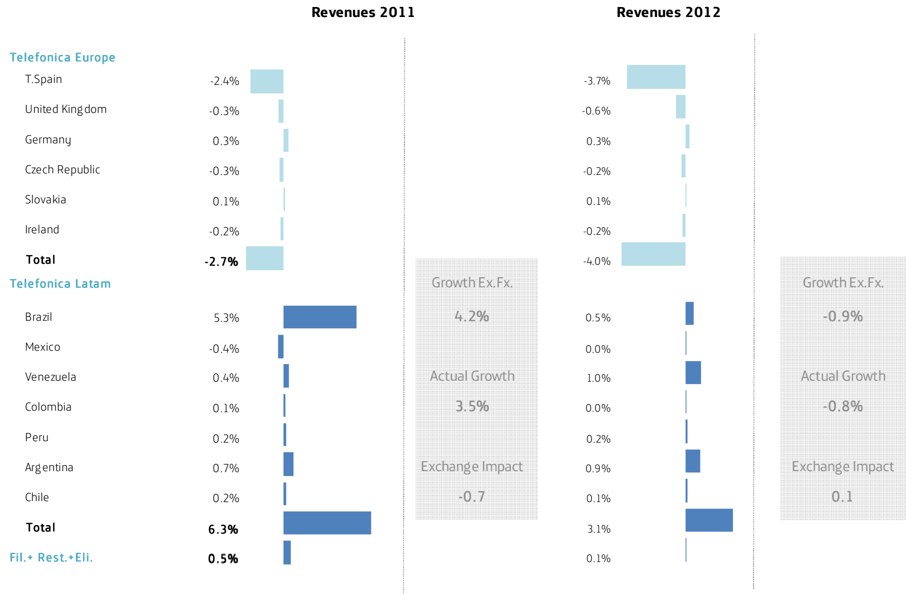
As the preceding charts show, the Telefónica Group has high geographic diversification, with Telefónica Europe (including Spain) and Telefónica Latin America showing similar shares in 2012. Spain and Brazil are the largest single contributors to OIBDA in the Group, and also to revenues , followed by the UK, Germany, Venezuela, Argentina and Chile. Together, these countries accounted for 87% of OIBDA and 81% of Group revenue in 2012 (83% of OIBDA and 82% of revenue in 2011 and 72% of OIBDA and 81% of revenue in 2010, respectively), and are therefore those on which our discussion of segment results is focused

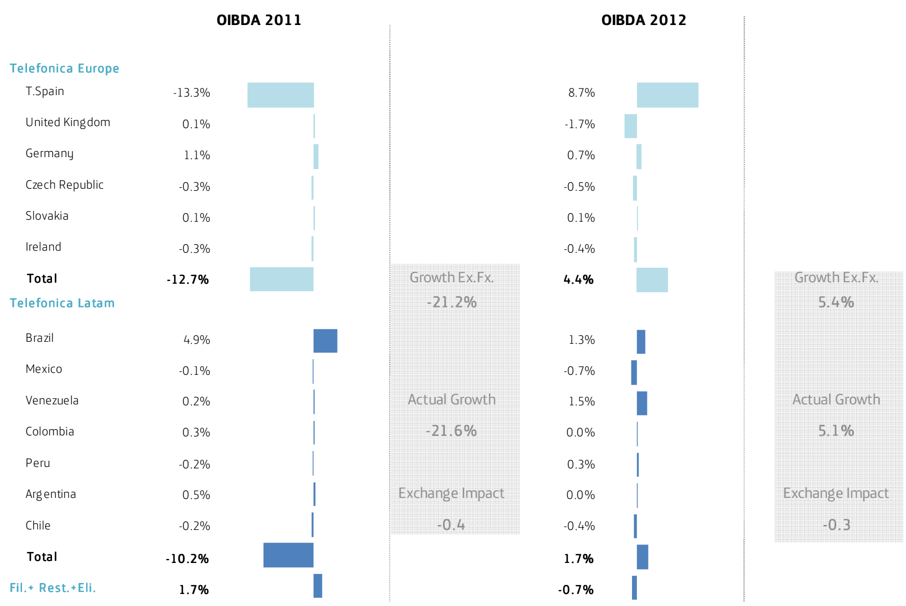
Contribution to growth by country

(Excludes the effects of exchange reates and hyperinflation in Venezuela)

In the charts included below, we disclose the contribution to growth by country and segment excluding the effects of exchange rates and hyperinflation in Venezuela. It is the contribution to consolidated growth of Revenues and OIBDA of main countries and segments, for 2011 and 2012. By way of explanation the negative 3.7% of Telefónica Spain in 2012 means that Telefónica Spain's drop in revenues caused a -3.7 p.p. decrease in total consolidated revenues in 2012, and the addition of all countries' contribution shown in the graph equals total group revenues drop in 2012 (-0.9% excluding the impact of exchange rates).

Contributions





Segment Outlook

TELEFÓNICA LATIN AMERICA

Accesses

Thousands of accesses	2010	2011	2012	%Var 10/11	%Var 11/12
Fixed telephony accesses (1)	24,403.6	23,960.7	24,153.3	(1.8)%	0.8%
Internet and data accesses	7,679.1	8,244.2	8,732.5	7.4%	5.9%
Narrowband	577.9	304.6	209.1	(47.3)%	(31.4)%
Broadband (2)	6,983.2	7,828.9	8,415.3	12.1%	7.5%
Other (3)	118.0	110.6	108.0	(6.3)%	(2.3)%
Mobile accesses	149,255.4	166,297.9	176,595.4	11.4%	6.2%
Prepay	119,359.1	131,087.2	137,141.5	9.8%	4.6%
Contract	29,896.3	35,210.7	39,453.9	17.8%	12.1%
Pay TV (4)	1,792.7	2,257.7	2,426.8	25.9%	7.5%
Final Clients Accesses	**183,130.8**	**200,760.5**	**211,908.0**	**9.6%**	**5.6%**
Wholesale Accesses	**55.9**	**50.9**	**47.0**	**(9.0)%**	**(7.5)%**
Total Accesses	**183,186.7**	**200,811.3**	**211,955.1**	**9.6%**	**5.5%**
Terra Accesses	556.1	641.7	604.7	15.4%	(5.8)%
Total Latin America Accesses	**183,742.8**	**201,453.0**	**212,559.8**	**9.6%**	**5.5%**

(1) PSTN (including public use telephony) x1; ISDN basis access x1; ISDN primary access; 2/6 access x30. Includes the Group's accesses for internal use and total fixed wireless accesses.
(2) Includes ADSL, fiber optic, cable modem and broadband circuits.
(3) Remaining retail circuits other than broadband
(4) Includes 150 thousand TVA customers as from June 2011.

Evolution of competitive position

	Mobile Market Share (1)		
Telefónica Latin America	2010	2011	2012
Brazil	29.7%	29.5%	29.1%
Argentina	31.0%	29.8%	29.7%
Chile	41.4%	39.1%	38.8%
Peru	63.4%	61.4%	60.0%
Colombia	22.4%	22.4%	21.6%
Venezuela	32.7%	32.7%	32.9%
Mexico	21.5%	20.9%	19.2%
Central America	n.a.	27.9%	29.7%
Ecuador	28.2%	28.4%	29.3%
Uruguay	38.5%	38.0%	37.4%

n.a. : not available.

(1) Internal estimates. (% of estimated market accesses)

Evolution of competitive position

	Share of ADSL (1)		
Telefónica Latin America	2010	2011	2012
Brazil	24.8%	21.9%	18.8%
Argentina	31.9%	31.1%	30.9%
Chile	45.5%	43.0%	41.2%
Peru	91.2%	90.1%	90.1%
Colombia	20.8%	18.1%	18.1%

(1) Internal estimates

Key trends in the mobile business

- Mobile accesses stood at 176.6 million, up 6.2% year-on-year, despite the disconnection of 1.6 million inactive pre-pay accesses in Brazil and the implementation of more restrictive criteria concerning both new connections and disconnections in several countries in the region.
- Mobile broadband accesses soared 67.5% (down from 114% in 2011), representing 15% of the region's total accesses, helping drive overall growth in revenues.
- The contract customer base grew 12.1% year-on-year and represented 22% of the total mobile accesses in Latin America, in line with the growth strategy laid down for the region.
- Traffic in Telefónica Latin America grew 16% from 2011 to 2012, outperforming the growth of accesses.
- ARPU fell slightly (-0.2% year-on-year) despite the significant negative impact derived from the reduction of mobile termination rates. Outgoing ARPU increased by 3.1% year-on-year reflecting the Company's focus on maximizing customer value.
- Both OIBDA and the OIBDA margin for both years reflect the sale of non-strategic towers: 583 million euros in 2012, and 541 million euros in 2011. The increase in expenses more than offset this impact.

Key trends in the fixed line business

- Broadband accesses grew 7.5% year-on-year, to 8.4 million, with a net addition of 586 thousand in 2012.
- Pay TV accesses were up 7.5% in 2012, to 2.4 million, with a net add of 169 thousand accesses in the year.
- Accesses in the fixed telephony business stood at 24.2 million, for year-on-year growth of 0.8%. This increase primarily derives from the launch of convergent service offers and the rise in market share in this service, thanks to "fixed wireless" technology.

Results

Millions of euros				Var 10/11		Var 11/12	
Telefónica Latin America	2010	2011	2012	Reported	Ex fx	Reported	Ex fx
Revenues	25,476	28,941	30,520	13.6%	15.2%	5.5%	6.7%
OIBDA	13,630	10,890	11,103	(20.1)%	(19.3)%	2.0%	3.1%
OIBDA Margin	53.5%	37.6%	36.4%	(15,9 p.p)	-	(1.3)	-
Depreciation and amortization	(3,944)	(4,770)	(5,088)	20.9%	19.0%	6.7%	6.3%
Operating Income	9,686	6,120	6,015	(36.8)%	(35.3)%	(1.7)%	0.7%

2012 results

Telefónica Latin America represented 49% of consolidated revenue (up 2.9 p.p. compared to 2011) and 52.3% of consolidated OIBDA (a 1.6 p.p. decrease compared to 2011). The segment contributed 3.1 p.p. to the year-on-year variation in the Group's revenues stripping out the impact of exchange rates, mainly due to Venezuela's, Argentina's and Brazil's contribution.

- Telefónica Latin America reported a 5.5% year-on-year increase in **revenue** to 30,520 million euros in 2012, despite the negative impact (-1.2 p.p.) of exchange rate differences and hyperinflationary adjustments in Venezuela. These figures reflect the strong mobile service revenues generated in the year 2012 (up 11.4%), despite the negative impact of regulations.

  The mobile broadband business posted a 24.1% rise in mobile data revenues compared to 2011, accounting for 29% of mobile services revenues (up 3 p.p. year-on-year). The increase in connectivity revenues underpinned growth in non-SMS data revenues (up 32.9% in the year, accounting for 57% of data revenues, up 4 p.p. year-on-year).

  Revenues from handset sales increased by 17.9% to 1,661.4 million euros.

  Brazil has shored up its role as the main regional market, accounting for 45% of the region's revenues in 2012.

  Revenue in the fixed line business was hit by the drop in fixed lines, which outweighed the growth in broadband and TV, with lower ARPUs due to intense commercial activity.

- **Total expenses** in 2012 were 20,577 million euros, an increase of 6.8%. Exchange rate differences and hyperinflation had an impact on total expenses of 322 million euros. Stripping out this impact, the increase would have been 8.2%.

  Expenses for supplies were 7,670 million euros, up 2.8%, due mainly to increased demand for terminals related to the larger share of Smartphone sale, to higher content, digital and data services costs and higher site lease costs for the deployment of towers and due to our sale and leaseback of certain towers.

  Personnel expenses rose 13.5% to 2,908 million euros, driven mostly by increases in certain countries in the area with high inflation.

  Other expenses rose 8.3% year-on-year to 9,999 million euros, driven by larger growth in commercial activity and increased spending on customer services.

- **OIBDA** was 11,103 million euros in 2012, for reported year-on-year growth of 2.0% (up 1.1 p.p. when stripping out the effect of exchange rate differences and hyperinflation in Venezuela). The OIBDA margin was 36.4% for the year, down 1.3 p.p. compared to 2011.

  - Both OIBDA and the OIBDA margin for 2011 and 2012 reflect the sale of non-strategic towers: 583 million euros in 2012, and 541 million euros in 2011.

  - In 2012 a number of factors (integration expenses, brand changes and reversal of provisions in Brazil, service interruptions in Argentina, retroactive impact of the new Venezuela labor law, etc.) brought OIBDA down by 42 million euros.

  - Following a contractual change in the handset sales model in Chile, as from the fourth quarter of 2012, OIBDA is affected by the new accounting treatment given for revenues and expenses formerly linked to a mobile handset sales model involving lease without charge, with a negative impact of 22 million euros in the fourth quarter of 2012.

2011 results

Telefónica Latin America represented 46% of consolidated revenue and 54% of consolidated OIBDA in 2011. It was also the largest contributor (6.3 p.p.) to revenue growth in the year. At the OIBDA level, the contribution declined 10.2 p.p. due to the recognition of 3,797 million euros in 2010, derived from the re-measurement of our previously held investment in VIVO at its fair value at the date of our acquisition of the 50% of Brasilcel held by Portugal Telecom.

- Telefónica Latin America reported a 13.6% increase in **revenue** in 2011, to 28,941 million euros, despite the negative impact (-1.6 p.p.) of exchange rate differences and hyperinflation in Venezuela. Results for this region are also impacted by the full consolidation of Vivo since October 2010. When excluding Mexico, which was affected by the performance of pre-pay revenues and the sharp reduction in mobile termination rates, revenue growth was strong in the region. As shown herein, the growth in the mobile business was driven by significant increases in both the customer base and mobile ARPU in virtually all countries. Revenue in the fixed line business was hit by the drop in fixed lines, which outweighed the growth in broadband and TV, with lower ARPUs due to significant competitive pressures.

  Finally, revenue trends indicate higher growth in mobile service revenues due to the Group's efforts to boost commercial activity (e.g. increased spending by content and service providers, increased cost of high-end handsets, etc.) in a bid to tap the growth potential of the market despite the negative short-term impact on commercial expenses.

  Brazil represented 49% of total revenue in Latin America in 2011, reinforcing its status as the region's leading market and the main driver of Telefónica's organic revenue growth in Latin America.

- **Total expenses** amounted to 19,258 million euros, 15% higher than in 2010. In 2010, total expenses were 16,677 million euros, although this would increase by 1,638 million euros if we added 50% of VIVO from January to September for purposes of comparison with 2011.

  In addition, 2010 included one-off costs from the restructuring of workforces of 410 million euros. Foreign exchange rates and hyperinflation contributed 261 million euros to total expenses. Like-for-like (i.e. stripping out these impacts), total expenses increased by 5.8%. The increase compared to 2010 was mainly the result of increased commercial activity than in the same period a year earlier, aimed at boosting the Company's future revenue growth.

  Expenses in supplies rose in line with market trends, driven by growth of the new businesses, higher expenditure on content providers, circuits, sites and tower sales~~,~~ and handsets costs, due to the growing weight of high-end handsets, such as smartphones.

  Personnel expenses rose as the result of the internalization of contractors in Brazil and higher inflation in some Latin American economies.

  The increase in **other expenses** was due to efforts to maintain high quality and customer service, which leads to larger fees and commissions, higher network and systems costs, larger energy costs related to both new sites and network deployment.

- **OIBDA** for Telefónica Latin America fell 20.1% in 2011 to 10,890 million euros, affected by:

  - The consolidation of the remaining 50% of Vivo, which would have added nearly 900 million euros had this taken place at the beginning of 2010.

  - Foreign exchange rates and hyperinflation in Venezuela, which reduced OIBDA in Latin America by 128 million euros.

- The recognition in 2010 of a 3,797 million euros gain deriving from the remeasurement of the previously held investment in Vivo at its fair value at the date of our acquisition of the 50% of Brasilcel previously held by Portugal Telecom.
- The recognition in 2010 of non-recurring restructuring charges of 410 million euros.

Excluding these effects, OIBDA for Telefónica Latin America was virtually flat in 2011, as revenue growth was offset by the increased commercial activity (larger share of high-end handsets), and efforts to enhance quality –affecting network and system costs- and customer service.

BRAZIL

Accesses

Thousands of accesses	2010	2011	2012	% Var 10/11	% Var 11/12
Fixed telephony accesses (1)	11,292.6	10,977.4	10,642.7	(2.8)%	(3.0)%
Internet and data accesses	3,848.2	3,942.6	3,964.3	2.5%	0.6%
Narrowband	446.2	214.5	137.9	(51.9)%	(35.7)%
Broadband (2)	3,319.2	3,648.0	3,748.4	9.9%	2.8%
Other (3)	82.8	80.0	78.1	(3.3)%	(2.5)%
Mobile accesses	60,292.5	71,553.6	76,137.3	18.7%	6.4%
Pre-Pay	47,658.6	55,438.1	57,335.1	16.3%	3.4%
Contract	12,633.9	16,115.5	18,802.2	27.6%	16.7%
Pay TV (4)	486.3	698.6	601.2	43.7%	(13.9)%
Final Clients Accesses	**75,919.6**	**87,172.1**	**91,345.4**	**14.8%**	**4.8%**
Wholesale Accesses	**33.9**	**28.0**	**24.4**	**(17.3)%**	**(13.0)%**
Total Accesses	**75,953.5**	**87,200.1**	**91,369.8**	**14.8%**	**4.8%**

(1) PSTN (including public use telephony) x1; ISDN basis access x1; ISDN primary access; 2/6 access x30. Includes the Group's accesses for internal use and total fixed wireless accesses.
(2) Includes ADSL, fiber optic, cable modem and broadband circuits.
(3) Remaining retail circuits other than broadband
(4) Includes 150 thousand TVA customers as from June 2011.

