



2009

Annual Report

Leadership  
to transform the present

*Telefonica*



# 2009

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**Leadership**  
to transform the present

*Telefonica*

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# Summary

Letter from the Chairman	04
<b>01</b> Telefónica Group Organisation	<b>08</b>
1 International Presence	
2 Group structure and description	
3 Board of Directors	
4 Management team	
<b>02</b> Leadership based on nine strengths	<b>16</b>
1 Differential scale that generates value	
2 Solid financial results	
3 A track record of honouring commitments	
4 First-class efficiency	
5 Innovation for growth	
6 Solid, reliable brands	
7 The commitment of an experienced team	
8 The right alliances and partners	
9 Outstanding performance in Sustainability	
<b>03</b> bravo! programme	<b>44</b>
<b>04</b> Results	<b>48</b>
1 Financial Highlights	
2 Market Size	
3 Consolidated Results	
4 Financial Data	
5 Results by regional business units: Telefónica España	
6 Results by regional business units: Telefónica Latinoamérica	
7 Results by regional business units: Telefónica Europe	
8 Results by regional business units: Other Companies	
<b>05</b> Risk management	<b>108</b>

# Letter from the Chairman

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



## Dear Shareholder,

I have always considered the Annual Report published on the occasion of the Annual General Meeting of Shareholders to be a highlight in the communications policy of any company, not just for its shareholders but also for all other stakeholders. The Annual Report that we are presenting today outlines the results of our management strategy over the course of 2009; these results are even more important than usual given the recession that has hit the economy, which is the most serious since the Great Depression of the 1920s with the largest drop in economic activity since the Second World War. Without doubt, overcoming the challenges posed by these unfavourable economic conditions has severely tested the management skills of most companies.

I am pleased to be able to tell you that our efforts in Telefónica to transform the business in recent years have enabled us, not just to withstand these conditions, but also to continue growing; once again –for the seventh consecutive year– we have met the objectives we committed to with the financial community, with a total return for shareholders which sets us apart not just in the sector, but also in the markets in general.

In 2010, emerging markets in Latin America and Asia are leading the economic recovery, and this is now starting to be noticed in the rest of the markets. The worst is over, and Telefónica is perfectly placed to take full advantage of its global positioning and diversity in order to move further ahead of the rest of the industry.

The global ICT sector also grows and a new social and economic paradigm is becoming evident around the new information and communication technologies. Telefónica is committed to playing a leading role in this new digital world, as I shall be outlining in this letter.

# Nobody is better positioned than Telefónica to tackle the challenges of the future

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## Expansion despite the recession

In spite of the complex situation faced by the sector throughout 2009, the diversification of Telefónica's operations enabled it to achieve turnover of 56,731 million euros, an increase of 0.2% on 2008.

The Company's intensive commercial activity has enabled it to increase its customer base by 5.1% in comparable terms over 2008, and we now have 265 million customers all over the world. This increase in Telefónica's customer base is mainly the result of a 7.4% rise in the mobile phone business, an increase of 8.2% in broadband landline services and a 9.8% growth in pay television. Mobile phone accesses have increased to 202 million, with a significant increase in mobile broadband accesses, which totalled 15 million by the end of 2009.

From a financial perspective, the Company's aim during 2009 was to guarantee cash flow at all times, meaning that there was a substantial emphasis on improving efficiency and fully exploiting economies of scale. This is reflected in operating income before depreciation and amortisation (OIBDA), which rose to 22,603 million euros, an overall increase of 0.9%, with an OIBDA margin of 39.8%.

Operating cash flow (OIBDA-Capex) stood at 15,346 million euros, overall year-on-year growth of 8%. There was an acceleration in conversion of revenue into operating cash flow, reflecting Telefónica's success in combining strong commercial activity with highly positive cash flow generation.

Telefónica's net 2009 profits increased by 2.4% to stand at 7,776 million euros, with basic net profit per share rising to 1.71 euros per share, 4.5% above the 2008 figure.

## Our first priority is always shareholder remuneration

In 2009 we set aside 61% of free cash flow for shareholder remuneration, through a combination of dividend payments and the repurchase of company stock. The positive results obtained in 2009 will enable us to continue with our shareholder remuneration policy in the future through increasing dividends, from 1.40 euros per share in 2010 to a minimum of 1.75 euros per share in 2012.

Telefónica's share price climbed by 23.2% in 2009, in excess of the largest increase by any comparable European or American company, and exceeding the annual increase in the Dow Jones Telco Index which is the worldwide reference for the sector. In 2009 Telefónica achieved the highest total return rate to its shareholder of any comparable European or American company, 29.5%.

Telefónica is currently offering the highest profitability to shareholders in terms of expected 2010 dividends of any of the fifty largest companies in the world by market capitalisation. However, our objective is not only to offer good dividends, but also to maximise value for Telefónica shareholders through continued growth. To this end, our constant objective is to expand more than our competitors and to be the market leaders.

## Solid corporate strength ensuring a unique profile

In last year's letter I stated that no other company is in a better position than Telefónica to tackle the challenges of the future. In a difficult situation, Telefónica has not only been able to post solid results but also to further strengthen its position, as can be seen in this Annual Report.

Telefónica is characterised by sustained profitability and growth. Since 2000 its revenue has doubled whilst its customers have quadrupled. This has resulted in Telefónica growing into the world's fifth largest operator in terms of accesses; this has been accompanied by extensive diversification in operations, both from a geographical and a business perspective, with almost 65% of company turnover coming from outside Telefónica's original market.

## Letter from the Chairman

Our profile as a global operator has been further strengthened by a series of strategic and industrial alliances with China Unicom and Telecom Italia, which together have a joint customer base of over 658 million people 10% of the world's population.

Telefónica's efficiency, which continues to set a benchmark within the sector, and its financial robustness, both of which were maintained throughout 2009, with a debt ratio measured in terms of net debt over OIBDA of 1.9, all make Telefónica a low-risk option in a highly promising industry.

We should also highlight the leadership of our brands; Telefónica's firm commitment to society, which was recognised internationally with the first place for our sector in the Dow Jones Sustainability Index; and the commitment of our executives and the whole Telefónica team, whose professionalism is recognised both within the sector and beyond.

We face 2010 therefore on a firm footing, in an unbeatable position from which to take full advantage of the great opportunities for growth that the sector affords us.

### **Growth in a sector which is crucial for the future**

Today, the most respected analysts agree that the worst of the difficult economic situation that we have been going through is now behind us. As we foresaw a year ago, the world of telecommunications has continued to undergo one of the most significant periods of development and transformation which any industry has ever experienced. The new decade begins with 4.4 billion mobile phone customers and over 1.2 billion landline and mobile broadband users.

The multiplying impact of telecommunications and ICTs in general is an essential part of a new cycle of sustainable growth. Studies indicate that broadband contributes growth of around 5% in productivity within the industrial sector, and 10% in the service sector; other reports suggest that the application of ICTs might reduce world CO<sub>2</sub> emissions by 15% by 2020. Broadband connectivity is the most efficient way of driving this sustainable growth, and this is clearly demonstrated by worldwide productivity gains; plans to stimulate economic growth, and the digital agendas being pursued by governments.

High-capacity broadband will be at the centre of all new value proposals. It is easy to appreciate the ever-increasing importance of the digital contribution to commerce, leisure, health, education and governmental administration. Companies need ICTs in order to open up new ways of doing business and ensure ever-better experiences for their customers. It is also true to say that ordinary people are the driving force behind change, living 24 hour-a-day lives that are increasingly digital. This is demonstrated by sales of more than 175 million smartphones in 2009, with increasing revenue from digital applications and content. Customers are the real drivers behind this process, constantly defining and redefining a demand-led marketplace.

Nobody is closer to these new digital customers than telecommunications operators, as can be seen from the amount of spending on communications increasing from 2.6% in 2000 to a forecast 4.2% in 2015. It is clear that there is a great opportunity in our industry for global, flexible operators with the size to adapt to the needs of their customers to offer the perfect channel for access to all the innovation and creativity in the digital world, simultaneously offering a comprehensive, high-quality, customised, personal experience.



Combining the skills of the various market leaders is the quickest, most efficient way of satisfying changing demand in the digital age. This encourages us to create flexible relationships and extend our platforms and processes to a range of business partners, both large and small, creating cooperative environments and generating new sources of growth.

In order to reach their end customers, other participants in the ICT world have no better alternative than to use the advanced data networks provided by operators; nor is there any better option for them to manage the non-differential aspect of their services than using our systems, including not only new technologies, but also commercial and support processes.

Other economic sectors –what is sometimes referred to as the "real economy"– also need to undertake this digital transformation to take advantage of efficiency savings and increased scope, and once again there is no more professional or convenient alternative than working with the leaders in global telecommunications.

#### **The best global communications company in the digital world**

Telefónica's vision is simple: to be the best option within this environment. In order to do so we are committed to striving to be the leading global communications company in the digital world. To this end, Telefónica is once again ahead of the trend and has established a three year programme of strategic priorities and key initiatives covering all of its spheres of activity which focus on four pillars: customer-centred focus; a comprehensive range of services; new platforms to support an innovative and efficient operating model; and a common culture that creates confidence in the countries in which the Company operates.

The communications business, by its very nature, is inherently orientated towards the long term and open to transformation. In addition to its contribution to the new knowledge-based economy, Telefónica's future is inextricably linked to the economic and social well-being of the societies in which it is active.

Telefónica mainly channels its socially-orientated activities through the Fundación Telefónica. Our Educared programme aims to improve education through the use of ICT, and our Proniño programme, which focuses on the eradication of child labour, had helped over 164,000 children in 13 Latin American countries to receive schooling by March 2010. Not only do ICTs have the potential to reduce emissions in other sectors of the economy, they also have the potential to do so in their own. Telefónica is committed to reducing electricity use in its networks by 30% per access in domestic use and by 10% per employee in office use by 2015.

Last year I stated that nobody is better positioned than Telefónica to tackle the challenges of the future, and that I was convinced that we would be able to emerge stronger from the current situation. I would like to confirm that we have taken full advantage of 2009 to reinforce our basis for significant and robust growth. I am enthusiastic about this unique opportunity to strengthen our leadership of the sector and to contribute to shaping a future full of possibilities offering significant benefits for all.

I would like to thank you once again for your support and the trust you have placed in Telefónica and its Board of Directors.



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



# 01

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## Telefónica Group Organisation

- 1 International presence **10**
- 2 Group structure and description **12**
  - 3 Board of Directors **14**
  - 4 Management team **15**

# 01

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# 1

## International Presence

Telefónica is present in 25 countries

### Providing services in 22 countries and with a presence in a further three.

In 2009, the Company had optimal distribution of its revenue by geographic area: 35% of its revenue came from Spain; 40% from Latin America; 17% from Europe; and 0.5% from other markets.



#### Mexico

Mobile: 17,401  
Fixed wireless: 334

#### Central America (El Salvador, Guatemala, Nicaragua and Panama)

Fixed telephony: 445  
Data and Internet: 15  
Mobile: 5,807

#### Colombia

Fixed telephony: 1,640  
Data and Internet: 428  
Mobile: 8,965  
Pay TV: 127

#### Venezuela

Mobile: 10,531  
Fixed wireless: 1,214  
Pay TV: 63

#### Ecuador

Mobile: 3,722  
Fixed wireless: 85

#### Peru

Fixed telephony: 2,971  
Data and Internet: 801  
Mobile: 11,458  
Pay TV: 686

#### Uruguay

Mobile: 1,615

#### Argentina

Fixed telephony: 4,608  
Data and Internet: 1,351  
Mobile: 15,932

#### Brazil

Fixed telephony: 11,254  
Data and Internet: 3,440  
Mobile: 51,744  
Pay TV: 487

#### Chile

Fixed telephony: 2,028  
Data and Internet: 807  
Mobile: 7,525  
Pay TV: 285

Presence in  
**25 countries**

**56,731**  
million euros in  
revenue

**64%**  
of revenue generated  
outside Spain

**4,290 million**  
euros invested  
in R+D+i

**265 million**  
customer accesses

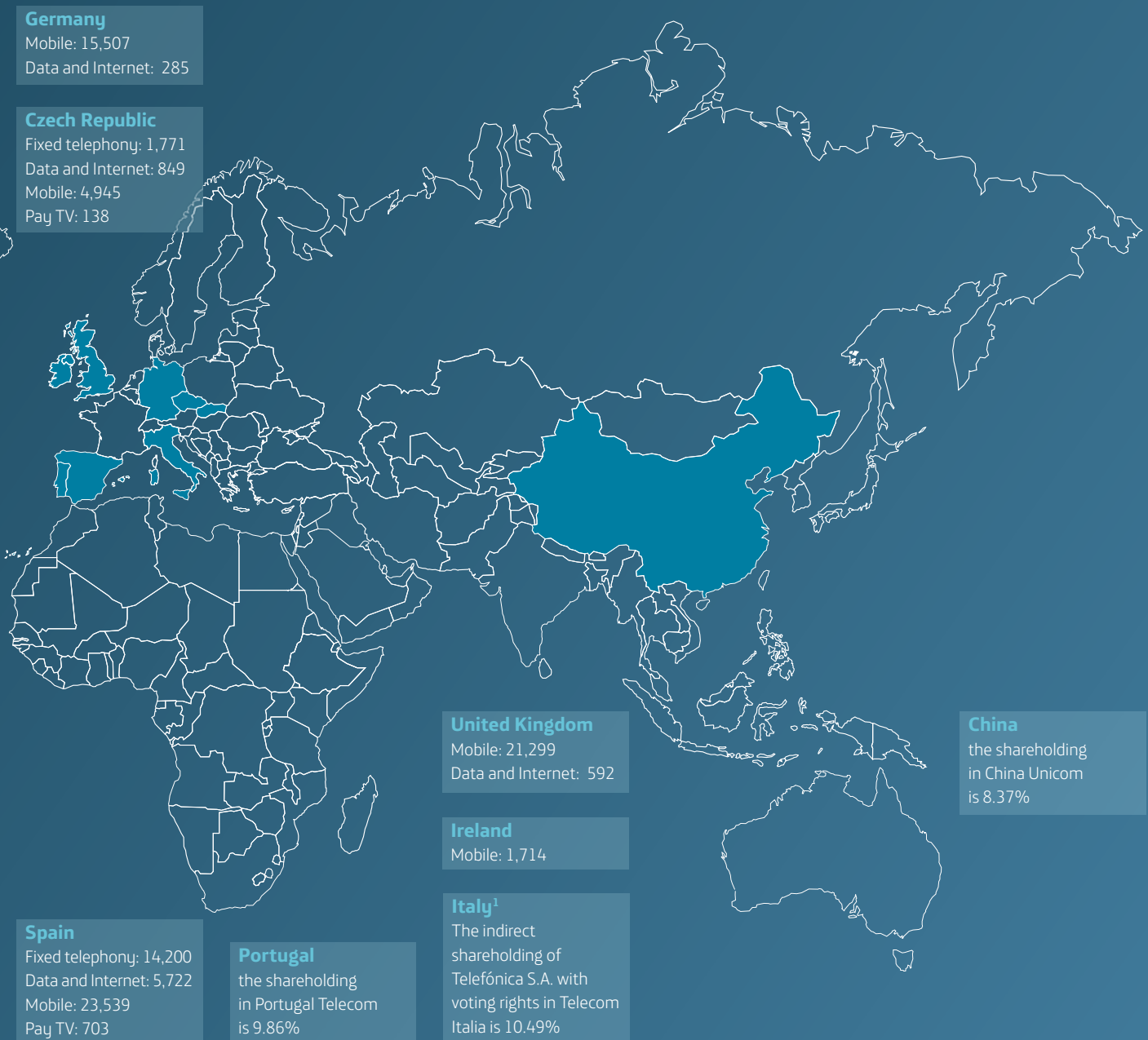
Over  
**202 million**  
mobile telephony  
accesses

Over  
**42 million**  
fixed telephony  
accesses

Over  
**13.5 million**  
Broadband accesses

**2.5 million**  
pay TV accesses

Over  
**257,000**  
employees



Figures in thousands at 31 December 2009.

<sup>1</sup> If we add the shares without voting rights, the indirect shareholding is 7.21%.

# 01 2

## Group structure and description

The Company is divided into three geographic regions: Spain, Latin America and Europe

**Telefónica's management model enables it to remain close to its customers and to promote synergies.**

### **Comprehensive Multi-local Management Model**

Telefónica's management model enables it to maximise the value of action taken at the global, regional and local levels. In 2009, the Company exploited its scale and strategic alliances in order to promote synergies and continue developing a sustainable business model.

In 2009, this structure enabled the creation of a new Multinational Companies Unit, and the concentration of all purchasing management for various product lines in Munich from 2010.



The Group's operations in 25 countries are organised into three geographic regions: Spain, Latin America and Europe.

### **Corporate Centre**

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

### **Telefónica España**

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

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

### **Telefónica Latin America**

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

In addition, Telefónica International Wholesale Services (TIWS) offers wholesale telecommunication services on a global scale. Its range includes international voice, capacity, IP interconnectivity, satellite, corporate and mobile services. It has an international network of over 45,000 km of optical fibre cables.

### **Telefónica Europe**

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

### **Alliances and other shareholdings**

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

### **Other companies**

Atento offers customer relation management services through its contact centres. It operates in Spain, Argentina, Brazil, Central America, Chile, Colombia, the USA, Morocco, Mexico, Peru, Puerto Rico, the Czech Republic, Uruguay and Venezuela.

T-gestiona provides a full range of financial administration, HR, property, logistics and distribution, process consultancy, ERP and comprehensive back-office services. It is active in Spain, Argentina, Brazil, Chile and Peru.

Telefónica R&D is involved in technological research and, in terms of activity and funding, it is the largest private R&D centre in Spain and the largest on the continent in the ICT sector in terms of participation in European research projects. It is operational in Spain, Brazil and Mexico.

## Telefónica España

	% Part
Telefónica de España <sup>1</sup>	100.00
Telefónica Móviles España <sup>1</sup>	100.00
Telyco	100.00
Telefónica Telecomunic. Públicas	100.00
T. Soluciones de Informática y Comunicaciones de España	100.00
Iberbanda	58.94

1 Company owned through Telefónica S.A.

## Telefónica Europe

	% shareholding
Telefónica O2 United Kingdom	100.00
Telefónica O2 Germany <sup>1</sup>	100.00
Telefónica O2 Ireland	100.00
Manx	100.00
Be	100.00
Group 3G (Germany) <sup>2</sup>	100.00
Telefónica O2 Czech Republic <sup>1</sup>	69.41
Telefónica O2 Slovakia <sup>3</sup>	100.00

1 Company owned through Telefónica S.A.

2 Company owned through Telefónica O2 Germany.

3 Company owned through Telefónica O2 Czech Republic.

## Telefónica Latin America

	% shareholding
Telesp <sup>1</sup>	87.95
Telefónica del Perú <sup>2</sup>	98.34
Telefónica de Argentina	100.00
TLD Puerto Rico	98.00
Telefónica Chile <sup>3</sup>	97.89
Telefónica Telecom	52.03
Telefónica USA	100.00
T. Intern. Wholesale Serv. (TIWS) <sup>4</sup>	100.00
Brasilsel <sup>5,6</sup>	50.00
T. Móviles Argentina	100.00
T. Móviles Perú	100.00
T. Móviles México <sup>6</sup>	100.00
Telefónica Móviles Chile	100.00
T. Móviles El Salvador	99.08
T. Móviles Guatemala	99.98
Telcel (Venezuela)	100.00
T. Móviles Colombia	100.00
Otecel (Ecuador)	100.00
T. Móviles Panamá	100.00
T. Móviles Uruguay	100.00
Telefonía Celular Nicaragua	100.00
T. Móviles Soluciones y Aplicac. (Chile) <sup>6</sup>	100.00

1 Effective holding of 88.01%.

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

3 Telefónica Internacional de Chile, S.A. owns 44.89% and Inversiones Telefónica Internacional Holding Ltda. owns 53%.

4 Telefónica, S.A. owns 92.51% and Telefónica DataCorp owns 7.49%.

5 Joint Venture which consolidates the subsidiary Vivo, S.A. using the full consolidation method through a shareholding in Vivo Participações, S.A. (59.42%).

6 Company owned through Telefónica S.A.

## Other holdings

	% shareholding
3G Mobile AG (Switzerland)	100.00
Grupo Atento <sup>1</sup>	100.00
Telefónica de Contenidos (Spain) <sup>1</sup>	100.00
Mobipay Internacional <sup>1</sup>	50.00
Telco SpA (Italy) <sup>2</sup>	46.18
IPSE 2000 (Italy) <sup>3</sup>	39.92
Mobipay España <sup>3</sup>	16.63
Lycos Europe	32.10
Hispasat	13.23
Portugal Telecom <sup>4</sup>	9.86
China Unicom (Hong Kong) Limited (CHINA)	8.37
ZON Multimedia <sup>5</sup>	5.40
BBVA <sup>1</sup>	0.98
Amper <sup>1</sup>	6.10

1 Company owned through Telefónica S.A.

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

3 Companies in which Telefónica Móviles España has a direct or indirect shareholding.

4 Effective percentage of the Telefónica Group. Not taking into account minority interests, the percentage shareholding of the Telefónica Group is 10%.

5 Effective percentage of the Telefónica Group. Not taking into account minority interests, the percentage shareholding of the Telefónica Group is 5.46%.

Note: on 21 October 2009 Telefónica and China Unicom agreed a share exchange under which Telefónica increased its shareholding in China Unicom from 5.38% to 8.06%. Following a capital reduction carried out by China Unicom, the Telefónica Group's shareholding amounts to 8.37%.

## Telefónica's largest shareholdings

- Last year, Telefónica sold its 32.18% shareholding in the Moroccan operator Médi Télécom to local shareholders.
- The Company has increased its shareholding in Telefónica CTC Chile to 97.89%.

- Through its subsidiary Telefónica Europe, the Group acquired JAJAH, a leading innovative company in the communications sector.
- In February 2010, Telefónica completed the acquisition of the German operator HanseNet through its subsidiary Telefónica Deutschland GmbH.

# 01 3

## Board of Directors

The Board of Director's Committees address a range of key issues for the Company

### An effective and operational governance system which is based on the global scale of Telefónica

In the context of the Company's commitment to its shareholders, the Board of Directors, with the support of its committees, carries out its work in accordance with corporate governance standards which are mostly contained in its Articles of Association, the Regulations of the General Meeting of Shareholders and the Regulations of the Board of Directors.

The Board of Directors of Telefónica has 17 members\*, and is responsible for supervision and control of the Company's activities. It has exclusive competence over issues such as general policy and strategies relating to corporate governance, corporate social

\* May 2010

responsibility, compensation to directors and senior managers and returns to shareholders, together with strategic investment.

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

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

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

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

	Type of Chief Operating	Committee Officer	Audit and Control	Appointments, Remuneration and Good Governance	HR, Reputation and Corporate Responsibility	Regulation	Service Quality and Commercial Attention	International Issues	Innovation	Strategy
César Alierta Izuel (Chairman)	●	●								
Isidro Fainé Casas (Vice-chairman)	●	●								
Vitalino Manuel Nafria Aznar (Vice-chairman)	●		●		●	●		●		
Julio Linares López (Chief Operation Officer)	●	●							●	
José María Abril Pérez	●	●						●		
José Fernando de Almansa Moreno-Barreda	●					●		●		●
José María Álvarez-Pallete López	●									
David Arculus	●					●		●		
María Eva Castillo Sanz	●					●	●			●
Carlos Colomer Casellas	●	●		●			●		●	
Peter Erskine	●	●		●					●	●
Alfonso Ferrari Herrero	●	●	●	●	●	●	●	●		●
Luiz Fernando Furlán	●							●		
Gonzalo Hinojosa Fernández de Angulo	●	●	●	●	●		●	●		●
Pablo Isla Álvarez de Tejera	●			●	●	●	●		●	
Antonio Massanell Lavilla	●		●		●	●	●		●	
Francisco Javier de Paz Mancho	●	●			●	●		●		
Non-Director Secretary										
Ramiro Sánchez de Lerín García-Ovies										
Non-Director Vice-Secretary										
María Luz Medrano Aranguren										

● Executive ● Nominee ● Independent ● Other External Directors



# 01 4

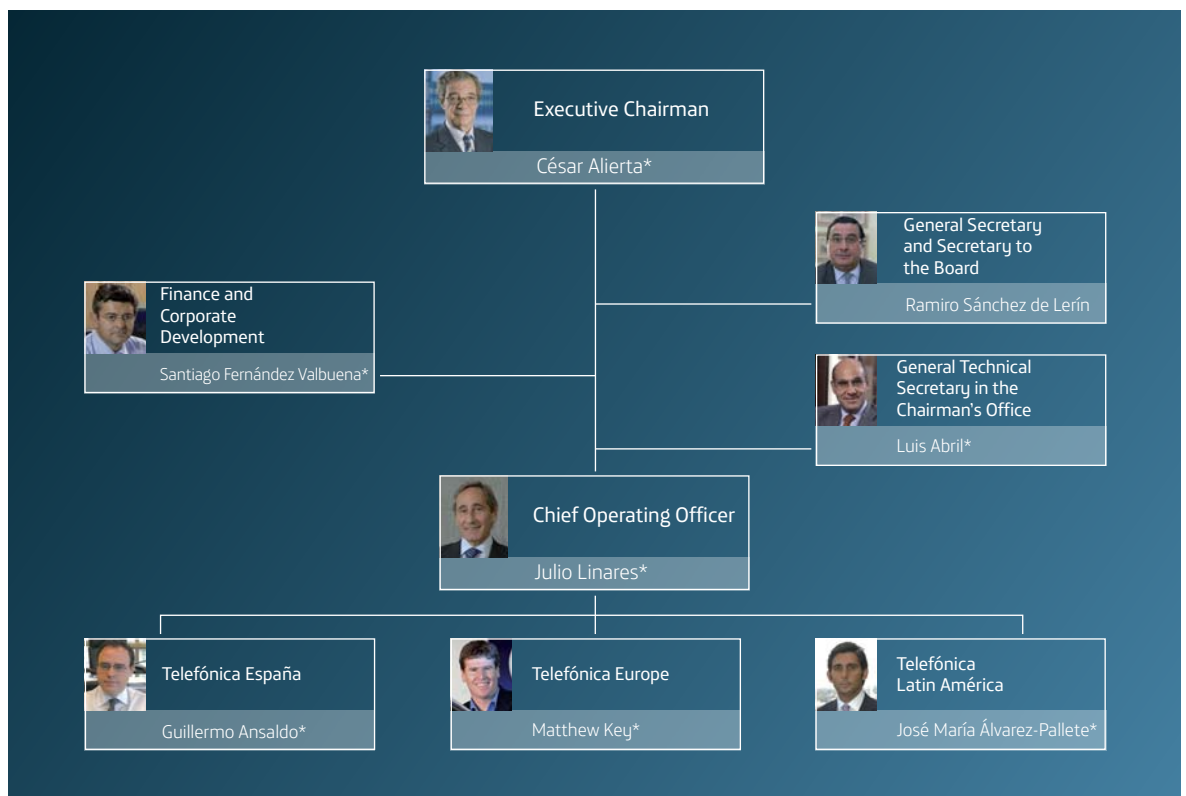
## Management team

The Company has continued to develop its organisational model to strengthen its customer focus and relations, innovation and the efficiency of its operations

The organisational strategy of Telefónica aims to improve and personalise relationships with our customers, taking advantage of the benefits of scale and diversity.