The Brazilian telecommunications market continues to grow, particularly in mobile and broadband data. In this setting, the company's operations in Brazil performed well. We continue to hold leading market positions in terms of mobile accesses and revenues based on internal estimates, although the share of fixed broadband accesses has eroded due to aggressive commercial efforts by competitors.

During the year, several new sales efforts were launched in the mobile segment, continually repositioning consumer plans in order to boost the market share in data services and voice traffic, as well as in the fixed business, rolling out convergent services and developing fixed wireless technology outside Sao Paulo. This technology is currently in place in the country's main metropolitan regions. In the television segment, the company launched the IPTV pay TV service in October and the OTT "Vivo Play" service (on demand video) in December 2012. The company also rolled out a 200 Mb fixed broadband offer through the fiber network, a notable market milestone.

Results

Millions of euros				% Var10/11		% Var 11/12	
Brazil	**2010**	**2011**	**2012**	**€**	**Local Currency**	**€**	**Local Currency**
Revenues	11,119	14,326	13,618	28.8%	28.7%	(4.9)%	2.3%
Wireless Business	**4,959**	**8,437**	**8,573**	**n.c.**	**n.c.**	**1.6%**	**9.4%**
Service revenues	4,649	8,014	8,167	n.c.	n.c.	1.9%	9.7%
Wireline Business	**6,843**	**5,890**	**5,045**	**n.c.**	**n.c.**	**(14.4)%**	**(7.8)%**
OIBDA	4,074	5,302	5,161	30.2%	30.0%	(2.7)%	4.8%
OIBDA Margin	36.6%	37.0%	37.9%	0.4 p.p.	0.4 p.p.	0.9 p.p.	0.9 p.p.
Capex	1,797	2,468	2,444	37.4%	37.2%	(1.0)%	6.6%
OpCF (OIBDA - Capex)	2,277	2,834	2,717	24.5%	24.3%	(4.1)%	3.2%

"n.c.":not comparable

2012 results

- **Revenues** amounted to 13,618 million euros in 2012, for year-on-year growth of 2.3% in local currency. Revenues from the mobile business came in at 8,573 million euros for the year, up 9.4% in local currency compared to 2011, where service revenues close at 9.7% in local currency compared to 2011 thanks to the good evolution of the outgoing revenues boosted by the average customer base growth and the growing weight in data revenues. This is partially offset by the incoming revenue fall (and consequent ARPU decrease) affected by the negative impact of the lower mobile termination rates. Additionally, our customer base in Brazil suffered a drop due to the disconnection in the second quarter of 1.6 million inactive prepay mobile accesses in Brazil.

Brazil - Mobile

	2010	2011	2012	% Var Local Currency 10/11	% Var Local Currency 11/12
Traffic (million minutes)	77,463	92,081	113,955	n.c.	27.4%
ARPU (euros)	11.0	10.2	8.9	n.c.	(6.4)%

"n.c.": not comparable

The fixed business reported revenues of 5,045 million euros, down 7.8% in local currency due to lower retail fixed-mobile rates and to steep competition in the fixed broadband and pay TV businesses.

- **OIBDA** stood at 5,161 million euros in 2012, up 4.8% in local currency driven by mobile revenues growth, offset by fixed voice revenues drop as well as expenses growth due to higher personnel costs coming from the internalization of contractors and workforce restructuring expenses and the increase of external services costs, associated to a higher commercial activity. On the other hand, OIBDA was positively affected by the recognition of 445 million euros in other income derived from the sale of non-strategic assets, compared to 187 million euros in 2011. The overall OIBDA margin was 37.9%, a 0.9 p.p. improvement on 2012.

2011 results

- **Revenues**: Revenues trends were impacted by a number of factors:

- The consolidation of the additional 50% of Vivo since October 2010, which affected period-to-period comparisons.

- The full consolidation of TVA from June 2011, with retroactive effects from January 1, 2011. TVA contributed 81 million euros to revenue and 22 million euros to OIBDA in 2011.

In addition, following the transfer of the long-distance license from Telesp to Vivo in the last quarter of 2011, long-distance revenues were reclassified such that long-distance revenues arising in the mobile network are attributed to the mobile business and those from the fixed network to the fixed line business, and shown net of eliminations. This has no impact at the consolidated level, but affects the year-on-year comparability of the mobile and fixed line businesses.

Like-for-like mobile service revenues (i.e. including the impacts in both years) were 10.6% higher in 2011, in line with the growth in our customer base, with ARPU falling 3.6% due to aggressive commercial activity in the region. Data business revenues, representing 24% of service revenues, reflected a solid performance and became a key driver of the company's future growth.

In the fixed line business, revenue adjusted, reduced by the transfer of the long-distance license, decreased by 1.4% in local currency. Growth in broadband (11% in local currency) and TV (45% in local currency, but not comparable due to the addition of TVA) was insufficient to offset the decline in the traditional voice business, mainly because of the loss of open lines (not bundled or pre-pay or controlled usage).

- **OIBDA**: OIBDA in Brazil amounted to 5,302 million euros in 2011, and, as with revenues, is not comparable to prior year results due to the impact of consolidation of the additional 50% stake in Vivo since October 2010. The contribution to OIBDA in the first nine months of 2010 would be approximately 900 million euros. Excluding this impact and the 60 million euros recognized in 2010 for workforce restructuring expenses, the OIBDA margin would be similar in 2011 and 2010. OIBDA also includes proceeds from the disposal of non-strategic assets of 186 million euros in 2011 and 117 million euros in 2010.

ARGENTINA

Accesses

Thousands of accesses	2010	2011	2012	% Var 10/11	% Var 11/12
Fixed telephony accesses (1)	4,621.5	4,611.0	4,762.4	(0.2)%	3.3%
Fixed wireless	35.5	38.2	234.6	7.6%	514.1%
Internet and data accesses	1,505.4	1,630.7	1,755.5	8.3%	7.7%
Narrowband	65.7	35.7	19.3	(45.7)%	(46.0)%
Broadband (2)	1,439.7	1,595.1	1,736.3	10.8%	8.9%
Mobile accesses	16,148.9	16,766.7	17,604.0	3.8%	5.0%
Pre-Pay	10,370.4	10,581.3	11,000.0	2.0%	4.0%
Contract	5,778.5	6,185.4	6,604.0	7.0%	6.8%
Final Clients Accesses	22,275.8	23,008.4	24,121.9	3.3%	4.8%
Wholesale Accesses	**13.0**	**13.9**	**14.1**	**7.0%**	**1.2%**
Total Accesses	**22,288.8**	**23,022.3**	**24,136.0**	**3.3%**	**4.8%**

(1) PSTN (including public use telephony) x1; ISDN basis access x1; ISDN primary access; 2/6 access x30. Includes the Group's accesses for internal use and total fixed wireless accesses.
(2) Includes ADSL, fiber optic, cable modem and broadband circuits.

In 2012, based on internal estimates, Telefónica Argentina maintained its market leadership, underpinned by a benchmark services portfolio with integrated fixed and mobile broadband bundles and added value services. The company applies a segmented approach in order to cover the diverse needs of its customer base. The key feature of the mobile business in 2012 was the heavy across-the-board increase in the mobile broadband service. In the fixed line business, the company retained its market leadership in both fixed line and broadband accesses in terms of market shares, based on internal estimates, maintaining growth in the number of lines, unlike the other operations in the region.

Results

Millions of euros				% Var10/11		% Var 11/12	
Argentina	2010	2011	2012	€	Local Currency	€	Local Currency
Revenues	3,073	3,174	3,697	3.3%	14.5%	16.5%	18.4%
Wireless Business	**1,979**	**2,039**	**2,431**	**3.0%**	**14.2%**	**19.2%**	**21.2%**
Service revenues	1,845	1,880	2,200	1.9%	12.9%	17.0%	19.0%
Wireline Business	**1,187**	**1,237**	**1,390**	**4.3%**	**15.6%**	**12.3%**	**14.2%**
OIBDA	1,082	1,085	1,076	0.2%	11.1%	(0.8)%	0.8%
OIBDA Margin	34.3%	33.4%	28.5%	(0.9) p.p.	(0.9) p.p.	(4.8) p.p.	(4.8) p.p.
Capex	398	449	519	12.6%	24.9%	15.6%	17.5%
OpCF (OIBDA - Capex)	684	636	557	(7.0)%	3.1%	(12.4)%	(10.9)%

2012 results

The financial results in Argentina for the year were negatively affected by compensation paid to customers in respect of a software outage in Movistar's national network equipment, which affected service on April 2, 2012. In addition, results were also adversely affected by the heavy storm that hit the northern part of Buenos Aires on April 4, 2012.

- **Revenues**: Service revenues from the mobile business grew sharply in 2012 (19.0% excluding foreign exchange rate effects), reflecting higher usage levels, driven by data usage and growth in the customer base. Data revenues are the main lever for growth (33.5%, excluding exchange rate differences).

Argentina - Mobile

	2010	2011	2012	% Var Local Currency 10/11	% Var Local Currency 11/12
Traffic (million minutes)	17,550	18,788	21,201	7.1%	12.8%
ARPU (euros)	9.2	9.7	11.0	17.3%	14.6%

Revenues in the fixed line business rose 14.2% in local currency due to the solid growth in revenues from broadband and new services (26.5%), reflecting the strong improvement in Internet and content revenues and revenues from data, IT and leasing of capacity.

- **OIBDA** at Telefónica Argentina stood at 1,076 million euros, a 0.8% rise in local currency, not fully reflecting the good evolution of revenues due to the general rise in prices that impacted operating expenses, (mainly personnel expenses and external services due to inflation).

2011 results

- **Revenues**: Growth in mobile service revenues (12.9% in local currency) was driven by a base of higher value customers, as seen in the increase in ARPU and the weight of the contract segment. Mobile data ARPU growth was driven by both the positive performance of SMS and the higher number of customers with data rates.

  Revenues in the fixed line business rose 15.6% in local currency due to higher internet and content revenues (up 29.5%), propelled by the growth in broadband, and revenues from data, IT and leasing of capacity (up 18.1%).

- **OIBDA** at Telefónica Argentina reached 1,085 million euros, an increase of 11.1% in local currency, not reflecting the growth percentages in revenue due to the general rise in prices that impacted operating expenses.

VENEZUELA

Accesses

Thousands of accesses	2010	2011	2012	% Var 10/11	% Var 11/12
Mobile accesses	9,514.7	9,438.7	10,549.0	(0.8)%	11.8%
Pre-Pay	8,740.3	8,570.9	9,514.8	(1.9)%	11.0%
Contract	774.4	867.8	1,034.3	12.1%	19.2%
Fixed wireless	966.2	883.4	900.3	(8.6)%	1.9%
Pay TV	69.3	114.3	215.3	65.0%	88.3%
Total Accesses	**10,550.2**	**10,436.4**	**11,664.6**	**(1.1)%**	**11.8%**

In 2012, Telefónica maintained a strong services offer in the market, strategically shoring up its leadership by maximizing the customer value, focusing on quality of service and innovation, and providing for the ongoing improvement of rates plans. Over the course of the year, results improved in both operating and financial terms. The company continued to focus on sales campaigns to promote mobile broadband, given the high percentage of smartphone customers.

Results

Millions of euros				% Var10/11		% Var 11/12	
Venezuela	2010	2011	2012	€	Local Currency	€	Local Currency
Revenues	**2,318**	**2,688**	**3,338**	**15.9%**	**11.2%**	**24.2%**	**28.1%**
Service revenues	2,073	2,435	2,972	17.5%	12.8%	22.0%	25.6%
OIBDA	1,087	1,177	1,500	8.2%	4.4%	27.5%	30.0%
OIBDA Margin	46.9%	43.8%	44.9%	(3.1) p.p.	(3.1) p.p.	1.2 p.p.	0.7 p.p.
CapEx	293	372	463	26.9%	0.9%	24.5%	31.2%
OpCF (OIBDA-CapEx)	794	805	1,037	1.3%	5.6%	28.8%	29.5%

2012 results

- **Revenues**: In 2012, revenues stood at 3,338 million euros, for a year-on-year growth of 28.1% in local currency. This improvement primarily reflected higher mobile service revenue (up 25.6%), driven by the larger customer base and the increase in ARPU, offset in part by lower interconnection rates, which had an impact of 28 million euros. Excluding this impact, service revenues would have increased by 26.9% year-on-year in local currency.

Data revenues for the year 2012 grew 37.4% compared to 2011, representing 39% of mobile service revenues (up 3 p.p. year-on-year). Non-SMS data revenues climbed 78% year-on-year, accounting for 53% of data revenues (up 12 p.p. compared to 2011).

Venezuela - Mobile

	2010	2011	2012	% Var Local Currency 10/11	% Var Local Currency 11/12
Traffic (million minutes)	14,195	14,529	16,408	2.4%	12.9%
ARPU (euros)	14.3	16.7	21.2	24.8%	17.4%

- **OIBDA**: OIBDA stood at 1,500 million euros in 2012, for year-on-year growth of 30.0% in local currency. This growth is due to the service revenues good performance that compensates the expenses growth (26.5% in local currency) mainly impacted by the increase in personnel expenses following the reform of the labor law what resulted in higher personnel provisions, and the higher commercial costs related to the increased commercial activity in the year. The OIBDA margin was 44.9% in 2012 (up 1.2 p.p. compared to 2011), driven by the ongoing focus on boosting efficiency levels.

2011 results

- **Revenues**: Growth in mobile service revenue (12.8% excluding foreign exchange rate effects) was driven by higher ARPU despite reductions in interconnection tariffs, with a negative impact of 22 million euros in the year.

  Data revenues remained a key growth driver, rising 23.7% in the year and representing 36% (up 3 p.p.) of mobile service revenues.

- **OIBDA**: OIBDA for 2011 was 1,177 million euros, increasing 4.4% from the prior year. Telefónica Venezuela's OIBDA margin stood at 43.8% (down 3 p.p. year-on-year), with continued high levels of efficiency in an environment characterized by widespread price increases that translated into higher personnel and subcontractor expenses.

CHILE

Accesses

Thousands of accesses	2010	2011	2012	% Var 10/11	% Var 11/12
Fixed telephony accesses (1)	1,939.3	1,848.1	1,737.9	(4.7)%	(6.0)%
Internet and data accesses	836.0	887.4	940.1	6.1%	5.9%
Narrowband	6.6	5.8	5.5	(12.3)%	(5.2)%
Broadband (2)	821.5	878.1	932.0	6.9%	6.1%
Other (3)	7.9	3.5	2.5	(55.9)%	(27.0)%
Mobile accesses	8,794.0	9,548.1	10,040.1	8.6%	5.2%
Pre-Pay	6,179.3	6,732.7	7,385.0	9.0%	9.7%
Contract	2,614.7	2,815.4	2,655.1	7.7%	(5.7)%
Pay TV (4)	341.2	390.8	424.0	14.5%	8.5%
Final Clients Accesses	**11,910.5**	**12,674.4**	**13,142.1**	**6.4%**	**3.7%**
Wholesale Accesses	**5.3**	**5.2**	**4.9**	**(2.2)%**	**(5.9)%**
Total Accesses	**11,915.8**	**12,679.6**	**13,147.0**	**6.4%**	**3.7%**

(1) PSTN (including public use telephony) x1; ISDN basis access x1; ISDN primary access; 2/6 access x30. Includes the Group's accesses for internal use and total fixed wireless accesses.
(2) Includes ADSL, fiber optic, cable modem and broadband circuits.
(3) Remaining retail circuits (broadband)

Telefónica maintained its position as one of the leaders in the Chilean telecommunications market, strengthening its competitive advantage through an integrated and unique service offer, despite the stiff market competition. In 2012, Telefónica Chile's commercial activity was negatively affected by the nationwide introduction of number portability, in both the mobile and the fixed businesses.

During the year, the company promoted mobile broadband and high-speed fixed broadband, both in VDSL and fiber optic technology, and continually enhanced its offers through bundled services. In late 2012, the company launched the new IPTV platform, following an alliance with Microsoft that made it possible to bundle broadband services and improve its television offers.

Results

Millions of euros				% Var10/11		% Var 11/12	
Chile	2010	2011	2012	€	Local Currency	€	Local Currency
Revenues	2,197	2,310	2,569	5.2%	4.8%	11.2%	3.3%
Wireless Business	**1,266**	**1,399**	**1,559**	**10.5%**	**10.1%**	**11.5%**	**3.6%**
Service revenues	1,175	1,283	1,429	9.2%	8.9%	11.4%	3.5%
Wireline Business	**1,038**	**1,037**	**1,113**	**(0.1)%**	**(0.4)%**	**7.3%**	**(0.3)%**
OIBDA	1,092	1,035	1,033	(5.2)%	(5.5)%	(0.2)%	(7.3)%
OIBDA Margin	49.7%	44.8%	40.2%	(4.9) pp	(4.9) pp	(4.6) pp	(4.6) pp
Capex	516	529	606	2.4%	2.1%	14.6%	6.5%
OpCF (OIBDA - Capex)	576	507	427	(12.0)%	(12.3)%	(15.7)%	(21.7)%

2012 results

- **Revenues**: Mobile revenues rose 3.6% in local currency to 1,559 million euros fuelled by growth in service revenues. Service revenues were 3.5% higher in local currency, with the growth in the customer base making up for the downtrend in ARPU in local currency caused by the drop in usage, mainly among pre-pay customers, in view of greater market competition.

Fixed line revenues remained stable with respect to 2011, amounting to 1,113 million euros, underpinned by broadband and new services revenues (52% of revenues and up 10.9% in local currency), reflecting the growth in Internet, TV, content revenues, data, IT and capacity lease revenues, which offset the 9.9% decrease in voice and access revenues (in local currency).

Chile - Mobile

	2010	2011	2012	% Var Local Currency 10/11	% Var Local Currency 11/12
Traffic (million minutes)	11,791	12,218	13,064	3.6%	6.9%
ARPU (euros)	12.1	11.6	12.0	(4.1)%	(3.9)%

- **OIBDA**: OIBDA dropped 7.3% in local currency in local currency despite revenues are increasing 3.3% due to a higher commercial activity in the mobile business with the start-up of portability, which results in higher growth in supplies, content and interconnection expenses plus the negative effect in other revenues of the sale of towers (32 million euros compared to 50.1 million euros in 2011). In addition, following a contractual change in the handset sales model in Chile, OIBDA is affected by the negative effect of the new accounting treatment applicable to revenues and expenses formerly linked to a mobile handset sales model involving lease without charge that was previously accounted as Capex (negative impact of 22 million euros, all included in the last quarter of the year).

2011 results

- **Revenues**: Mobile revenues rose 10.1% in local currency to 1,399 million euros in 2011, fuelled by the strong growth in service revenues. Service revenues increased by 8.9% in local currency, as a result of the growth in the customer base, offsetting the downtrend in ARPU caused by the drop in usage from pre-pay customers. Data revenues also had a positive performance, with a 34% increase in the year in local currency, representing 19% of total service revenues.

  Fixed line revenues in Chile remained stable with respect to 2010, with the 12.3% increase in Internet, TV and content revenues offsetting the 8% decrease in local currency in traditional business revenues.

- **OIBDA**: OIBDA decreased 5.5% in local currency, partly due to the recognition in 2010 of damage compensation received on insurance contracts following earthquake damage in February 2010 and gains from the disposal of non-strategic assets (15 million euros) in 2010. Gains on the sale of non-strategic assets in 2011 amounted to 50 million euros OIBDA for the year was also impacted by the 24% increase in supply costs (excluding foreign exchange rate effects) caused by higher interconnection costs from increased traffic and greater equipment costs resulting from the increased commercial activity in the mobile business attributable to purchases of high-end handsets.

MÉXICO

Accesses

Thousands of accesses	2010	2011	2012	% Var 10/11	% Var 11/12
Mobile accesses	19,661.6	19,742.4	19,168.0	0.4%	(2.9)%
Pre-Pay	18,061.3	18,149.8	17,668.3	0.5%	(2.7)%
Contract	1,600.2	1,592.6	1,499.7	(0.5)%	(5.8)%
Fixed wireless	565.5	745.3	1,158.9	31.8%	55.5%
Total Accesses	**20,227.1**	**20,487.7**	**20,326.9**	**1.3%**	**(0.8)%**

The company launched its "Zero Prepayment" campaign in the latter part of the year, allowing customers to call any fixed or mobile operator in Mexico, the US or Canada for 0.85 Mexican pesos/minute. This campaign was a milestone in the strategy to reduce rates within the "call anywhere" plans, rolled out following the drastic reduction in interconnection rates in the first half of 2011. In addition, through the year the company unveiled new data plans aimed at boosting the mobile broadband business. These plans include the LTE launch, with Movistar being the first operator to offer this service in Mexico. All these efforts reflect the company's strategic focus on innovation and quality of service.

It should also be noted that in the second half of 2012 the agreement on national roaming with Iusacell came into effect, significantly reinforcing the coverage and capacity of the services that both companies provide (Iusacell and Telefónica Móviles México).

Results

Millions of euros				% Var10/11		% Var 11/12	
México	2010	2011	2012	€	Local Currency	€	Local Currency
Revenues	**1,832**	**1,557**	**1,596**	**(15.0)%**	**(12.3)%**	**2.5%**	**0.4%**
Service revenues	1,651	1,387	1,416	(16.0)%	(13.3)%	2.1%	(0.0)%
OIBDA	623	572	432	(8.2)%	(5.2)%	(24.6)%	(26.1)%
OIBDA Margin	34.0%	36.7%	27.0%	2.7 p.p.	2.7 p.p.	(9.7) p.p.	(9.7) p.p.
CapEx	1,580	471	427	(70.2)%	(69.2)%	(9.4)%	(11.3)%
OpCF (OIBDA-CapEx)	(957)	101	5	c.s.	c.s.	(95.2)%	(95.3)%

2012Results

- **Revenues** amounted to 1,596 million euros in 2012, for 0.4% growth year-on-year in local currency. Mobile service revenues remained stable compared to 2011 in local currency amounting to 1,416 million euros in 2012 thanks to an increase in data revenues, despite an estimated negative impact of 64 million euros from the lower interconnection rates approved by the regulatory authorities in the second quarter of 2011. Data revenues climbed 15.0% from 2011 to 2012, despite the 54% reduction in SMS interconnection rates in September 2012. Data revenues account for 33% of mobile service revenues (up 4 p.p. year-on-year). Non-SMS data revenues rose 61.8% year-on-year, accounting for 39% of data revenues (up 11 p.p. compared to 2011).

- **OIBDA:** OIBDA was 432 million euros in 2012 (down 26.1% year-on-year in local currency), for an OIBDA margin of 27.0%, strongly impacted by the sale of non-strategic towers in 2011, which amounted to 240 million euros compared with the year-on-year comparison to 77 million euros for tower sales in 2012. Stripping out this effect, OIBDA grew 6.5%, slightly over revenue evolution. It is important to highlight the interconnection rates reduction which negatively impacted OIBDA by 14 million euros. Such rate reduction is more than offset by a higher level of efficiency coming from the

Iusacell roaming agreement and higher commercial efficiency. For 2012, OIBDA margin was 27.0%, due to the gradual improvement in margin throughout the year.

2011 results

- **Revenues**: Service revenues decreased by 13.3% in local currency to 1,387 million euros, principally as the result of the aforementioned reductions in interconnection tariffs and the impact of lower revenue from outgoing traffic in the pre-pay segment attributable to decreased usage. These changes prompted the Company to launch new commercial offers in the second half of the year.

- **OIBDA**: The decrease in OIBDA was caused by increased costs associated with the Company's overall commercial repositioning efforts and 3G network deployment, as well as the impact of the interconnection tariff reductions described above. The 2011 decrease in OIBDA was partially offset by the sale of non-strategic assets, which resulted in a gain 240 million euros.

PERU

Accesses

Thousands of accesses	2010	2011	2012	% Var 10/11	% Var 11/12
Fixed telephony accesses (1)	2,871.2	2,848.4	2,883.4	(0.8)%	1.2%
Fixed wireless	537.8	444.6	580.3	(17.3)%	30.5%
Internet and data accesses	885.4	1,120.4	1,317.6	26.5%	17.6%
Narrowband	15.4	9.4	8.2	(38.7)%	(12.8)%
Broadband (2)	850.8	1,090.6	1,288.3	28.2%	18.1%
Other (3)	19.2	20.4	21.0	6.1%	3.1%
Mobile accesses	12,507.1	13,998.3	15,196.9	11.9%	8.6%
Pre-Pay	10,104.4	11,079.6	11,555.3	9.7%	4.3%
Contract	2,402.7	2,918.7	3,641.6	21.5%	24.8%
Pay TV (4)	690.6	799.0	901.6	15.7%	12.8%
Final Clients Accesses	**16,954.3**	**18,766.1**	**20,299.5**	**10.7%**	**8.2%**
Wholesale Accesses	**0.5**	**0.4**	**0.4**	**(3.7)%**	**(8.0)%**
Total Accesses	**16,954.8**	**18,766.6**	**20,299.9**	**10.7%**	**8.2%**

(1) PSTN (including public use telephony) x1; ISDN basis access x1; ISDN primary access; 2/6 access x30. Includes the Group's accesses for internal use and total fixed wireless accesses.
(2) Includes ADSL, fiber optic, cable modem and broadband circuits.
(3) Remaining retail circuits (broadband)

Telefónica consolidated its position as one of the key players shored up its leadership of the Peruvian market, boosting total accesses by 8.2%, driven by growth in the mobile, traditional fixed, pay TV and fixed broadband businesses.

Results

Millions of euros				% Var10/11		% Var 11/12	
					Local		Local
Perú	2010	2011	2012	€	Currency	€	Currency
Revenues	1,960	2,030	2,400	3.6%	6.1%	18.2%	4.6%
Wireless Business	**1,001**	**1,088**	**1,314**	**8.7%**	**11.3%**	**20.8%**	**6.9%**
Service revenues	854	948	1,164	11.1%	13.7%	22.7%	8.6%
Wireline Business	**1,097**	**1,069**	**1,226**	**(2.5)%**	**(0.2)%**	**14.7%**	**1.5%**
OIBDA	812	751	909	(7.6)%	(5.3)%	21.0%	7.1%
OIBDA Margin	41.4%	37.0%	37.9%	(4.5) p.p.	(4.5) p.p.	0.9 p.p.	0.9 p.p.
Capex	295	302	378	2.3%	4.8%	25.2%	10.8%
OpCF (OIBDA - Capex)	517	449	531	(13.2)%	(11.1)%	18.2%	4.6%

2012 results

- In 2012, **revenues** amounted to 2,400 million euros, up 4.6% year-on-year in local currency, due to growth in both the mobile and fixed businesses.

  Revenues in the mobile business (up 6.9%) were driven by voice and data revenues, with a year-on-year rise of 44.8% despite adverse regulatory impacts which affected fixed-mobile calls (due to a decrease in the regulated retail rate) and the mobile interconnection rate cuts in October 2011 and 2012. On the other hand, handset revenues fall by 4.4% year-on-year. Revenues from the fixed business totaled 1,226 million euros in 2012, up 1.5% on the prior year. As in 2011, broadband and new services revenues were the primary growth drivers, with a year-on-year rise of 12.9%, offsetting a sharp decline in voice revenues.

- **OIBDA** stood at 909 million euros in 2012 (up 7.1% year-on-year), mainly explained by the good revenue performance, partially offset by higher commercial costs driven by the increased commercial activity relating to higher-value customers, higher taxes related to the canon for the usage of radio electric spectrum and also the personnel expenses increase related to the employee participation of the company results (employees get a percentage of net income of the company). This OIBDA growth is positively affected by the recognition in 2012 of 23 million euros gains from the sale of non-strategic assets, compared to gains of 2 million euros in the fourth quarter of 2011. Finally the OIBDA margin places at 37.9% (up 0.9 p.p. compared to 2011).

2011 results

- Overall, the business performed well, resulting in a 6% increase in **revenue** in local currency despite the reduction in interconnection rates in the mobile network in October, 2011. The increase in revenue was due to the strong performance by the mobile business and the maintenance of the traditional fixed telephony business.

- **OIBDA** is not comparable to the prior year due to the recognition in 2010 of gains from the sale of non-strategic assets (39 million euros) and workforce restructuring expenses (23 million euros).

COLOMBIA

Accesses

Thousands of accesses	2010	2011	2012	% Var 10/11	% Var 11/12
Fixed telephony accesses (1)	1,586.9	1,480.6	1,420.4	(6.7)%	(4.1)%
Internet and data accesses	553.6	620.3	714.0	12.0%	15.1%
Narrowband	5.6	7.9	8.5	41.5%	7.5%
Broadband (2)	548.0	612.3	705.4	11.7%	15.2%
Other (3)	-	-	-	na	na
Mobile accesses	10,004.5	11,391.1	11,703.6	13.9%	2.7%
Pre-Pay	7,679.1	8,626.8	8,675.2	12.3%	0.6%
Contract	2,325.5	2,764.2	3,028.4	18.9%	9.6%
Pay TV	205.3	255.0	284.8	24.2%	11.7%
Final Clients Accesses	**12,350.3**	**13,746.9**	**14,122.8**	**11.3%**	**2.7%**
Wholesale Accesses	**3.3**	**3.3**	**3.3**	**-**	**-**
Total Accesses	**12,353.6**	**13,750.2**	**14,126.1**	**11.3%**	**2.7%**

n.a.: not applicable
(1) PSTN (including public use telephony) x1; ISDN basis access x1; ISDN primary access; 2/6 access x30. Includes the Group's accesses for internal use and total fixed wireless accesses.
(2) Includes ADSL, fiber optic, cable modem and broadband circuits.
(3) Retail circuits other than broadband

The year 2012 has meant a significant milestone in the development of Telefónica's operations in Colombia after the Telefónica Móviles Colombia, S.A. and Colombia Telecomunicaciones S.A. merger (completed at the end of June 2012), through which the company brought all of its operations in the country (fixed and mobile services) together under the Movistar brand. Telefónica shored up the integrated sale of products, bundling fixed and mobile services, while maintaining its focus on higher-value customers.

Telefónica Colombia reported 14.1 million accesses at the 2012 year end, for a year-on-year growth of 2.7%.

Results

Millions of euros				% Var10/11		% Var 11/12	
Colombia *	2010	2011	2012	€	Local Currency	€	Local Currency
Revenues	1,529	1,561	1,765	2.1%	4.5%	13.0%	1.6%
Wireless Business	**859**	**906**	**1,070**	**5.5%**	**8.0%**	**18.1%**	**6.1%**
Service revenues	801	841	994	4.9%	7.4%	18.3%	6.3%
Wireline Business	**670**	**655**	**695**	**(2.3)%**	**0.0%**	**6.1%**	**(4.7)%**
OIBDA	484	540	607	11.6%	14.3%	12.4%	1.0%
OIBDA Margin	31.7%	34.6%	34.4%	2.9 p.p.	2.9 p.p.	(0.2) p.p.	(0.2) p.p.
Capex	334	405	352	21.3%	24.2%	(13.2)%	(22.0)%
OpCF (OIBDA - Capex)	150	135	256	(9.9)%	(7.7)%	89.2%	70.0%

* Mobile and fixed telephone revenues for 2010 and 2011 have been restated in view of the merger carried out in June 2012, in order to assign the eliminations to the corresponding businesses.

2012 results

- **Revenues** totaled 1,765 million euros in 2012 (year-on-year growth of 1.6% in local currency), thanks to the strong performance of the mobile business, despite lower ARPU and the reduction in mobile termination rates. The fixed business reported revenues of 695 million euros, down -4.7% in local currency due to a lower number of accesses, the increase of competition in an already highly competitive environment and the reduction in termination rates.

- **OIBDA** was 607 million euros at the 2012 year end, up 1.0% compared to the prior year as a result of higher revenues (up 1.6% year-on-year) and operating expenses decreasing 2.2% year-on-year, thanks to the efficiency measures applied by the business operator in Colombia, which were mainly reflected in lower personnel and subcontract expenses. Supply costs also fell year-on-year due to the reduction in termination rates. These were offset by the year-on-year comparison affected by recognition of gains on the sale of non-strategic towers of 2 million euros in 2012 and 25 million euros in 2011.

2011 results

- Solid business growth resulted in a 4.5% increase in **revenues** in local currency, underpinned by strong revenues from the mobile business.

- **OIBDA** increased by 14.2% in 2011 and was impacted by sales of non-strategic assets during 2011 (25 million euros) and 2010 (71 million euros). The comparability at the OIBDA level was also impacted by the recognition in 2010 of 85 million euros of non-recurring workforce restructuring expenses, bad debts provisions, and third-party claims.

TELEFÓNICA EUROPE

Accesses

Thousands of accesses	2010	2011	2012	%Var 10/11	%Var 11/12
Fixed telephony accesses (1)	16,952.1	16,158.5	15,849.3	(4.7)%	(1.9)%
Internet and data accesses	10,376.2	10,248.3	10,065.4	(1.2)%	(1.8)%
Narrowband	639.3	519.8	444.1	(18.7)%	(14.6)%
Broadband	9,687.2	9,680.4	9,576.2	(0.1)%	(1.1)%
Other (2)	49.8	48.2	45.1	(3.2)%	(6.4)%
Mobile accesses (3)	70,985.1	72,450.7	70,674.1	2.1%	(2.5)%
Prepay (4)	31,914.7	31,159.7	28,618.2	(2.4)%	(8.2)%
Contract (5)	39,070.3	41,291.0	42,055.8	5.7%	1.9%
Pay TV	994.6	1,052.2	909.3	5.8%	(13.6)%
Final Clients Accesses	99,308.0	99,909.7	97,498.1	0.6%	(2.4)%
Wholesale Accesses (6)	**4,581.5**	**5,245.1**	**5,684.3**	**14.5%**	**8.4%**
Total Accesses	**103,889.5**	**105,154.8**	**103,182.3**	**1.2%**	**(1.9)%**

(1) PSTN (including public use telephony) x1; ISDN basis access x1; ISDN primary access; 2/6 access x30. Includes the Group's accesses for internal use and VOIP and naked ADSL. As from the first quarter of 2012, fixed telephone accesses include 384 thousand VoIP customers in Germany and 65 thousand fixed lines in the UK, in order to standardize these accesses with Telefónica criteria.
(2) Remaining retail circuits other than broadband.
(3) In the first quarter of 2012, 2.0 million inactive accesses were derecognized in Spain.
(4) In the first quarter of 2012, 1.2 million inactive accesses were derecognized in Spain.
(5) In the first quarter of 2012, 800 thousand inactive accesses were derecognized in Spain.
(6) Includes ULL rented by Telefónica Germany and Telefónica UK. In the fourth quarter of 2011, 78 thousand inactive accesses were derecognized in Germany.