Our organisational model is currently divided into three large regional organisations (Spain, Europe and Latin America) which report directly to the Chief Operating Officer, who in turn reports directly to the Executive Chairman of Telefónica.

In addition to the Chief Operating Officer, the Finance and Corporate Development General Manager, the Industrial Alliances and Shareholdings Manager (newly created post) and the two General Secretaries –the General Secretary and Secretary to the Board and the General Technical Secretary to the Chairman– also report to the Executive Chairman.



\* Members of the Executive Committee

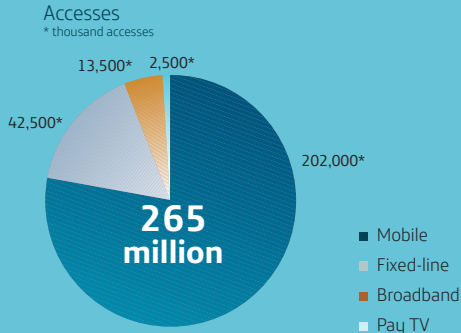
The Industrial Alliances and Shareholdings Department was created in 2009 to drive corporate growth by developing and exploiting alliances with, and shareholdings in, other companies in the sector, which include China Unicom, Telecom Italia and Portugal Telecom.

In addition, Telefónica has continued to innovate and develop new businesses in the search for new sources of revenue, and to convert the Company to more efficient management models.

# 1

## Differential scale that generates value

Telefónica, the fifth largest operator in the world by number of accesses

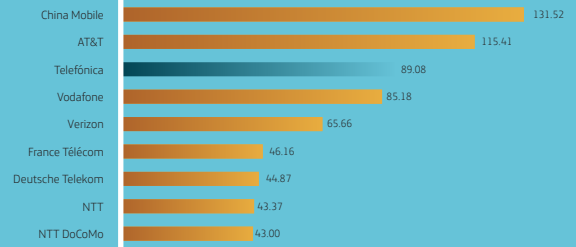


# 2

## Robust financial results

Basic earnings per share of €1.71

Ranking in sector according to stock market capitalisation



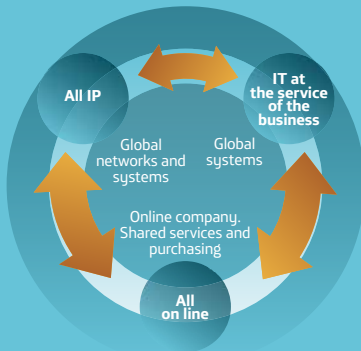
Source: Bloomberg, End of 2009

# 4

## First class efficiency with room for improvement

Telefónica tops the sector for efficiency with a ratio of 74.1%

Towards a new operating model

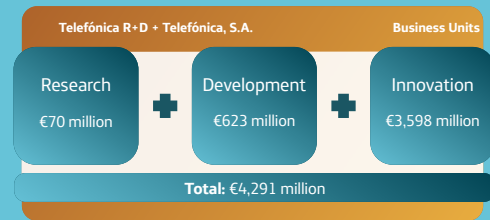


# 5

## Innovation for growth

Investment in R&D&i amounted to 4,291 million euros

Telefónica's open innovation network



# 7

## The commitment of an experienced team

Our employment satisfaction index is 73%

Number of employees, 2009

	Excluding Atento	Including Atento
Spain	40,108	52,060
Latin America	58,031	175,350
Europe	27,031	27,964
Rest of Europe	-	2,052
<b>Total number of employees</b>	<b>125,170</b>	<b>257,426</b>

# 8

## The right alliances and partners

The boost from alliances reinforces the Company's leading position



### 3

#### A history of commitments complied with

7 consecutive years of meeting our commitments

Figures related to Compliance with Guidance

	Organic Growth 09/08	Guidance
Revenues	+ 0.3%	✓
OIBDA	+ 1.1%	✓
CAPEX (million euros)	7,459	✓
OpCF	+ 8.4%	✓

### 6

#### Solid, reliable brands

Movistar and O2 rank first and second in international rankings of brand recognition

Telefonica

movistar

O<sub>2</sub>

### 9

#### Excellent performance in sustainability

Telefónica scored 86 points in the DJSI (+28p.p. above the average of the Telco sector)

Dow Jones Sustainability Index  
Global leaders in the sector



DJSI World, GLOBAL SUPERSECTOR LEADERS (2009/2010)

Name	Supersector
Bayerische Motoren Werke AG (BMW)	Automobiles & Parts
Australia & New Zealand Banking Group Ltd	Banks
Xstrata PLC	Basic Resources
DSM NV	Chemicals
Panasonic Electric Works Co Ltd	Construction & Materials
Itausa-Investimentos Itau	Financial Services
Unilever	Food & Beverage
Roche Holding AG	Health Care
TNT N.V.	Industrial Goods & Services
Swiss Re	Insurance
Pearson Plc.	Media
Total SA	Oil & Gas
adidas AG	Personal & Household Goods
GPT Group	Real Estate
Kingfisher Plc	Retail
Nokia Corp.	Technology
Telefónica, S.A.	Telecommunications
Sodexo	Travel & Leisure
Cia Energetica Minas Gerais (CEMIG)	Utilities

Source: [http://www.sustainability-indexes.com/07\\_html/indexes/djsiworld\\_supersectorleaders\\_09.html](http://www.sustainability-indexes.com/07_html/indexes/djsiworld_supersectorleaders_09.html)

# O2

## Leadership based on nine strengths

- 1 Differential scale that generates value **18**
- 2 Solid financial results **22**
- 3 A track record of honouring commitments **26**
- 4 First-class efficiency **30**
- 5 Innovation for growth **32**
- 6 Solid, reliable brands **36**
- 7 The commitment of an experienced team **38**
- 8 The right alliances and partners **40**
- 9 Outstanding performance in Sustainability **42**

## Differential scale that generates value

Telefónica, the fifth largest operator in the world by number of accesses

### An optimal combination of global, regional and local scale

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

Since the year 2000, the number of customers has increased fourfold. Telefónica closed the financial year 2009 with almost 265 million customer accesses.

The Company's intense commercial activity has led to a 5.1% increase in the number of total accesses compared to 2008, with sharp rises in mobile telephony (+7.4%), fixed broadband (+8.2%) and Pay TV (+9.8%). In terms of geographical areas, the highlights were the growth rates attained by Telefónica Europe (year-on-year increase of +6.9%) and Telefónica Latin America (year-on-year increase of +6.5%).

### Fixed telephony

42.5 million accesses (-0.9% year-on-year)

In the mature market of fixed telephony, Telefónica ended 2009 with 42.5 million accesses, compared to 42.9 million in 2008.

In Spain, the Company's retail fixed access base stood at 14.2 million at the end of 2009 (15.3 million in December 2008). Therefore, the Company's estimated market share was around 72% in 2009.

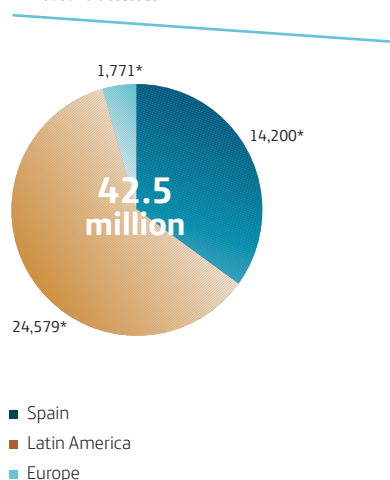
In this regard, it should be highlighted that 66% of the losses in retail fixed telephony accesses was compensated for by the net growth in wholesale accesses; with revenue therefore also being generated for the company.

In Latin America, accesses stood at 24.6 million at the close of the year, down 4.2% compared to 2008 (2.7% if the disconnection of inactive customers affected by fixed-mobile replacement in Colombia is excluded).

In the Czech Republic, accesses stood at 1.8 million at the end of 2009, with a year-on-year drop of 6.5%, compared to one of -8.3% in 2008.

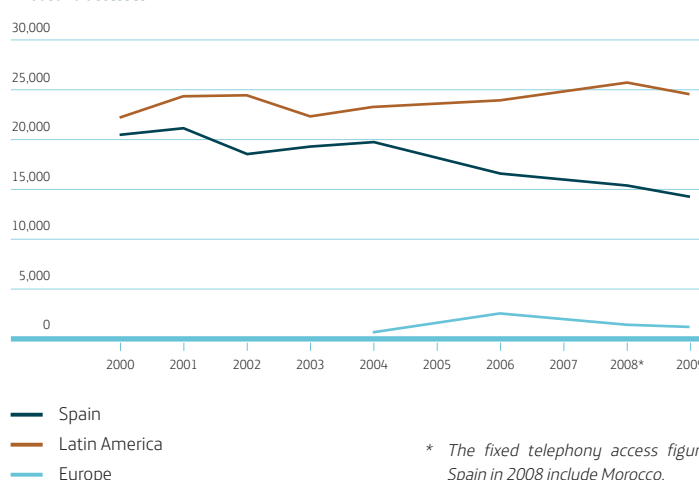
### Accesses Fixed telephony in 2009

\* Thousand accesses



### Changes in fixed telephony accesses 2000/2009

Thousand accesses



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

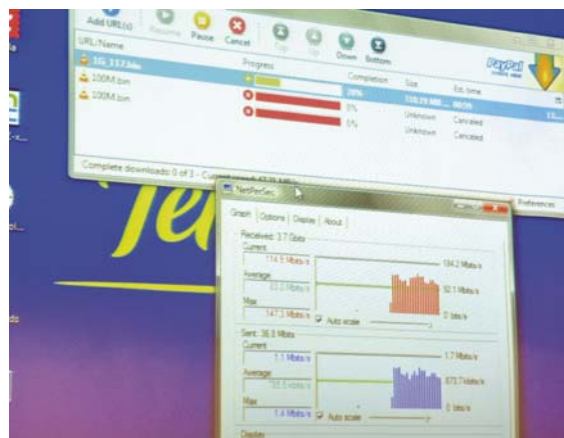
# With the trust of almost 265 million customers

## Broadband

13.5 million accesses (+8.2% year-on-year)

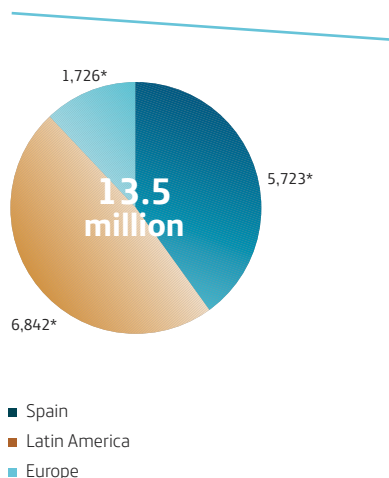
Retail broadband internet accesses stood at 13.5 million, with a year-on-year growth rate of 8.2 %, driven by the increase in the adoption of packaged voice, ADSL and Pay TV service offerings.

In terms of geographical areas, in Spain, Telefónica closed the financial year with 5.5 million accesses, up 4.4% on the previous financial year; in Latin America it topped 6.4 million accesses, which represents a further 5.9% year-on-year increase. Lastly, in Europe data and internet accesses totalled over 1.3 million accesses, i.e. a further 29.5% year-on-year increase.



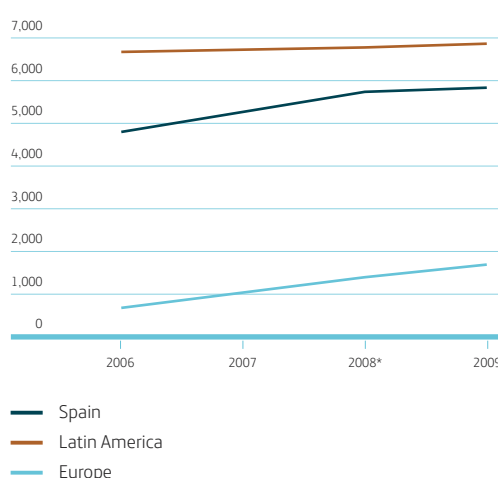
## Accesses Data and Internet in 2009

\* Thousand accesses



## Change in Data and Internet accesses 2006/2009

Thousand accesses



# 02/1 Differential scale that generates value

## Mobile telephony

202 million accesses

(+8% in comparable terms)

The Telefónica Group's mobile accesses exceeded 202 million by the end of 2009, with a net rise of approximately 15 million accesses in comparable terms in the financial year.

In the context of these figures, special mention should be made of the significant increase in the number of mobile Broadband accesses, which exceeded 15 million by the close of 2009 (compared to 9 million accesses in 2008).

Telefónica España's mobile base reached a total of 23.5 million mobile customers. Adoption of flat rates for mobile data is continuously increasing, standing at over 1.9 million at the end of the year, which represents double the figure for the end of 2008.

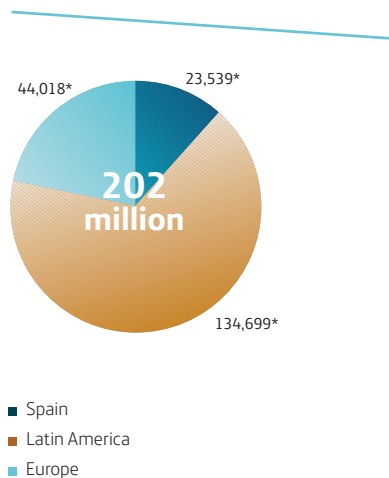
In Latin America, mobile accesses climbed to 134.7 million, maintaining a year-on-year growth rate of 9.2% after registering a net gain for the year of 11.4 million accesses.



In Europe, the Company attained a total base of 44.1 million accesses (year-on-year increase of +6.5 %) after registering a net increase of 2.3 million customers in 2009.

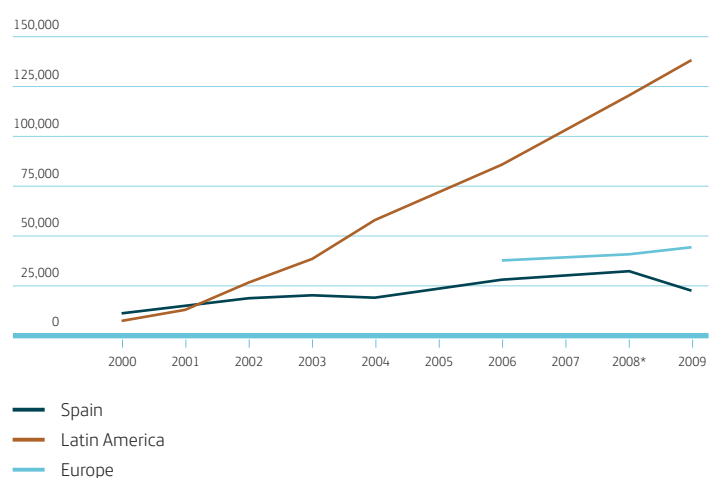
### Accesses Mobile telephony in 2009

\* Thousand accesses



### Changes in mobile telephony accesses 2000/2009

Thousand accesses



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

All our products  
are called Movistar



Fixed Voice

42.5 million accesses

## Pay TV

2.5 million accesses (-9.8% year-on-year)

Accesses to Pay TV were approaching 2.5 million at the end of 2009, which represents a 9.8% increase on the figure for the previous year.

Telefónica España gained 90,486 new customers in the last financial year, rising to 702,980 customers (a year-on-year increase of +14.8%), with a significant climb in estimated market share, which stood at around 17% at the end of 2009.

In Latin America, the number of customers stood at 1.6 million (up 7% year-on-year) after having captured 179,556 accesses in the course of the year.

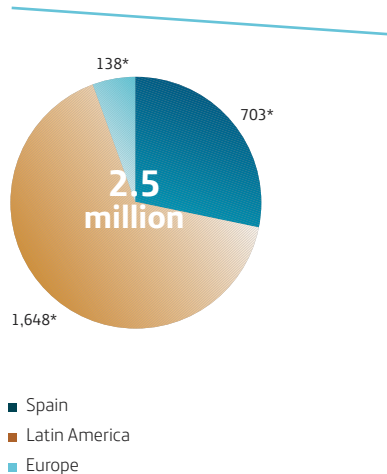
Telefónica O2 Czech Republic totalled 137,630 customers at the end of December 2009, with a year-on-year increase of 20.2%.



Product image of Movistar Imagenio with the new brand identity.

### Accesses Pay TV in 2009

\* Thousand accesses



### Changes in pay TV accesses 2000/2009

Thousand accesses



Mobile Voice

202 million accesses

Tv

2.5 million accesses

Adsl / Internet

13.5 million accesses

## Robust financial results

Basic earnings per share of €1.71

### Shareholder remuneration

5,516 million euros

In this regard, Telefónica reaffirms its policy of increasing dividends. In 2009 the Company allocated 5,516 million euros to shareholder remuneration; this is equivalent to 61% of the cash flow generated in the year, and 7% of the Company's stock market capitalisation<sup>1</sup>.

Shareholder return involved the payment of dividends in cash and buying back shareholders' equity. It should be noted that as at 31 December 2009 the Company owned derivatives on 150 million Telefónica shares, and it owned 27.3 million treasury shares as at 19 February 2010, representing 0.6% of the share capital of Telefónica.

#### 2009 dividend payment 1.15 euros per share

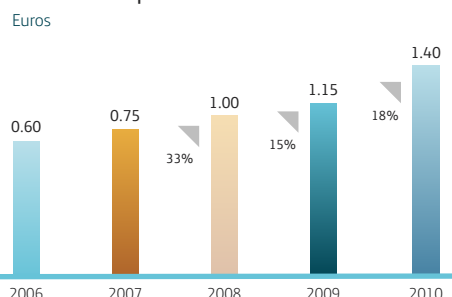
On 12 May 2009, the Company distributed dividends charged to the profit and loss account for the financial year 2009 amounting to 0.50 euros gross to each of the Company's shares in circulation with dividend rights. With this payout and the one in November 2008, the Company honoured its announced commitment to providing a shareholder return of 1 euro per share before the end of the first semester of 2009.

Similarly, on 11 November 2009, Telefónica distributed dividends of 0.50 euros gross per share from Unrestricted Reserves to each of the Company's shares in circulation with dividend rights.

#### Dividend improvement policy Objective for 2010 of 1.40 euros per share

Following the announcement in February 2009 of a 15% increase in the annual dividend to 1.15 euros per share, and the subsequent reiteration of this commitment by the Company's Board of Directors at its meeting held on 29 April 2009, the Telefónica Group once again committed itself, at the Investors' Conference held on 9 October 2009, to a schedule of gradual increases in dividends in the medium term.

### Continued increase in dividend per share



### Earnings per share 2009: 29.46%

	No. of shares	Gross amount in €
Value of 100 shares on 1 January 2009	100	1,585
Cash dividend (12 May 2009)	100	50
Cash dividend (11 November 2009)	100	50
Value of 100 shares at 1 January 2010	100	1,952
Value of portfolio consisting of 100 shares	100	2,052
Return		29.46%

<sup>1</sup> As of 26 February 2010



# Earnings per share increased by 4.5%

Thus, an increase of 21.7% compared to 2009 was announced for the dividend in 2010, rising to 1.40 euros per share. In addition, a goal of distributing a minimum dividend of 1.75 euros per share by 2012 was set for the medium term.

Since 2003, the year in which Telefónica regained control of its dividend distribution policy, the Company has gradually improved its shareholder returns policy and is currently one of the best companies in this respect and among the few to undertake an express commitment to increasing dividends in the medium term (three years).

## Basic earnings per share

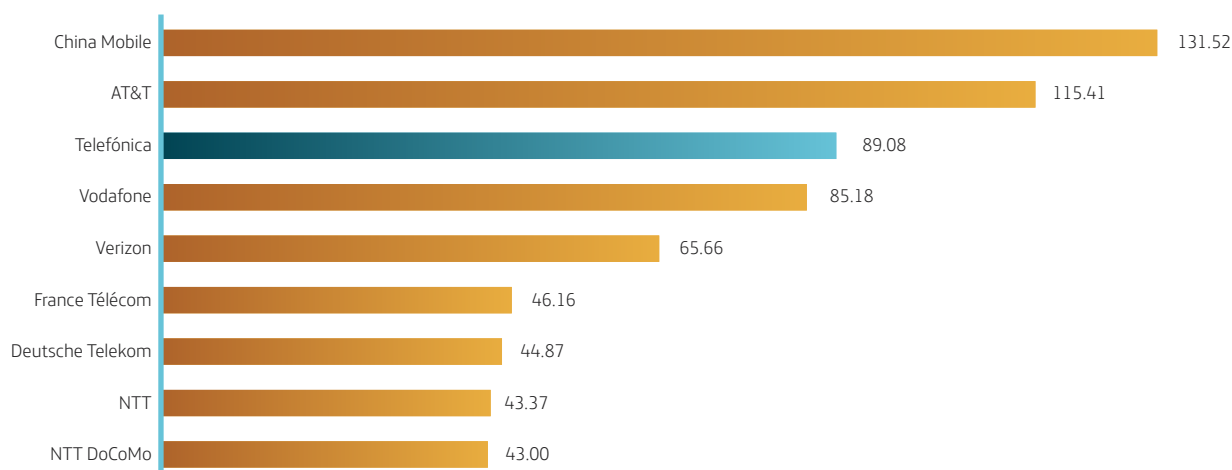
### Target of € 2.10 Net EPS in 2010 maintained

In a very adverse economic environment, Telefónica has managed to achieve very solid results for yet another year, after leveraging the opportunities that arose during the financial year and using its differential scale as an important tool for operating in a global market. As a result, the Company has combined the highest rate of organic growth in the sector with the best EBITDA margins.

The basic return per share stands at €1.71, with a 4.5% year-on-year growth rate. The Company remains true to its goal of attaining Net Earnings per Share (Net EPS) of €2.10 per share in financial year 2010 and reaffirms its objectives for growth in the medium term.

Telefónica confirms its goals for dividends through 2012: €1.15 per share in 2009, €1.40 per share in 2010 and a minimum of €1.75 per share in 2012.

## Ranking in sector by stock market capitalisation



Source: Bloomberg. Year-end of 2009

## Returns to shareholders

7,776 million euros (+2.4%)

The net profit attained by Telefónica in 2009 totalled 7,776 million euros, a 2.4% increase on the amount reported in 2008, while the basic net earnings per share rose to 1.71 euros, a year-on-year increase of 4.5%.

As highlighted in a previous section of this report, the Company remains committed to its goal of Net Earnings Per Share (Net EPS) of 2.10 euros per share in the financial year 2010.

## Share performance

29.5% total return

In 2009, Telefónica shares returned to the upward trend seen in 2003-2007, with an annual increase of 23.2%, ending the year at 19.52 euros per share. This solid performance, which was backed by the stock market recoveries in 2009, sets the Company apart as it performed better in relative terms than its reference sector in Europe – the *DJ Stoxx Telecommunications* index recorded an 11.2% increase – and compared to the general *EStoxx-50* index, which was up 21.3%.

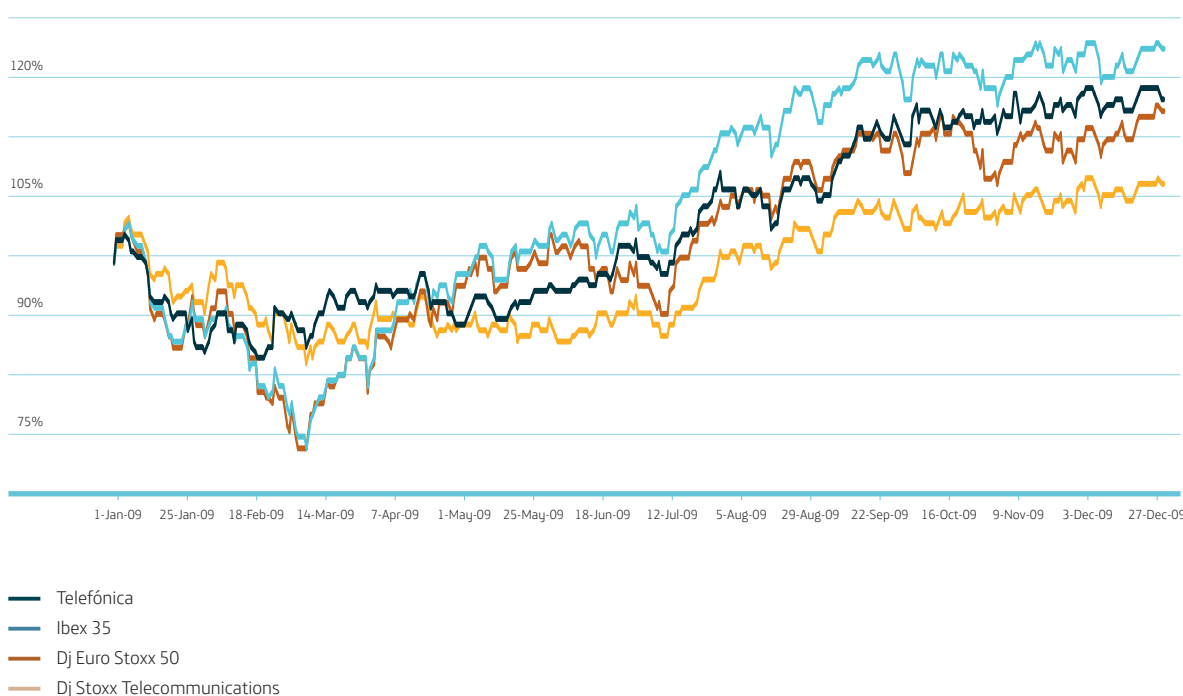
Telefónica's better performance compared to other European operators –Vodafone (+3.2%), BT (+1.5%), *Deutsche Telekom* (-4.3%), *Telecom Italia S.p.A.* (-5.4%) and *France Telecom* (-12.2%)– reflects the advantages of its diversification, both geographically and in business areas; its proven ability to perform in changing environments; the Company's strong cash flow generation; and its commitment to its shareholders. The latter is clearly reflected in its commitment to continue to increase returns for shareholders in the form of dividends, with dividends being announced in February 2009 and October 2009.

This resulted in the total return on Telefónica shares in 2009 reaching 29.5%, following the inclusion of all of the dividends distributed during 2009 (0.50 euros on 12 May 2009 and 0.5 euros on 11 November 2009).

This strong performance by Telefónica has made it into the third largest telecommunications company in the world in terms of market capitalisation, and into one of the top fifty worldwide. Telefónica's stock market capitalisation at the end of 2009 stood at 89,089 million euros.