Competitive Positioning

	Mobile Market Share (1)		
Telefónica Europe	2010	2011	2012
Spain	41.4%	39.6%	36.2%
United Kingdom	26.6%	26.6%	26.6%
Germany	15.7%	16.1%	16.7%
Czech Republic	38.5%	38.0%	38.6%
Ireland	32.0%	33.2%	33.0%
Slovakia	14.7%	18.3%	21.1%

	ADSL Market Share (1)		
	2010	2011	2012
Spain	53.4%	49.7%	48.8%

(1) Internal estimates.

Following reorganization of the Telefónica Group in September 2011, two segments (business units) were defined in the Group. One of these segments is Telefónica Europe, which includes operations in Spain as well as those in the United Kingdom, Germany, the Czech Republic, Slovakia and Ireland.

Telefónica Europe operators have aimed to set the groundwork for future growth in 2012 by leveraging the success of their sales efforts (e.g. "Movistar Fusion" in Spain) and the greater efficiencies derived from the transformation initiatives rolled out during the year. These initiatives focus on improving resource allocation, costs and strategic investing.

All these efforts have allowed Telefónica Europe to stabilize in 2012, by containing operating costs in several areas despite the pressure on revenues caused by declines in usage, the adverse economic environment, strong market competition and lower mobile interconnection and roaming rates.

Key trends in the mobile business

- Mobile accesses stood at 70.6 million, a year-on-year decrease of 2.5%. This figure was strongly affected by the disconnection of 2.0 million inactive accesses in Telefónica Spain in the first quarter of 2012. Growth in mobile accesses was especially strong in Germany in 2012 (up 5.0%), with 19.3 million customers, and to a lesser extent in the United Kingdom (up 3.1%), with 22.9 million customers.
- Solid sales efforts translated into a growth in mobile contract customers of 1.9%. These customers accounted for 60% of the total mobile customer base at the 2012 year end (up 2 p.p. compared to the prior year).
- Mobile broadband accesses increased 16% to 25.5 million, representing 36% of the region's total accesses and driving growth in revenues.
- ARPUs of some European operators (mainly Spain and the UK) are under heavy pressure, affected by interconnection rates cuts, an adverse economic backdrop (with waning consumption) and, in some cases, decreases in prices amid fierce competitive pressure.

Key trends in the fixed line business

- Retail fixed line broadband accesses stood at 9.6 million, a year-on-year decrease of 1.1%. Nevertheless, this trend reversed in the fourth quarter of 2012 as these accesses increased, when net adds were obtained as a consequence of the launch of "Movistar Fusión," a convergent product in Telefónica Spain
- Fixed telephone accesses were down 1.9% year-on-year, to 15.8 million at December 2012.

Results

Millions of euros				Var 10/11		Var 11/12	
Telefónica Europe	2010	2011	2012	Reported	Ex fx	Reported	Ex fx
Revenues	**33,726**	**32,066**	**29,995**	**(4.9)%**	**(4.8)%**	**(6.5)%**	**(7.8)%**
OIBDA	12,541	9,278	10,244	(26.0)%	(26.1)%	10.4%	9.5%
OIBDA Margin	37.2%	28.9%	34.2%	(8,3 p.p.)	-	5,2 p.p.	-
Depreciation and amortization	(5,086)	(5,081)	(5,011)	(0.1)%	(0.2)%	(1.4)%	(2.5)%
Operating Income	7,455	4,197	5,233	(43.7)%	(43.8)%	24.7%	23.9%

2012 results

Telefónica Europe represents 48% of the Group's 2012 revenues and OIBDA. Its revenues decreased by 6.5% in 2012, contributing -4.0 p.p. to the year-on-year variation in the Group's revenues, excluding foreign exchange rate effects, primarily due to lower revenues in Telefónica Spain (contributing -3.7 p.p.). In addition, at 2012 year end, the Group recorded a 527 million euros write-down in the value of its stake in Telefónica Ireland in Telefónica Europe's OIBDA and in 2011, and the Group recognized personnel restructuring expenses of 2,591 million euros in Telefónica Spain's OIBDA.

- Telefónica Europe posted **revenues** of 29,995 million euros in 2012, down 6.5% on the 2011 figure (down 7.8% excluding foreign exchange rate effects). The year-on-year decrease in Telefónica Europe's revenues is primarily due to revenue trends in Telefónica Spain, which dropped 13.2% from 2011, to 14,985 million euros in 2012. This reduction in revenues mainly reflects lower accesses and ARPU in the different services, all within an adverse and highly-competitive macroeconomic environment.

  At Telefónica Spain, **revenues in the fixed line business** plunged 10.2%. This reduction was primarily due to lower revenues from traditional accesses (caused by the loss of accesses), the 16.7% decrease in voice services revenues (affected by the growing weight of flat-rate plans and traffic packages) and the 13.8% drop in retail broadband revenues (12.2% year-on-year decrease in broadband ARPU, affected by customer migration to new rates). **Revenues from the mobile business** fell 16.6% on the 2011 figure. This reduction reflects the 16.8% drop in mobile service revenues (chiefly pressured by trends in ARPU and the reduction in interconnection rates effective as from April and October, and in roaming rates, effective as from July). Telefónica Spain accounted for 50% of Europe’s revenue.

  In the rest of Telefónica Europe’s operations, revenues rose 1% year-on-year, driven by growth in revenues in Germany, but undermined by reduction to interconnection and roaming rates.

  The mobile strategy, based on boosting mobile broadband penetration and limited use data rates, was the main factor to promote revenue growth**.** As a result of this strategy, total data revenue increased 5.8% in 2012 and represented 41% of mobile service revenue (up 5 p.p. compared to 2011). The growth in data revenue is primarily due to the 18.6% increase in non-P2P SMS revenues, which represented 58% of total data revenues in 2012.

- **Total expenses** at Telefónica Europe amounted to 20,465 million euros, down 12.7% on the previous year, affected by the recognition in 2011 of 2,591 million euros of restructuring expenses in Telefónica Spain, which affected the variance in personnel expenses. This impact represented 11 p.p. of the year-on-year decline. Excluding this effect, operating expenses would have fallen 1.8% year-on-year.

  - **Supplies expenses** decreased 4.6% year-on-year in 2012 to 9,821 million euros, mainly driven by lower interconnection costs, and, to a lesser extent, lower supplies, due to a new commercial strategy of subsidies in Spain.

  - **Personnel expenses** amounted to 3,497 million euros in the year, a decline of 45.4% compared with 2011, mainly due to the provision included in Spain mentioned above. Excluding this impact personnel expenses decreased by 8.9% year-on-year in 2012 mainly on the back of the increase of company savings related to the restructuring plan in Spain.

  - **Other expenses** were 7,147 million euros and increased by 6.1% as a consequence of including the 527 million euros write-down in the value of Telefónica’s stake in Telefónica Ireland, due to the slowdown in activities in the prevailing market uncertainty. Excluding this impact, other expenses would have dropped by -1.8% reflecting the higher commercial efficiency delivered by the leaner business model.

- **OIBDA** in Telefónica Europe stood at 10,244 million euros in 2012, up 10.4% year-on-year (9.5% when stripping out exchange rate differences). The 2012 figure includes the 527 million euros write-down of the Group's stake in Telefónica Ireland, while 2011 OIBDA reflects workforce restructuring expenses in Telefónica Spain in the amount of 2,591 million euros. OIBDA performance is also affected by pressures on revenues (including the impact of lower regulatory interconnection rates), partially offset by costs savings generated from the efficiency initiatives implemented throughout the Group.

2011 results

In 2011, Telefónica Europe represented 51% of the Group's revenues, and 46% of OIBDA. Telefónica Europe dragged -2.7 p.p. to Group's revenue growth on a constant euros basis. The main contributor to this negative contribution to Group revenues was Telefónica Spain, which contributed 2.4 p.p. to the Group's revenue drop. Reported OIBDA of Telefónica Europe showed a 26% year-on-year decline, but, it is important to highlight that OIBDA for 2011 reflected workforce restructuring expenses of 2,591 million euros in Telefónica Spain, while the 2010 figure included workforce restructuring expenses of 202 million euros for Telefónica Spain and 320 million euros for other Telefónica Europe operations (recognized under personnel expenses). The aforementioned impacts contribute to the year-on-year decrease by -17 p.p. Excluding these effects, the year-on-year decrease in Telefónica Europe's OIBDA would be 9.2%, primarily derived from the 13% year-on-year decline in Telefónica Spain (excluding restructuring expenses).

- **Revenues** (32,066 million euros at December 2011) were down 4.9% on 2010, mainly reflecting the drop in Telefónica Spain's revenues.

  In 2011, Telefónica Spain's revenue fell 7.7% to 17,269 million euros, pulled down by lower ARPU in the various services and lower accesses, amid waning consumption and stronger pressure on prices.

  Telefónica's Spain revenues in the fixed line business decreased by 6.8% year-on-year, mostly because of lower revenues from traditional accesses, voice services and retail broadband. Also, Telefónica's Spain revenues from mobile services were down 10.0%, primarily reflecting a 10% drop in ARPU following the reduction in interconnection rates, lower consumption, and pressure on retail prices.

  In the rest of Telefónica Europe's operations, revenues were down 1.5%, primarily due to lower interconnection rates. These decreased, coupled with the impact of exchange rates, adversely affected revenues. Excluding these effects, revenues would have increased by 2.1%.

  In Telefónica Europe, revenues from mobile data continued to grow steadily, up 10.4% year-on-year. At December 2011, these revenues accounted for 35.7% of mobile service revenues (up 5.4 p.p. compared to the year-ago figure). This upward trend was underpinned by the solid year-on-year growth in non-SMS data revenues, which rose 29.3% over the course of 2011, to account for 51.8% of total data revenues (up 7.6 p.p. year-on-year). The mobile data strategy, focusing on expanding the Group's market share in mobile broadband and on limited-use data rates, was a key factor to this performance.

- **Total expenses** at Telefónica Europe amounted to 23,432 million euros, up 7.6% on the previous year, affected by the recognition of 2,591 million euros of restructuring expenses in Telefónica Spain. This impact, recognized in personnel expenses, accounted for 12 p.p. of the increase.

  - **Supplies expenses** decreased 2.9% year-on-year in 2011 to 10,294 million euros, mainly driven by lower interconnection costs.

  - **Personnel expenses** amounted to 6,400 million euros in the year, an increase of 49.8% compared with 2010, mainly due to the provision included in Spain mentioned above. Excluding this impact personnel expenses decreased by 10.8% year-on-year in 2011.

  - **Other expenses** amounted to 6,738 million euros and decreased by 2.2% as a consequence of lower customer service costs.

- **OIBDA** stood at 9,278 million euros at December 2011, representing a reported year-on-year decrease of 26.0%. OIBDA was primarily affected by:

- Workforce reduction expenses in Spain (2,591 million euros in the third quarter of 2011, and 202 million euros in the fourth quarter of 2010).
- Restructuring expenses in other European countries, primarily in respect of personnel restructuring (320 million euros in the second half of 2010).

Reported OIBDA of Telefónica Europe showed a 26.0% year-on-year decline, with the two aforementioned impacts accounting for -17 p.p. of the variance. The year-on-year decline in OIBDA was also due to pressure on revenues (including the impact of lower regulatory interconnection rates) and to the higher commercial expenditure generated on the launch of new high-end smartphones in the last quarter of 2011, among other sales efforts.

TELEFÓNICA SPAIN

Accesses

Thousands of accesses	2010	2011	2012	%Var 10/11	%Var 11/12
Fixed telephony accesses (1)	13,279.7	12,305.4	11,723.0	(7.3)%	(4.7)%
Naked ADSL	38.1	34.4	25.0	(9.6)%	(27.3)%
Internet and data accesses	5,879.8	5,710.9	5,779.3	(2.9)%	1.2%
Narrowband	136.1	84.4	54.0	(38.0)%	(36.0)%
Broadband (2)	5,722.3	5,608.6	5,709.3	(2.0)%	1.8%
Other (3)	21.4	17.9	16.0	(16.6)%	(10.5)%
Mobile accesses (4)	24,309.6	24,174.3	20,531.2	(0.6)%	(15.1)%
Prepay (5)	7,919.8	7,359.4	5,118.3	(7.1)%	(30.5)%
Contract (6)	16,389.7	16,814.9	15,412.9	2.6%	(8.3)%
Pay TV	788.2	833.2	710.7	5.7%	(14.7)%
WLR (7)	294.5	440.6	481.2	49.6%	9.2%
Unbundled loops	2,477.1	2,881.1	3,262.0	16.3%	13.2%
Shared ULL	264.0	205.0	183.5	(22.3)%	(10.5)%
Full ULL (8)	2,213.1	2,676.1	3,078.5	20.9%	15.0%
Wholesale ADSL	561.3	709.6	652.3	26.4%	(8.1)%
Other (9)	0.9	0.6	0.5	(29.2)%	(20.8)%
Final Clients Accesses	**44,257.4**	**43,023.8**	**38,744.3**	**(2.8)%**	**(9.9)%**
Wholesale Accesses	**3,333.8**	**4,031.9**	**4,396.0**	**20.9%**	**9.0%**
Total Accesses	**47,591.2**	**47,055.7**	**43,140.3**	**(1.1)%**	**(8.3)%**

(1) PSTN (including public use telephony) x1; ISDN basis access x1; ISDN primary access; 2/6 access x30. Includes the Group's accesses for internal use and VOIP and naked ADSL.
(2) ADSL, satellite, fiber optic and broadband circuits.
(3) Remaining retail circuits other than broadband.
(4) In the first quarter of 2012, 2.0 million inactive accesses were derecognized in Spain.
(5) In the first quarter of 2012, 1.2 million inactive accesses were derecognized in Spain.
(6) In the first quarter of 2012, 800 thousand inactive accesses were derecognized in Spain.
(7) Wholesale line rental.
(8) Includes naked shared loops.
(9) Wholesale circuits

Telefónica Spain continued with the transformation strategy rolled out in the second half of 2011. This strategy has led to major changes in the sales and operating model, beginning with improvements to the value proposition and service quality at year-end 2011 through the launch of a new rates portfolio, taken up by a wide percentage of the customer base by December 2012. In March 2012, the Company rolled out a new handset sales model, focused on building customer loyalty and phasing out subsidies to attract customers. This generated considerable savings in sales costs, as did the greater efficiencies derived from the lower personnel expenses, among others.

In October 2012, Telefónica Spain furthered this strategic approach with the launch of "Movistar Fusión," a convergent product that bundles all home communications needs in a single product, at an attractive price, and features unique services such as fiber optics and special TV content. The launch of the "Fusion" product marked a change in the Company's sales focus, towards growth in high-value services. This allowed the Company to recover a net add in fixed broadband, and enabled a net add in fiber, while boosting smartphone adoption.

All these measures have strongly contributed to the higher customer satisfaction reached in 2012 based on internal estimates, as well as to the lower number of customer claims and decreased churn, a fundamental aspect of the improvement in sales activity.

Moreover, despite the strong investment for the roll-out of fiber, the 2012 investment was lower than that made in 2011, due to the greater efficiency derived from the quality increase, the lower churn, the streamlining of systems and the focus on prioritizing the development of new services.

2012 results

Results

Millions of euros

Spain	2010	2011	2012	% Var 10/11	% Var 11/12
Revenues	18,706	17,269	14,985	(7.7)%	(13.2)%
Wireless business	**8,545**	**7,739**	**6,453**	**(9.4)%**	**(16.6)%**
Service revenues	7,264	6,540	5,442	(10.0)%	(16.8)%
Wireline business	**11,397**	**10,624**	**9,541**	**(6.8)%**	**(10.2)%**
OIBDA	8,522	5,095	6,830	(40.2)%	34.0%
OIBDA Margin	45.6%	29.5%	45.6%	(16.1) p.p.	16.1 p.p.
Capex	2,021	2,912	1,692	44.1%	(41.9)%
OpCF (OIBDA - Capex)	6,501	2,184	5,139	(66.4)%	135.3%

- In 2012, **revenues** totaled 14,985 million euros (down 13.2% year-on-year), primarily reflecting lower accesses and the lower ARPU across different services in a highly-competitive and adverse macroeconomic environment.