Telefónica's average daily trading volume on the Spanish continuous market amounted to 48.5 million shares in 2009 (57.2 million securities in 2008).

## Stock market performance 2009



Source: Bloomberg

In 2009, Telefónica's shares increased in value in absolute terms (+23.2%), exceeding in relative terms the DJ Telco (+11.3%) and DJ Euro Stoxx 50 (+21.1%) indices. However, the increase in the Telefónica share price was slightly below the increase in the Ibex 35 (+29.8%).

With the exception of Portugal Telecom (for which the increase was 40.4%), Telefónica's share price increased by more than the rest of its major European counterparts.

Telefónica climbed one place to third in terms of stock market capitalisation at the close of 2009 (€89,089 million).

## Other information

### Stock Markets

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

### Share capital

On 28 December 2009, the Company proceeded to reduce its share capital by 141,000,000 euros, by cancelling 141,000,000 of its own shares. As a consequence of this, the share capital of Telefónica, which is fully subscribed and paid up, was calculated at 4,563,996,485 euros, consisting of 4,563,996,485 ordinary shares of the same category and series, each with a par value of one euro and being represented by account entries.

### Number of shareholders

Telefónica had 1,500,000 shareholders at 21 May 2009, according to the individualised records detailing private individuals and legal entities, and with the data held by the Spanish Central Securities Depository (Sociedad de Gestión de los Sistemas de Registro, Compensación y Liquidación de Valores - Iberclear).

### Significant holdings

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

As of 31 December 2009, Caja de Ahorros y Pensiones de Barcelona (La Caixa) and Banco Bilbao Vizcaya Argentaria, S.A. (BBVA), were the direct or indirect holders of 5.170% and 5.543% of the share capital of Telefónica, respectively.

## The Office of the Telefónica Shareholder

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

### Free phone line for shareholders:

900 111 004. In 2009, a total of 73,881 calls were received, up 7.27% on 2008, at an average of 6,157 calls a month.

In addition to telephone queries, the Office of the Shareholder dealt with a further 3,487 queries by email and post (up from 2,360 in 2008). Of the queries received in 2009, 54,955 related to economic and financial issues as follows:

- 25,085 queries about the General Meeting of Shareholders.
- 22,318 queries about stock market performance and the share price.
- 7,507 queries about results and relevant events.
- 45 queries on rights issues and special financial operations.

### On line channel:

#### ([www.telefonica.com/accionistaseinversores](http://www.telefonica.com/accionistaseinversores))

In 2009, there were a total of 1,363,455 page views on the Shareholder and Investors website, a 12.4% increase on the 1,213,070 the previous year. The website is available in Spanish, English and Portuguese, and has specific sections on:

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

### The "Acción Telefónica" magazine

The Office of the Shareholder publishes the magazine "Acción Telefónica" for Company shareholders. The magazine is published every three months. In 2009, 603,676 copies were sent to the homes of shareholders. The magazine is filled with information on results, company facts, stock market information, reports and culture.

# A track record of honouring commitments

7 consecutive years of meeting our commitments

## Responding to commitments

One of the Company's greatest strengths lies in its excellent track record in honouring commitments undertaken, regardless of the economic cycle at the time. This makes Telefónica a Company that is highly predictable and which presents minimal risk levels for investors. Strictly honouring its commitments gives Telefónica credibility and reinforces its leading role in the markets where it operates.

In the financial year 2009, it attained the targets that had been set and made a net profit of 7,776 million euros. The Company achieved robust results in the last year, through its good management in a difficult environment.

Operating cash flow (OIBDA-CapEx) stood at 15,346 million euros, over 8% more than in 2008, and the ratio of net financial debt plus commitments to OIBDA was 2.1 times in 2009, which is proof of the Company's financial solidity.

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

## Compliance with Guidance

### 7 consecutive years

For the last seven years, the Company has met all of the financial targets it announced in advance for the financial year. The Telefónica Group obtained robust financial results in 2009, despite the complexities of the economic and operating environment, demonstrating the value of the high degree of diversification of its operations.

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

Effective performance of the financial objectives for 2009<sup>1</sup> is demonstrated by:

1. Revenues increased by 0.3%, in line with the positive growth expected.
2. OIBDA increased by 1.1% and is within the announced range of 1%-3%.

	Guidance			Reported with guidance criteria*			Compliance
	Revenues	OIBDA	OI	Revenues	OIBDA	OI	
2003	5%-8%	6 - 9%	18 - 21%	6%	12.5%	29.7%	✓
2004	7% - 10%	5 - 7%	15 - 18%	8.3%	6%	15.5%	✓
2005	>15%	10 - 13%	12 - 18%	17.2%	12.3%	16.1%	✓
2006	>37%	26 - 29%	26 - 30%	38.8%	28.9%	29.2%	✓
2007	8 - 10%	10 - 13%	19 - 23%	9.8%	12.8%	27.6%	✓
2008	6 - 8%	7.5 - 11%	13 - 19%	7.3%	10.6%	20.4%	✓
2009	>0%	1 - 3%	-	0.3%	1.1%	-	✓

Source: Presentation of TEF results

\* The increases in the table are reported using the criteria current when the annual guidance was set, and may as a result not match published figures.

<sup>1</sup> Base guidance figures for 2009: The base figures for 2008 exclude the impact of the sales of assets (143 million euro gain from the sale of Sogecable) and 174 million euros from the appropriation of T. Europe provisions to cover potential commitments resulting from past disposals of shareholdings once these risks had dissipated or failed to materialise) and includes 9 months of consolidation of Telemig. The base figures for guidance in 2009 assume constant exchange rates in 2008 (average for 2008) and exclude the impact of adjustments for hyperinflation in Venezuela. For the purpose of calculating guidance, OIBDA excludes capital gains and losses from the sale of companies and balance sheet cleansing. CapEx for the Telefónica Group excludes Telefónica España's Real Estate Efficiency Programmes and spectrum investments.

# For yet another year, Telefónica achieved the goals that it set for itself

3. Investment (CapEx) stood at 7,459 million euros, compared to a target of keeping it below a limit of 7,500 million euros;
4. Operating cash flow (OIBDA-CapEx) increased at a year-on-year rate of 8.4% and was well within the announced target range of 8%-11%.

The Company's strategy has enabled it to reinforce the foundations for future growth and to maintain exceptional operational efficiency, as can be seen in the OIBDA margin and the high cash flow generation.

## Revenues of

€56,731 million (+0.2% year-on-year in organic terms)

Despite the complicated operating environment in 2009, which placed strong pressure on revenues in some markets, the Company's strong diversification of operations enabled it to achieve net turnover (revenues) of 56,731 million euros in 2009, up 0.2 % on 2008 in organic terms.

Mention should be made of the excellent performance of revenue from Telefónica Latin America, which contributed 2.7 percentage points to organic growth and, to a lesser extent, that of Telefónica Europe, with a 0.2 percentage point contribution in the period. Furthermore, the improved performance of Telefónica España's revenues in the second semester of the year should be highlighted, as the rate at which revenues were falling decelerated in the fourth quarter for the second quarter in a row.

By area of activity, revenue from Broadband connectivity, both fixed and mobile, and revenue from applications and new services are continuing to make increasing contributions to the Group's overall revenues, adding 2.5 percentage points to organic revenue growth in 2009.

By regions, over the year as a whole, the revenues contributed by Telefónica Latin America represented 40.5% of the Group's total, with Telefónica España and Telefónica Europe accounting for 34.7% and 23.9%, respectively.

## Profitability of the business

OIBDA of €22,603 million

(+0.9% year-on-year)

The Company's focus on improving efficiency and leveraging economies of scale was reflected in its operating income before depreciation and amortisation (OIBDA), which amounted to 22,603 million euros in 2009.

In organic terms, the figure for OIBDA presented a growth rate of 0.9%, basically supported by Telefónica Latin America and Telefónica Europe, with the revenue margin increasing to 39.8%.

As regards regional distribution, the OIBDA figure for Telefónica España represented 43.2% of the total OIBDA figure for the Group, compared to 40.5% for Telefónica Latin America and 17.3% for Telefónica Europe.



Figures related to Compliance with Guidance 09/08

	Organic Growth 09/08	Compliance
Revenues	+ 0.3%	✓
OIBDA	+ 1.1%	✓
CAPEX (million euros)	7,459	✓
OpCF	+ 8.4%	✓

Cash flow generation of €15,346 million (+8% year-on-year in organic terms)

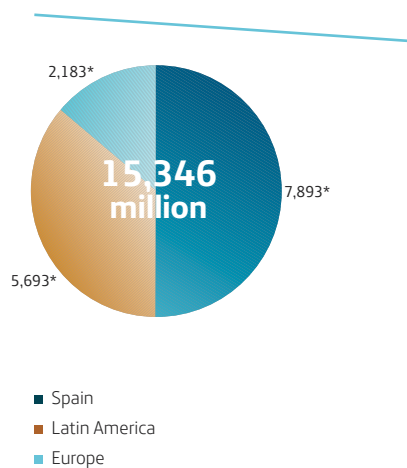
The Company's effort to manage operating expenses and investment translated into an increase in operating cash flow (OIBDA-CapEx) that by the end of last year had reached 15,346 million euros, which represents a year-on-year growth rate of 8.0% in organic terms. In terms of regional distribution, Telefónica España contributed 7,893 million euros; Telefónica Latin America 5,693 million euros and Telefónica Europe, 2,183 million euros.

The free cash flow generated by the Telefónica Group in 2009 totalled 9,097 million euros, of which 959 million euros were allocated to the purchase of treasury stock; 4,557 million euros to Telefónica S.A. dividend payouts; 793 million euros to cancelling commitments undertaken by the Group (mostly derived from workforce reduction programmes); and 1,178 million euros to financial investments and divestments in the period.

As a result, net financial debt reduced by 1,610 million euros. In addition, there was also a 2,429 million euros increase in financial debt due to variations in exchange rates; changes in the scope of consolidation; and other effects on financial accounts. This resulted in net financial debt of 43,551 million euros at the end of 2009, up 818 million euros on net financial debt at the close of the 2008 financial year (42,733 million euros).

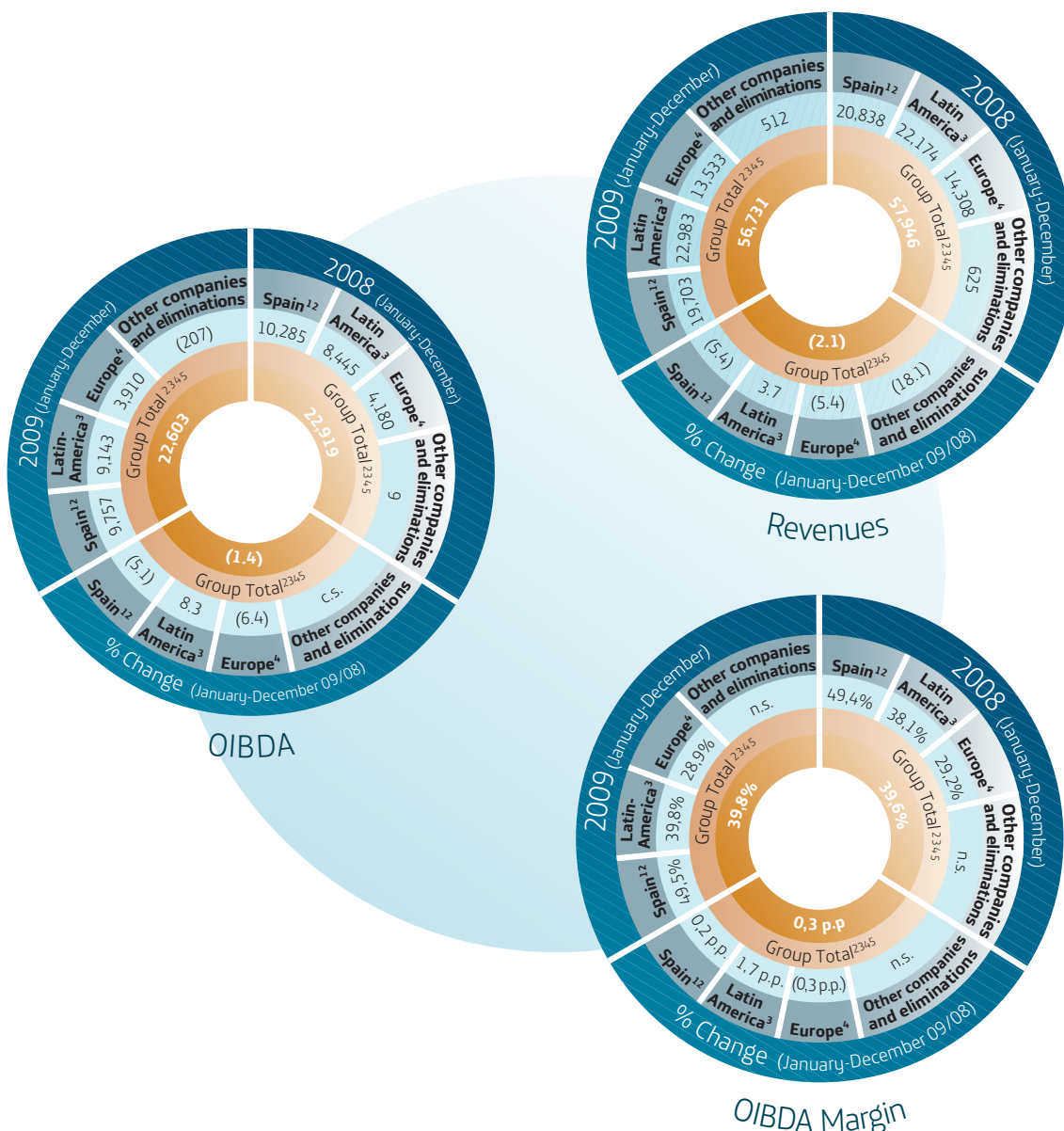
Operating Cash Flow

\* Million euros



# Telefónica Group Results by business unit

Million euros



**Notes:**

- OIBDA and OI for businesses are presented before management and brand expenditure.
- OIBDA margin calculated as OIBDA on net turnover.
- 2009 data impacted by hyperinflation adjustment in Venezuela.

1 In comparable terms, Telefónica España's revenues would be down by 5.9%, OIBDA would be down by 8.0% and OpCF would be down by 5.9%. Comparable terms exclude the impact of the Universal Service: 183 million euros in revenue and 51 million euros in OIBDA in the third quarter of 2008; 75 million euros in revenue and 22 million euros in OIBDA in the first quarter of 2009; and 148 million euros in revenue and 47 million euros in OIBDA in the fourth quarter of 2009; sale of bad debt portfolio: 25 million euros in OIBDA in the first quarter of 2008; capital gains from real estate: 6 million euros in OIBDA January - December 2009 and 74 million euros in OIBDA for the same period of 2008; review of estimates made in previous financial years corresponding to workforce adjustment plans, which led to 90 million euro lower expenditure in the second quarter of 2009; sale of application rights: 48 million euros in revenue and OIBDA in the third quarter of 2009; and capital gains from the sale of Medi Telecom: 220 million euros in OIBDA in the fourth quarter of 2009.

2 The fourth quarter of 2009 includes capital gains from the sale of the holding in Medi Telecom (220 million euros).

3 From April 2008 onwards, the scope of consolidation of Vivo includes Telemig.

4 2008 includes a positive 174 million euro impact from the sale of Airwave. OIBDA and OI include restructuring expenditure of 44 million euros.

5 The second quarter of 2008 includes capital gains from the sale of the holding in Sogecable (143 million euros).

## First class efficiency with room for improvement

Telefónica tops the sector for efficiency with a ratio of 74.1%

### Efficiency ratios

74% efficiency rating in 2009

In 2008 Telefónica led comparative efficiency ratios ( $(Opex+CapEx)/Profits$ ), with a ratio of 75.5%, the best among its main global competitors. Despite this leadership, there is still room for improvement and the objective is to achieve 70% efficiency by 2012.

The success of the action taken so far in this regard is the decrease in this ratio to 74.1% in 2009.

Improving efficiency is of vital importance, as it improves competitiveness and as a result strengthens the capacity to generate profits. Transformation of its operating model will not only enable Telefónica to be more efficient, but will also enable it to take advantages of opportunities which arise in the new digital world.

This model is based on global networks and technology with full IP; global systems employing IT in the service of business; and processes which are ever more on line.

### Greater coverage and increased capacity

3G network coverage: +15p.p.

The focus in this area centres on equipping the Company with the tools that will enable it to leverage future growth in the sector, particularly in Broadband, which will be one of the greatest sources of revenue.

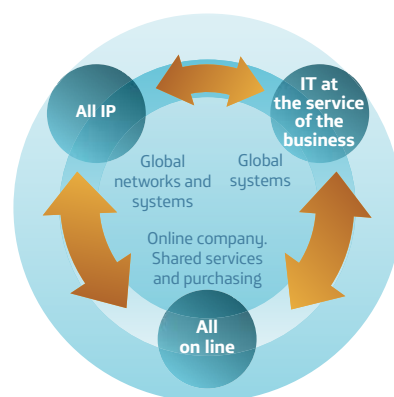
In 2009, Telefónica continued working to develop a powerful, integrated, flexible, intelligent, open and low-cost network. Despite the economic background, throughout the year, Telefónica increased its 3G network coverage by 15 percentage points; it increased fixed lines with capacity for over 25 megabytes by more than 5 percentage points; and it doubled the capacity of its IP network.

Telefónica priority areas of work for networks and technology are:

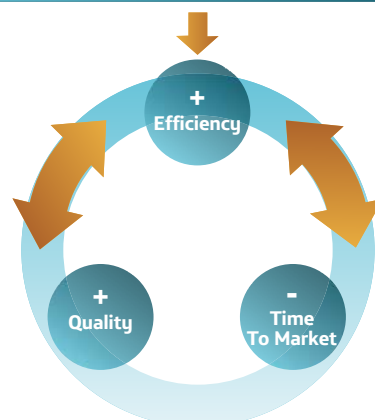
- Integrating the customer's vision of fixed and mobile services from a technological perspective, by offering the best connectivity in all environments.

- Making efficiency of service –in terms of both speed and quality– into one of the main elements that set the Company apart from its competitors.
- Standardising its network model to take advantage of economies of scale in purchasing equipment and contracting services.
- Sharing network infrastructure with other operators and outsourcing processes, where these are not elements which set the Company apart.
- Boosting network automation.

### Towards a new operating model



- Taking maximum advantage of scale
- Accelerating the changes required to exploit the advantages of Mobile Broadband, and having a single view of the customer





# The target is to reduce it to 70% by 2012

The Company's most recent initiatives in this area include an agreement with Vodafone to share mobile network assets in a number of countries in Europe; the automation of network alarm management; and global purchasing of standardised fixed line broadband equipment for the customer's home.

## A new IT company for Group operators

Telefónica's commitment to putting Information Technology at the heart of business, with a clear, customer-focused approach, is helping it to exploit these new sources of growth to the maximum. The goal is to unify customer information using integrated processes with clear internal and external visibility to provide our customers with a differentiated experience, irrespective of the channels and devices used, thus reinforcing their relationship with our brand and products.

The 2009 launch of a standardised systems management model across the whole group was a key step in exploiting the values of scale and aligning priorities with business strategy.

Fundamental elements of this model include:

- Consolidating and optimising Data Centres, providing them with common technical architecture and management processes which will enable them to simultaneously achieve higher levels of efficiency and operational excellence (availability, security, etc).
- Providing employees with better tools (*common hardware and software*) and exploiting scale to combine functionality and efficiency.
- A shared IT model for managing relations with suppliers.
- Common systems architecture, defining a global systems map which maximises scale and reutilisation in the development of applications to implement the business strategy.

A new IT company has been created as a management tool for this model to provide a full range of IT services to Group operators.

## Creation of a new global purchasing unit in Munich

Telefónica's new organisation in Munich concentrates purchasing activity for Information Systems, Network Infrastructure and Market Products; it has three objectives: to simplify purchasing processes; to improve relations with suppliers; and to exploit economies of scale by combining demand.

Munich was chosen as the centre for this new unit as many of the main suppliers in the sector are also based in this city. Its team consists of people from Telefónica's purchasing units around the world. This enables it to benefit from the experience and know how of all these professionals.

The new unit receives all purchasing requests for the three product areas mentioned from our operations all over the world and then negotiates global deals with suppliers, resulting in more efficient management, cost savings and simplified processes. The unit will be fully equipped with the tools it needs to function on line. For example, suppliers will submit all of their invoices electronically.

## Progressing into an on line Company

In 2009, Telefónica continued working to develop into a company which is fully on line. The Company's objective is to increase the volume of transactions with customers which are performed electronically by 22 percentage points between 2008 and 2012. At the same time, it is continuing to develop more transparent and responsive relationships with suppliers, using on line auctions in a high proportion of its Purchasing processes.

For example, this philosophy of on line working is guiding the work of the new global purchasing unit established by Telefónica in Munich. This unit has enabled the Group to take advantage of economies of scale, which is something it is also achieving through synergies with its partners China Netcom and Telecom Italia.

## Innovation for growth

Investment in R&D of 4,291 million euros

### Managing innovation

As a result of the changes in the current economic environment, characterised by globalisation and technological convergence, innovation has become key in attaining Telefónica's targets of increasing revenue and optimising operational costs.

This model rests on three basic pillars: a **global innovation platform** with local application in business units, the development of capabilities aimed at securing **long-term business opportunities** and, lastly, offering a **global response** to competitors and partners.

#### Innovation Management Process

The objective of innovation management is to ensure that there is a portfolio of projects and investments in resources with high rates of return. We currently have in place an annual process to establish the innovation and transformation priorities based on a rigorous review of the Company's strategies, context, consumer and customer trends, emerging technologies, etc.

As a result, during this first year, in the Innovation Committee 12 global priorities were established for the 2010-2012 period, as

specific areas of focus to generate new revenues. In parallel, in the Transformation Area, 18 Global Priorities were established, focusing the company's efforts on technology and network capacities, platforms and specific, vital systems for the support and development of business in these highly important innovation areas.

In this Committee, the three regional business units are represented (Telefónica Spain, Telefónica Europe and Telefónica Latin America) and the corporate areas of Innovation and Transformation.

### Research and Development

+4% year-on-year in R&D

R&D (research and development) activity continues to be a catalyst for technological innovation. In the course of 2009, Telefónica's total investment in technological innovation (R&D&i) amounted to 4,291 million euros. Of this amount, 693 million euros were invested in R&D, a 4% increase on 2008.

### Telefónica's open innovation network



# Investment in R&D&i of 4,291 million euros

As part of this effort in the area of R&D, Telefónica devoted 70 million euros to **"applied research"**, mostly intended for the conceptualisation and development of new services and the networks of the future. Moreover, during 2009, Telefónica R&D registered 57 patents in areas related to information and communication technologies.

The rest of the investment in R&D, i.e. 623 million euros, was mostly in the **development of new products**, services and management systems, as well as in introducing substantial improvements in those already in existence. A major part of this effort was in collaboration with leading companies in each sector. Some examples of these collaborative development platforms are the Morfeo Platform and Movilforum (Mobile Forum).

In the course of 2009, Telefónica also made a major effort in **technological innovation** in order to deploy the services and networks developed through R&D activities, with investment of 3,598 million euros. The two main lines were, on the one hand, measures to ensure the deployment of these innovations, and on the other, the implementation of fixed and mobile broadband networks in the countries where the Company operates.

Some of the projects developed by Telefónica R+D include Rehabilitic, Colabor@ in Chile and Spain, the platform for people with chronic illnesses, and Telecare Móvil, "Mi familia".

## Global Products and Services

The goal of the Global Products and Services Development unit is to identify new products, services and applications and develop them on a unified basis for all the markets in which the Company operates.

The creation of a catalogue of global products and services is supported by specialised Competence Centres, based on four operating principles: developments by global units; dedicated resources and clear management rules; clear budgeting of expenses and investments; and alignment of global and local objectives and incentives.

The Company's Competence Centres (CCs) are global teams dedicated to working on specific projects by segment and type of service. Their new structure was approved in July 2009:

## Basic Home Station

The Hogar Digital (Digital Home) Competence Centre has designed a new concept in ADSL customer user terminals (routers) called *Basic Home Stations*, which are a technological leap forward for Telefónica's customers. This development enhances user experience through its attractive design and easy-to-use interface.

The functionality of the *Basic Home Station* includes enhanced wireless coverage within the home, and the ability to share printers and USB hard drives on the home network. It also encourages users to take advantage of the full range of Movistar coverage by connecting the equipment to a USB modem with 3G connectivity.

1. People-oriented CC: Mobile Data group (MDG) in T. Europe.
2. Home-oriented CC: IPTV (TdE) and Hogar Digital, in Telefónica, S.A.
3. Company-oriented CC: Corporate ICT, in Telefónica España.
4. Cross-disciplinary CC: provides technological support to other CCs (New Access Services-NAS, in T. Spain).
5. Global project: Open Telefónica, in Telefónica, S.A.

## New businesses

The mission of the new business unit is to develop and grow new businesses in new and complementary areas. It currently includes the e-Health, Financial Services, e-Learning, e-Travel and Security business lines.

The first two enable leveraging of the potential technological discontinuities that generate increased purchasing power in new areas. e-Learning and Travel and Security contribute towards the growth of existing businesses.

### e-Health

The e-Health corporate unit was created as a result of strategic analysis of new business areas where Telefónica can contribute value to the societies where it operates. The global e-Health initiative divides products and services into three categories (ICT, Telemedicine and Teleassistance) and has been implemented on

## Colabor@

Colabor@ is a system developed in the Granada centre of Telefónica I&D, which facilitates collaboration in real time between health care professionals. Its goal is to improve the service to patients and to facilitate the work of professionals by applying ITC to medicine. The Granada centre has more than 50 employees dedicated to innovation and is a pioneer in the development of products and services in the areas of health and tele-assistance.

The system is a simple, agile tool, which allows for the establishment of virtual work sessions which permit medical professionals to share information in real time. Using the capacities offered by multimedia communication, doctors can interact with one another to solve complex cases; hold daily sessions to cooperate and exchange opinions; set up sessions between professionals of a health centre or a geriatric centre with hospitals to treat cases they have in common; or carry out tele-diagnostics via video conference or other methods.

During 2009, Colabor@ was awarded the "Innovation in Telecommunications" prize of the revista Muy Interesante

a global scale throughout Telefónica, with a presence in Spain, Europe and Latin America.

Examples of the activity of this unit include the iPhone application for people with autism developed by Telefónica O2 Ireland, based on communication through images.

### Financial Services

In 2009, Telefónica worked to develop financial services using mobile phones. Telefónica's objective is to enable new forms of access to funds and ways to control accounts at low cost; this is generating significant revenues for the Group in Europe and Latin America.

For example, in the United Kingdom Telefónica signed an agreement involving Natwest and O2 in 2009, launching its first pre-paid cash card –the O2 Money Card– based on the concept of spending control and freedom. The card operates through a system of alerts received on the customer's mobile phone and will result in a substantial increase in loyalty among UK customers.

### e-Learning

Telefónica Learning Services –until recently known as Educaterra– has 9 years' experience in the market and over 150 clients, including private companies and public bodies. Its main focus is in Spain, although it is currently expanding its presence and services to the other countries in which Telefónica operates.

## Mobile Banking (Colombia)



This Mobile Banking pilot project for coffee growers was developed in collaboration with the Federation of Colombian Coffee Growers and Banco de Bogotá. Its purpose is to enable users to carry out financial operations with their coffee cards. The card can also be used to consult coffee prices, balances and the most recent credits to the card. The towns of San Gil, Río Sucio, Socorro and Quinchía were the first to join the scheme, which benefited 5,000 coffee growers up to the year 2009 and registered a total of 1,300 transactions in the first month alone.

### e-Travel

A 50-50 joint venture between Telefónica and Orizonia, Rumbo is now active in Spain, Portugal, Argentina, Brazil, Colombia and Venezuela. The two basic pillars of its success are technological innovation and quality customer service. In order to expand its most popular area of business –sales of flight tickets– Rumbo Negocios was launched in 2009; this is a specialist website for business travel which enables SMEs and large customers to achieve savings through low-cost package offers. In 2009, Rumbo recorded revenues of 455 million euros, up 11% on the previous year, with a 28% jump in the number of customers.

## Venture Capital

Telefónica has a venture capital fund for investing in companies with strategic capabilities (products, services and technology) for Group businesses. The main objectives of the fund are promoting new businesses and acquiring knowledge of new and emerging technologies. The minority shareholdings of this fund are centred in Silicon Valley and Israel.

This search for new opportunities benefits from carefully nurtured relationships with a number of global venture capital leaders, such as Sequoia, Benchmark and Draper Fisher Jurvetson.

Some of the companies currently in the portfolio include "Amobee" ("Mobile Advertising") and "Kyte" (a video platform).

## Assia



"ASSIA is proud of having Telefónica as a strategic investor and an observing member on its Management Board. ASSIA considers Telefónica to be one of the global leaders in telecommunications innovation and it hopes to be able to roll out its solutions through the Group and to combine innovation efforts to increase the global leadership of the Telefónica Group's broadband DSL networks". (John. M. Cioffi, CEO ASSIA)

In 2009, an investment of \$5 million was made in "Assia." This company is a global leader in DSM technology with more than 200 patents. These technologies make it possible to increase the quality and scope of DSL services over traditional copper networks, thus enhancing customer satisfaction and service capacity.

optimises the use of network resources, minimising impact on the existing infrastructure. Secondly, it enables Telefónica to play a role in the "content delivery" market, which is currently led worldwide by companies such as Akamai. In addition, it makes it possible to offer exceptional quality of service to our broadband customers that sets us apart from our competitors, both for content managed by Telefónica and OTT content.

The funds allocated to the project in 2009, which amount to 500,000 euros, have enabled the development of in-house CDN technology (T I+D) and the establishment of a pilot project at 60 points in 10 countries. The estimated commercial launch date for the service is the third quarter of 2010.

## Acquisitions

Acquisitions are an important tool for incorporating emerging technologies and innovative services into the Group's capacities in order to develop complementary businesses.

This is demonstrated by the acquisition of Jajah in 2009. This acquisition was a major leap forward for Telefónica's VoIP capabilities.

## Best practices as leverage for innovation

The sharing of best practices among business units provides another lever for effective innovation in Telefónica, allowing for the immediate application of local profits and increasing these profits with lower investment of resources in implementation.

### Incubators

The incubator initiative focuses on looking within Telefónica to support the entrepreneurial skills of the Company's employees, providing their new ideas with the resources required to bring them to fruition. The incubators make innovation more democratic, taking advantage of Telefónica's diversity and knowledge in its more than 255,000 employees. Anybody in the company with a good idea and an entrepreneurial spirit can develop a new business.

#### NFC technology

*Near Field Communication technology* enables fast, easy payments using mobile phones, by equipping them with a built-in credit card. Incubation funds have been used to develop a user-friendly interface for customers and pilot studies have been carried out in various countries to perfect the project and evaluate it in real-life situations.

#### Hybrid CDN

The CDN initiative has a number of simultaneous objectives. Firstly, it proposes a system for managing video traffic that

## Telefónica acquires Jajah, a leading company in IP Communication



In 2009, Telefónica announced that it had acquired Jajah, a leading communication innovator headquartered in Silicon Valley, California and Israel, for 145 million euros (207 million dollars).

Jajah offers integrated VoIP services, instant messaging with social networks in nearly 200 countries. Its solutions for the business segment include integral IP communications services for the entire organization, regardless of the location or device.

Trevor Healy, CEO of Jajah, has said, "This is a very exciting union of a young, innovative company with one of the largest integrated communications companies in the world. Together, we look forward to creating the next generation of communication."

## Solid, reliable brands

Movistar and O2 hold first or second place in international rankings of brand recognition

### A new brand model

In early 2009, Telefónica approved a new brand model for the entire Group, a model that was first introduced in Spain in May 2010 and which will be implemented in all the countries where the Telefónica Group operates over the course of the next two years. There is no doubt that it will be one of the fundamental pillars on which its future growth will be based.

The new brand model is based on the Company's business vision and, being primarily focused on the customer, it evolves to meet their needs, which are in turn developing in to an increasingly convergent and global environment.

With a view to strengthening the position of the Telefónica Group and leveraging future opportunities, the current brand model, which is heterogeneous and based on growth and acquisitions, is being rearranged into a simplified regional model, which is capable of speaking with a single voice to each target audience.

The Telefónica brand will be used for all corporate and institutional roles in all geographical areas, while Movistar and O2 will embody the Company's commercial offer in their respective geographical areas: Movistar for Spain and Latin America, and O2 in the UK, Ireland, Germany, the Czech Republic and Slovakia.

This new model maximises the value of the brands and gives them the flexibility needed to adapt to the new realities of the markets. The new brand model is a key element in transforming the organisation and building an even more closely integrated Group.

### The institutional brand

The Telefónica brand represents the Company at the institutional level, in dealings with institutions, shareholders and investors, multinationals and large accounts, society and employees in all the countries where the Group operates.

The objective of this new role is to support the new strategic stage the Company is entering and to raise the institutional profile of Telefónica, making it more global, more powerful and more resonant for its various audiences, as the link that unites and brings together all the Company's brands and the brand that unites all employees.

Telefónica's new corporate vision, expressed as "The Power to Transform", is based on a tradition of more than 85 years of history. A legacy of growth, innovation, transformation and value creation for the Company's audiences.

The new commercial brands –Movistar and O2– have the support and backing of the financial strength of Telefónica S.A, together with the business vision and the talent of a committed organisation with over 250,000 employees.

The new role of Telefónica as a brand is reflected in a highly evolved visual identity that is in line with the new brand strategy. Thus, we are keeping the current logo, the corporate colours are changing to a darker, premium shade of blue, with a view to reinforcing the relevance and importance of the brand's institutional role.

### Commercial brands

Under the new brand model, the Telefónica Group's commercial offering will be embodied in the Movistar and O2 brands, both of which are clearly focused on the customer.

This will drive the integrated carrier model, with an integrated range of products and services in an environment that is increasingly convergent and competitive; this will make it possible to simplify and streamline the customer experience, creating emotional ties that strengthen the commercial brands compared to our competitors and enable greater efficiency in marketing and communication.

#### **Movistar. "Life is better when you share it"**

The new Movistar, with its range of capabilities, is the stage for this new reality for Spain and Latin America.

Movistar, with a single voice for both private customers and businesses, brings together for the first time all the capabilities of its world-leading integrated range, placing the customer at the heart of all the Company's activity, thereby building strong emotional ties and lasting relationships.

This has meant that the Movistar brand has had to be repositioned with the help of a brand concept ("Life is better when you share it"), as well as values and a personality that will help to build up



# A single voice for each target audience

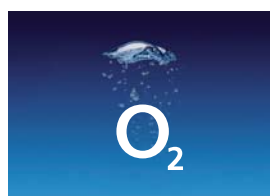


positive differentiation from its competitors; intensify ties with customers; and reorganise the portfolio of products and services to match the new reality of the brand architecture, creating a system that can respond to developments in the sector.

Movistar as a brand has matured, becoming the Company's commercial brand in Spain and Latin America for all its products and services, both fixed and mobile. Therefore, as a pragmatic response to the current situation, its visual brand identity has evolved and become more formal, more adult and more mature. This change responds directly to the new business strategy and the new brand model.

## 02. Looking towards Europe

The O2 brand is being maintained for our mobile and fixed telephony and broadband services in the United Kingdom, Ireland, Germany, the Czech Republic and Slovakia. Under this new brand model, O2 will have closer links with other Telefónica Group brands. Brand values: Bold, Open, Trusted and Clear are relevant to their markets and consistent with both the Movistar brand and with the institutional brand



## Leading the rankings

Both Movistar and O2 occupy top positions in the international rankings for brand presence and recognition. The new approach will reinforce this position and strengthen the institutional brand, extending its presence in all geographical areas.

On a highly selective basis, other brands, such as Terra, Atento and Fonic, may be used in areas not covered by our main brands, Movistar and O2, or where there is no interest in using them.

In order to ensure effective implementation of this model, the Company has implemented Brand Guardianship, which will ensure consistency in all applications and decisions in connection with the brands.

## Brand recognition

Spontaneous recognition of the Telefónica brand (data for 2009).

### Fixed Telephony

Country	Ranking
Spain	1
Chile	2
Peru	1
Argentina (Broadband)	1
Colombia *	2

### Mobile Telephony

Country	Ranking
Spain	1
Chile	1
Peru	2
Argentina	2
Mexico	2
Uruguay	1
El Salvador	1
Guatemala	1
Nicaragua	1
Venezuela	1
Colombia	2
Ecuador	1
Panama	1
Ireland	2
Slovakia	3
Czech Republic	1
UK	2
Germany **	3

Data obtained from the Millward Brown TPSM (ATP), based on accumulated totals for 2009.

\* Data for Telefónica Telecom.

\*\* Data obtained from the KANTAR Group's ICON Added Value study (part of the same group as Millward Brown).

## The commitment of an experienced team

Our employee climate and commitment index is 73%

### Workforce

#### 257,426 employees in 25 countries

At the end of the financial year 2009, the Telefónica Group had a workforce of 257,426 employees in 25 countries. Overall, the size of the workforce remained stable compared to 2008.

By regions, Latin America has the largest percentage of the Telefónica Group's workforce (68%), followed by Spain (20%) and Europe (11%).

If Atento is not included, Telefónica's workforce is mainly divided between Commercial and Production roles, which account for 41.2% and 46.5% of the total respectively. The remaining 12.3% are involved in support functions.

97% of the equivalent workforce have permanent contracts with the Company; if Atento is included, this percentage is 84%.

Women account for 36% of the Telefónica Group's workforce; this figure increases to 50% if Atento is included. The percentage of women in management roles in 2009 was 21%, compared to 17% in 2008, as a result of Telefónica's commitment to equal opportunity and diversity.

### Employee commitment

#### ICC: 73% (+4 p.p. year-on-year)

In 2009, the employee climate and commitment index, which is calculated in the same way in all countries, stood on average at 73%, a 4 point increase on the previous year, exceeding the objective set. Over the last 3 years this index has increased by 7

percentage points. Regionally, the largest increase has been in Latin America, which has increased by 6 p.p. to 83%. This is followed by Spain, which has seen a 5 p.p. increase to 60%. Europe, with an CGI of 76%, has been stable over the last three years, having increased by 1 p.p. in 2009.

The main causes of this increase in labor climate are the results of the Company's transformation and management programmes in Business Units in Spain ("GPS", featuring the "Team Satisfaction" initiative) and Latin America ("Ahora", launched in 2007), that have developed focused, goal-based management, which has reinforced the sensation of teamwork and leadership.

### Best Place to Work

#### 22 Group companies included in ranking

As a result of this increase in employee satisfaction, in 2009 the various business units were recognised as being "best places to work".

In Latin America, the number of Group operators in the "Great Place to Work Institute" rankings increased from 17 in 2008 to 22 in 2009, achieving first place in Uruguay, Ecuador and Venezuela.

In Europe, Telefónica achieved first place in the "Best Place to Work" ranking in Germany, second place in Ireland (and best company in the Telecommunications sector), and 16th in the "Best Big Company to Work for" in the UK (awarded by the Sunday Times).

Telefónica España has received a number of awards which recognise the Company as one of the best places to work. These include the "Top Company to Work For" (awarded by the "CRF

### Workforce by region

	2009	2008	2007	Change % 09/08
Spain	52,060	52,576	53,300	-1.0
Latin America	175,350	173,014	164,231	1.4
Europe	27,964	29,349	29,310	-4.7
Rest of the world	2,052	2,096	1,646	-2.1
<b>Total</b>	<b>257,426</b>	<b>257,035</b>	<b>248,487</b>	<b>0.2</b>



# The Company has over 257,000 employees in 25 countries

Institute"); 8th place in the general "Mercopersonas 2009" rankings; second place in the international "Best Company to Work For" ranking; and first place in the Actualidad Económica ranking (produced by Iberinform), awarded to Telefónica S.A.

## Training

63 Million € (+4% year-on-year)

Training is the basis for excellent performance. In 2009, Telefónica invested more than 11 million hours of training, compared to more than 10 million hours in 2008, an 18% increase. In 2009 the Company invested 63 million euros in training.

**Universitas Telefónica**, which opened in March 2009, plays a key role in training. It is located in an excellent position some 40 km to the north of Barcelona, on an 18,000 m<sup>2</sup> campus; it has excellent residential facilities, including 180 rooms, and numerous classrooms.

The mission of Universitas Telefónica is to promote the continuous development of the Company's professionals; to promote a distinctive style of leadership; and to disseminate business strategy through teamwork and the exchange of knowledge and best practices in the markets where Telefónica operates.

In 2009 it ran 19 programmes focusing on competencies in the Telefónica Leadership Model 51 times; these courses were attended by 1,395 professionals who returned an overall satisfaction level of 8.7 out of 10. An additional 28 corporate events were organised as supplementary activities for a total of 1,178 attendees.

## Talent Management

Talent management in Telefónica aims to reward, develop and retain the skills which will guarantee sustainability of the business. In order to achieve this, Telefónica's Competences model is adapted to business needs, with six key areas having been identified for senior management posts.

The second round of 360° evaluation at the senior management level was held at the end of 2008 and start of 2009, with the same

questionnaire being used in all regions. In Telefónica España and Telefónica Latin America, the rate of completed reports was 99%; in Telefónica S.A. and subsidiaries it was 97% and in Telefónica Europe, it was 96%.

## Mobility

Telefónica is aware of the possibilities it has as a global Company to develop an international network. In 2009 it completed implementation of its International Assignment Management Model. 57% of international movements have been long-term (2-3 years); 3% have been short-term (up to 12 months); and 40% have been rotations.

In terms of transparency, in 2009 55 senior management vacancies were advertised globally, of which 25% were filled by candidates from Group businesses, and 95% were expatriates.

## Workplace dialogue and collective agreements

186.970 workers covered by collective contracts (73%)

In 2009, the Company's Business Principles, together with its Social Protocols of International Agreements and Code of Conduct (which were renewed and signed in December 2007, between the Union Network International (UNI) and the UGT and CCOO unions and Telefónica), were the main reference points in its workplace dialogue, particularly with regards to rights of association, participation and collective contracts.

In 2009, over 72% of the workforce –some 186,970 employees– were covered by collective agreements.

In Spain in 2009, the companies with the largest numbers of employees continued to apply the agreements which were already in place, applying continuous negotiation mechanisms to ensure on-going workplace dialogue during the life of such agreements.

## The right alliances and partners

The boost from alliances reinforces the Company's leading position

### Strengthening alliances

The Company's strategic alliances have enabled it to strengthen its leadership position. These alliances enable the Company to reach 650 million customers worldwide, which represents approximately 10% of the world population.

During 2009, the strategic alliances signed by the group were given a significant boost. Firstly, we decided to create a specific area at the level of Telefónica S.A. with the fundamental mission of optimising the management of these alliances with a common perspective and leadership.

Starting in June, the Strategic Alliances and Industrial Holdings Directorate made quantitative and qualitative progress in these aspects of management. These decisions translated into specific initiatives in terms of control of shareholding and industrial management with Telefónica's partners: Telecom Italia and China Unicom.

At the end of the year it was also agreed to extend this operational model of maximising synergies to other markets where the Group does not operate. The ultimate goal is to leverage the scale attained by the Group with third party carriers under a strictly commercial relationship model

### Telecom Italia

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

In October 1997, Telefónica joined a group of Italian institutions (Generali, Mediobanca, Intesa Sanpaolo and Benetton) to form the Telco consortium with the aim of acquiring a significant package of ordinary shares in Telecom Italia.

This investment has enabled the Group to become the majority shareholder in the aforementioned consortium and to lay the groundwork for the development of a significant programme of operational synergies with a view to enhancing the mutual scale of both companies by implementing the best commercial and operational practices.

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

In October last year, Telefónica and its partners Generali, Mediobanca and Intesa San Paolo agreed to renew the shareholders' agreement to extend the agreements already in place for an additional period of 3 years until April 2013. As a consequence of Sintonía's separation at its own request, Telco acquired control of 22.45% of the ordinary shares of Telecom Italia, thereby giving Telefónica (which owns 46.2% of the company shares) an indirect holding of 10.4% of the ordinary share capital of Telecom Italia.

As a result of the industrial alliance with Telecom Italia, relations have continued to intensify in order to achieve the 1,300 million euros in synergies mentioned previously. By the end of 2009, synergies to the value of 620 million euros had already been captured. 90% of these synergies have been achieved in the Purchasing, Technology and IT departments and from wholesale agreements between the two companies in Germany.

It should be noted that for regulatory reasons, all joint activity specifically excludes Group operations in Brazil and Argentina.

### China Unicom

#### 8.37% shareholding

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



Chang Xianbing, Chairman of China Unicom and Cesar Alierta, Executive Chairman of Telefónica

# Through its alliances, the Company reaches 650 million customers

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

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

As a result of the close ties between the two companies, on 6 September 2009, Telefónica and China Unicom announced a broad-ranging Strategic Alliance and a Share Exchange Agreement to the value of 1,000 million US dollars.

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

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

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

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

## A privileged partner in the new digital ecosystem

Telefónica's scale and position in the value chain of the Information and Communication Technologies (ICT) sector mean that it is a perfect ally in the digital world. In order to embrace the opportunities deriving from this situation, in 2009 the Company increased its collaboration with third parties in several fields: innovation, where it strengthened the concept of "Open Telefónica" in order to innovate in collaboration with companies, developers, customers and employees..., marketing, networks, processes... Agreements were signed with companies in the sector and with partners from other sectors.

In 2009, the Company continued to invest in alliances with other internet companies, contents, devices and outsourcing. Some of the most recent agreements are with Microsoft, HP, Nokia, Dell, LG and Yahoo!

For Telefónica, collaboration with other carriers was also of crucial importance. In this regard, mention should be made of the agreement with Vodafone to share mobile network assets in various countries in Europe, and the alliance signed in 2010 with the main carriers to create the WAC (Wholesale Applications Community) platform, which will allow developers to create applications and offer them to a massive customer base of over 3,000 million people.

In addition, Telefónica is considered a privileged partner in the new digital ecosystem for establishing strong intersectoral alliances to make advances in key areas such as education, healthcare, finance, climate change, etc.

## Alliances with other sectors



## Excellent performance in sustainability

Telefónica scored 86 points in the DJSI (+28p.p. above the average of the Telco sector)

### Leading sustainability

In 2009 Telefónica was recognised as the leading global telecommunications company by the Dow Jones Sustainability Index (DJSI). In its annual review, the Ratings Agency evaluates the sustainability of companies –Sustainable Asset Management (SAM)– based on economic, environmental and corporate issues; it awarded Telefónica a score of 86, which is 28 percentage points higher than the average for the sector.

For the DJSI, "Corporate Sustainability is a business approach that creates long-term shareholder value by embracing opportunities and managing risks resulting from economic, environmental and corporate issues".

Among the key aspects, Telefónica was recognised for having the best risk management practices; the best Corporate Social Responsibility coverage of suppliers; its contribution to the reduction in the digital divide; the impact of its telecommunication services on the societies in which the Group operates; brand management; and its business, anti-corruption and social action principles.

### Dow Jones Sustainability Index Global leaders in the sector

DJSI World, GLOBAL SUPERSECTOR LEADERS (2009/2010)

Name	Sector
Bayerische Motoren Werke AG (BMW)	Automobiles & Parts
Australia & New Zealand Banking Group Ltd	Banks
Xstrata PLC	Basic Resources
DSM NV	Chemicals
Panasonic Electric Works Co Ltd	Construction & Materials
Itausa-Investimentos Itau	Financial Services
Unilever	Food & Beverage
Roche Holding AG	Health Care
TNT N.V.	Industrial Goods & Services
Swiss Re	Insurance
Pearson Plc.	Media
Total SA	Oil & Gas
adidas AG	Personal & Household Goods
GPT Group	Real Estate
Kingfisher Plc	Retail
Nokia Corp.	Technology
<b>Telefónica, S.A.</b>	<b>Telecommunications</b>
Sodexo	Travel & Leisure
Cia Energetica Minas Gerais (CEMIG)	Utilities

Source: [http://www.sustainability-indexes.com/07\\_html/indexes/djsiworld\\_supersectorleaders\\_09.html](http://www.sustainability-indexes.com/07_html/indexes/djsiworld_supersectorleaders_09.html)

### Economic Dimension

In terms of economic issues, Telefónica received a score which was 31 percentage points higher than the average for the sector. This made the Group the best company in the telecommunications sector for this area, which includes aspects such as customer relationship management; privacy; risk management; corporate governance; and business, anti-corruption and brand management principles.

Telefónica was judged to have best practices in 3 of these categories: risk management, brand management and management of business and anti-corruption principles. This was achieved by the Telefónica Group's implementation of a single risk management model in all the countries in which it operates, together with inclusion in this of aspects related to sustainability, development of a single brand strategy and its efforts to guarantee integrity through internal regulations and training employees in Business Principles.

### Environmental Dimension

In this area the Group scored 19 percentage points more than the average for the sector. This area covers issues such as environmental policies, eco-efficiency, environmental information and climate change.

Telefónica has made progress in these areas through its strategy to combat climate change, which has reversed the downward trend in 2008 with a 34 percentage point increase. The Climate Change Office is enabling Telefónica to implement a more effective global energy efficiency management model; and to reduce its energy consumption and, as a result, its CO<sub>2</sub> emissions. This Office focuses on five areas: Operations, Suppliers, Employees, Customers and Society.

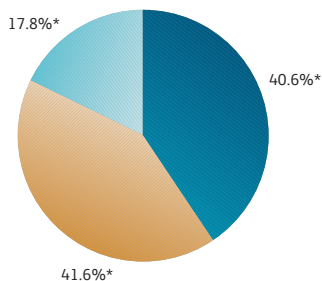
# Telefónica leads the telecommunications sector in the 2009 DJSI index

## Social Dimension

In the Social Dimension, Telefónica is only one percentage point from best practice in the sector. This dimension examines performance in developing human resources; talent retention; digital inclusion; the impact of telecommunication services; social action; corporate information; commitment to stakeholders; and responsibility in the supply chain.

Telefónica was judged to have best practices in 4 of these 9 categories: responsibility in the supply chain; digital inclusion; the impact of telecommunication services; and social action.

## Aspects assessed by the DJSI in the telecommunications sector and their weightings



- Corporate aspects
  - Employment practices (5.2%)
  - Development of human capital (5.6%)
  - Attracting and retaining talent (5.6%)
  - Suppliers (4.6%)
  - Dialogue with stakeholders (4.6%)
  - Philanthropy (3.0%)
  - Company reports (3.0%)
  - Digital inclusion (4.6%)
  - Impact of telecommunication services (4.6%)

- Environmental aspects
  - Environmental policy (4.6%)
  - Eco-efficiency (5.7%)
  - Environmental reports (3.0%)
  - Climate strategy strategy (4.6%)

- Economic aspects
  - Corporate Governance (5.6%)
  - Risk and crisis management (6.0%)
  - Code of conduct (6.0%)
  - Customer relations (10.3%)
  - Brand management (8.0%)
  - Privacy policy (5.7%)

\* Dimension weight on the index total.

## Some sustainability management tools

### Economic dimension:

#### The Business Principles Office

In order to manage the "Code of Conduct" section of the DJSI, Telefónica has established a **Business Principles Office**, which reports to the HR and Corporate Responsibility Committee (the only such office in the IBEX-35). The functions of this Office include ensuring that there are adequate implementation processes; dealing with queries and complaints by different groups; identifying and evaluating risks associated with non-compliance; and promoting policies and regulations. Its main focuses at the corporate, regional and local levels are: integrity, the supply chain, privacy, data protection, adult content, responsible advertising, health and safety, diversity, radio-electronic emissions, human rights, environmental management and comparative reporting.

### Environmental dimension:

#### The Climate Change Office

Telefónica has established the **Climate Change Office** to manage the "Energy Efficiency" and "Climate Change Strategy" sections; the Office reports to the Transformation Department and the General Secretary to the Chairman, and is responsible for achieving reductions in the Company's energy consumption; promoting the development of more efficient services for customers; and promoting the sector as a driver of energy efficiency.

Some of its actions in 2009 include: implementation of the energy efficiency best practices manual; the incorporation of energy efficiency criteria into the Total Cost of Ownership (TCO) model for corporate purchases; the sustainability and energy efficiency agreement with Nokia; the inclusion of energy efficiency principles in offers for SMEs and large customers in Spain; the "Echo Effect" communication campaign for employees relating to energy and mobility sustainability; participation in the "Smart 2020" study in Spain and Latin America; and participation in, and leadership of, external sectoral workgroups on climate change.

### Corporate Dimension:

#### Accessible Telefónica

Accessible Telefónica is a comprehensive project to help people with disabilities which was launched in 2008. The objective of this programme is to make Telefónica into a group which is fully accessible for all, and which contributes actively to full equality of opportunity for people with disabilities.

In collaboration with the CNSE (Confederación Nacional de Sordos - the National of the Deaf Confederation), Telefónica has developed a communication platform for people with hearing disabilities in public and private services, including emergency services, healthcare, education and official administration.

## "Homage to Communication"

A sculpture by Ramón Carrera



The sculpture "Homage to Communication," as seen by the artist.

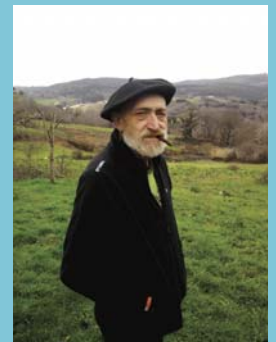
"There is no telephone without sound and sound is represented like this: ☎ and there is no sound without voice ☎ mouth ☎ or a speaker ☎, and it can be written as: ☎telephone.