  Revenues in the fixed line business amounted to 9,541 million euros in 2012, a year-on-year decrease of 10.2%. This reduction was primarily due to lower revenues from traditional accesses (down 9.3% caused by the loss of accesses), a 16.7% decrease in voice services revenues (affected by the growing weight of flat-rate plans and traffic packages) and a 13.8% drop in retail broadband revenues (a 12.2% year-on-year decrease in effective broadband ARPU, affected by customer migration to new rates).

  Revenues from the mobile business totaled 6,453 million euros in 2012, down 16.6% on the 2011 figure. This reduction reflects a 16.8% drop in mobile service revenues (due to negative trends in ARPU and the reduction in interconnection rates effective as from April and October, and in roaming rates, effective as from July).

  Mobile data revenues were down 4.6% year-on-year, despite the steady growth in non-SMS revenues (up 8.2% from 2011), accounting for 85% of total data revenues (up 10 p.p. year-on-year). The trends in these revenues primarily reflect the lower SMS revenues, the higher weight of fixed-rate data plans, driven in the last quarter by the "Fusion" product, and by the migration of customers with USB modems toward more affordable multi-device options. In addition, data revenues continue to be affected by the shift in the Premium SMS sales strategy in November 2011 (70% year-on-year decrease in Premium SMS revenues in 2012).

Mobile traffic dropped 9% from 2011 to 2012, as customers reduced their usage in line with the general contraction of household spending in an adverse macroeconomic environment.

Total ARPU for 2012 was down 7.1% year-on-year. The 2011 ARPU figure is not comparable to 2012 ARPU, as in 2012 it is affected by the disconnection of 2.0 million inactive mobile accesses in the first quarter of 2012. Therefore, in comparable terms, the year on year decrease would have been -14.9%, due to lower usage by customers, lower prices in the new rates portfolio, and reduction in interconnection rates. Voice ARPU decreased 20.0% from 2011 to 2012, while data ARPU fell 0.4%, the latter accounting for 31% of total ARPU. The growth in connectivity revenues, included in data ARPU was not sufficient to completely offset the lower SMS revenues.

Spain	2010	2011	2012	%Var 10/11	%Var 11/12
Traffic (million minutes)	41,700	39,909	36,355	(4.3)%	(8.9)%
ARPU (euros)	**25.4**	**22.9**	**21.2**	**(10.2)%**	**(7.1)%**
Prepay	11.4	9.3	9.1	(18.7)%	(2.0)%
Contract	32.6	29.1	25.5	(10.8)%	(12.3)%
Data ARPU	**5.5**	**6.0**	**6.5**	**9.9%**	**8.6%**
% rev. non-SMS over data revenues	66.6%	74.6%	84.6%	7.9 p.p.	10.0 p.p.

- **OIBDA** totaled 6,830 million euros in 2012, compared to 5,095 million euros in the prior year, 34.0% increase. OIBDA in 2011 was affected by the provision for personnel restructuring made in the third quarter of 2011 (2,591 million euros). Excluding such impact, the year-on-year decrease would be 11.1% due to the year-on-year decrease in revenues, partially offset by the sharp reduction of commercial expenses through the new model eliminating subsidies and also personnel expenses savings as a result of the workforce reduction plan approved in 2011.

2011 results

In 2011 the Spanish market was shaped by the economic downturn, with declines in the principal macroeconomic indicators in the latter months of the year, and a fiercely competitive environment with intense commercial pressure.

At the end of 2011, Telefónica Spain managed a total of 47.1 million accesses, nearly the same as in 2010 (-a 1% decline) despite heavy pressure from competitors. Against this backdrop, Telefónica Spain's market share fell slightly.

Fixed broadband Internet accesses fell 2.0% in 2011 as our commercial strategy focused more on "value" amid stiff competition, with a slowdown in promotional activity in certain months of the year before the September launch of a new ADSL offer boosted activity and net adds in the latter part of the year.

Telefónica Spain took a number of steps during the course of the year focused on reducing its operating costs (primarily the labor force reduction plan) and improving its competitive position. At the end of the third quarter, the company launched its new services catalog, which promotes customer exclusivity by offering cross discounts for customers whose entire telecommunications spend is with Movistar. The company also completed the repositioning of its commercial offerings in the fourth quarter of 2011 with the launch of new mobile rates for contract customers. The new rates combine voice, data and SMS offerings, increasing value to customers by eliminating the voice rate structure that varied depending on time of call and call destination and include unlimited SMS in all data tariffs. Rates are now structured by usage in corresponding to the amount each customer wishes to spend. Also, in the fourth quarter of 2011, voice tariffs were streamlined for pre-pay customers with a highly competitive and flexible offer.

In the fixed line business, in the third quarter of 2011, Telefónica launched 10 mega ADSL with value-added services at 24.90 euros per month, while in the fourth quarter of the year it enhanced its offerings with a basic ADSL plan at 19.90 euros per month (excluding value-added services and fixed-to-mobile calls). Value-added services packages enjoyed greater adoption during the year.

- **Revenues** fell 7.7% in 2011 to 17,269 million euros, pulled down by lower ARPU in the various services and lower accesses amid waning consumption and stronger pricing pressure.

  Revenues in the fixed line business decreased by 6.8% to 10,624 million euros, mostly because of declines in revenues from traditional access of 10.6% (7% fall in accesses and lower amounts recognized from universal service) a decrease in revenues from voice services of 9.0% (due to reduction in traffic carried and the increasing weight of flat rates) and a 10.1% decrease in revenues from retail broadband services (10.2% decrease in effective broadband ARPU due to lower effective prices from the promotions carried out and the new prices launched in the latter part of the year).

  Revenues from the mobile business decreased by 9.4% in 2011 to 7,739 million euros, due mainly to the 10.0% fall in mobile service revenues (due to a 10% drop in ARPU –explained below- and among a slightly reduced customer base).

  Mobile traffic continued to reflect lower customer usage, falling 4.3% in 2011.

  Total ARPU fell 10.2% in 2011 to 22.9 euros, undermined by a 15.7% fall in voice ARPU because of the interconnection rates cuts, lower usage and downward pressure on retail prices. Conversely, data ARPU rose 9.9% in 2011, representing 26% of total ARPU (+5 p.p.), fuelled by the rapid growth of mobile broadband.

  Non-P2P SMS revenues continue to be the biggest growth driver in the data business, increasing by 24.1% in 2011 and representing 75% of total data revenue (+8 p.p.). Data revenue had a solid increase of 10.9% in 2011.

- **OIBDA** in 2011 amounted to 5,095 million euros, down 40.2% from 2010 due to the negative impact of expenses related to the labor force reduction plan. Excluding the workforce restructuring expenses recognized (2,591 million euros in the third quarter of 2011 and 202 million euros in the fourth quarter of 2010), OIBDA would have decreased by 12% in 2011, mostly due to the decline in revenues.

UK

Accesses

Thousands of accesses	2010	2011	2012	% Var 10/11	% Var 11/12
Fixed telephony accesses (1)	86.7	216.1	377.4	ns	74.6%
Internet and data accesses	671.6	620.3	560.1	(7.6)%	(9.7)%
Broadband	671.6	620.3	560.1	(7.6)%	(9.7)%
Mobile accesses	22,211.5	22,167.5	22,864.2	(0.2)%	3.1%
Pre-Pay	11,712.3	11,227.3	10,962.9	(4.1)%	(2.4)%
Contract	10,499.2	10,940.3	11,901.3	4.2%	8.8%
Final Clients Accesses	**22,969.8**	**23,003.9**	**23,801.7**	**0.1%**	**3.5%**
Wholesale Accesses (2)	**-**	**26.7**	**40.5**	**n.a**	**51.5%**
Total Accesses	**22,969.8**	**23,030.7**	**23,842.2**	**0.3%**	**3.5%**

n.s.: not significant
(1) PSTN (including public use telephony) x1; ISDN basis access x1; ISDN primary access; 2/6 access x30. Includes the Group's accesses for internal use and VOIP and naked ADSL. As from the first quarter of 2012, the figure for fixed line telephone accesses includes 65 thousand lines in order to standardize these accesses with Telefónica Group criteria.
(2) Includes unbundled lines rented by Telefónica United Kingdom.
n.a.: not applicable

In 2012, Telefónica UK had high commercial activity, thanks to the ongoing success of its "On&On" smartphone rates. This has led to a solid net add in contract customers, shoring up the segmented data rates strategy and contributing to keep churn extremely low.

Telefónica UK has prepared the commercial launch of 4G services in 2013, through a network sharing agreement with Vodafone. This agreement is expected to shore up the current network collaboration, expand coverage, and set the bases for the 4G network.

As a result of the commercial strategy, in late 2012, Telefónica UK had a total of 23.8 million accesses (up 3.5% year-on-year), primarily drawing from the greater mobile customer base. This customer base grew 3.1% over the course of the year, standing at 22.9 million in December 2012. The contract segment is the main lever for growth (up 8.8% year-on-year). In addition, the weight of contract customers raised 3 p.p. from 2011 to 2012, accounting for 52% of mobile accesses. The steady demand for smartphones increased the penetration of these handsets to 45% at the end of 2012, up from 38% the year before.

Results

Millions of euros				% Var 10/11		% Var 11/12	
Telefónica UK	2010	2011	2012	€	Local Currency	€	Local Currency
Revenues	**7,201**	**6,926**	**7,042**	**(3.8)%**	**(2.7)%**	**1.7%**	**(5.0)%**
Service revenues	6,513	6,198	6,060	(4.8)%	(3.7)%	(2.2)%	(8.6)%
OIBDA	1,830	1,836	1,601	0.3%	1.5%	(12.8)%	(18.5)%
OIBDA Margin	25.4%	26.5%	22.7%	1.1 p.p.	1.1 p.p.	(3.8) p.p.	(3.8) p.p.
Capex	717	732	748	2.0%	3.3%	2.2%	(4.5)%
OpCF (OIBDA - Capex)	1,113	1,104	854	(0.8)%	0.3%	(22.7)%	(27.8)%

- **Revenues**: Total revenues increased 1.7% year-on-year (or decreased 5.0% when excluding exchange rate effects) to 7,042 million euros. Mobile service revenues totaled 6,060 million euros, a year-on-year decrease of 2.2%. The impact of exchange rates accounted for 6.4 p.p. of the variance, so excluding the effect of exchange rates, service revenue would have decreased 8.6%. These results were heavily impacted by reductions in interconnection rates and the new roaming rates, which dragged revenue growth by -4 p.p., excluding theses impacts, services revenues would have decreased by 4.7% year-on-year, due primarily to ARPU trends. Non-SMS data revenue rose 18.4% from 2011 to 2012, underpinned by the higher presence of smartphones and the adoption of segmented data rates. Data revenues were up 2.4% compared to 2011, representing 51% of mobile service revenues (up 6 p.p. year-on-year).

- Total **ARPU** slumped 9.3% year-on-year in local currency, heavily affected by the reduction in interconnection rates, which accounted for 3 p.p. of the decrease and a 7.7% decline in traffic. Voice ARPU fell 18.3% compared to 2011 due to lower interconnection rates, the new regulations on roaming rates, and the rates reduction made to stay competitive in the market. Data ARPU grew by 1.5%, reflecting the success of limited-use data rates offers.

Telefónica UK

	2010	2011	2012	% Var Local Currency 10/11	% Var Local Currency 11/12
Traffic (million minutes)	58,143	52,250	48,250	(10.1)%	(7.7)%
ARPU (euros)	**25.1**	**23.2**	**22.5**	**(6.6)%**	**(9.3)%**
Prepay	11.8	10.3	9.6	(11.4)%	(13.1)%
Contract	40.6	37.1	35.0	(7.6)%	(11.8)%
Data ARPU	**10.1**	**10.5**	**11.4**	**5.1%**	**1.5%**
% rev. non-SMS over data revenues	32.8%	40.5%	46.8%	7.7 p.p.	6.3 p.p.

Mobile voice traffic was 7.7% lower than in 2011, primarily due to optimization of usage.

- **OIBDA** totaled 1,601 million euros in 2012, down 12.8% on the 2011 figure (down 18.5% on a constant euros basis), primarily as a result of the decreasing service revenue trends (derived from lower ARPU), partially offset by lower interconnection costs as a consequence of termination rate cuts. OIBDA drop is also affected by commercial costs increase in 2012 compared to 2011, especially in the first half of the year in response to the greater commercial activity undertaken in late 2011.

2011 results

- **Revenues**: Telefónica UK reported a 3.8% decrease in revenue to 6,926 million euros, with foreign exchange rates contributing a negative 1.1 p.p. Mobile service revenue was down 4.8% (-3.7% excluding foreign exchange rate effects), at 6,198 million euros. These results were heavily impacted by reductions in interconnection rates, excluding this impact, service revenues would have only fallen by 0.4%, because of lower customer growth and lower ARPU.

- Total **ARPU** slumped 6.6% or 3.5% excluding the interconnection price cuts. Voice ARPU plunged 14.6% (or decreased 9.2% excluding interconnection price cuts) because of the optimization of traffic consumption outside of minute bundles, the reduction in rates amid stiff competition and the adverse macroeconomic climate Data ARPU growth held steady at 5.1%, with more than 80% of contract customers with data tariffs opting for limited data usage.

  Mobile voice traffic was 10% lower in 2011, due to the decrease in the pre-pay customer base and the optimization of usage.

- **OIBDA** at Telefónica UK increased by 0.3% to 1,836 million euros in 2011 and increased by 1.5% excluding the impact of foreign exchange rates. That said, 72 million euros of non-recurring restructuring expenses were recognized in 2010. Excluding this impact as well, OIBDA would have fallen by 2.3% due to lower revenue.

GERMANY

Accesses

Thousands of accesses	2010	2011	2012	% Var 10/11	% Var 11/12
Fixed telephony accesses (1)	1,916.4	2,055.1	2,249.0	7.2%	9.4%
Internet and data accesses	2,914.7	2,922.3	2,678.9	0.3%	(8.3)%
Narrowband	385.7	334.6	302.6	(13.2)%	(9.6)%
Broadband	2,529.1	2,587.7	2,376.3	2.3%	(8.2)%
Mobile accesses	17,049.2	18,380.1	19,299.9	7.8%	5.0%
Pre-Pay	8,795.2	9,144.5	9,191.3	4.0%	0.5%
Contract	8,254.0	9,235.7	10,108.5	11.9%	9.5%
Pay TV	77.2	83.3	57.2	7.9%	(31.3)%
Final Clients Accesses	**21,957.5**	**23,440.9**	**24,284.9**	**6.8%**	**3.6%**
Wholesale Accesses (2)	**1,116.5**	**1,042.4**	**1,087.9**	**(6.6)%**	**4.4%**
Total Accesses	**23,074.0**	**24,483.2**	**25,372.8**	**6.1%**	**3.6%**

(1) PSTN (including public use telephony) x1; ISDN basis access x1; ISDN primary access; 2/6 access x30. Includes the Group's accesses for internal use and VOIP and naked ADSL. As from the first quarter of 2012, the figure for fixed line telephone accesses in Germany includes 384 thousand VoIP customers in order to standardize these accesses with Telefónica criteria.
(2) Includes unbundled lines rented by Telefónica Germany. In the fourth quarter of 2011, 78 thousand inactive accesses were derecognized in Germany.

The company's strong operating performance in 2012, with solid net adds, is reflected in its financial statements, with growth in revenues and higher year-on-year growth in OIBDA (see explanation of 2011 results for Germany). Telefónica Germany reported favorable trends in the OIBDA margin and growing revenues, despite the new cuts in termination rates established in December 2012. As a result, the company remains the third-largest integrated operator in the German market based on our internal estimates of market share.

Telefónica Germany continues to gear its investment toward LTE mobile technology, with a view to meeting future growth and ensuring one of the most advanced VDSL platforms in the country.

Telefónica Germany achieved a 3.6% increase in accesses in 2012, fuelled by 5.0% growth in mobile accesses on the back of a 9.5% larger contact customer base. This strong contract customer net add reflects the strong demand for integrated data mobile rates ("O2 Blue" rates").

Demand for smartphones remained strong in the year, raising mobile broadband penetration by 6 p.p. to 26% at December 31, 2012. This reflects the success of the "My Handy" handset distribution model, with an increase in the number of pre-pay customers using smartphone handsets, as the unit cost of these handsets is beginning to become attractive for those customers.

Results

Millions of euros				% Var 10/11		% Var 11/12	
Telefónica Germany	2010	2011	2012	€	Local Currency	€	Local Currency
Revenues	4,826	5,035	5,213	4.3%	4.3%	3.5%	3.5%
Wireless Business	**3,414**	**3,606**	**3,845**	**5.6%**	**5.6%**	**6.6%**	**6.6%**
Service revenues	2,932	2,946	3,152	0.5%	0.5%	7.0%	7.0%
Wireline Business	**1,412**	**1,426**	**1,363**	**1.0%**	**1.0%**	**(4.4)%**	**(4.4)%**
OIBDA	944	1,219	1,351	29.1%	29.1%	10.8%	10.8%
OIBDA Margin	19.6%	24.2%	25.9%	4.7 p.p.	4.7 p.p.	1.7 p.p.	1.7 p.p.
Capex	2,057	558	609	(72.9)%	(72.9)%	9.2%	9.2%
OpCF (OIBDA - Capex)	(1,113)	662	743	n.m.	n.m.	12.2%	12.2%

n.m.: non meaningful

- **Revenue:** Total revenue rose 3.5% year-on-year to 5,213 million euros, primarily due to strong mobile revenues. Mobile services revenues increased by 7.0% year-on-year in 2012, drawing from the expanded contract customer base and the success of limited-use data rates. As a result, the 30.7% year-on-year growth in non-P2P SMS data revenues continued to drive total data revenues. Mobile data revenues were up 16.1% compared to 2011, representing 44% of mobile service revenues (up 3 p.p. year-on-year).