To see the full meaning, simply turn the sculpture around and connect what you see with what it reminds you of ☎ is this a "C" or a mouth? Or the moon... in sculpture there are no opposites, just complements; it is symbolized just as it occurs. ☎ OSO = everything, called yin yang in Chinese and OSO in Basque.

*Pepín Carrera  
Goiuri 26-1-10*

This sculpture by the Basque sculptor Pepín Karrera represents his personal vision of the Company.

With it, Telefónica wants to, on the one hand, represent its transformation programme for the year 2012, the bravo! programme; and on the other, to make a visible recognition of those professionals who contribute transforming ideas to it over the next three years. Telefónica's goal is to award 1,500 small versions of this sculpture to its most innovative employees. 1,500 sculptures...1,500 bravo! awards.





# 03

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## bravo! programme

Telefónica's transformation  
project for 2012

# 03

## bravo! programme

bravo! sets the path  
for Telefónica's transformation  
process, returning to growth

### A new environment

Telefónica operates in a growing environment. Consumer habits are the driving force behind greater use of communications: it has been estimated that global data traffic will increase fourfold between 2008 and 2012. We are experiencing a paradigm shift: from the Internet of people, to the Internet of things, with mobile communications becoming ever more important.

There are several factors behind this growth: new consumer habits, social networking and the increasing importance of online shopping.

Communications make it possible for businesses and companies to increase productivity and competitiveness, and they are becoming a fundamental tool for Governments in promoting a new economic model.

A third important factor is the constant appearance of new devices with greater capacity and ever more features which are driving demand.

In this environment, the great challenge is to monetise this growth in traffic whilst maintaining profitability and investment to ensure the progress of Telefónica as a business.

### A necessary transformation

In this new environment, the nature of revenue will change considerably and we need to transform ourselves in order to lead the market and become the best global communication company in the digital world. This transformation will be based on 4 pillars: customers, offer, platforms and culture.

Our **customers** shape our commercial model and what we offer, and the Company aims to create emotional links with them.

In order to reinforce our **offer**, we offer innovative plans based on service quality.

By accelerating the **transformation process**, the Company's platforms will offer more efficient processes and activities.

The Company regards its sustainable management **culture** as an opportunity to set itself apart and increase its long-term value. The Company is strongly committed to the sustainable development of people, the brand and the reputation of the companies in which it is involved.

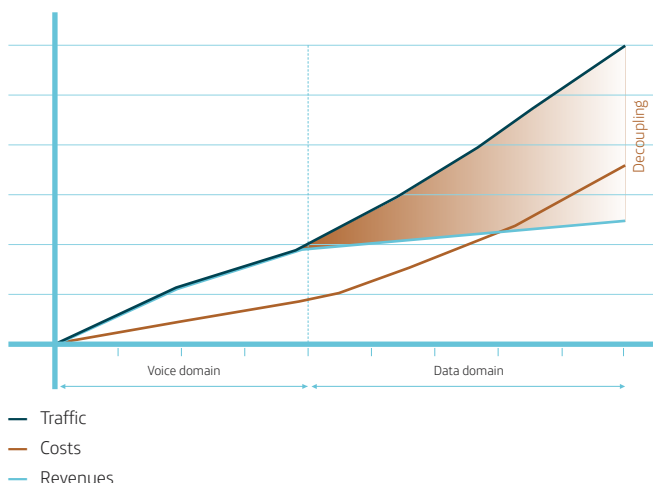
### A strategy in response: bravo!

Telefónica has a goal for 2012: to develop into the best communications company in the digital world. The bravo! transformation programme will set the course for achieving this.

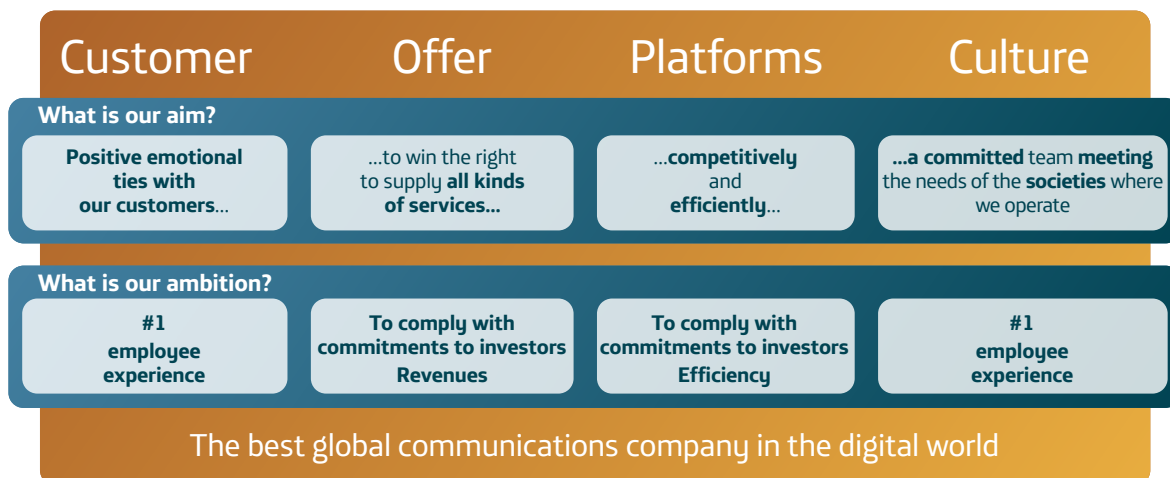
The way markets are developing requires the Company to respond, and it is able to do this because of its maturity and the advantages of being the leader in the sector.

The bravo! programme is based on four pillars which support our route to becoming the best global company in the digital world. We have a target for each of these for 2012.

- **Customer:** with the goal of developing positive emotional relations.







- **Offer:** to transform ourselves into a supplier of services which go beyond connectivity, aided by building emotional bonds with our customers. Objective: To comply with our revenue growth commitments with investors.
- **Platforms:** developing towards a transformative operating model which is competitive and efficient, which exploits scale and synergies to improve efficiency ratios.
- **Culture:** sustainability for all shareholders. Our goal is to become the leaders in employee satisfaction.

The bravo! programme will enable the Company to continue on its path of growth and market leadership, reflecting the diversity of Telefónica and how this combines into a common culture.

## The four pillars of bravo!



### Customer

Our goal is to develop emotional ties and to develop into a more customer-centred company. In order to do this, we need to have comprehensive and segmented information on our customers. We need to focus on what they value most, we need to meet their needs on first contact, and we need to do this in the simplest way possible.

Our goal is to achieve substantial leadership in Customer Satisfaction (CSI) in every market so that we can develop positive emotional ties with our customers and reinforce their loyalty.



### Offer

As a result of the way the sector and new habits are developing, the main challenge for what we offer is monetising traffic growth from new services. Telefónica has launched 3 initiatives to achieve this:

1. **Increasing and defending traditional business.** The value of fixed line services is being increased by packaging fixed line and mobile services and accelerating the adoption of broadband in the medium and low income segments.
2. **Leadership in Broadband.** Exploiting its potential. In fixed broadband we aim to lead the market with a segmented offer

which focuses on customer experience. For mobile broadband, we aim to capture potential growth in the value of our offer and to promote new devices.

3. **Developing new applications and businesses.** Our goal is to be a supplier of services which go further than just connectivity: the digital home, improved TV, ICT solutions, new businesses and online fixed and mobile services.



### Platforms

It is essential that we develop an operating model which is geared to transformation in order to achieve greater efficiency. Telefónica will achieve this through the following 3 initiatives:

1. We will continue progressing towards being an online company promoting the transformation processes and online migration.
2. We need our information systems to enable this transformation. We must ensure that our systems become facilitators for business without compromising IT efficiency.
3. We must offer the best network, through a multi-access strategy which makes it possible to achieve the best possible combination of fixed line and mobile accesses with a focus on achieving excellent customer experience.



### Culture

In order to drive the transformation, we need to create a single and common culture uniting all our employees. In Telefónica's case, this is based on:

1. **A committed team.**  
Creating a new customer-centred culture with a global focus, developing a team which is motivated, committed and high-performing.
2. **An emotional and integrated approach.**  
We will gradually increase differentiation between our corporate brand (Telefónica) and our commercial brands (Movistar and O2).
3. **A Commitment to Society.**  
We want to be perceived as the most trusted long-term "strategic partner" for all relevant communities and organisations.



# 04

## Results

1	Financial Highlights	<b>50</b>
2	Market Size	<b>53</b>
3	Consolidated Results	<b>55</b>
4	Financial Data	<b>59</b>
5	Results by regional business units: Telefónica España	<b>66</b>
6	Results by regional business units: Telefónica Latinoamérica	<b>74</b>
7	Results by regional business units: Telefónica Europe	<b>96</b>
8	Results by regional business units: Other Companies	<b>106</b>

## Financial Highlights

- Telefónica recorded solid results in 2009, meeting all its financial targets for the seventh consecutive year despite the challenging economic and operating environment, reflecting the value of its highly diversified business portfolio.
  - Under the criteria used to establish 2009<sup>1</sup> guidance:
    - Revenues advanced 0.3%, in line with the Company's positive growth forecast;
    - OIBDA increased by 1.1%, within the announced range of 1%-3%;
    - CapEx totalled 7,459 million euros vs. a target of less than 7,500 million euros;
    - Operating Cash Flow (OIBDA-CapEx) increased by 8.4%, in line with the range of 8%-11%.
- The Company's strategy allowed it to strengthen the bases for future growth while sustaining an outstanding operating efficiency. This is reflected in Telefónica's OIBDA margin and its high cash flow generation. As a result, there was acceleration from revenues to operating cash flow in year-on-year organic<sup>2</sup> growth rates.
  - Total accesses increased by 5.1%<sup>3</sup>, to around 265 million, with sharp rises in mobile<sup>3</sup> (+7.4%), fixed broadband (+8.2%) and pay TV (+9.8%) accesses. Mobile broadband accesses also registered significant growth, topping 15 million at the end of December (vs. 9 million accesses in 2008).
  - There was a ramp-up in commercial activity across all areas of operation in the fourth quarter, with mobile net adds<sup>3,4</sup> exceeding 6.8 million (around 15.0 million in the full year).
  - Revenues reached 56,731 million euros (+0.2% in organic<sup>2</sup> terms) while OIBDA advanced 0.9% year-on-year in organic<sup>2</sup> terms to 22,603 million euros.
  - The OIBDA margin stood at 39.8%, a 0.3 percentage points year-on-year improvement in organic<sup>2</sup> terms.
  - Operating cash flow (OIBDA-CapEx) totalled 15,346 million euros, representing solid year-on-year growth of 8.0% in organic<sup>2</sup> terms thanks to the 1.4 percentage points improvement in the efficiency ratio<sup>5</sup> versus 2008, to 74.1%.

*Note 1: **Base guidance 2009:** 2008 adjusted figures for guidance excludes Sogecable capital gain (143 million euros) and the application of provisions made in T. Europe in respect of potential contingencies deriving from the past disposal of shareholdings, one these risks had dissipated or had not materialized (174 million euros), includes 9 months of consolidation of Telemig in T. Latam. 2009 figures for guidance assume 2008 constant FX (average FX in 2008) and exclude the impact of the hyperinflationary accounting in Venezuela. In terms of guidance calculation, OIBDA exclude capital gains and losses from sale of companies and write-offs. Group CapEx excludes Real Estate Efficiency Program of T. España and spectrum licenses.*

*Note 2: **Organic growth rates:** Assuming constant exchange rates, excluding the impact of the hyperinflationary accounting in Venezuela, and including the consolidation of Telemig in January-March 2008. OIBDA and OI exclude the impacts of the capital gains from the sale of Airwave and Sogecable, registered in 2008, and the impact of the capital gains from the disposal of Medi Telecom in the fourth quarter of 2009.*

*Note 3: **Accesses growth criteria:** Excluding Medi Telecom's customers from the 2008 and 2009 bases, after its disposal in the fourth quarter of 2009.*

*Note 4: **Net adds calculation criteria:** For comparison purposes, net customer additions exclude the disconnection of inactive customers in December 2008 and December 2009.*

*Note 5: **Efficiency ratio definition:** Last twelve months (OpEx+CapEx-Internal expenses capitalized in fixed assets)/Revenues. CapEx excludes the acquisition of spectrum and Efficiency Program at T. España.*

- **Telefónica España** consolidated its leadership position, built the foundations for future growth and maintained a substantial cash flow generation against a challenging economic backdrop:
  - Noteworthy is the slowdown in the pace of year-on-year revenue decline for the second consecutive quarter, both at the wireline and wireless businesses. In the fourth quarter this improvement stood at 2.1 percentage points versus the third quarter on comparable<sup>6</sup> basis.
  - The Company remains a sector benchmark for efficiency with an OIBDA margin of 48.0% in 2009 on comparable basis<sup>6</sup>.
- **Telefónica Latinoamérica** delivered a solid operating and financial performance in a region with significant growth potential:
  - The number of accesses managed in the region advanced by 6.5% to close to 169 million, and commercial activity increased sharply in the fourth quarter, which saw the first positive year-on-year growth in net adds in 2009.
  - Particularly noteworthy is the acceleration in year-on-year organic growth<sup>7</sup> from revenues (+5.3%) to operating cash flow (OIBDA-CapEx +29.8%), being Mexico the main contributor to operating cash flow growth in 2009.
- **Telefónica Europe's** 2009 results reflect the benefits of its increased business diversification and ongoing efficiency improvements:
  - Telefónica Europe strengthened its competitive position in its main markets, outperforming market revenue growth.
  - Revenue growth, excluding the impact of mobile termination rates cuts and foreign exchange rates, improved on a sequential basis, underpinned by the increase in wireless accesses (+6.9% year-on-year); operating cash flow jumped 21.7% year-on-year in organic<sup>8</sup> terms.
- **Net income** reached 7,776 million euros in 2009 and earnings per share amounted to 1.71 euros, up 2.4% and 4.5% year-on-year in reported terms, respectively.
- **The ratio of net debt + commitments to OIBDA** stood at 2.1 times in 2009, reflecting the Company's financial strength.
- **The Company announces its guidance<sup>9</sup> for 2010**, which reflect a strategy focused on capturing the growth in its markets while maintaining high cash flow generation. **Telefónica forecasts:**
  - Consolidated year-on-year revenue growth in the range of +1%/+4%;
  - Consolidated year-on-year OIBDA growth in the range of +1%/+3%;
  - CapEx in the range of 7,450/7,650 million euros.
- **2009 Bases<sup>9</sup> for financial targets:**
  - Consolidated revenues: 56,407 million euros.
  - Consolidated OIBDA: 22,344 million euros.
  - Consolidate CapEx: 7,262 million euros.
- **The Company also reiterates its 2010 EPS<sup>10</sup> target of 2.10 euros and its medium-term guidance.**
- **Telefónica confirms its dividend targets through 2012** (1.15 euros per share in 2009, 1.40 euros per share<sup>11</sup> in 2010 and a minimum of 1.75 euros per share<sup>11</sup> in 2012).

Note 6: **Comparable basis in T. España:** Exclude the following effects: Universal Service Obligation: 183 million euros in revenues and 51 million euros in OIBDA in the third quarter of 2008, 75 million euros in revenues and 22 million euros in OIBDA in the first quarter of 2009 and 148 million euros in revenues and 47 million euros in OIBDA in the fourth quarter of 2009; bad debt recovery: 25 million euros in OIBDA in the first quarter of 2008; real estate capital gains: 6 million euros in OIBDA in 2009 and 74 million euros in 2008; revision of the estimates for the adjustment to workforce provision provided for in prior periods, which has resulted in lower expenses of 90 million euros in the second quarter of 2009; sale of application rights: 48 million euros in revenues and OIBDA in the third quarter of 2009; and 220 million euros in OIBDA from capital gains on the disposal of Medi Telecom in the fourth quarter of 2009.

Note 7: **Organic growth in T. Latinoamérica:** Assuming constant exchange rates, excluding the impact of the hyperinflationary accounting in Venezuela, and including the consolidation of Telemig in January-March 2008.

Note 8: **Organic growth in T. Europe:** Assuming constant exchange rates and excluding the impacts of the capital gains from the sale of Airwave.

Note 9: **Base guidance 2010:** 2009 adjusted figures for guidance exclude Telyco Morocco results in T. España, Medi Telecom capital gain and write-offs. 2010 guidance assumes constant exchange rates as of 2009 (average FX in 2009) and excludes hyperinflationary accounting in Venezuela in both years. It also includes 10 months of consolidation of Hansenet and Jajah in T. Europe. In terms of guidance calculation, OIBDA excludes capital gains and losses from sale of companies and write-offs. Group CapEx excludes Real Estate Efficiency Program of T. España and spectrum licenses.

Note 10: **Earnings per share criteria:** Reported EPS.

Note 11: **Dividend's considerations:** Targeted under current guidance hypothesis.

## Telefónica Group Selected Financial Data

	January - December		% Chg		Guidance criteria
	2009	2008	Reported	Organic	
Unaudited figures (Euros in millions)					
Revenues	56,731	57,946	(2.1)	0.2	0.3
Telefónica España <sup>1</sup>	19,703	20,838	(5.4)	(5.4)	
Telefónica Latinoamérica	22,983	22,174	3.7	5.3	
Telefónica Europe	13,533	14,308	(5.4)	1.1	
OIBDA <sup>2,3,4</sup>	22,603	22,919	(1.4)	0.9	1.1
Telefónica España <sup>1,4</sup>	9,757	10,285	(5.1)	(7.3)	
Telefónica Latinoamérica	9,143	8,445	8.3	10.1	
Telefónica Europe <sup>2</sup>	3,910	4,180	(6.4)	4.1	
OIBDA margin <sup>2,3,4</sup>	39.8%	39.6%	0.3 p.p.	0.3 p.p.	
Telefónica España <sup>4</sup>	49.5%	49.4%	0.2 p.p.	(1.0 p.p.)	
Telefónica Latinoamérica	39.8%	38.1%	1.7 p.p.	1.7 p.p.	
Telefónica Europe <sup>2</sup>	28.9%	29.2%	(0.3 p.p.)	0.8 p.p.	
Operating Income (OI) <sup>2,3,4</sup>	13,647	13,873	(1.6)	0.7	
Telefónica España <sup>4</sup>	7,617	8,046	(5.3)	(8.1)	
Telefónica Latinoamérica	5,350	4,800	11.5	13.9	
Telefónica Europe <sup>2</sup>	1,015	1,144	(11.3)	14.3	
Net income <sup>2,3,4</sup>	7,776	7,592	2.4		
Basic earnings per share (euros) <sup>2,3,4</sup>	1.71	1.63	4.5		
Free Cash Flow per share (euros)	2.00	1.97	1.5		
OpCF (OIBDA-CapEx) <sup>2,3,4</sup>	15,346	14,519	5.7	8.0	8.4
Telefónica España <sup>1,4</sup>	7,893	8,077	(2.3)	(5.0)	
Telefónica Latinoamérica	5,693	4,410	29.1	29.8	
Telefónica Europe <sup>2</sup>	2,183	2,108	3.5	21.7	

### - Reconciliation included in the excel spreadsheets.

- In comparable terms revenues of Telefónica España would decline by 5.9%, OIBDA would decrease by 8.0% and OpCF would drop 5.9%. Comparable terms exclude Universal Service: 183 million euros in revenue and 51 million euros in OIBDA in the third quarter of 2008, 75 million euros in revenues and 22 million euros in OIBDA in the first quarter of 2009, and 148 million euros in revenues and 47 million euros in OIBDA in the fourth quarter of 2009; bad debt recovery: 25 million euros in OIBDA in the first quarter of 2008; real estate capital gains: 6 million euros in OIBDA in January-December 2009 and 74 million euros in OIBDA in the same period in 2008; revision of the estimates for the adjustment to workforce adaptation plans provided for in prior periods, which resulted in lower expenses of 90 million euros in the second quarter of 2009; sale of applications rights: 48 million euros in revenue and OIBDA in the third quarter of 2009 and capital gain from the disposal of Medi Telecom of 220 million in OIBDA in the fourth quarter of 2009.
- 2008 includes a positive impact of 174 million euros derived from Airwave disposal. OIBDA and OI include 44 million euros from restructuring costs registered in 2009.
- Sogecable capital gain amounting 143 million euros is recorded in the second quarter of 2008.
- Medi Telecom capital gain amounting 220 million euros is recorded in the fourth quarter of 2009.

### Notes:

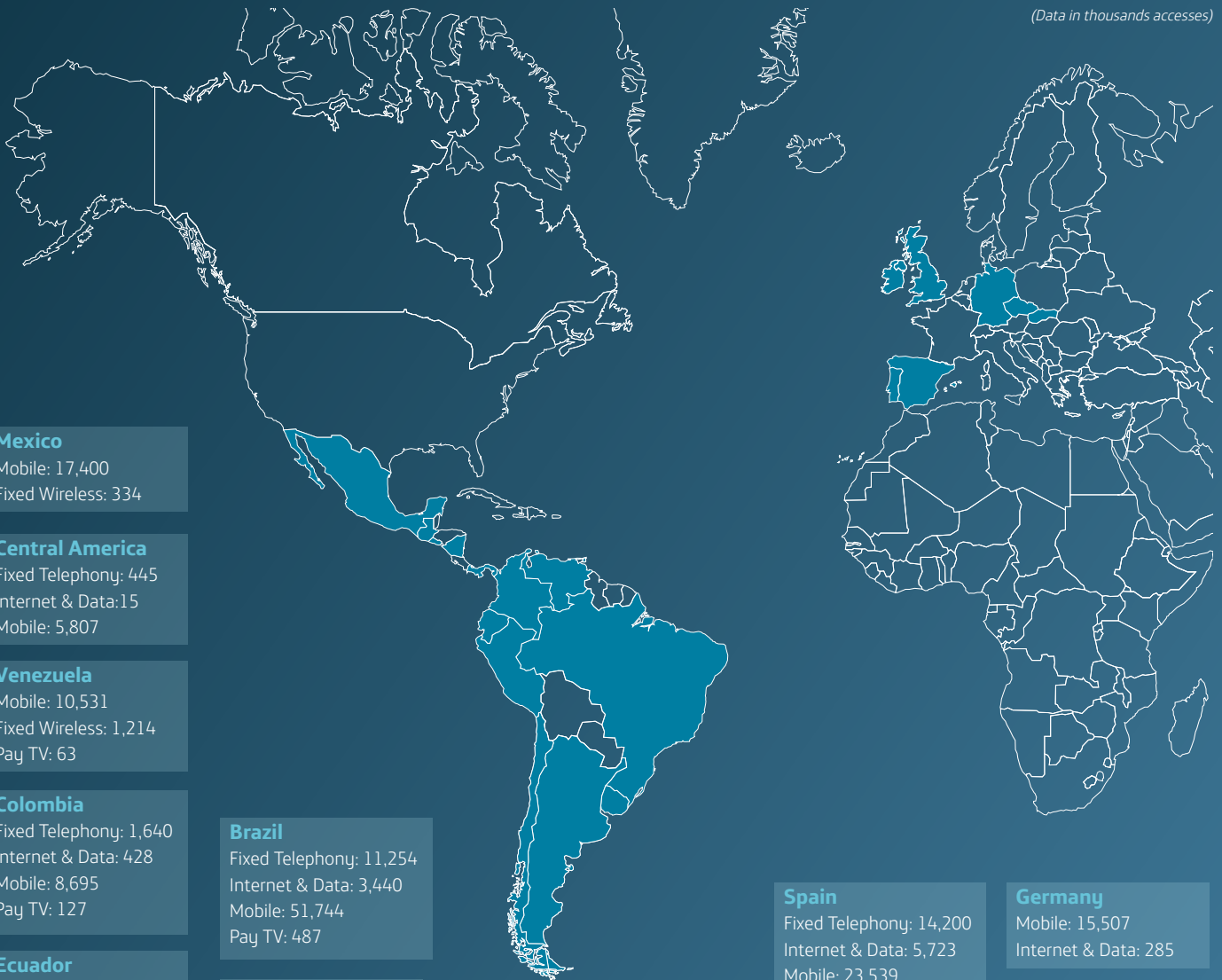
- OIBDA and OI are presented before brand fees and management fees.
- OIBDA margin calculated as OIBDA over revenues.
- Starting April 2008, Vivo consolidates Telemig.
- Organic criteria: Assuming constant exchange rates, excluding the impact of the hyperinflationary accounting in Venezuela, and including the consolidation of Telemig in January-March 2008. OIBDA and OI exclude the impacts of the capital gains from the sale of Airwave and Sogecable, registered in the second quarter of 2008, and the impact of the capital gain from the disposal of Medi Telecom in the fourth quarter of 2009.
- Guidance criteria: 2008 adjusted figures for guidance excludes Sogecable capital gain (143 million euros) and the application of provisions made in T. Europe in respect of potential contingencies deriving from the past disposal of shareholdings, one these risks had dissipated or had not materialized (174 million euros), includes 9 months of consolidation of Telemig in T. Latam. 2009 figures for guidance assume 2008 constant FX (average FX in 2008) and exclude the impact of the hyperinflation in Venezuela. In terms of guidance calculation, OIBDA exclude capital gains and losses from sale of companies and write-offs. Group CapEx excludes Real Estate Efficiency Program of T. España and spectrum licenses.
- 2009 figures impacted by the hyperinflation in Venezuela.

# 04

## 2

### Market Size

(Data in thousands accesses)



**Mexico**  
 Mobile: 17,400  
 Fixed Wireless: 334

**Central America**  
 Fixed Telephony: 445  
 Internet & Data: 15  
 Mobile: 5,807

**Venezuela**  
 Mobile: 10,531  
 Fixed Wireless: 1,214  
 Pay TV: 63

**Colombia**  
 Fixed Telephony: 1,640  
 Internet & Data: 428  
 Mobile: 8,695  
 Pay TV: 127

**Ecuador**  
 Mobile: 3,722  
 Fixed Wireless: 85

**Peru**  
 Fixed Telephony: 2,971  
 Internet & Data: 801  
 Mobile: 11,458  
 Pay TV: 686

**Brazil**  
 Fixed Telephony: 11,254  
 Internet & Data: 3,440  
 Mobile: 51,744  
 Pay TV: 487

**Uruguay**  
 Mobile: 1,615

**Chile**  
 Fixed Telephony: 2,028  
 Internet & Data: 807  
 Mobile: 7,525  
 Pay TV: 285

**Argentina**  
 Fixed Telephony: 4,608  
 Internet & Data: 1,351  
 Mobile: 15,932

**Spain**  
 Fixed Telephony: 14,200  
 Internet & Data: 5,723  
 Mobile: 23,539  
 Pay TV: 703

**United Kingdom**  
 Mobile: 21,299  
 Internet & Data: 592

**Ireland**  
 Mobile: 1,714

**Germany**  
 Mobile: 15,507  
 Internet & Data: 285

**Slovakia**  
 Mobile: 553

**Czech Republic**  
 Fixed Telephony: 1,771  
 Internet & Data: 849  
 Mobile: 4,945  
 Pay TV: 138

## Telefónica Group Accesses

	December		
	2009	2008	% Chg
Unaudited figures (thousands)			
<b>Final Clients Accesses</b>	<b>260,510.2</b>	<b>255,671.1</b>	<b>1.9</b>
Fixed telephony accesses <sup>1</sup>	40,606.0	42,930.8	(5.4)
Internet and data accesses	15,082.5	14,654.3	2.9
Narrowband	1,427.5	1,997.2	(28.5)
Broadband <sup>2</sup>	13,492.6	12,472.1	8.2
Other <sup>3</sup>	162.4	185.0	(12.2)
Mobile accesses	202,332.5	195,818.6	3.3
Pay TV	2,489.2	2,267.5	9.8
<b>Wholesale Accesses</b>	<b>4,095.3</b>	<b>3,433.0</b>	<b>19.3</b>
Unbundled loops	2,206.0	1,748.1	26.2
Shared ULL	447.7	602.3	(25.7)
Full ULL	1,758.3	1,145.8	53.5
Wholesale ADSL <sup>4</sup>	463.4	534.7	(13.3)
Other <sup>5</sup>	1,426.0	1,150.1	24.0
<b>Total Accesses</b>	<b>264,605.5</b>	<b>259,104.1</b>	<b>2.1</b>

**Notes:**

- As of 31 December 2007, in order to align the criteria for the key performance indicators of the mobile operations of the Group, the series of mobile accesses, and therefore, of total accesses, have been revised, including machine to machine accesses. In addition, the accounting criteria for pre-pay access in the Czech Republic and Slovakia have been modified to align them, changing from 13 months (registered) to three months (active).
- December 2008 and 2009 accesses include the disconnection of inactive customers.

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

2 ADSL, satellite, optical fibre, cable modem and broadband circuits.

3 Retail circuits other than broadband.

4 Includes Unbundled Lines by T. O2 Germany.

5 Circuits for other operators. Includes Wholesale Line Rental (WLR).



## Consolidated Results

Telefónica posted a solid set of results in 2009 meeting all its financial targets for the year, despite the adverse economic environment and the major operational challenges the Company had to face.

These results highlight the strengths of the Company, being key the value of its highly diversified asset portfolio -both geographical and by business-, its competitive leadership in its main markets and its proven execution skills, all in a framework of sound financial position.

The Company's flexibility to adapt to changes in the operating environment is reflected in its performance over a year in which Telefónica adapted its commercial focus to the progressive economic upturn, with a sharp increase in commercial activity across all regions of operations in the second half. This strategy allowed the Company to strengthen the bases for future growth while maintaining a high efficiency. This is reflected in Telefónica's OIBDA margin and its high cash flow generation.

The Company's intense commercial activity resulted in a 5.1% year-on-year increase in **total accesses**<sup>1</sup> to around 265 million. This growth was underpinned by the increase in wireless<sup>1</sup> (+7.4%), fixed broadband (+8.2%) and pay TV (+9.8%) accesses. By region, the growth rates reported by Telefónica Europa (+6.9% year-on-year) and Telefónica Latinoamérica (+6.5% year-on-year) must be highlighted.

By type of access, the Telefónica Group had over 202 million **wireless accesses** at the end of 2009, with net adds of around 15.0 million accesses in comparable terms<sup>1,2</sup>. It is worth highlighting that in the second half of the year net adds tripled the ones for the first six months. This impressive performance was underpinned by the significant improvements in the three areas of operations, whose quarterly net adds progressively rose over the year. In the second half of the year, net adds<sup>2</sup> in Latin America were 3.3 times higher than in January-June 2009, while wireless net adds<sup>2</sup> at Telefónica España and Telefónica Europa in the second half were 4.9 times and 1.9 times higher respectively than in January-June 2009.

The main drivers of wireless net adds to December 2009 were Brazil (6.8 million), Mexico (2.1 million), Germany<sup>2</sup> (1.5 million), Argentina (1.1 million) and UK (1.0 million). The main contributors in the fourth quarter were Brazil (2.9 million), Mexico (0.9 million), Argentina (0.5 million) and Germany<sup>2</sup> (0.6 million).

Mobile broadband accesses also registered significant growth, exceeding 15 million at the end of December 2009 (vs. 9 million accesses recorded in 2008).

**Retail internet broadband accesses** stood at 13.5 million, a year-on-year increase of 8.2%, driven by the growing adoption of bundled voice, ADSL and Pay-TV service packages. In Spain nearly 88% of retail broadband accesses are bundled as part of some kind of dual or triple play package, whilst in Latin America almost 56% of broadband accesses are bundled as part of Duos or Trios. In 2009 net adds exceeded 1.0 million accesses (0.3 million in the fourth quarter), mostly from Argentina and UK.

**Pay TV accesses** stood at around 2.5 million at the end of 2009, 9.8% up from a year earlier. It is worth mentioning that the Company already offers Pay-TV services in Spain, the Czech Republic, Peru, Chile, Colombia, Brazil, Venezuela and Argentina.

With regard to financial results, it is worth mentioning that during 2009 and the beginning of 2010 several factors have surfaced with respect to the Venezuelan economy that have led to reconsider the accounting treatment that the Telefónica Group currently applies in the translation of the financial statements of its subsidiaries in Venezuela, and the recoverability of their financial investments in the country. Key among these factors are: the inflation index reached in 2009 and the cumulative inflation index over the last three years, restrictions in the official foreign exchange market, and finally, the devaluation of the Bolívar, by decision of the Government of that country on January 8th, 2010. Consequently, according to International Financial Reporting Standards (IFRS), the Venezuelan economy should be

<sup>1</sup> Excluding Medi Telecom's customers from the 2008 and 2009 bases, after its disposal in the fourth quarter of 2009.

<sup>2</sup> For comparison purposes, net customer additions exclude the disconnection of inactive customers in December 2008 and December 2009.

considered as hyperinflationary for 2009. As a result, the financial results of Telefónica Group and, therefore, those of Telefónica Latinoamérica and the Atento Group are affected by the above mentioned effects.

With respect to the above mentioned matters, the main impacts on the 2009 consolidated financial statements of the Telefónica Group are the following:

Million euros	
Revenue	267
OIBDA	64
Net Income	(548)
Translation differences	1,224
Net impact in Equity	676

For comparative purposes and in order to facilitate the interpretation of the year-on-year variations versus 2008 results, changes in constant currency of the items affected by the hyperinflation adjustment are reported excluding these impacts.

Therefore, and despite the complex trading environment in 2009, reflected in sharp pressure on revenues in some of our markets, the strong diversification of the Company's business portfolio enabled the Group to achieve revenues of 56,731 million euros in 2009 (-2.1% year-on-year in reported terms), up 0.2% year-on-year in organic<sup>3</sup> terms. Particularly noteworthy is the significant increase in revenues at Telefónica Latinoamérica, which contributed 2.7 percentage points to organic<sup>3</sup> growth and, to a lesser extent, at Telefónica Europa, which contributed 0.2 percentage points. Also worth noting is the improved revenue performance from Telefónica España in the second half of the year, with a slowdown in the pace of year-on-year revenue decline in the fourth quarter (for the second consecutive quarter).

The negative impact from foreign exchange rates reduced revenue growth by 2.9 percentage points, excluding the impact from hyperinflationary accounting while changes in the consolidation perimeter added 0.1 percentage points, also excluding the adjustment from hyperinflationary accounting.

By service, broadband connectivity revenues (wireline and mobile) and revenues from applications and services continued to increase their contribution to Group revenues, adding 2.5 percentage points to organic<sup>3</sup> revenue growth in 2009. This offsets the lower contribution of access, voice and equipment resulting from the consumers' usage optimization in the current economic environment.

In absolute terms, Telefónica Latinoamérica contributed 40.5% to total Group revenues (+1.8 percentage points compared to 2008, excluding the impact from hyperinflationary accounting), whilst Telefónica España and Telefónica Europe contributed 34.7% and 23.9% to Group revenue respectively.

Telefónica Group's operating expenses in 2009 amounted to 35,489 million euros, down 0.4% from 2008 in organic terms<sup>3</sup> (-2.9% in reported terms), as a result of lower supply expenses.

**Supply expenses** declined by 6.2% to December in reported terms. Excluding exchange rate effects and the impact from hyperinflationary accounting, supply expenses fell 3.1% year-on-year. This decline is mainly due to lower interconnection costs resulting from the decline in fixed-to-mobile traffic and the fall in mobile termination rates.

**Personnel expenses** rose 2.7% year-on-year in constant euros and excluding the impact from hyperinflationary accounting to 6,775 million euros (+0.2% in reported terms). The average number of employees in the period was 255,151 (3,376 more than the 2008 average), mainly due to the larger workforce at the Atento Group. Excluding the Atento Group workforce, the average number of employees in the Telefónica Group was virtually stable year-on-year at 125,266.

**External service expenses** (9,921 million euros) rose 1.0% year-on-year in 2009 excluding the impact from exchange rates and from hyperinflationary accounting. This increase is largely due to higher customer, network and systems management expenses at Telefónica Latinoamérica. External service expenses fell 1.6% in reported terms in 2009.

**Gains on sale of fixed assets** in 2009 amounted to 248 million euros, mainly from the disposal of Medi Telecom, which generated 220 million euros of capital gains, registered in the fourth quarter of the year. It is worth highlighting that gains on sale of fixed assets in 2008 (292 million euros) were affected mainly by the sale of Sogecable and real estate disposals at Telefónica España and Telefónica O2 Czech Republic.

<sup>3</sup> Assuming constant exchange rates, excluding the impact of the hyperinflationary accounting in Venezuela, and including the consolidation of Telemig in January-March 2008. OIBDA and OI exclude the impacts of the capital gains from the sale of Airwave and Sogecable, registered in 2008, and the impact of the capital gains from the disposal of Medi Telecom in the fourth quarter of 2009.

The Company's focus on increasing efficiency and exploiting economies of scale was reflected in **operating income before depreciation and amortisation (OIBDA)**, which totalled 22,603 million euros in 2009 (-1.4% in reported terms). In organic<sup>4</sup> terms, OIBDA grew 0.9% year-on-year, underpinned by Telefónica Latinoamérica (+3.8 percentage points) and Telefónica Europa (+0.7 percentage points), which offset Telefónica España's lower contribution (-3.3 percentage points). In organic<sup>4</sup> terms, the Telefónica Group improved its OIBDA margin by 0.3 percentage points to 39.8%, mainly boosted by margin expansion at Telefónica Latinoamérica (+1.7 percentage points) and at Telefónica Europe (+0.8 percentage points).

OIBDA at Telefónica España accounted for 43.2% of total Group OIBDA, compared to 40.5% and 17.3% for Telefónica Latinoamérica and Telefónica Europe, respectively.

**Depreciation and amortisation** in 2009 totalled 8,956 million euros, up 1.2% year-on-year in organic terms<sup>4</sup> and excluding the adjustment for hyperinflationary accounting, mainly due to higher depreciation and amortisation at Telefónica Latinoamérica (+2.0 percentage points contribution to growth) and Telefónica Europa (+0.7 percentage points contribution to growth). In reported terms, depreciation and amortisation was down 1.0% year-on-year.

**Operating income (OI)** amounted to 13,647 million euros in 2009, with 0.7% year-on-year growth in organic<sup>4</sup> terms (-1.6% in reported terms).

**Profit from associated companies** reached 47 million euros to December (-161 million euros in 2008), mainly as a result of increased profits from the Company's stake in Portugal Telecom and reduced losses from its participation in Telco, S.p.A. Results for 2008 include the impact of the impairment charge taken by Telco, S.p.A.'s on the Company's investment in Telecom Italia, amounting to 209 million euros (146 million euros after the related tax effect at Telefónica, S.A.).

**Net financial results** in 2009 amounted to 3.307 million euros (+18.2% vs. 2008), with the average cost of debt of the Group standing at 7.3%. The impact derived from recent announcements coming from Venezuela amounted to 630 million euros; stripping out this effect, the average cost was 5.92%, with a 4.3% decline in the financial costs vs. the previous year, due to:

- Lower expenses (298 million euros) due to lower interest rates during 2009 mainly in European currencies.
- A decrease of 3.7% in the average debt, which has generated savings of 104 million euros.
- Changes of the actual value of commitments derived mainly from the pre-retirement plans and other positions equally accounted at market value have generated a lower income of 85 million euros. .
- Changes in the foreign exchange gains and losses up to December 2009 with respect to 2008 yielded a higher cost of 197 million euros.

**Free cash flow** generated by the Telefónica Group in 2009 reached 9,097 million euros. Out of this figure, 959 million euros were assigned to Telefónica's share buyback program, 4,557 million euros to Telefónica S.A. dividend payment and 793 million euros to commitment cancellations derived mainly from the pre-retirements plans. In addition there was a payment of 1,178 million euros due to financial investments and divestments. As a result, net financial debt decreased by 1,610 million euros. On the other hand, net debt increased by an additional 2,429 million euros because of the foreign exchange impact, changes in the consolidation perimeter and other effects on financial accounts. All this led to an increase of 818 million euros with respect to the net financial debt at the end of 2008 (42,733 million euros), leaving the final figure in December 2009 at 43,551 million euros.

**The leverage ratio**, net debt over OIBDA, stood at 1.9 times at December 2009, in line with the reported leverage ratio at September 2009.

During 2009, the **financing activity** of the Telefónica Group, excluding short term Commercial Paper Programmes activity, rose above 14,000 million euros mainly focused on refinancing 2009 maturities and pre-financing part of 2010 debt at Telefónica, S.A. level. It is worth highlighting the 5 years Euro-denominated bond issue for an amount of 2,000 million euros raised in January, 1,000 million euros raised in March through a 7 years bond issue, the re-opening of this last one in June for another 500 million euros, a 6 year private issue of 400 million euros placed in the same month and a US dollar-denominated issue for USD 2,250 million divided in 2 tranches of 5.5 and 10 years maturities launched in June. During the last quarter of the year, Telefónica issued in November a 10 year euro denominated bond for an amount of 1,750 million euros and, in December, Telefónica launched a 5 year private issue for 100 million euros and a 13 year bond for an amount of GBP 650 million. Thanks to these transactions, the Group's cash position exceeds 2010 maturities.

<sup>4</sup> Assuming constant exchange rates, excluding the impact of the hyperinflationary accounting in Venezuela, and including the consolidation of Telemig in January-March 2008. OIBDA and OI exclude the impacts of the capital gains from the sale of Airwave and Sogecable, registered in 2008, and the impact of the capital gains from the disposal of Medi Telecom in the fourth quarter of 2009.

Additionally, in February a 4,000 million euros extension on a syndicated facility maturing in 2011 was successfully signed, smoothing 2011 maturities and adjusting them to levels more in line with cash flow generation figure. Of this figure, 2,000 million euros were shifted to 2012 and the remaining 2,000 million euros were shifted to 2013.

Telefónica S.A. and its holding companies have continued active during 2009 under its various Commercial Paper Programmes (Domestic and European), for an outstanding balance of approximately 800 million euros.

Regarding Latin America, Telefónica subsidiaries have tapped the capital markets up to December 2009 for an amount above 2,000 million equivalent euros, mainly for refinance 2009 maturities and renewing existing debt.

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

In 2009 income taxes totalled 2,450 million euros, implying a tax rate of 23.6%. It is worth mentioning that at the end of 2009, the European Commission's conclusion with respect to the legal action against the Kingdom of Spain regarding tax amortization of goodwill generated from certain foreign investments made subsequent to December 21st, 2007 was published. In accordance to the above, this decision has no effect on the Telefónica Group. As the above mentioned legal action has been resolved, the consolidated income statement of the Telefónica Group for 2009 will reflect a lower income tax expense for the tax amortization of goodwill from the acquisition date to year-end, in an amount of 591 million euros.

In addition, the expected impact in future years is estimated to be a lower income tax expense of approximately 140 million euros on an annual basis. It should be noted that, in accordance with the Spanish Tax Income Law goodwill amortization charges are deductible for 20 years.

Losses attributable to minority interests reduced net income to the end of December by 161 million euros (-234 million euros in 2008), mainly due to minority interests in the profits of Telesp, Telefónica O2 Czech Republic and in the losses of Telefónica Telecom. This year-on-year change in performance is explained by the lower profits attributable to minority interests in Telefónica Chile (following the takeover bid for minority interests in 2008) and Telesp, and the increased losses at Telefónica Telecom.

As a result of the above, consolidated net income in 2009 amounted to 7,776 million euros, up 2.4% from 2008 in reported terms, whereas basic earnings per share in 2008 stood at 1.71 euros, with a 4.5% year-on-year growth.

CapEx in 2009 reached 7,257 million euros (-11.1% year-on-year in organic terms<sup>5</sup>), with the investment devoted to growth and transformation being the Company's priority. Therefore, as compared to 2008, 3G coverage increased by 15 percentage points, fixed loops able to support bandwidth above 25 Mbps grew by 6 percentage points, whereas the capacity of the IP network doubled. As a result, operating cash flow (OIBDA-CapEx) stood at 15,346 million euros, up 8.0% year-on-year in organic terms<sup>6</sup>. million euros) and at Telefónica Europa (+21.7% in organic terms<sup>6</sup>, 5,693 million euros) and at Telefónica Europa (+21.7% in organic terms<sup>6</sup>; 2,183 million euros), which offset the lower cash flow generated by Telefónica España in comparable terms<sup>5</sup> (-5.9% to 7,893 million euros). Economies of scale and efficient management of operating expenses and investment enabled an efficiency ratio<sup>7</sup> of 74.1% to be achieved, a year-on-year improvement of 1.4 percentage points.

All in all, 2009 results show acceleration from revenues to operating cash flow in organic growth terms<sup>6</sup>, with the latter exceeding revenue growth by 7.8 percentage points, highlighting the Company's success in combining strong commercial activity with high cash flow generation in a complex macroeconomic context.

5 Comparable basis exclude following effects: Universal Service Obligation: 183 million euros in revenues and 51 million euros in OIBDA in the third quarter of 2008, 75 million euros in revenues and 22 million euros in OIBDA in the first quarter of 2009 and 148 million euros in revenues and 47 million euros in OIBDA in the fourth quarter of 2009; bad debt recovery: 25 million euros in OIBDA in the first quarter of 2008; real estate capital gains: 6 million euros in OIBDA in 2009 and 74 million euros in 2008; revision of the estimates for the adjustment to workforce provision provided for in prior periods, which has resulted in lower expenses of 90 million euros in the second quarter of 2009; sale of application rights: 48 million euros in revenues and OIBDA in the third quarter of 2009; and 220 million euros in OIBDA from capital gains on the disposal of Medi Telecom in the fourth quarter of 2009.

6 Assuming constant exchange rates, excluding the impact of the hyperinflation accounting in Venezuela, and including the consolidation of Telemig in January-March 2008. OIBDA and OI exclude the impacts of the capital gains from the sale of Airwave and Sogetel, registered in 2008, and the impact of the capital gains from the disposal of Medi Telecom in the fourth quarter of 2009.

7 Defined as (Operating expenses + CapEx - Own work capitalised) / Revenues for the last twelve months. CapEx excludes the acquisition of spectrum and the Real Estate Efficiency Programme at T. España.

Telefónica Group  
Consolidated income statement

	January - December			October - December		
	2009	2008	% Chg	2009	2008	% Chg
Unaudited figures (Euros in millions)						
Revenues	56,731	57,946	(2.1)	14,976	14,804	1.2
Internal exp capitalized in fixed assets	720	736	(2.2)	237	207	14.6
Operating expenses	(35,489)	(36,553)	(2.9)	(9,654)	(9,367)	3.1
Supplies	(16,717)	(17,818)	(6.2)	(4,560)	(4,607)	(1.0)
Personnel expenses	(6,775)	(6,762)	0.2	(1,770)	(1,697)	4.4
Subcontracts	(9,921)	(10,079)	(1.6)	(2,734)	(2,607)	4.9
Bad Debt Provisions	(874)	(748)	16.8	(210)	(186)	13.0
Taxes	(1,203)	(1,147)	4.9	(380)	(271)	40.3
Other net operating income (expense)	435	510	(14.7)	221	196	12.8
Gain (loss) on sale of fixed assets	248	292	(15.1)	230	56	n.m.
Impairment of goodwill and other assets	(42)	(12)	n.m.	(32)	(3)	n.m.
<b>Operating income before D&amp;A (OIBDA)</b>	<b>22,603</b>	<b>22,919</b>	<b>(1.4)</b>	<b>5,978</b>	<b>5,893</b>	<b>1.4</b>
<b>OIBDA margin</b>	<b>39.8%</b>	<b>39.6%</b>	<b>0.3 p.p.</b>	<b>39.9%</b>	<b>39.8%</b>	<b>0.1 p.p.</b>
Depreciation and amortization	(8,956)	(9,046)	(1.0)	(2,293)	(2,243)	2.2
<b>Operating income (OI)</b>	<b>13,647</b>	<b>13,873</b>	<b>(1.6)</b>	<b>3,685</b>	<b>3,650</b>	<b>0.9</b>
Profit from associated companies	47	(161)	c.s.	0	(180)	c.s.
Net financial income (expense)	(3,307)	(2,797)	18.2	(1,034)	(698)	48.0
<b>Income before taxes</b>	<b>10,387</b>	<b>10,915</b>	<b>(4.8)</b>	<b>2,651</b>	<b>2,771</b>	<b>(4.3)</b>
Income taxes	(2,450)	(3,089)	(20.7)	(161)	(715)	(77.5)
<b>Income from continuing operations</b>	<b>7,937</b>	<b>7,826</b>	<b>1.4</b>	<b>2,490</b>	<b>2,057</b>	<b>21.1</b>
Income (Loss) from discontinued ops.	(0)	0	c.s.	(0)	0	c.s.
Minority interest	(161)	(234)	(31.1)	(50)	(60)	(17.0)
<b>Net income</b>	<b>7,776</b>	<b>7,592</b>	<b>2.4</b>	<b>2,440</b>	<b>1,996</b>	<b>22.2</b>
<b>Weighted average number of ordinary shares outstanding during the period (millions)</b>	<b>4,553</b>	<b>4,646</b>	<b>(2.0)</b>	<b>4,554</b>	<b>4,593</b>	<b>(0.8)</b>
<b>Basic earnings per share (euros)</b>	<b>1.71</b>	<b>1.63</b>	<b>4.5</b>	<b>0.54</b>	<b>0.43</b>	<b>23.3</b>

## Notes:

- Starting April 2008, Vivo consolidates Telemig.
- For the basic earnings per share calculation purposes, the weighted average number of ordinary shares outstanding during the period have been obtained applying IFRS rule 33 "Earnings per share". Thereby, there are not been taken into account as outstanding shares the weighted average number of shares held as treasury stock during the period.
- 2008 includes a positive impact of 174 million euros from Airwave disposal.
- Sogecable capital gain amounting 143 million euros is recorded in the second quarter of 2008. Medi Telecom capital gain amounting 220 million euros is recorded in the fourth quarter of 2009.
- 2009 figures impacted by the hyperinflation in Venezuela.

## Telefónica Group Results by regional business units

	Revenues			OIBDA			Margin OIBDA		
	January - December			January - December			January - December		
	2009	2008	% Chg	2009	2008	% Chg	2009	2008	% Chg
Unaudited figures (Euros in millions)									
Telefónica España <sup>1,2</sup>	19,703	20,838	(5.4)	9,757	10,285	(5.1)	49.5%	49.4%	0.2 p.p.
Telefónica Latinoamérica <sup>3</sup>	22,983	22,174	3.7	9,143	8,445	8.3	39.8%	38.1%	1.7 p.p.
Telefónica Europe <sup>4</sup>	13,533	14,308	(5.4)	3,910	4,180	(6.4)	28.9%	29.2%	(0.3 p.p.)
Other companies and eliminations	512	625	(18.1)	(207)	9	c.s	n.m.	n.m.	n.m.
<b>Total Group<sup>2,3,4,5</sup></b>	<b>56,731</b>	<b>57,946</b>	<b>(2.1)</b>	<b>22,603</b>	<b>22,919</b>	<b>(1.4)</b>	<b>39.8%</b>	<b>39.6%</b>	<b>0.3 p.p.</b>

	Operating Income			CapEx			OPCF (OIBDA-CapEx)		
	January - December			January - December			January - December		
	2009	2008	% Chg	2009	2008	% Chg	2009	2008	% Chg
Unaudited figures (Euros in millions)									
Telefónica España <sup>1,2</sup>	7,617	8,046	(5.3)	1,863	2,208	(15.6)	7,893	8,077	(2.3)
Telefónica Latinoamérica <sup>3</sup>	5,350	4,800	11.5	3,450	4,035	(14.5)	5,693	4,410	29.1
Telefónica Europe <sup>4</sup>	1,015	1,144	(11.3)	1,728	2,072	(16.6)	2,183	2,108	3.5
Other companies and eliminations	(335)	(117)	n.m.	216	85	153.6	(423)	(76)	n.m.
<b>Total Group<sup>2,3,4,5</sup></b>	<b>13,647</b>	<b>13,873</b>	<b>(1.6)</b>	<b>7,257</b>	<b>8,401</b>	<b>(13.6)</b>	<b>15,346</b>	<b>14,519</b>	<b>5.7</b>

Notes:

- OIBDA and OI are presented before brand fees and management fees.
- OIBDA margin calculated as OIBDA over revenues.
- 2009 figures impacted by the hyperinflation in Venezuela

1 In comparable terms revenues of Telefónica España would decline by 5.9%, OIBDA would decrease by 8.0% and OpCF would drop 5.9%. Comparable terms exclude Universal Service: 183 million euros in revenue and 51 million euros in OIBDA in the third quarter of 2008, 75 million euros in revenues and 22 million euros in OIBDA in the first quarter of 2009, and 148 million euros in revenues and 47 million euros in OIBDA in the fourth quarter of 2009; bad debt recovery: 25 million euros in OIBDA in the first quarter of 2008; real estate capital gains: 6 million euros in OIBDA in January-December 2009 and 74 million euros in OIBDA in the same period in 2008; revision of the estimates for the adjustment to workforce adaptation plans provided for in prior periods, which resulted in lower expenses of 90 million euros in the second quarter of 2009; sale of applications rights: 48 million euros in revenue and OIBDA in the third quarter of 2009 and capital gain from the disposal of Medi Telecom of 220 million in OIBDA in the fourth quarter of 2009.

2 Medi Telecom capital gain amounting 220 million euros is recorded in the fourth quarter of 2009.

3 Starting April 2008, Vivo consolidates Telemig.

4 2008 includes a positive impact of 174 million euros derived from Airwave disposal. OIBDA and OI include 44 million euros from restructuring costs registered in 2009.