  Revenue from the fixed line service fell 4.4% from 2011 to 2012, due mainly to the decrease in fixed broadband accesses.

- Total **ARPU** was up 0.9% in the year. Voice ARPU decreased 5% year-on-year; however, this decrease was offset by the strong data ARPU (up 9.3% compared to 2011), drawing from the greater share in mobile broadband and the increased adoption of integrated rates among the customer base.

Telefónica Germany

	2010	2011	2012	% Var 10/11	% Var 11/12
Traffic (million minutes)	25,543	27,993	29,519	9.6%	5.5%
ARPU (euros)	**14.8**	**13.6**	**13.8**	**(7.8)%**	**0.9%**
Prepay	6.1	5.7	5.5	(7.0)%	(3.0)%
Contract	23.8	21.9	21.5	(8.4)%	(1.6)%
Data ARPU	**5.0**	**5.6**	**6.2**	**13.2%**	**9.3%**
% rev. non-SMS over data revenues	41.9%	50.4%	56.7%	8.5 p.p.	6.3 p.p.

Mobile voice traffic rose 5.5% over the course of the year, underpinned by growth in the contract customer base.

- **OIBDA** rose 10.8% to 1,351 million euros, as a consequence of growth in mobile service revenues boosted by data revenue growth, combined with cost control as total operating expenses are nearly flat year-on-year. Supplies grow driven by increase in handset costs (higher commercial activity) and mobile interconnection expenses, personnel expenses increase due to general increase in salaries, and network costs also increase, partially offset by other expenses decrease with savings in administration expenses, bad debts and advertising costs.

2011 results

- **Revenues**: Total revenue rose 4.3% in 2011 to 5,035 million euros. Revenues for 2010 included the results of HanseNet as of mid-February 2010, while 2011 results included them for the full year. Excluding this impact, revenue would have increased by 1.6% during 2011.

  Mobile services revenues performed positively, especially at the end of 2011, although they were adversely affected by the reductions in interconnection tariffs. Excluding this effect, mobile services increased 7.1%, driven by growth in the customer base, and trends in ARPU Non-P2P SMS data revenue growth (49%) was a key driver of revenue, leveraging the increasing penetration of smartphones and the adoption of limited use data rates.

- Total **ARPU** fell 7.8% in the year due to the sharp reduction in interconnection rates in December 2010. This impact accounted for 6.2 p.p. of the decrease. Excluding this impact, total ARPU would have only declined 1.6% mainly due to the weak performance of the pre-pay segment. Regulatory changes affected voice ARPU, with an 18.5% drop in the year. This was partly offset by the good performance of data ARPU (up 13.2%) thanks to increasing mobile broadband penetration and strong adoption of limited use data rates.

  Mobile traffic increased 10% in 2011 due to growth in the customer base and an overall increase in usage.

- **OIBDA** increased 29.1% to 1,219 million euros in 2011. Excluding the impact of the consolidation of HanseNet results from February 2010 and for 12 months in 2011 and the 202 million euros of restructuring provisions recognized in 2010, OIBDA in 2011 would have increased by 4.9% primarily due to higher revenues and efficiency gains achieved through the restructuring plan and other efficiencies, which offset the increase in commercial costs.

CZECH REPUBLIC AND SLOVAKIA

Accesses

Thousands of accesses	2010	2011	2012	% Var 10/11	% Var 11/12
TELEFÓNICA CZECH REPUBLIC					
Fixed telephony accesses (1)	1,669.2	1,581.9	1,499.9	(5.2)%	(5.2)%
Naked ADSL	163.7	237.4	285.9	45.0%	20.4%
VoIP	38.6	52.1	76.7	35.0%	47.2%
Internet and data accesses	898.8	970.6	1,016.1	8.0%	4.7%
Narrowband	117.5	100.7	87.6	(14.3)%	(13.1)%
Broadband	753.0	839.6	899.4	11.5%	7.1%
Other (2)	28.3	30.3	29.1	6.9%	(4.0)%
Mobile accesses	4,838.6	4,941.7	5,082.9	2.1%	2.9%
Pre-Pay	1,975.0	1,892.4	1,891.1	(4.2)%	(0.1)%
Contract	2,863.6	3,049.3	3,191.7	6.5%	4.7%
Pay TV	129.2	135.6	141.4	5.0%	4.3%
Final Clients Accesses	**7,535.8**	**7,629.8**	**7,740.3**	**1.2%**	**1.4%**
Wholesale Accesses	**131.2**	**144.1**	**159.9**	**9.8%**	**11.0%**
Total Accesses	**7,667.0**	**7,773.9**	**7,900.1**	**1.4%**	**1.6%**

(1) PSTN (including public use telephony) x1; ISDN basis access x1; ISDN primary access; 2/6 access x30. Includes the Group's accesses for internal use and VOIP and naked ADSL.
(2) Remaining retail circuits other than broadband.

Accesses

Thousands of accesses	2010	2011	2012	% Var 10/11	% Var 11/12
SLOVAKIA					
Mobile accesses	880.4	1,164.1	1,354.2	32.2%	16.3%
Pre-Pay	545.9	666.1	694.9	22.0%	4.3%
Contract	334.5	498.0	659.3	48.9%	32.4%
Total Accesses	**880.4**	**1,164.1**	**1,354.2**	**32.2%**	**16.3%**

Accesses in the Czech Republic increased 1.6% in 2012 due to growth in mobile and fixed broadband accesses. The total mobile customer base rose 2.9% year-on-year, to 5.1 million customers at December 31, 2012. This increase was driven by the steady growth in the contract segment (up 4.7% from 2011), which accounts for 63% of the total base (up 1 p.p. year-on-year). In Slovakia, the number of accesses continued to rise, largely underpinned by the contract segment.

In respect of the 2012 performance of the fixed line telephone business:

- Fixed line telephone accesses stood at 1.5 million at the 2012 year end, for a net loss of 82 thousand customers during the course of the year.

- Retail broadband accesses continue to rise (up 7.1% year-on-year), to 899 thousand at December 31, 2012 (annual net add of 60 thousand accesses). VDSL continues to gain strength, with 260 thousand customers subscribing to this service (32% of the residential xDSL customer base).

- The number of pay TV customers reached 141 thousand at the 2012 year end (up 4.3% from 2011).

Results

Millions of euros				% Var 10/11		% Var 11/12	
Telefónica Czech Republic (*)	2010	2011	2012	€	Local Currency	€	Local Currency
Revenues	2,197	2,130	2,010	(3.0)%	(5.5)%	(5.7)%	(3.7)%
Wireless Business	**1,237**	**1,211**	**1,159**	**(2.1)%**	**(4.4)%**	**(4.3)%**	**(2.5)%**
Service revenues	1,182	1,145	1,097	(7.7)%	(5.4)%	(4.2)%	(2.4)%
Wireline Business	**960**	**919**	**851**	**(4.2)%**	**(6.9)%**	**(7.4)%**	**(5.4)%**
OIBDA	953	931	832	(2.3)%	(4.9)%	(10.6)%	(8.7)%
OIBDA Margin	43.4%	43.7%	41.4%	0.3 p.p.	0.3 p.p.	(2.3) p.p.	(2.3) p.p.
Capex	224	229	248	2.1%	(0.5)%	8.6%	10.4%
OpCF (OIBDA - Capex)	729	702	584	(3.7)%	(6.3)%	(16.9)%	(15.0)%

(*) Includes Slovakia.

2012 results

- **Revenues** in the Czech Republic and Slovakia amounted to 2,010 million euros, for a year-on-year decrease of 3.7% in local currency. Mobile service revenues amounted to 1,097 million euros (down 2.4% year-on-year, in local currency), primarily reflecting weaker consumption across all segments and the lower mobile interconnection rates (which accounted for 3.4 p.p. of the year-on-year decline). When stripping out the impact of these rates cuts, mobile service revenues rose 1.0% from 2011 to 2012.

  In Slovakia, revenue growth remained solid (up 22.1% compared to 2011), amounting to 192 million euros.

  Fixed line telephone revenues totaled 851 million euros (a 5.4% decrease from 2011), primarily due to pressures on fixed ARPU.

- **OIBDA** totaled 832 million euros, down 8.7% on 2011 in local currency. Pressure on revenues is the main reason for this drop, as operating costs are nearly flat year on year despite customer base growth and expansion of business activities. Efficiency measures have been implemented in both commercial and non-commercial areas of its operations, with personnel expenses declining significantly as a consequence of headcount reduction (excluding restructuring costs).

2011 results

- **Revenues** in the Czech Republic and Slovakia amounted to 2,130 million euros, for a year-on-year decrease of 3%. In Slovakia, growth in the customer base led to higher revenues in 2011.

- **OIBDA** totaled 931 million euros in 2011, affected by major efficiency initiatives, sales of non-strategic assets and wide margins in Slovakia, which resulted in a smaller decrease in OIBDA than in revenue in the year.

Services and products

Mobile business

Telefónica offers a wide variety of mobile and related services and products to personal and business customers. Although they vary from country to country, our principal services and products are as follows:

- **Mobile voice services:** Our principal service in all of our markets is mobile voice telephony.
- **Value added services:** Customers in most of the markets have access to a range of enhanced mobile calling features, including voice mail, call hold, call waiting, call forwarding and three-way calling.
- **Mobile data and Internet services:** Current data services offered include Short Messaging Services, or SMS, and Multimedia Messaging Services, or MMS, which allow customers to send messages with images, photographs, sound recordings and video recordings. Customers may also receive selected information, such as news, sports scores and stock quotes. We also provide mobile broadband connectivity and Internet access. Through mobile Internet access, customers are able to send and receive e-mail, browse the Internet, download games, purchase goods and services in m-commerce transactions and use our other data and software services.
- **Wholesale services:** Telefónica has signed network usage agreements with several MVNOs in different countries.
- **Corporate services:** Telefónica provides business solutions, including mobile infrastructure in offices, private networking and portals for corporate customers that provide flexible online billing.
- **Roaming:** Roaming agreements allow Telefónica customers to use their mobile handsets when they are outside their service territories, including on an international basis.
- **Fixed wireless.** Telefónica provides fixed voice telephony services through mobile networks in Venezuela, Argentina, Peru, Mexico, Ecuador, El Salvador, Guatemala and Nicaragua.
- **Trunking and paging:** In Spain and Guatemala, Telefónica provides digital mobile services for closed user groups of clients and paging services.
- **Mobile payment solutions:** Through these services, customers can carry out banking transactions, purchases and mobile phone top-ups, among other financial transactions, using pre-paid accounts or through their existing bank accounts.

Fixed business

The principal services Telefónica offers in its fixed businesses in Europe and Latin America are:

- **Traditional fixed telecommunication services:** Telefónica's principal traditional fixed telecommunication services include PSTN lines; ISDN accesses; public telephone services; local, domestic and international long-distance and fixed-to-mobile communications services; corporate communications services; supplementary value added services (including call waiting, call forwarding, voice and text messaging, advanced voicemail services and conference-call facilities); video telephony; business oriented value-added services; intelligent network services; leasing and sale of handset equipment; and telephony information services.
- **Internet and broadband multimedia services:** the principal Internet and broadband multimedia services include Internet service provider service; portal and network services; retail and wholesale broadband access through ADSL, naked ADSL (broadband connection without the monthly fixed line fee); narrowband switched access to Internet for universal service, and other technologies. Telefónica

also offers high-speed Internet services through fiber to the home (FTTH) in certain markets (primarily Spain, Brazil and Chile) and VDSL-based services (primarily Spain, Czech Republic and Germany). The Company offers IPTV services, over-the-top network television services, and cable and satellite TV. In certain markets, advanced pay TV services are offered, such as high-definition TV (HDTV), Multiroom (allowing clients to watch different TV channels in different rooms) and Digital Video Recording (DVR). Telefónica provides VoIP services, as well as value-added services for the residential sector (including instant messaging, concerts and video clips by streaming video, e-learning, parental control, firewall protection, anti-virus protection, content download and personal computer sales). Value-added services for companies include "*puesto integral/puesto informático*", a comprehensive work station including ADSL, computer and maintenance for a fixed price, along with VoIP services

- **Data and business-solutions services:** the data and business-solutions services principally include leased lines; virtual private network, or VPN, services; fiber optics services; the provision of hosting and application, or ASP, service, including web hosting, managed hosting, content delivery and application, and security services; outsourcing and consultancy services, including network management, or CGP; and desktop services and system integration and professional services.

- **Wholesale services for telecommunication operators:** the wholesale services for telecommunication operators principally include domestic interconnection services; international wholesale services; leased lines for other operators' network deployment; and local loop leasing under the unbundled local loop regulation framework). It also includes bit stream services, bit stream naked, wholesale line rental accesses and leased ducts for other operators' fiber deployment.

- **Cloud computing services**, such as the Instant Servers services, Telefónica's new global public cloud service for corporate clients. This entails high-performance virtual servers that are optimized for mobile and corporate applications (both fixed and mobile).

Share price performance

The main European markets were severely affected by the performance of the debt markets in 2012. During the first half of the year, rising risk premiums of countries in Southern Europe drove the Ibex 35 index down to its lowest level since March 2003 on July 24, 2012, after the Spanish risk premium reached 627.7 points, situating the Spanish ten-year bond yield at 7.5%. Despite this, during the latter half of the year, decisions taken by the European Union and the statements of the Chairman of the ECB led to a gradual reduction in the risk premium and the equities markets rebounded, ending 2012 with gains across Europe: EStoxx-50 +13.8%; DAX +29.1%; CAC-40 +15.2%; FTSE-100 +5.8% and FTSEMIB: +7.8).

The Spanish ten-year bond yield closed 2012 at 5.2% (5.0% at year-end 2011), while the spread compared to the German bond was 388.7 basis points (317.0 basis points at year-end 2011). This was reflected in the performance of the Spanish stock market which, despite gains in the second half of the year (+37% from lows in July), posted losses for the third consecutive year. The Ibex-35 index contracted by 4.7% in 2012 affected by the euro zone crisis, the rising risk premium and doubts surrounding the health of the financial sector.

Against this backdrop, Telefónica shares dropped by 23.9% (10.19 euros per share at year-end 2012), having performed more poorly than the sector in Europe (-10.7%). Other European operators also suffered declining share prices during the year: KPN: -59.8%; France Telecom: -31.3%; Telecom Italia: -17.8%; PT: -15.8; Vodafone: -13.7%; Deutsche Telekom: -3,0%. The total return on Telefónica shares in 2012 was -17.8% (including the dividends distributed throughout 2012).

At the 2011 year end, Telefónica featured among the world's ten largest telecommunications company by market cap (46,375 million euros).

Daily trading volume in Telefónica shares on Spain's continuous market was 42.9 million shares in 2012 (56.4 million shares in 2011).

Research, Development and Innovation

Telefónica remains firmly committed to technological innovation as an essential tool for achieving competitive advantages, anticipating market trends and differentiating its products. By introducing new technologies and developing new products and business processes, we seek to become a more effective, efficient and customer-oriented Group.

Telefónica has developed an open innovation model for the management of technological innovation to boost the application of technical research in the development of new commercial products and services. Telefónica focuses on certain applied research and development (R&D) priorities that are aligned with its strategy. Open innovation initiatives driving this model include the creation of a venture capital fund and involvement in business collaboration forums, among others. The model also promotes the use of knowledge developed at technology centers, universities and start-ups, among other sources, and encourages innovation in conjunction with other agents (e.g. customers, universities, public administrations, suppliers, content providers and other companies), making them "technological partners." Telefónica believes it cannot rely solely on acquired technology to differentiate its products from those of its competitors and to improve its market positioning. It is also important to encourage R&D initiatives in an effort to achieve this differentiation and make inroads in other innovation activities. The Group's R&D policy is geared towards:

- developing new products and services in order to win market share;
- boosting customer loyalty;
- increasing revenue;
- enhancing innovation management;
- improving business practices;
- increasing the quality of infrastructure services to improve customer service and reduce costs;
- promoting global products;
- supporting open innovation; and
- creating value from the technology generated.

In 2012, the technological innovation projects undertaken focused on sustainable innovation, process efficiency, creation of new revenue streams, customer satisfaction, consolidation of operations in new markets and technological leadership.

Technical innovation activities are a key part of Telefónica's strategy of creating value through latest-generation network communications and services.

In 2012, projects were undertaken to promote greater access to information technology, new services focused on new internet business models, advanced user interfaces, mobile television and other broadband services. These initiatives, among others, were undertaken based on our objective of rapidly identifying emerging technologies that could have a relevant impact on our businesses and pilot testing these technologies in new services, applications and platform prototypes.

Most of our R&D activities are carried out by Telefónica Investigación y Desarrollo, S.A.U. (Telefónica I+D), a wholly-owned subsidiary, which works mainly for the lines of business. In its operations, Telefónica I+D receives the assistance of other companies and universities. Telefónica I+D's mission is centered on enhancing the Company's competitive positioning by leveraging technological innovation and product development. Telefónica I+D undertakes experimental and applied research and new product development with the overriding goal of broadening the range of services offered and reducing operating costs.

Telefónica I+D's technological innovation activities focus on certain areas:

Telefónica I+D's works on new networks, primarily in collaboration with Telefónica's Global Resources team. These activities are related with new radio access technologies (LTE-Advanced); network virtualization technologies, in line with the technology trend known as software defined networks (SDN); and network optimization and zero touch developments making networks more flexible and moldable and able to adapt dynamically to new digital consumer and service requirements.

R&D activities to develop new products and services are conducted as part of Telefónica Digital's strategy. Indeed, Telefónica I+D' forms the foundations of Telefónica Digital's Product Development & Innovation Department. These activities include the following:

- Natural P2P communication of the future, using the Internet, Web 2.0 and smartphones.
- Video and multimedia services (combining text, audio, images and video) offering a user experience in all connected devices.
- Advanced solutions in emerging ITC businesses such as e-health, and remote patient support or monitoring.
- M2M (machine-to-machine) service management associated with energy efficiency and mobility.
- Making use of user communication profiles to exploit opportunities to operate different products and business models (marketing campaigns, target marketing, contextual services, churn reduction, cross-selling, etc.)

Telefónica I+D's also boasts scientific work groups with a more medium- to long-term focus and aim to look into opportunities relating to new networks and services and solutions to the technological challenges that arise.

At December 31, 2012, Telefónica I+D had 667 employees (653 employees in 2011).

Total I+D expense for 2012 amounted to 1,071 million euros, up 9% from the 983 million euros incurred in 2011 (797 million euros in 2010). This expense represents 1.7%, 1.6% and 1.3% of the Group's consolidated revenue for 2012,2011 and 2010, respectively. These figures were calculated using guidelines of the Organization for Economic Co-operation and Development (OECD). Using these and other guidelines, there are R&D costs that, due to the length of projects and/or accounting classifications, are not entirely included in the consolidated statement of financial position.

In 2012, Telefónica registered 87 patents (95 patents in 2011), 78 of which were registered with the Spanish Patent and Trademark Office and (OEPM for its initials in Spanish) and nine with the United States Patent and Trademark Office (USPTO). Of the patents pending with the OEPM, 45 are Spanish (ES) applications, 29 European (EP) applications, and four international (PCT) applications.

Financing

The main financing transactions carried out in the bond market in 2012 are as follows:

Item	Date	Maturity Date	Nominal (millions) Currency	Euros (1)	Currency of issuance	Coupon
EMTN Bonds	02/07/2012	02/07/2017	120	120	EUR	4.7500%
	02/21/2012	02/21/2018	1,500	1,500	EUR	4.7970%
	03/12/2012	03/12/2020	700	858	GBP	5.5970%
	03/30/2012	03/30/2017	1,250	50	CZK	3.9340%
	07/11/2012	07/11/2018	10,000	88	JPY	4.2500%
	09/19/2012	09/05/2017	1,000	1,000	EUR	5.8110%
	10/19/2012	01/20/2020	1,200	1,200	EUR	4.7100%
	12/14/2012	12/14/2018	250	207	CHF	2.7180%
	12/14/2012	12/14/2022	150	124	CHF	3.4500%
Telefónica Emisiones, S.A.U.						
Debentures	09/10/2012	09/10/2017	2,000	742	BRL	100% CDI + 0.75% a.a.
Telefónica Brasil, S.A.						
Bonds	10/12/2012	10/12/2022	500	379	USD	3.8750%
Telefónica Chile, S.A.						
Bonds	09/27/2012	09/27/2022	750	568	USD	5.375%
Colombia Telecomunicaciones, S.A. ESP						
Bonds	08/10/2012	08/10/2019	50	15	PEN	5.5313%
Telefónica Móviles, S.A. (Perú)						
Debentures	11/29/2012	11/29/2022	1,165	1,165	EUR	4.1840%
Telefónica, S.A.						

(1) Exchange rate as at December 31, 2012

The main financing transactions carried out in the bank market in 2012 are as follows:

Item	Limit	Currency	Nominal (millions of euros)	Arrangement Date	Maturity Date
Telefónica, S.A					
Bilateral loan	200	EUR	200	02/27/12	02/27/15
Syndicated loan Tranche D2 *	923	EUR	923	03/02/12	12/14/15
Telefonica Europe, B.V.					
Syndicated loan Tranche D1 *	801	EUR	801	03/02/12	12/14/15
Syndicated loan Tranche E1	756	EUR	-	03/02/12	03/02/17
Syndicated loan Tranche E2 ***	1,469	GBP	-	03/02/12	03/02/17
Vendor Financing **	375	USD	284	01/05/12	01/31/22
Vendor Financing **	1,200	USD	-	08/28/12	10/31/23
Colombia					
Bilateral loan	318,475	COP	137	09/27/12	09/27/19
Bilateral loan	600,000	COP	257	09/28/12	09/28/19
Czech Republic					
Sindicated loan	3,000	CZK	119	09/27/12	09/27/16

* Facility signed in GBP redenominated into EUR on 12/14/12 and available from 12/14/12
** Facilities with amortization schedule
*** Available from 12/13/13

Transactions with treasury shares

At December 31, 2012, 2011 and 2010, Telefónica Group companies held the following shares in the Telefónica, S.A. parent company:

	Number of shares	Euros per share Acquisition price	Euros per share Trading price	Market value*	%
Treasury shares at 12/31/12	47,847,810	10.57	10.19	488	1.05136%
Treasury shares at 12/31/11	84,209,364	15.68	13.39	1,127	1.84508%
Treasury shares at 12/31/10	55,204,942	17.01	16.97	937	1.20957%

(*) Millions of euros

Telefónica, S.A. directly owns all treasury shares in the Group, except 1 share that is held by Telefónica Móviles Argentina, S.A. at December 31, 2012 and 2011 (16,896 treasury shares held by Telefónica Móviles Argentina, S.A. at December 31, 2010).

In 2010, 2011 and 2012 the following transactions involving treasury shares were carried out:

	Number of shares
Treasury shares at 12/31/09	**6,329,530**
Acquisitions	52,650,000
Disposals	(810,151)
Employee share option plan	(2,964,437)
Treasury shares at 12/31/10	**55,204,942**
Acquisitions	55,979,952
Disposals	(24,075,341)
Employee share option plan (Note 20.a)	(2,900,189)
Treasury shares at 12/31/11	**84,209,364**
Acquisitions	126,489,372
Disposals	(76,569,957)
Employee share option plan (Note 20.a)	(2,071,606)
Capital reduction	(84,209,363)
Treasury shares at 12/31/12	**47,847,810**

The amount paid to acquire treasury shares in 2012 was 1,346 million euros (822 million euros and 897 million euros in 2011 and 2010, respectively).

On May 25, 2012, pursuant to the resolutions adopted in the General Shareholders' Meeting of May 14, 2012, capital was reduced by redeeming 84,209,363 treasury shares, thereby reducing this caption by 1,321 million euros.

Treasury shares disposed of in 2012, 2011 and 2010 amounted to 801 million euros, 445 million euros and 14 million euros, respectively. The main disposals are as follows:

In November 2012, Telefónica submitted an offer to acquire and redeem the preference shares that it had indirectly issued in 2002 through its subsidiary Telefónica Finance USA, LLC totaling 2,000 million euros. The offer entails acquiring these shares at their par value, subject unconditionally and irrevocably to the simultaneous reinvestment in Telefónica, S.A. shares and the subscription of newly issued plain-vanilla bonds, in the following percentage:

a) 40% of the amount in treasury shares of Telefónica, S.A.

c) 60% of the amount of the bond subscription, of 600 euros nominal value, issued at face value.

97% of the holders of the preference shares accepted the offer, and therefore 76,365,929 treasury shares with a carrying amount of 815 million euros (exchange value of 776 million euros) were handed over, which are included under "Disposals" in 2012.

In addition to these disposals, on July 27, 2012, Group employees received 2,071,606 shares upon maturity of the first edition of the Global Employee Share Plan (GESP). In December 2012, the second phase of the GESP started, and 116,443 treasury shares were earmarked to meet the demand for shares of employees that have adhered to this plan.

The sales for 2011 included 371 million euros in respect of the Strategic Partnership Agreement with China Unicom.

Also in 2011, following the end of the third phase of the Performance Share Plan, a total of 2,446,104 treasury shares were added, corresponding to two derivative financial instruments arranged by the Company to meet its obligations to deliver treasury shares to managers and executives. A net 2,900,189 shares (33 million euros) was finally delivered. The fourth phase expired on June 30, 2012, with no shares being awarded.

At December 31, 2012, 2011 and 2010, Telefónica held 178 million, 190 million and 160 million purchase options on treasury shares, subject to physical settlement.

The Company also has a derivative financial instrument on approximately 28 million Telefónica shares, subject to net settlement, recognized under "Current financial assets" of the accompanying consolidated statement of financial position (26 million euros recognized under "Current interest-bearing debt").

Risks and uncertainties facing the company

The Telefónica Group's business is conditioned by a series of intrinsic risk factors that affect exclusively the Group, as well as a series of external factors that are common to businesses of the same sector. The main risks and uncertainties facing the Company which could affect its business, financial position and results, are as follows:

Group-related risks

Country risk (investments in Latin America)

At December 31, 2012, approximately 48.9% of the Telefónica Group's revenue (approximately 49.6% of its assets) is generated by the Latin American segment (primarily in Brazil, Argentina, Venezuela, Chile and Peru); 78.3% of those assets are generated in countries classified as investment grade (Brazil, Chile, Peru, Colombia, Mexico, Uruguay and Panama) by some of the credit rating agencies. The Telefónica business is especially sensitive to any of the risks related to Latin America described in this section, particularly if they affect or arise in Brazil, which at December 31, 2012 accounted for 50.6% of assets and 44.6% of revenue from Latin American operations.

The Group's investments and operations in Latin America could be affected by a series of risks related to economic, political and social factors in these countries, collectively denominated "country risk," including risks related to the following:

- government regulation or administrative polices may change unexpectedly, including changes that modify the terms and conditions of licenses and concessions and their renewal (or delay their approvals) which could negatively affect the Group's interests in such countries;
- the effects of inflation, currency depreciation or currency restrictions and other restraints on transfer of funds may be imposed. For example, in Venezuela, the official US Dollar to Bolivar fuerte exchange rate is established by the Central Bank of Venezuela and the Minister of Finance. Additionally, the acquisition of foreign currencies by Venezuelan companies to pay foreign debt or dividends is subject to the pre-authorization of the relevant Venezuelan authorities;
- 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 the Telefónica Group's operations in such countries.

Foreign currency and interest rate risk

The Telefónica Group's business is exposed to various types of market risks, above all the impact of changes in interest rates or foreign currency exchange rates.

At December 31, 2012, 23% of the Group's net debt was at floating rates, while 20% was denominated in a currency other than the euro.

To illustrate the sensitivity of financial expenses to a change in short-term interest rates at December 31, 2012: (i) a 100 basis points increase in interest rates in all currencies in which Telefónica has a financial position at that date would lead to an increase in financial expenses of 96 million euros, (ii) whereas a 100 basis points decrease in interest rates in all currencies except the euro, dollar and the pound sterling, in order to avoid negative rates, would lead to a reduction in financial expenses of 36 million euros. These calculations were made assuming a constant currency and balance position equivalent to the position at that date and bearing in mind the derivative financial instruments arranged.

As for the impact on the income statement, specifically exchange gains and losses in the financial result at December 31, 2012, the impact of a 10% increase or decrease in the exchange rate would be 159 million euros (assuming a constant currency position with an impact on profit or loss at that date including derivative instruments arranged and that Latin American currencies would fall against the US dollar and the rest of the currencies against the euro by 10%).

The Telefónica Group uses a variety of strategies to manage this risk, mainly through the use of financial derivatives, which themselves are also exposed to risk, including counterparty risk. Furthermore, the Group's risk management strategies may not achieve the desired effect, which could adversely affect the Group's business, financial condition, results of operations and cash flows.

Dependence on external sources of financing

The performance, expansion and improvement of networks, the development and distribution of the Telefónica Group's services and products, as well as the development and implementation of new technologies or the renewal of licenses require a substantial amount of financing.

The performance of financial markets in terms of liquidity, cost of credit, access and volatility, continues to be overshadowed by persisting uncertainty regarding certain factors such as the pace of economic recovery, the health of the international banking system or the concerns regarding the burgeoning deficits of some European countries. The worsening international financial market conditions caused by some of these factors could make it more difficult and more expensive to refinance existing financial debt (at December 31, 2012, gross maturities in 2013, including the net position in derivative financial instruments, certain current payables and expected early redemptions amounted to around 10,074 million euros, or 9,574 million euros should Telefónica elect not to exercise expected early redemptions, and in 2014 to 7,850 million euros) or arrange new debt if necessary, and more difficult and costly to raise funds from our shareholders.

Furthermore, obtaining financing on the international capital markets could also be restricted (in terms of access and cost) if Telefónica's credit ratings are revised downwards, either due to lower solvency or operating performance, or as a result of a downgrade in the rating for Spanish sovereign risk by rating agencies. Any of these situations could have a negative impact on our ability to honor our debts.

Moreover, market conditions could make it harder to renew existing undrawn bilateral credit lines, 18% of which, at December 31, 2012, initially mature prior to December 31, 2013.

Risks related to the Company's industry

Current global economic situation

The Telefónica Group's business is impacted by general economic conditions in each of the countries in which it operates. The uncertainty about whether economic recovery will continue may negatively affect the level of demand from existing and prospective customers, as customers may no longer deem critical the services offered by the Group. The main macroeconomic factors that could have an adverse impact on consumption and, accordingly, demand for our services and the Telefónica Group's results include the dearth of credit as banks adjust their balance sheets, trends in the labor market, further erosion of consumer confidence, with an immediate increase in saving rates, or needs for greater fiscal adjustment, which would undermine household income levels. This risk is higher in Europe, but less relevant in other countries where the Telefónica Group operates.

Similarly, the sovereign debt crisis in certain euro-area countries and rating downgrades in some of these countries should be taken into account. Any further deterioration in sovereign debt markets or greater restrictions on credit in the banking sector could have an adverse impact on Telefónica's ability to raise financing and/or obtain liquidity. This could have a negative effect on the Group's business, financial condition, results of operations or cash flows. In addition, there could be other possible follow-on effects from the economic crisis on the Group's business, including insolvency of key customers or suppliers.

Lastly, in Latin America, the exchange rate risk in Venezuela (as reflected by the recent currency devaluation in February 2013) and Argentina (with a constant devaluation of the Argentinean peso against U.S. dollar) exists in relation to the negative impact any unexpected weakening in their currencies could have on cash flows from these countries. On February 8, 2013, the Venezuelan bolivar fuerte was devalued from 4.3 bolivar fuertes per U.S. dollar to 6.3 bolivar fuertes per U.S. dollar. The exchange-rate situation of the Bolivar fuerte affects the estimates made by the Group of the net asset value of the foreign currency position related to investments in Venezuela, which translates to an approximate pre-tax loss of 438 million euros on the 2012 financial statements.

Highly regulated markets

As a multinational telecommunications company that operates in regulated markets, the Telefónica Group is subject to different laws and regulations in each of the jurisdictions in which it provides services and in which supranational regulators such as the European Union and national, state, regional and local authorities intervene to varying degrees and as appropriate. This regulation is strict in the countries in which the Company holds a significant market power position.

In Europe, wholesale mobile network termination rates came down in 2011. There were considerable reductions in many of the countries where the Group operates, notably in the UK (with a final reduction scheduled for 2015 and a decrease in prices of over 83% compared to the end of 2010) and Germany (cuts of over 50% since December 2010). In Spain, the schedule for reducing mobile call termination rates came into play on April 16, 2012, and the target price (1.09 euros) will be attained in July 2013, with a decrease of approximately 75% in wholesale prices. Other countries where rates will fall as from 2012 are the Czech Republic (slightly more than 49%), Ireland (approximately 72%) and Slovakia (approximately 58%).

Other services with regulated prices in Europe include call roaming, SMS and data services. The European Parliament and Council has approved the new Roaming III regulation which replaces all previous regulations. The objective of this Regulation is to set maximum prices for voice and SMS retail and wholesale services between July 2012 and July 2014, which will then be progressively reduced. It also regulates retail and wholesale data roaming charges for the first time.

Additionally, according to Roaming III, from July 2014, mobile operators would be forced to separate the sale of roaming services from their domestic services. This would allow users to choose a different operator for calls made in other Member States. Lastly, in relation to net neutrality, the new European regulatory framework establishes as a general principle the importance of ensuring European citizens have free internet access. Nevertheless, regulators could also adopt at any time measures or additional requirements to reduce roaming prices and fixed and/or mobile termination rates, and force Telefónica to provide third-party access to its networks.

Moreover, in Latin America there is tendency to review –and reduce– mobile network termination rates. For instance, reductions of 61% and 60% have been approved in Mexico and Chile, respectively. In Brazil, in October 2011, the regulator (Anatel) approved the fixed-mobile rate adjustment regulation, which entails a gradual reduction of these rates through to 2014 by applying a CPI-factor, which results in a reduction of approximately 29% in 2012-2014. The absolute decrease in public rates must be passed on to mobile interconnection rates (VU-M). In addition, there is a trend towards reductions in termination rates in Peru, Venezuela and Colombia.