5 Sogecable capital gain amounting 143 million euros is recorded in the second quarter of 2008.

## Telefónica Group

### Consolidated statement of financial position

	December 2009	December 2008	% Chg
Unaudited figures (Euros in millions)			
<b>Non-current assets</b>	<b>84,311</b>	<b>81,923</b>	<b>2.9</b>
Intangible assets	15,846	15,921	(0.5)
Goodwill	19,566	18,323	6.8
Property, plant and equipment and Investment property	32,003	30,546	4.8
Non-current financial assets and investments in associates	10,925	10,153	7.6
Deferred tax assets	5,971	6,980	(14.5)
<b>Current assets</b>	<b>23,830</b>	<b>17,973</b>	<b>32.6</b>
Inventories	934	1,188	(21.4)
Trade and other receivables	10,622	9,315	14.0
Current tax receivable	1,246	970	28.5
Current financial asset	1,906	2,216	(14.0)
Cash and cash equivalents	9,113	4,277	113.1
Non-current assets classified as held for sale	9	7	33.3
<b>Total Assets = Total Equity and Liabilities</b>	<b>108,141</b>	<b>99,896</b>	<b>8.3</b>
<b>Equity</b>	<b>24,274</b>	<b>19,562</b>	<b>24.1</b>
Equity attributable to equity holders of the parent	21,734	17,231	26.1
Minority interest	2,540	2,331	9.0
<b>Non-current liabilities</b>	<b>56,931</b>	<b>55,202</b>	<b>3.1</b>
Long-term financial debt	47,607	45,088	5.6
Deferred tax liabilities	3,082	3,576	(13.8)
Long-term provisions	4,993	5,421	(7.9)
Other long-term liabilities	1,249	1,117	11.8
<b>Current liabilities</b>	<b>26,936</b>	<b>25,132</b>	<b>7.2</b>
Short-term financial debt	9,184	8,100	13.4
Trade and other payables	7,365	8,120	(9.3)
Current tax payable	2,766	2,275	21.6
Short-term provisions and other liabilities	7,621	6,637	14.8
<b>Financial Data</b>			
Net financial Debt <sup>1</sup>	43,551	42,733	1.9

**Note:**

- 2009 figures impacted by the hyperinflation in Venezuela.

<sup>1</sup> Net Financial Debt = Long term financial debt + Other long term liabilities + Short term financial debt - Short term financial investments - Cash and cash equivalents - Long term financial assets and other non-current assets.

## Telefónica Group Free cash flow and change in debt

		January - December		
		2009	2008	% Chg
Unaudited figures (Euros in millions)				
I	Cash flow from operations	21,178	20,571	3.0
II	Net interest payment <sup>1</sup>	(2,070)	(2,781)	
III	Payment for income tax	(2,942)	(1,413)	
A=I+II+III	Net cash provided by operating activities	16,165	16,377	(1.3)
B	Payment for investment in fixed and intangible assets	(7,592)	(7,861)	
C=A+B	Net free cash flow after CapEx	8,573	8,516	0.7
D	Net Cash received from sale of Real Estate	241	248	
E	Pagos netos por inversión financiera	(1,419)	(1,575)	
F	Net payment for operations with minority shareholders and treasury stock <sup>2</sup>	(5,785)	(6,681)	
G=C+D+E+F	Free cash flow after dividends	1,610	508	n.m.
H	Effects of exchange rate changes on net financial debt	1,226	(2,142)	
I	Effects on net financial debt of changes in consolid. and others	1,203	99	
J	Net financial debt at beginning of period	42,733	45,284	
K=J-G+H+I	Net financial debt at end of period	43,551	42,733	1.9

Note:

2009 figures impacted by the hyperinflation in Venezuela.

<sup>1</sup> Including cash received from dividends paid by subsidiaries that are not under the full consolidation method.

<sup>2</sup> Dividends paid by Telefónica S.A., operations with treasury stock and operations with minority shareholders from subsidiaries that are under full consolidation method.



## Reconciliations of cash flow and OIBDA minus CapEx

	January - December		
	2009	2008	% Chg
Unaudited figures (Euros in millions)			
<b>OIBDA</b>	<b>22,603</b>	<b>22,919</b>	<b>(1.4)</b>
- CapEx accrued during the period	(7,257)	(8,401)	
- Payments related to cancellation of commitments	(793)	(920)	
- Net interest payment	(2,070)	(2,781)	
- Payment for tax	(2,942)	(1,413)	
- Results from the sale of fixed assets	(248)	(292)	
- Investment In working capital and other deferred income and expenses	(719)	(597)	
<b>= Net Free Cash Flow after CapEx</b>	<b>8,573</b>	<b>8,516</b>	<b>0.7</b>
+ Net Cash received from sale of Real Estate	241	248	
- Net payment for financial investment	(1,419)	(1,575)	
- Net payment for operations with minority shareholders and treasury stock	(5,785)	(6,681)	
<b>= Free Cash Flow after dividends</b>	<b>1,610</b>	<b>508</b>	<b>n.m.</b>

	January - December		
	2009	2008	% Chg
Unaudited figures (Euros in millions)			
<b>Net Free Cash Flow after CapEx</b>	<b>8,573</b>	<b>8,516</b>	<b>0.7</b>
+ Payments related to cancellation of commitments	793	920	
- Operations with minority shareholders	(269)	(291)	
<b>= Free Cash Flow</b>	<b>9,097</b>	<b>9,145</b>	<b>(0.5)</b>
Weighted average number of ordinary shares outstanding during the period (millions)	4,553	4,646	
<b>= Free Cash Flow per share (euros)</b>	<b>2.00</b>	<b>1.97</b>	<b>1.5</b>

*Note:*

The concept "Free Cash Flow" reflects the amount of cash flow available to remunerate Telefónica S.A. Shareholders, to protect solvency levels (financial debt and commitments), and to accommodate strategic flexibility.

The differences with the caption "Net Free Cash Flow after CapEx" included in the table presented above, are related to "Free Cash Flow" being calculated before payments related to commitments (workforce reductions and guarantees) and after operations with minority shareholders, due to cash recirculation within the Group.

Note: 2009 figures impacted by the hyperinflation in Venezuela.

## Net financial debt and commitments

		December 2009
Unaudited figures (Euros in millions)		
	Long-term debt <sup>1</sup>	48,122
	Short term debt including current maturities	9,184
	Cash and cash equivalents	(9,113)
	Short and Long-term financial investments <sup>2</sup>	(4,642)
<b>A</b>	<b>Net Financial Debt</b>	<b>43,551</b>
	Guarantees to IPSE 2000	71
<b>B</b>	<b>Commitments related to guarantees</b>	<b>71</b>
	Gross commitments related to workforce reduction <sup>3</sup>	4,257
	Value of associated Long-term assets <sup>4</sup>	(827)
	Taxes receivable <sup>5</sup>	(1,169)
<b>C</b>	<b>Net commitments related to workforce reduction</b>	<b>2,260</b>
<b>A + B + C</b>	<b>Total Debt + Commitments</b>	<b>45,883</b>
	Net Financial Debt / OIBDA <sup>6</sup>	1.9x
	Total Debt + Commitments/ OIBDA <sup>6</sup>	2.1x

Note:

2009 figures impacted by the hyperinflation in Venezuela.

1 Includes "long-term financial debt" and 515 million euros of "other long-term debt".

2 Current financial assets and 2,736 million euros recorded under the caption of "Non-current financial assets and investments in associates".

3 Mainly in Spain. This amount is detailed in the captions "Long-term provisions" and "Short-term provisions and other liabilities" of the Statement of Financial Position, and is the result of adding the following items: "Provision for Pre-retirement, Social Security Expenses and Voluntary Severance", "Group Insurance", "Technical Reserves", and "Provisions for Pension Funds of Other Companies".

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

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

6 Calculated based on December 2009 OIBDA excluding results on the sale of fixed assets.

## Debt structure by currency

	December 2009				
	EUR	LATAM	GBP	CZK	USD
Unaudited figures					
Currency mix	69%	12%	8%	6%	4%

## Credit ratings

	Long-Term	Short-Term	Perspective	Last review
Moody's	Baa1	P-2	Positive	17/2/09
JCR	A	-	Stable	17/12/08
S&P	A-	A-2	Stable	2/12/08
Fitch/IBCA	A-	F-2	Stable	25/11/08

## Telefónica Group Exchanges rates applied

	P&L and CapEx <sup>1</sup>		Statement of Financial Position <sup>2</sup>	
	Jan - Dec 2009	Jan - Dec 2008	December 2009	December 2008
USA (US Dollar/Euro)	1.390	1.463	1.441	1.392
United Kingdom (Sterling/Euro)	0.891	0.795	0.888	0.952
Argentina (Argentinean Peso/Euro)	5.174	4.632	5.474	4.806
Brazil (Brazilian Real/Euro)	2.757	2.659	2.508	3.252
Czech Republic (Czech Crown/Euro)	26.435	24.969	26.465	26.930
Chile (Chilean Peso/Euro)	775.795	758.725	730.460	885.740
Colombia (Colombian Peso/Euro)	2,985.075	2,873.563	2,941.176	3,125.000
El Salvador (Colon/Euro)	12.165	12.806	12.605	12.177
Guatemala (Quetzal/Euro)	11.331	11.069	12.035	10.830
Mexico (Mexican Peso/Euro)	18.778	16.239	18.812	18.841
Nicaragua (Cordoba/Euro)	28.258	28.365	30.023	27.623
Peru (Peruvian Nuevo Sol/Euro)	4.186	4.285	4.165	4.371
Uruguay (Uruguayan Peso/Euro)	31.303	30.605	28.275	33.888
Venezuela (Bolivar Fuerte/Euro) <sup>3</sup>	2.989	3.147	3.097	2.992

<sup>1</sup> These exchange rates are used to convert the P&L and CapEx accounts of the Group foreign subsidiaries from local currency to euros.

<sup>2</sup> Exchange rates as of 31/December/09 and 31/December/08.

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

## Results by regional business units

Telefónica España

Against an adverse economic backdrop, the Company adapted its management priorities throughout the year, delivering a healthy cash flow generation in 2009 while posting a sharp pick up in commercial activity during the second half, thereby setting the base for future growth from a sound leadership position. All this, in a highly mature and very competitive market, and against a backdrop of an increasing number of customers optimising their spending, especially on voice services.

It is especially noteworthy the better revenue performance evidenced across all business in the fourth quarter, recording a slowdown in the year-on-year decline versus previous quarters. As a result there was a 1.1 percentage point quarter-on-quarter improvement in wireline revenues on a comparable basis<sup>1</sup>, and a 3.9 percentage point improvement in wireless revenues (+0.4 percentage points in service revenues).

At the end of 2009, Telefónica España continues leading the Spanish market, with a total of 46.8 million accesses. It is worth highlighting the greater number of **retail broadband Internet accesses**, which rose 4.4% year-on-year to nearly 5.5 million, the significant increase in the number of **pay-TV** customers (+14.8% versus December 2008), and the strong growth in contract customers in the wireless business (+5.3% year-on-year), to reach the **wireless customer base** 23.5 million. At the same time, the rising appetite for wireless flat-rate data plans continued, which exceeded 1.9 million at the end of the year, twice the figure for year-end 2008.

**Revenues** totalled 19,703 million euros in 2009, down 5.4% year-on-year and 1.6% in the fourth quarter. The improved performance in the fourth quarter reflects revenues booked in the quarter associated with the recognition of the Universal Service Obligation for the 2007 and 2008 fiscal years. Recall that in 2008 revenues associated with the recognition of the Universal Service Obligation totalled 183 million euros (all booked in the third quarter) while for the full-year 2009 the figure is 223 million euros (75 million euros booked in the first quarter and 148 million euros booked in the fourth quarter).

On a comparable basis<sup>1</sup>, 2009 revenues declined 5.9% year-on-year and 4.5% in the fourth quarter, a decrease that was smaller than in previous quarters (-6.6% in the third quarter and -6.9% in the second quarter). The major driver of 2009 revenue performance was the lower consumption of voice services. On the other hand, in the wireline business, IT Services (+14.7% year-on-year in 2009; +19.5% in the fourth quarter of 2009) and Data Services (+8.7% versus 2008; +11.3% in the fourth quarter), performed very well in both the fourth quarter and the full year, as well as wireless data connectivity revenues (+52.2% versus 2008).

Reported **operating income before depreciation and amortisation (OIBDA)** reached 9,757 million euros in 2009 (-5.1% versus 2008), with a solid OIBDA margin of 49.5%, similar to the margin of the previous year (+0.2 percentage points). On comparable basis<sup>1</sup>, OIBDA declined 8.0% year-on-year in 2009, mainly due to the loss of higher-margin revenues, mostly from wireline and wireless voice traffic and wireline access related revenues, and the higher commercial activity in the second half of 2009. In the fourth quarter OIBDA was down 7.5% on a comparable basis<sup>1</sup>, following the sharp increase in commercial activity in the wireless business targeted at the business' most valuable customers. On a comparable basis<sup>1</sup>, the OIBDA margin stood at 48.0% for 2009, a figure that remains a benchmark in the European telecom sector.

**CapEx** totalled 1,863 million euros in 2009 (-15.6% year-on-year), reflecting the Company's ability to adapt investments as a function of demand and to focus on the fastest growing businesses, such as mobile broadband.

As a result, **operating cash flow (OIBDA-CapEx)** totalled 7,893 million euros in 2009 (-2.3% year-on-year on a reported basis and -5.9% on a comparable basis<sup>1</sup>), reflecting the initiatives taken to contain costs and investment in order to limit the impact of pressure on revenues.

<sup>1</sup> Comparable basis exclude following effects: Universal Service Obligation: 183 million euros in revenues and 51 million euros in OIBDA in the third quarter of 2008, 75 million euros in revenues and 22 million euros in OIBDA in the first quarter of 2009 and 148 million euros in revenues and 47 million euros in OIBDA in the fourth quarter of 2009; bad debt recovery: 25 million euros in OIBDA in the first quarter of 2008; real estate capital gains: 6 million euros in OIBDA in 2009 and 74 million euros in 2008; revision of the estimates for the adjustment to workforce provision provided for in prior periods, which has resulted in lower expenses of 90 million euros in the second quarter of 2009; sale of application rights: 48 million euros in revenues and OIBDA in the third quarter of 2009; and 220 million euros in OIBDA from capital gains on the disposal of Medi Telecom in the fourth quarter of 2009.

## Wireline business

In 2009, Spanish wireline access market continued affected by an adverse economic climate, and showed an estimated year-on-year decrease of 0.8%. Against this backdrop, the Company's total number of wireline accesses in service (retail wireline telephony accesses, wholesale line rental, fully unbundled loops, and naked wholesale ADSL) was down 2.4% in 2009 (-386,465 wireline accesses in the year).

Total **retail wireline telephony accesses** stood at 14.2 million at the end of 2009 (15.3 million in December 2008), affected by ongoing loop unbundling. Hence, the Company had an estimated market share in 2009 of 72%. It is worth highlighting that in 2009 66% of the retail wireline telephony accesses lost were offset by net growth in wholesale accesses, which generate revenues for the company.

It should also be highlighted that in the fourth quarter the Company registered the lowest quarterly line losses of 2009, with the exception of the third quarter, which was affected by seasonal factors; line losses in the fourth quarter were 282,352 accesses.

The number of pre-selected lines continued to decline, dropping by 122,583 in the quarter and by 406,815 in 2009 to below 1.1 million lines at the end of December.

Telefónica remains market leader in **wireline retail broadband Internet accesses**, with an estimated market share of around 56% and nearly 5.5 million accesses (+4.4% versus December 2008), after registering 53,262 net adds in the fourth quarter and 230,379 in 2009. As of December 2009, the total market topped 9.9 million accesses after posting an estimated year-on-year growth of 7.2%.

The Company lost 64,739 wholesale indirect broadband accesses in 2009, down to a total of 359,025 at year end (-15.3% versus 2008) after posting an increase of 21,786 accesses in the fourth quarter. Unbundled loops net adds in 2009 were 455,749 (132,455 in the fourth quarter). Total unbundled loops reached 2.2 million, of which 21% are shared access loops, and the remainder 79% are fully unbundled loops (including more than 428,000 naked shared access loops). In 2009 net adds of fully unbundled loops were 610,426 (184,789 in the fourth quarter), 28% of which were naked shared access loops. Shared access loops decreased by 154,677 in 2009 and by 52,334 in the fourth quarter.

During the fourth quarter **Pay-TV** accesses continued delivering an excellent performance, with net adds of 48,725 (+112.4% year-on-year). After registering 90,486 Pay-TV net adds in 2009, Telefónica finished the year with a total of 702,980 customers (+14.8% year-on-year) and a significant improvement in its

estimated market share to around 17%; this market share figure is even more remarkable bearing in mind current Imagenio's coverage, limited to 60% of Spanish households.

The total number of Dúo and Trío accesses means that nearly 88% of the Company's retail broadband accesses now form part of a double or triple play bundle.

Full-year 2009 **revenues** amounted to 12,167 million euros in 2009, down 3.3% year-on-year. On a comparable basis<sup>2</sup>, revenues fell 2.9% in the fourth quarter (-3.7% in 2009), which represented an improvement on the performance in previous quarters (4.7% year-on-year decline in the second quarter and 4.0% year-on-year decline in the third quarter). By item:

- **Traditional access revenues** were down 5.2% year-on-year in 2009 while rose 12.6% in the fourth quarter, affected by the booking of revenues associated with the recognition of the Universal Service Obligation amounting to 183 million euros in 2008 (in the third quarter of 2008) and of 223 million euros in 2009 (75 million euros in the first quarter of 2009 and 148 million euros in the fourth quarter of 2009). On a comparable basis<sup>2</sup>, traditional access revenues declined 7.0% year-on-year in 2009 (-9.1% in the fourth quarter) due to the lower number of accesses (-7.3% year-on-year).
- **Voice service revenues** continued to improve on a relative basis, recording a slowdown in the year-on-year decline in the fourth quarter (-9.5%) vs. the previous two quarters (-12.1% in the second quarter and -10.8% in the third). Over the full year, voice service revenues fell by 10.2% on the back of lower fixed-to-mobile and international traffic handled and the growing weight of traffic under flat-rate plans, stemming from consumers' usage optimization.
- **Internet and broadband revenues** fell by 1.9% year-on-year in 2009 (-1.7% in the fourth quarter):
  - Retail broadband service revenues declined 1.7% in 2009 (-2.7% in the fourth quarter), mainly due to slower growth in the total number of accesses and a reduction in effective ARPU (-6.4% in 2009 and -5.5% in the fourth quarter).
  - Wholesale broadband revenues (+3.3% year-on-year for the full year and +7.5% over the fourth quarter) reflect the growth in unbundled loops.
- Revenues from **Data services** continued to show significant growth year-on-year (+11.3% in the fourth quarter and +8.7% in 2009), driven by increased revenues from leased circuits to mobile operators, mainly Telefónica Móviles España, as a result of the rapid growth in mobile broadband.

<sup>2</sup> Comparable basis exclude following effects: Universal Service Obligation: 183 million euros in revenues and 51 million euros in OIBDA in the third quarter of 2008, 75 million euros in revenues and 22 million euros in OIBDA in the first quarter of 2009 and 148 million euros in revenues and 47 million euros in OIBDA in the fourth quarter of 2009; bad debt recovery: 25 million euros in OIBDA in the first quarter of 2008; real estate capital gains: 6 million euros in OIBDA in 2009 and 74 million euros in 2008; revision of the estimates for the adjustment to workforce provision provided for in prior periods, which has resulted in lower expenses of 90 million euros in the second quarter of 2009; sale of application rights: 48 million euros in revenues and OIBDA in the third quarter of 2009; and 220 million euros in OIBDA from capital gains on the disposal of Medi Telecom in the fourth quarter of 2009.

# 04/5 Results by regional business units

## Telefónica España

- Revenues from **IT services** posted robust growth (+14.7% year-on-year in 2009 and +19.5% in the fourth quarter).

Operating expenses declined by 2.4% in 2009 on a comparable basis<sup>3</sup> (down 3.1% in the fourth quarter). Reported operating expenses declined by 2.8% to 6,527 million euros, and break down as follows:

- External service expenses fell by 2.7% to 1,300 million euros in 2009. In the fourth quarter these expenses decreased by 5.7%, due to lower commercial activity.
- Personnel costs dropped by 0.9% to 2,052 million euros. Excluding the impact of the revision of the estimates for the adjustment to workforce provision provided for in prior periods, personnel costs rose by 1.9% in 2009, due to a higher year-on-year costs in the fourth quarter of 2009. The positive impact of lower than budgeted CPI for salary revision purposes was accounted for in the fourth quarter of 2008.
- Supply costs decreased 6.0% to 2,785 million euros in 2009, thanks to lower interconnection costs associated with lower fixed-to-mobile traffic and the reduction in mobile termination rates.

As a result, operating income before depreciation and amortisation (OIBDA) in 2009 reached 5,810 million euros (-4.0% year-on-year), while the OIBDA margin stood at 47.7%. On a comparable basis<sup>3</sup>, OIBDA was down 4.1% for the full year (-0.5% in the fourth quarter). Meanwhile, on a comparable basis<sup>3</sup>, the OIBDA margin was virtually unchanged, at 47.0% for the year (47.2% in 2008), reaching 46.8% in the fourth quarter.

## Wireless business

Given the economic climate, Telefónica's commercial activity in 2009 continued to focus on the highest-value segments of the market, a strategy that enabled the Company to maintain its market leadership in terms of revenues, being the company with the widest gap between revenue share and customer market share in Spain.

At the end of 2009, the Company's mobile customer base stood at 23.5 million accesses (23.6 million in 2008). It should be noticed that in December the Company recorded the disconnection of 715,000 inactive prepay lines without any impact on the Company's financial results. Excluding this adjustment, net adds for the full year reached 648,765, 538,027 of which came in the second half (+41.8% year-on-year) and 260,445 in the last quarter (+54.2% year-on-year).

The focus on highest-value customers led to positive commercial results in the contract segment, with net adds amounting to 766,244 in 2009, 639,705 of which came in the second half and 324,921 in the fourth quarter (the best-performing quarter in terms of contract net adds in the last two years). At the end of 2009, contract customers accounted for 65% of the Company's total accesses.

With regards to **mobile portability**, during the fourth quarter, and for the third quarter in a row, there was a positive balance in the contract segment, with net adds of 24,975 lines, compared with a negative balance of 20,616 net adds in the fourth quarter of 2008. As a result, the net positive balance in the contract segment in 2009 was 8,078 lines. In terms of total portability, the balance was negative (153,858 accesses), although the trend was much more favourable during the second half (-30,139 in the second half of 2009 versus -123,719 in the first half).

The churn rate stood at 2.3% in 2009 (+0.4 percentage points year-on-year), rising to 3.1% in the fourth quarter (+1.2 percentage points higher than in the fourth quarter of 2008), due to the disconnection of inactive lines mentioned above. Excluding this effect, the churn rate would have been 2.2% in the fourth quarter and 2.1% in 2009. It is worth highlighting that in the highest-value segments churn rate continues to be well below blended ratios, standing at 1.3% in the contract segment in 2009 (+0.2 percentage points versus 2008).

In terms of usage, during the fourth quarter, there was a further slow down in the pace of year-on-year decline in **traffic**. Traffic was down 2.2% year-on-year in the fourth quarter, compared with a drop of 3.8% in the third quarter and of 4.0% during the first half of 2009. This left 2009 traffic down 3.5% versus 2008, at 42,039 million minutes.

**Voice ARPU**, affected by mobile termination rate cuts over the last year (-21.7% following the cuts introduced in October 2008, April 2009, and October 2009) and by the change in customer usage patterns due to the economic situation, dropped 12.4% in 2009 to 22.1 euros (-12.6% in the fourth quarter). Outgoing voice ARPU posted a relatively stronger performance in 2009, with a year-on-year decline of 10.3% (10.1% in the fourth quarter).

**Data ARPU** continued to register positive growth (+3.0% year-on-year for 2009 and +2.8% for the quarter), reaching 5.4 euros for 2009, despite smaller contributions from P2P SMS and premium SMS, with the latest being affected by regulatory changes introduced during the fourth quarter.

<sup>3</sup> Comparable basis exclude following effects: Universal Service Obligation: 183 million euros in revenue and 110 million euros in OIBDA in the third quarter of 2008, 75 million euros in revenues and 46 million euros in OIBDA in the first quarter of 2009 and 148 million euros in revenue and 91 million euros in OIBDA in the fourth quarter of 2009; bad debt recovery: 17 million euros in OIBDA in the first quarter of 2008; real estate capital gains: 6 million euros in OIBDA in 2009 and 74 million euros in 2008; revision of the estimates for the adjustment to workforce provision provided for in prior periods, which has resulted in lower expenses of 58 million euros in the second quarter of 2009

Given the current climate, the performance of wireless data connectivity revenues is particularly noteworthy, as this revenue continues to show solid year-on-year growth, even accelerating in the fourth quarter. Over the full year, these revenues rose 52.2% versus 2008, driven by a strong demand of flat-rate data plans, which exceeded 1.9 million in December 2009, doubling the year-end 2008 figure. Thus, data ARPU accounted for 19.6% of total ARPU in 2009 (+2.4 percentage points year-on-year).

This performance was boosted by the increased customer penetration of 3G handsets, which reached 8.9 million (1.4 times the December 2008 figure).

It is also noteworthy that the fourth quarter saw confirmation of the stabilisation in outgoing ARPU, with a very similar performance year-on-year to that of the third quarter in comparable terms, and both quarters showing an improvement over the first half. As a result, outgoing ARPU was down 7.8% in 2009 and 7.3% in the fourth quarter. **Total ARPU** dropped by 9.7% year-on-year, both in 2009 and in the fourth quarter, to 27.5 euros in 2009.

As a result of these trends, **revenues** declined 4.4% year-on-year in the fourth quarter, improving by 1.9 percentage points on the third quarter of 2009. This left 2009 revenues down 7.4% at 8,965 million euros (-7.9% year-on-year on a comparable basis<sup>4</sup>). Highlights by revenue item:

- **Service revenues** were down 7.4% year-on-year in 2009 to 7,828 million euros. Mobile termination rate cuts accounted for 3.3 percentage points of the year-on-year revenue decline in the quarter and 2.6 percentage points in the full year. On a comparable basis<sup>4</sup>, service revenues declined 7.7% year-on-year in the fourth quarter but posted a 0.4 percentage points improvement from the previous quarter. The year-on-year decrease in 2009 stood at 8.0%.
  - **Customer revenues** were down 4.5% year-on-year in the fourth quarter, posting a better performance than in the third quarter (-5.3%) thanks to the slight recovery in usage patterns. Over the year these revenues declined 5.4% from 2008 to 6,571 million euros.
  - **Interconnection revenues** declined 22.7% year-on-year in the quarter and 19.5% over the year (to 1,001 million euros), due to the cuts in mobile termination rates.
  - **Roaming-in revenues** fell 27.4% year-on-year in the quarter and by 22.8% in 2009 versus 2008 (to 153 million euros), affected by the continued decrease in wholesale prices.