The new regulatory principles established in Europe's common regulatory framework, adopted in 2009 and transposed in the national legislation of each Member State in which Telefónica operated during 2011 and 2012 could result in increased regulatory pressure on the local competitive environment. Specifically, this framework supports the possibility of national regulators, in specific cases and under exceptional conditions, establishing the functional separation between the wholesale and retail businesses of operators with significant market power and vertically integrated operators, whereby they would be required to offer equal wholesale terms to third-party operators that acquire these products.

The recommendation on the application of the European regulatory policy to next-generation broadband networks drawn up by the European Commission (EC) could also play a key role in the incentives for operators to invest in net fixed broadband networks in the short-term and medium-term, thus affecting the outlook for the business and competition in this market segment. Nonetheless, the EC is currently drafting respective recommendations on cost accounting and non-discrimination, and it is expected that these recommendations, which will affect the earlier recommendation, will be approved in mid-2013. According to statements by Commissioner Kroes, initial evaluations are that the Commission could make the regulation for new generation networks more flexible in exchange for stricter measures on new operators concerning non-discrimination.

Meanwhile, as the Group provides most of its services under licenses, authorizations or concessions, it is vulnerable to economic fines for serious breaches and, ultimately, revocation or failure to renew these licenses, authorizations or concessions or the granting of new licenses to competitors for the provisions of services in a specific market.

The Telefónica Group pursues their renewal to the extent provided by the contractual conditions, though it cannot guarantee that it will always complete this process successfully or under the most beneficial terms for the Group. In many cases it must satisfy certain obligations, including, among others, minimum specified quality standards, service and coverage conditions and capital investment. Failure to comply with these obligations could result in fines or even revocation or forfeiture of the license, authorization or concession.

Additionally, the Telefónica Group could be affected by regulatory actions carried out by antitrust of competition authorities. These authorizations could prohibit certain actions, such as new acquisitions or specific practices, create obligations or lead to heavy fines. Any such measures implemented by the competition authorities could results in economic and/or reputational loss for the Group, in addition to a loss of market share and/or in harm to the future growth of certain businesses.

Highly competitive markets and markets subject to constant technological development

The Telefónica Group operates in markets that are highly competitive and subject to constant technological development. Therefore, it is subject to the effects of actions by competitors in these markets and its ability to anticipate and adapt to constant technological changes taking place in the industry.

To compete effectively, the Telefónica Group needs to successfully market its 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 appropriately could have an adverse impact on the Group's financial condition, results of operations and cash flows.

New products and technologies arise constantly, while the development of existing products and technologies can render obsolete the products and services the Telefónica Group offers and the technology it uses. This means that Telefónica must invest in the development of new products, technology and services so it can continue to compete effectively with current or future competitors, and which may result in the decrease of the Group's revenue margins. In this respect, margins from traditional voice and data business are shrinking, while new sources of revenues are deriving from mobile internet and connectivity services that are being launched. Research and development costs amounted to 1,071 million euros and 983 million euros in 2012 and 2011, respectively, representing 1.7% and 1.6% of the Group's consolidated revenue, respectively.

One technology that telecommunications operators, including Telefónica (in Spain and Latin America), are focused on is the new FTTx-type network, which offers broadband access using optical fiber with superior services, e.g. internet speed of up to 100mb or HD television services. However, substantial investment is required to deploy these networks, which entails fully or partially substituting copper loop access with optic fiber. As things stand today, scant 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 the aforementioned works directed to network upgrade and to offer new products or services are not entirely under the Telefónica Group's control and could be constrained by applicable regulation.

Limitations on spectrum capacity could be costly and curtail growth.

Telefónica's mobile operations in a number of countries may rely on the availability of spectrum. The Company's failure to obtain sufficient or appropriate spectrum capacity or its capacity to assume the related costs, could have an adverse impact on the quality on the launching and provision of new services and on the Company's ability to maintain the quality of existing services, which may adversely affect the Group's financial condition, results of operations and cash flows

In 2012, Telefónica Ireland invested 127 million euros to obtain spectrum in the 800, 900 and 1800 MHz bands. On February 20, 2013, Telefónica UK was granted two blocks of 10 MHz in the 800 MHz spectrum band for the rollout of a nationwide 4G network, total investment was of approximately 645 million euros. Meanwhile, in 2012, an investment was made in spectrum capacity in Nicaragua amounting to 5 million euros. In Brazil, Vivo was awarded a block of band with "X" of 2500 MHz (20+20 MHz), including the 450 MHz band in certain states in 2012. In Venezuela, in August 2012, a concession agreement was signed between Telefónica Venezuela and the regulator for the additional 20 MHz in the 1900 MHz frequency that had been granted to this company. Also in August 2012, Telefónica Móviles Chile, S.A. was awarded radiofrequencies for 4G technology. As regards new spectrum allocations in the countries where the Telefónica Group operates, in 2013 we are expecting auctions to take place in Slovakia, Colombia and Uruguay.

Supplier failures

As a mobile and fixed telephony operator and provider of telecommunications services and products, the Telefónica Group, like other companies in the industry, depends upon a small number of major suppliers for essential products and services, mainly network infrastructure and mobile handsets. Telefónica Group depends on 13 handset suppliers and five network infrastructure suppliers, which together accounted for 80% of orders in 2012. 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 to the Telefónica Group on a timely basis, it could jeopardize network deployment and expansion plans, which in some cases could adversely affect the Telefónica Group's ability to satisfy its license terms and requirements or have an adverse impact on the Group's business, financial condition, results of operations and cash flows.

Risks associated with unforeseen network interruptions

Unanticipated network interruptions as a result of system failures, including those due to network, hardware or software or cyber-attacks, which affect the quality of or cause an interruption in the Telefónica Group's service, could lead to customer dissatisfaction, reduced revenues and traffic, costly repairs, penalties or other measures imposed by regulatory authorities and could harm the Telefónica Group's reputation.

Telefónica attempts to mitigate these risks through a number of measures, including backup systems and protective systems such as firewalls, virus scanners and other physical and logical security. However, these measures are not always effective. Although the Telefónica Group has insurance policies to cover this type of incidents and risks, these policies may not be sufficient to cover all possible monetary losses, although the claims and loss in revenue caused by service interruptions to date have been covered by these policies.

Electromagnetic radio emissions and possible health risks

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

In May 2011, the specialized cancer research body of the World Health Organization (IARC) classified the electromagnetic fields in mobile telephony as "possibly carcinogenic," a classification which also includes products such as coffee and pickled foods. The World Health Organization subsequently indicated, in its 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.

The most recent official study (to the best of our knowledge), published in 2012 by Advisory Group on Non-ionising Radiation (AGNIR), concludes that there are not convincing evidences showing that mobile phone technologies cause adverse effects in the health of individuals. It cannot be certain that future reports and medical studies establish a link between the electromagnetic signals or emissions of radio frequencies and health problems.

Irrespective of the scientific evidence that may be obtained and even though the Telefónica Group has considered these risks and has an action plan for the various countries in which it provides services to ensure compliance with codes of good practice and relevant regulations, this concern, may affect the capacity to capture or retain customers, discourage the use of mobile telephones, or lead to legal costs and other expenses.

Society's worries about radiofrequency emissions could reduce the use of mobile telephones, which could cause the public authorities to implement measures restricting where transmitters and cell sites can be located and how they operate, and the use of our mobile devices, telephones and other products using mobile technology. This could lead to the Company being unable to expand or improve its mobile network. Furthermore, if any relevant authorities request that the thresholds of exposure to electromagnetic fields be reduced, the Company may have to invest in reconstructing its network to comply with these guidelines.

The adoption of new measures by governments or administrations or other regulatory interventions in this respect that may also arise in the future may adversely affect the Group's business, financial condition, results of operations and cash flows.

Risk of asset impairment

The Telefónica Group reviews on an annual basis, or more frequently when the circumstances require it, the value of assets and cash-generating units, to assess whether their carrying values can be supported by the future expected cash flows, including, in some cases synergies allowed for in acquisition cost. Potential changes in the regulatory, business, economic or political environment may result in the need to introduce changes to estimates made and recognize impairment losses in goodwill, intangible assets or fixed assets.

Although the recognition of impairments of property, plant and equipment, intangible assets and financial assets results in a non-cash charge on the income statement, it could adversely affect the results of the Telefónica Group's operations. In this respect, the Telefónica Group has experienced impairment losses on certain of its investments, affecting the results of the year in which they were made. In 2012, an impairment loss was recognized on the stake in Telco, S.p.A. which, coupled with the impact of the recovery of all the operational synergies considered at the time of the investment and the profit contribution for the year, resulted in a negative impact of 1,277 million euros. In 2012, an impairment loss in goodwill was recognized amounting to 414 million euros for Telefónica operations in Ireland which, combined with the write-off of the intangible asset associated with the customer portfolio allocated to this market, resulted in a negative impact of 527 million euros.

Risks associated with internet

Our internet access and hosting services may involve us in civil liability for illegal or illicit use of the internet. In addition, Telefónica, like all telecommunications services providers, may be held liable for the loss, release or inappropriate modification of the customer data stored on its services or carried by its networks

In most countries in which Telefónica operates, the provision of its internet access and hosting services (including the operation of websites with shelf-generated content) are regulated under a limited liability regime applicable to the content that it makes available to the public as a technical service provider, particularly content protected by copyright or similar laws. However, regulatory changes have been introduced imposing additional obligations on access providers (such as. blocking access to a website) as part of the struggle against some illegal or illicit uses of the internet, notably in Europe.

Other risks

Litigation and other legal proceedings

Telefónica and Telefónica Group companies are party to lawsuits and other legal proceedings in the ordinary course of their businesses, the financial outcome of which is unpredictable. An adverse outcome or settlement in these or other proceedings could result in significant costs and may have a material adverse effect on the Group's business, financial condition, results of operations and cash flows.

Trend evolution

Telefónica is an integrated diversified telecommunications group that offers a wide range of services, mainly in Europe and Latin America. Its core business is the provision of fixed and mobile telephony, broadband, internet, data, pay TV and value added services, among others. The Group's operations in 25 countries, managed through a regional organization geared towards certain businesses in global units, enable it to leverage the strong local positioning, as well as the advantages afforded by the scale, two features that have been reinforced by the opportunities arising from the Group's holdings in and strategic alliances with China Unicom and Telecom Italia.

As a multinational telecommunications company that operates in regulated markets, Telefónica is subject to different laws and regulations in each of the jurisdictions in which it provides services. Telefónica expects the regulatory landscape to continue to change in Europe as a consequence of the revised regulations resulting from the implementation of the review of the common regulatory framework currently in place in the European Union. In addition, Telefónica may also face pressure from regulatory initiatives in some European countries regarding tariffs, the reform of rights of spectrum use and allocation, issues related to the quality of service, and the regulatory treatment of new broadband infrastructure deployments.

Telefónica faces intense competition in the vast majority of the markets it operates in, and is therefore subject to the effects of actions taken by its competitors. The intensity of the competition may deepen, which could have an impact on tariff structures, consumption, market share and commercial activity and negatively affect the number of customers, revenues and profitability.

However, Telefónica believes that it is in a strong competitive position in most of the markets where it operates, which it expects to help enable it to continue taking advantage of the growth opportunities that arise in these markets, such as by boosting both fixed and mobile broadband services and by furthering the development of services beyond connectivity, information technology services and related businesses. In this respect, Telefónica seeks to lead the industry by anticipating trends in the new digital environment.

Telefónica embarked on a restructuring in September 2011 with the aim of reinforcing its growth story, actively participating in the digital world and capturing the most of the opportunities afforded by its scale and industrial alliances. This new organization gave rise to two cross-cutting areas, Telefónica Digital and Telefónica Global Resources, in addition to the Telefónica Europe and Telefónica Latin America business segments. This structure should bolster Telefónica's place in the digital world, enabling it to tap any growth opportunities arising in this environment, drive innovation, strengthen the product and services portfolio and maximize the advantages afforded by its global customer bases in an increasingly connected world. In addition, the creation of a Global Resources operating unit ensures the profitability and sustainability of the business by leveraging economies of scale and driving Telefónica's transformation into a fully global company. Telefónica Europe's and Telefónica Latin America's objective is to shore up the results of the business and generate sustainable growth through available capacity, backed by the Global Corporation.

In Europe, customers remain at the core of the Group's strategy and management priorities in the region in order to provide a high level of customer satisfaction with our services. With the objective of offering our customers the best value, we aim to boost the mobile broadband services, adding new products and services to our current services. In such a competitive market such as presently prevails, we will dedicate our efforts on reinforcing our market positioning. Another objective in coming years is to improve operating efficiency, for which we are rolling out several local and regional initiatives, such as network sharing agreements, with the support of Telefónica Global Resources.

In Telefónica Europe, in Spain, a transformation strategy was kicked off half way through 2011 to improve the Company's competitive position in the market and boost the efficiency of its business model. This strategy has led to major changes in the sales and operating model, such as improvements to the value proposition and service quality by the end of 2011 through the launch of a new tariff portfolio, the elimination of subsidies to attract customers in March 2012, and the launch of Movistar Fusión (convergent offer meeting all home communication needs). Telefónica will continue to focus on service quality, improving the effectiveness of campaigns in the sales channel, and further increasing network quality and characteristics (by developing fiber optics). The aim of this strategy is to boost customer satisfaction by offering them a portfolio of products and services that best meets their communication needs.

In Latin America, Telefónica's strategy is based on a regional model that captures growth and efficiency of scale without losing sight of the local management of the client. Telefónica expects the mobile business to continue to play a fundamental role as an engine of regional growth. That is why we will continue to improve the capacity and coverage of our networks, adapting our distribution channel to enhance the quality of our offerings both in voice and data in order to keep and attract high-value customers. Regarding the fixed telephony business, we will encourage the increase of broadband speed and expand the supply of bundled services. Meanwhile, we will further advance efficiency, in operational and commercial terms, and attempt to achieve further synergies by implementing global, regional and local projects.

In summary, in the context of intense competition and regulatory pressure on pricing, Telefónica aims to continue strengthening its business model to make it more efficient and capture the synergies arising from the integrated approach of businesses, processes and technologies, while focusing even more on the client and staying ahead of trends in the new digital world.

Events after the reporting period

The following events regarding the Telefónica Group took place between December 31, 2012 and the date of authorization for issue of the accompanying consolidated financial statements:

Financing

- On January 22, 2013, Telefónica Emisiones, S.A.U., as part of the European Medium Term Note ("EMTN") registered with the Financial Services Authority (FSA) in London and updated on June 12, 2012, issued bonds for an amount of 1,500 million euros maturing on January 23, 2023. These bonds are guaranteed by Telefónica, S.A.

- In January 2013, repayments were made for a total amount of 1,830 million euros of the syndicated loan signed by Telefónica, S.A. on July 28, 2010.

- On February 4, 2013 Telefónica Emisiones, S.A.U. redeemed bonds that were issued on July 2, 2007, for an amount of 750 million US dollars and 850 million US dollars (approximately 1,213 million euros). These bonds were guaranteed by Telefónica, S.A.

- On February 14, 2013 Telefónica Emisiones, S.A.U. redeemed bonds that were issued on October 31, 2004, for an amount of 1,500 million US dollars. These bonds were guaranteed by Telefónica, S.A.

- On February 21, 2013, Telefónica, S.A. arranged financing for the purchase of capital goods from suppliers worth 206 million euros maturing in 2016. At the date of authorization for issue of these consolidated financial statements, no amount of this financing had been drawn down.

- On February 22, 2013, Telefónica, S.A. arranged financing for the purchase of capital goods worth 1,001 million US dollars (approximately 759 million euros). At the date of authorization for issue of these consolidated financial statements, no amount of this financing had been drawn down.

- On February 22, 2013, Telefónica, S.A. arranging refinancing of 1,400 million euros for Tranche A2 (initially for 2,000 million euros with expected maturity on July 28, 2014) of the 8,000 million euros syndicated loan arranged on July 28, 2010. This refinancing entails two tranches: a syndicated loan of 700 million euros maturing in 2017 and a syndicated loan of 700 million euros maturing in 2018.

Devaluation of the Venezuelan bolívar

On February 8, 2013, the Venezuelan bolívar was devalued from 4.3 bolívars per US dollar to 6.3 bolívars per US dollar.

The new exchange rate of 6.3 bolívars per US dollar will be used from 2013 in the conversion of financial information on Venezuelan subsidiaries. The main aspects to be considered in 2013 are as follows:

- The decrease of the Telefónica Group's net assets in Venezuela as a result of the conversion to euros at the new exchange rate with a balancing entry in Group equity of approximately 1,000 million euros, based on the net assets as at December 31, 2012.

- As part of the decrease mentioned above, the value in euros of the net financial assets denominated in bolívars will drop by approximately 873 million euros, considering the balance at December 31, 2012.

The income and cash flows from Venezuela will be converted at the new devalued closing exchange rate from January 1, 2013.

UK spectrum auction

On February 20, 2013, Telefónica UK Limited won two 10 MHz blocks in the 800 MHz spectrum band in the UK spectrum auction.

Total investment by Telefónica UK in new frequencies amounted to 550 million pounds sterling (approximately 645 million euros).