- **Revenues from handset sales** totalled 1,137 million in 2009 (-7.3% versus 2008), having risen 15.8% in the fourth quarter due to the different rates of channel uptake.

**Operating expenses** were down 4.0% year-on-year to 5,277 million euros, thanks to the Company's measures to improve efficiency and adapt to the current economic environment. However, these efforts were partially offset by the increased commercial activity rolled out during the last two quarters (especially in the contract segment), the loss of higher-margin revenues, and the accounting of 68 million euros of expenses to cover Universal Service-related costs (24 million euros in the first quarter and 44 million euros in the fourth quarter), compared with the 59 million accounted for in 2008 (third quarter). Thus, operating costs went down 3.8% on a comparable basis<sup>4</sup> in 2009 (+5.2% in the quarter). This evolution, mainly in the quarter, is driven by: i) increased commercial activity, ii) increased costs related with leased circuits from the wireline business, due to the boom in data traffic related to mobile broadband and iii) the unfavourable comparison of personnel costs with the fourth quarter of 2008, when the Company recognised the positive impact of lower than budgeted CPI for salary revision purposes.

On the other hand, it should be noticed that the disposal of the stake in Medi Telecom in the fourth quarter of 2009 generated a capital gain of 220 million euros.

As a result, **OIBDA** for 2009 declined 6.8% to 3,975 million euros (-13.3% on a comparable basis<sup>4</sup>). Reported OIBDA in the fourth quarter was stable versus the same period in 2008, although declining 17.1% on a comparable basis<sup>4</sup>, affected by lower revenues, and the aforementioned expenses evolution. As a result, OIBDA margin in 2009 was 44.3% (+0.3 percentage points). On a comparable basis<sup>4</sup>, OIBDA margin came in at 42.0% in 2009 (-2.6 percentage points year-on-year).

<sup>4</sup> Comparable basis exclude following effects: bad debt recovery: 8 million euros in OIBDA in the first quarter of 2008; expenses associated with the Universal Service amounting to 59 million euros in the third quarter of 2008, 24 million euros in the first quarter of 2009 and 44 million euros in the fourth quarter of 2009; revision of the estimates for the adjustment to workforce provision provided for in prior periods, which has resulted in lower expenses of 32 million euros in the second quarter of 2009; sale of application rights: 48 million euros in revenues and OIBDA in the third quarter of 2009; and 220 million euros in OIBDA from capital gains on the disposal of Medi Telecom in the fourth quarter of 2009.

Telefónica España  
Accesses

	2008	2009				% Chg y-o-y
	December	March	June	September	December	
Final Clients Accesses	45,213.6	44,885.7	44,676.7	44,858.6	44,164.2	(2.3)
Fixed telephony accesses <sup>1</sup>	15,326.3	15,004.9	14,691.4	14,482.5	14,200.1	(7.3)
Internet and data accesses	5,670.0	5,661.3	5,660.1	5,728.7	5,722.5	0.9
Narrowband	388.0	336.4	297.6	276.5	219.5	(43.4)
Broadband <sup>2</sup>	5,246.4	5,291.8	5,331.4	5,423.5	5,476.8	4.4
Other <sup>3</sup>	35.6	33.1	31.1	28.7	26.2	(26.3)
Mobile accesses	23,604.8	23,614.7	23,715.6	23,993.2	23,538.6	(0.3)
Pre-Pay <sup>4</sup>	9,037.0	9,061.8	9,021.2	8,984.0	8,204.5	(9.2)
Contract	14,567.8	14,552.9	14,694.4	15,009.1	15,334.1	5.3
Pay TV	612.5	604.8	609.5	654.3	703.0	14.8
<b>Wholesale Accesses</b>	<b>2,136.1</b>	<b>2,271.5</b>	<b>2,369.1</b>	<b>2,418.1</b>	<b>2,614.0</b>	<b>22.4</b>
WLR <sup>5</sup>	9.5	25.9	45.4	55.6	97.4	n.m.
Unbundled loops	1,698.0	1,835.3	1,950.7	2,021.3	2,153.8	26.8
Shared ULL	602.3	584.8	546.1	500.0	447.7	(25.7)
Full ULL <sup>6</sup>	1,095.7	1,250.5	1,404.7	1,521.3	1,706.1	55.7
Wholesale ADSL	423.8	405.8	368.8	337.2	359.0	(15.3)
Other <sup>7</sup>	4.7	4.4	4.2	3.9	3.7	(21.6)
<b>Total Accesses</b>	<b>47,349.7</b>	<b>47,157.2</b>	<b>47,045.7</b>	<b>47,276.6</b>	<b>46,778.2</b>	<b>(1.2)</b>

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

2 ADSL, satellite, optical fibre and broadband circuits.

3 Leased lines.

4 715,000 inactive prepay accesses were disconnected in December 2009.

5 Wholesale Line Rental.

6 Includes naked shared loops.

7 Wholesale circuits.

Telefónica España  
Consolidated income statement

	January - December			October - December		
	2009	2008	% Chg	2009	2008	% Chg
Unaudited figures (Euros in millions)						
Revenues	19,703	20,838	(5.4)	5,048	5,132	(1.6)
Internal exp capitalized in fixed assets	218	213	2.3	70	61	14.0
Operating expenses	(10,402)	(10,818)	(3.8)	(2,825)	(2,738)	3.2
Other net operating income (expense)	25	7	n.m.	1	(24)	c.s.
Gain (loss) on sale of fixed assets	222	54	n.m.	226	(0)	c.s.
Impairment of goodwill and other assets	(9)	(8)	15.9	(4)	(3)	51.8
<b>Operating income before D&amp;A (OIBDA)</b>	<b>9,757</b>	<b>10,285</b>	<b>(5.1)</b>	<b>2,517</b>	<b>2,428</b>	<b>3.6</b>
<b>OIBDA margin</b>	<b>49.5%</b>	<b>49.4%</b>	<b>0.2 p.p.</b>	<b>49.8%</b>	<b>47.3%</b>	<b>2.5 p.p.</b>
Depreciation and amortization	(2,140)	(2,239)	(4.5)	(542)	(550)	(1.6)
<b>Operating income (OI)</b>	<b>7,617</b>	<b>8,046</b>	<b>(5.3)</b>	<b>1,975</b>	<b>1,878</b>	<b>5.2</b>

## Notes:

• OIBDA and OI before brand fees.

• In comparable terms revenues of Telefónica España would decline by 5.9%, OIBDA would decrease by 8.0% and OpCF would drop 5.9%. Comparable terms exclude Universal Service: 183 million euros in revenue and 51 million euros in OIBDA in the third quarter of 2008, 75 million euros in revenues and 22 million euros in OIBDA in the first quarter of 2009, and 148 million euros in revenue and 47 million euros in OIBDA in the fourth quarter of 2009; bad debt recovery: 25 million euros in OIBDA in the first quarter of 2008; real estate capital gains: 6 million euros in OIBDA in 2009 and 74 million euros in OIBDA in 2008; revision of the estimates for the adjustment to workforce adaptation plans provided for in prior periods, which resulted in lower expenses of 90 million euros in the second quarter of 2009; sale of applications rights: 48 million euros in revenue and OIBDA in the third quarter of 2009 and capital gain from the disposal of Medi Telecom of 220 million in OIBDA in the fourth quarter of 2009.



## Telefónica España: Wireline business

### Selected financial data

	January - December			October - December		
	2009	2008	% Chg	2009	2008	% Chg
Unaudited figures (Euros in millions)						
Revenues	12,167	12,581	(3.3)	3,170	3,113	1.8
OIBDA	5,810	6,050	(4.0)	1,509	1,421	6.2
OIBDA margin	47.7%	48.1%	(0.3 p.p.)	47.6%	45.6%	2.0 p.p.
CapEx	1,305	1,498	(12.9)	513	455	12.8
OpCF (OIBDA-CapEx)	4,505	4,552	(1.0)	996	966	3.1

#### Notes:

- OIBDA before brand fees.
- Comparable terms exclude Universal Service: 183 million euros in revenue and 110 million euros in OIBDA in the third quarter of 2008, 75 million euros in revenues and 46 million euros in OIBDA in the first quarter of 2009, and 148 million euros in revenue and 91 million euros in OIBDA in the fourth quarter of 2009; bad debt recovery: 17 million euros in OIBDA in the first quarter of 2008; real estate capital gains: 6 million euros in OIBDA in 2009 and 74 million euros in 2008 and revision of the estimates for the adjustment to workforce adaptation plans provided for in prior periods, which resulted in lower expenses of 58 million euros in the second quarter of 2009.

## Telefónica España: Wireline business

### Selected revenues data

	January - December			October - December		
	2009	2008	% Chg	2009	2008	% Chg
Unaudited figures (Euros in millions)						
Traditional Access <sup>1</sup>	2,792	2,944	(5.2)	767	681	12.6
Traditional Voice Services	3,983	4,436	(10.2)	975	1,078	(9.5)
Traffic <sup>2</sup>	2,209	2,566	(13.9)	535	619	(13.6)
Interconnection <sup>3</sup>	911	960	(5.1)	220	230	(4.2)
Handsets sales and others <sup>4</sup>	864	910	(5.0)	220	228	(3.7)
Internet Broadband Services	2,960	3,017	(1.9)	741	754	(1.7)
Narrowband	33	55	(40.3)	6	7	(16.5)
Broadband	2,928	2,962	(1.2)	736	747	(1.5)
Retail <sup>5</sup>	2,590	2,635	(1.7)	646	663	(2.7)
Wholesale <sup>6</sup>	337	327	3.3	90	84	7.5
Data Services	1,294	1,190	8.7	349	313	11.3
IT Services	508	443	14.7	156	131	19.5

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

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

<sup>3</sup> Includes revenues from fixed to fixed incoming traffic, mobile to fixed incoming traffic, and transit and carrier traffic..

<sup>4</sup> Managed Voice Services and other businesses revenues.

<sup>5</sup> Retail ADSL Services and other Internet Services.

<sup>6</sup> Includes Megabase, Megavía, GigADSL and local loop unbundling.

#### Note:

In the third quarter of 2008, 183 million euros associated with the recognition of the Universal Service Obligation for years 2003-2005 and 75 million euros in the first quarter of 2009 for year 2006, and 148 million euros in the fourth quarter of 2009 for years 2007 and 2008. These figures are included in "Traditional Accesses".

Telefónica España: Wireless business  
Selected financial data

	January - December			October - December		
	2009	2008	% Chg	2009	2008	% Chg
Unaudited figures (Euros in millions)						
Revenues	8,965	9,684	(7.4)	2,278	2,383	(4.4)
OIBDA	3,975	4,265	(6.8)	1,014	1,012	0.2
OIBDA margin	44.3%	44.0%	0.3 p.p.	44.5%	42.5%	2.1 p.p.
CapEx	559	710	(21.3)	223	199	12.3
OpCF (OIBDA-CapEx)	3,417	3,555	(3.9)	791	813	(2.7)

## Notes:

- OIBDA before brand fees.
- Comparable terms exclude bad debt recovery: 8 million euros in OIBDA in the first quarter of 2008; expenses associated with the recognition of the Universal Service of 59 million euros in the third quarter of 2008, 24 million euros in the first quarter of 2009 and 44 million euros in the fourth quarter of 2009; revision of the estimates for the adjustment to workforce adaptation plans provided for in prior periods, which resulted in lower expenses of 32 million euros in the second quarter of 2009; sale of applications rights: 48 million euros in revenue and OIBDA in the third quarter of 2009 and capital gain from the disposal of Medi Telecom of 220 million in OIBDA in the fourth quarter of 2009.

Telefónica España: Wireless business  
Selected revenues data

	January - December			October - December		
	2009	2008	% Chg	2009	2008	% Chg
Unaudited figures (Euros in millions)						
Service Revenues	7,828	8,457	(7.4)	1,898	2,055	(7.7)
Customer Revenues	6,571	6,943	(5.4)	1,636	1,713	(4.5)
Interconnection	1,001	1,243	(19.5)	221	286	(22.7)
Roaming - In	153	198	(22.8)	27	37	(27.4)
Other	103	73	41.3	14	19	(26.9)
Handset revenues	1,137	1,227	(7.3)	380	328	15.8

## Note:

- Service revenues include a positive impact of 48 million euros from the sale of application rights in the third quarter of 2009.

## Telefónica España: Wireless business Selected operating data

	2008	2009				% Chg y-o-y
	Q4	Q1	Q2	Q3	Q4	
Unaudited figures						
Traffic (Million minutes)	10,727	10,038	10,499	11,007	10,495	(2.2)
ARPU (EUR)	29.5	27.6	27.6	28.0	26.7	(9.7)
Pre-pay	13.8	12.5	12.6	13.2	11.9	(13.2)
Contract	39.3	36.9	36.8	37.0	35.3	(10.2)
Data ARPU (EUR)	5.5	5.3	5.1	5.4	5.6	2.8
% non-P2P SMS over data revenues	55.5%	59.4%	60.6%	61.9%	60.7%	5.2 p.p.

**Notes:**

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

## Telefónica España: Wireless business Selected operating data

	January - December		% Chg
	2009	2008	
Unaudited figures			
Traffic (Million minutes)	42,039	43,568	(3.5)
ARPU (EUR)	27.5	30.4	(9.7)
Pre-pay	12.6	14.5	(13.4)
Contract	36.5	40.5	(9.9)
Data ARPU (EUR)	5.4	5.2	3.0
% non-P2P SMS over data revenues	60.6 %	54.2%	6.5 p.p.

**Notes:**

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

## Results by regional business units

### Telefónica Latinoamérica

In accordance with International Financial Reporting Standards (IFRS), the Venezuelan economy must be considered hyperinflationary in 2009. This means that the financial results of Telefónica Latinoamérica are affected by the designation of Venezuela as a hyperinflationary economy.

For comparison purposes and to facilitate the interpretation of the year-on-year changes vs. 2008, variations in local currency of the headings affected by the hyperinflation adjustments and the other financial and operating indicators are reported in organic terms, excluding the impact of this adjustment for hyperinflation.

In a general context of global economic deterioration, Latin America's economies remained remarkably stable in 2009 and prospects for 2010 point towards an evident economic recovery, with some signs of this recovery becoming apparent in the fourth quarter of 2009.

Against this backdrop, Telefónica Latinoamérica ended 2009 with 168.6 million accesses under management, up 6.5% year-on-year, underpinned by the steady growth of mobile and broadband businesses.

In **wireless telephony**, estimated market penetration in Latin America stood at 90%, an increase of 8 percentage points from December 2008. Telefónica managed 134.7 million wireless accesses in the region, yielding year-on-year growth of 9.2% after reporting net adds of 11.4 million accesses in the full year<sup>1</sup>. The main trends in this business in 2009 are as follows:

- Significant **commercial activity**, with net adds rising 7.8% year-on-year in the last quarter to 5.5 million accesses<sup>1</sup>. The company reported an acceleration in commercial activity for the second consecutive quarter, showing in the fourth quarter a turnaround relative to the first nine months of the year, when net adds were down compared with 2008.

This improved commercial performance was underpinned by the growth in gross adds vs. previous quarters and stable **churn** rates. Gross adds in the fourth quarter were stable year-on-year despite the increased penetration in the region,

surpassing third quarter adds by 20.2%. This growth was significantly higher than that reported between the same quarters of 2008. Churn in the fourth quarter stood at 2.3%, down 0.3 percentage points year-on-year, standing at 2.5% in the full year (down 0.1 percentage points from 2008).

- **Traffic** carried grew 13.8% year-on-year in 2009, underpinned by a 16.4% rise in outgoing traffic thanks to the initiatives launched to encourage usage, primarily by boosting the community effect.
- The **data business** continues to account for an increasing proportion of the Company's wireless revenues, contributing 18.0% of total service revenues in 2009 and 19.4% of fourth quarter service revenues, representing year-on-year organic<sup>2</sup> growth of 3.6 percentage points and 4.8 percentage points respectively.
- **ARPU** also recovered slightly over the course of 2009, falling by 2.1% year-on-year in organic<sup>2</sup> terms in 2009 and by 1.2% in the fourth quarter. It should be noted that ARPU was affected by lower mobile termination rates in 2009, because outgoing ARPU posted positive organic<sup>2</sup> year-on-year growth in both the full year and the fourth quarter.

In 2009, **wireline business** companies continued to focus on raising quality as a lever to drive the transformation of the Company, increasing the weight of new businesses in our service portfolio. As a result 56% of broadband accesses are now part of a 2P/3P offering (+8.0 percentage points on 2008). Meanwhile they continue to tailor services to the emerging needs of their customer base with the aim of stabilising the traditional business. As a result over 62% of wireline accesses are now part of some form of traffic bundle (+2.3 percentage points from December 2008). The customer base totalled 33.9 million at the end of December 2009 (34.9 million in 2008). By service:

- The number of **broadband** accesses exceeded 6.4 million, and is still recording significant growth rates (+5.9% year-on-year) as a result of solid growth in Argentina (+14.4% year-on-year), Peru (+10.0% year-on-year) and Chile (+9.3% year-on-year).

<sup>1</sup> For comparison purposes, net customer additions exclude the disconnection of inactive customers in December 2009.

<sup>2</sup> Assuming constant exchange rates, excluding the impact of the hyperinflation accounting in Venezuela, and including the consolidation of Telemig in January-March 2008.

In 2009, net adds<sup>3</sup> stood at 384,448. Particularly noteworthy was the positive fourth quarter performance in Brazil after the quality issues experienced in prior quarters were resolved.

- **Pay TV** customers reached 1.6 million (up 7% year-on-year), with 179,556 accesses added since the start of the year<sup>3</sup>.
- **Wireline accesses** remained affected by fixed-mobile substitution and fell by 4.2% on 2008 (2.7% excluding the disconnection of inactive accesses in Colombia), to 24.6 million. Particularly noteworthy is the improved performance in the fourth quarter, when line losses were significantly lower in comparable terms<sup>3</sup> than in prior quarters and in relation to the fourth quarter of 2008, underlining the impact of the quality improvements in Brazil.

Thanks to its strong operating performance, Telefónica Latinoamérica delivered a strong set of financial results in 2009. **Revenues** totalled 22,983 million euros in 2009, a year-on-year increase of 5.3% in organic<sup>4</sup> terms (+3.7% in reported terms).

Operating expenses reached 14,274 million euros, an increase of 5.0% year-on-year in organic terms<sup>4</sup> (+1.2% reported).

The drive to foster efficiency improvements is reflected in **operating income before depreciation and amortisation (OIBDA)**, which advanced 10.1% year-on-year in organic terms<sup>4</sup> (+8.3% reported), outstripping revenue growth, to 9,143 million euros in 2009. This left an OIBDA margin of 39.8%, up 1.7 percentage points from 2008, both in organic<sup>4</sup> and reported terms.

Also noteworthy is the 29.8% year-on-year jump in organic terms<sup>4</sup> in **operating cash flow (OIBDA-CapEX)** to 5,693 million euros (+29.1% reported).

The Company's strong performance reflects both a regional strategy closely focused on the real needs of our customers and Telefónica Latinoamérica's capability to adapt to changing competitive and economic environments.

In addition, Telefónica Latinoamérica continues to explore new business models that position us as a benchmark in capturing new opportunities in product and service development. Particularly noteworthy is the Open Telefónica initiative, aimed at the joint development of adjacent services to our business in partnership with third parties, drawing on their specific skills which complement our capabilities. This permits us to gain an edge in tapping additional revenue sources going forward. The agreements reached with our partners in certain projects led to an improvement in the Company's results, derived from the access to the services platform and knowhow or rights of use's assignments. These projects have a positive contribution of 117 million euros in revenues and 140 million euros in OIBDA in 2009.

Also noteworthy is the Company's commitment to the ongoing improvement of processes and quality ratios as a source of value. Telefónica is committed to providing the best service on the market to achieve improved customer satisfaction and enhance efficiency. In this sense, the company is pressing ahead with a series of initiatives with a regional scope aimed at reorganising its relationship with suppliers in processes such as technical, logistical and other services, which in some cases led to agreements with third parties. All these initiatives have a positive impact on the generation of synergies and, therefore, on the results of Telefónica Latinoamérica. These initiatives have a positive contribution of 196 million euros in revenues and 217 million euros in OIBDA in 2009.

Two key features of Telefónica Latinoamérica's business performance in 2009 are: (i) the significant acceleration of organic<sup>4</sup> growth rates from revenue to operating cash flow (+5.3% year-on-year in revenues, +10.1% in OIBDA and +29.8% in operating cash flow); and (ii) the high geographic diversification of operating cash flow, both in terms of contributors and sources of growth. Mexico (+5.9 percentage points), Brazil (+5.6 percentage points), Venezuela (+4.7 percentage points) and Argentina (+3.9 percentage points) made the largest contributions to operating cash flow organic<sup>4</sup> growth in 2009.

## Brazil

In 2009, the Brazilian telecommunications market remained buoyant while keeping potential for further growth, thanks to the favourable economic situation in the country which is among those that have most successfully weathered the global crisis.

At the end of 2009, Telefónica was managing 67.0 million **accesses** in Brazil, year-on-year growth of 10.2%. Growth was particularly strong in the second half of the year, and most notably in the fourth quarter, in which the Company gained 2.8 million accesses (an 11.1% year-on-year increase).

Wireless telephony continues to drive growth in accesses, although at the commercial level the results of initiatives to improve the quality of the fixed line services are now beginning to be noticed. Hence, in the fourth quarter of the year, commercial activity in the wireline broadband business improved significantly, in terms of both gross adds and churn as well as better results in fixed accesses.

<sup>3</sup> For comparison purposes, net customer additions exclude the disconnection of inactive customers in December 2009.

<sup>4</sup> Assuming constant exchange rates, excluding the impact of the hyperinflation accounting in Venezuela, and including the consolidation of Telemig in January-March 2008.

As noted in previous quarters, Telefónica's financial results in Brazil in 2009 were adversely affected by operational problems related to the quality of service and networks of Telesp.

**Revenue** in 2009 totalled 8,376 million euros, up 0.9% year-on-year in local currency, after performance improved in the fourth quarter (-2.2% in local currency) from the previous quarter (-3.0% year-on-year in the third quarter).

**Operating income before depreciation and amortisation (OIBDA)** stood at 3,139 million euros in 2009, thus decreasing 3.1% in local currency from 2008 (-11.2% in local currency in the fourth quarter). The OIBDA margin stood at 37.5% in 2009 (-1.6% percentage points year-on-year) and at 36.7% in the fourth quarter (-3.8 percentage points year-on-year).

**CapEx** in 2009 was 1,228 million euros, a 21.1% year-on-year reduction in local currency, due to the acquisition of 3G licences by Vivo in 2008; excluding this effect, CapEx fell by 8.3% year-on-year in local currency.

**Operating cash flow (OIBDA-CapEx)** stood at 1,911 million euros in 2009, up 13.5% in local currency from 2008 (+0.6% stripping out the impact of Vivo's 3G licences).

## VIVO

Brazil's wireless telephony market stood at 174.0 million accesses at the end of 2009, year-on-year growth of 15.5%. To highlight, the trend of SIM only gross adds throughout the year, as a key market driver. The penetration rate thus stood at 90%, revealing very positive trend throughout 2009, with an increase of 11 percentage points over 2008.

In a highly competitive environment, Vivo is consolidating its leadership in Brazil, in terms not only of accesses -including an improvement in its market share in the last four months of the year-, service quality and customer satisfaction, but also financial results (revenue and OIBDA).

The Company's commercial focus in 2009 was predicated on three key drivers for consolidating its leadership in revenue share: i) capturing market growth, ii) leveraging the community effect, and iii) fostering the data business.

At the end of 2009, Vivo had more than 51.7 million accesses, year-on-year growth of 15.1%, and a market share that was virtually unchanged at 29.7%, according to Anatel's data, from that of 2008 (-0.1 percentage points). The Company's net add in 2009 were 6.8 million accesses. In particular, the trend in the fourth quarter was positive, with a net gain of 2.9 million accesses (42.6% of the year's total), a year-on-year increase of 8.6%. Also noteworthy is the fact that GSM and 3G customers accounted for 84.1% of Vivo's total customer base.

In a market with high churn levels, due to the growth of SIM only customers, Vivo's churn remains at 2.5%, both for the year overall and for the fourth quarter, an improvement over the preceding year (2.6% in 2008).

The importance of the community effect -which reduces the business's exposure to interconnection- can be seen in the strong growth in on-net traffic (54.1% higher than in 2008). This made it possible to handle a total of 52,134 million minutes of traffic in 2009, a year-on-year increase of 28.6% (25.1% in organic terms<sup>5</sup>) and 65.4% in the fourth quarter year-on-year, boosted by commercial campaigns launched by the Company in order to foster usage in a very competitive environment.

As for data services, Vivo continues positioned as market leader, with data revenues growing 45.8% in 2009 on organic terms<sup>5</sup> (+72.4% in the fourth quarter year-on-year). Data revenue growth was boosted by non-P2P SMS revenue, already accounting for 60.7% of total data revenue and showing the positive performance of data connectivity services.

The trend in ARPU in 2009 reflects the growth in SIM only gross adds, the decrease in off-net traffic and the aforementioned marketing campaigns. Hence, ARPU in 2009 declined 8.2% year-on-year in organic terms<sup>6</sup> (-9.5% for the quarter), although the trend in outgoing ARPU was better (-3.9% in 2009 in organic terms<sup>6</sup> and -6.0% in the fourth quarter).

**Revenue** totalled 3,036 million euros in 2009, for a 7.4% increase in local currency and a 5.0% increase in organic terms<sup>6</sup> (1.9% in the fourth quarter). Especially noteworthy is the fact that service revenue increased at a rate higher than total revenue, rising 7.7% year-on-year in 2009 in organic terms<sup>6</sup> and 4.6% in the quarter. The trend in total revenue was strongly influenced by the fall in revenue from handset sales, down 18.0% in organic terms<sup>6</sup> in 2009, and down 19.4% in the fourth quarter.

As a result of higher cost efficiency, OIBDA stood at 949 million euros in 2009, a year-on-year increase of 19.2% in local currency (16.4% in organic terms<sup>6</sup>) and 13.6% in the fourth quarter. The OIBDA margin stood at 31.2% in 2009, an improvement of 3.1 percentage points over 2008. In the fourth quarter the OIBDA margin stood at 31.9%, a year-on-year increase of 3.2 percentage points, reflecting greater efficiency in commercial expenses, lower bad debt levels, and a tax reversal.

<sup>5</sup> Including Telemig in January-March 2008.

<sup>6</sup> In local currency and including Telemig from January to March 2008.

CapEx in 2009 stood at 422 million euros. The year-on-year comparison is skewed by the purchase of 3G licenses in 2008. If this effect is excluded, CapEx falls 15.1% in organic terms<sup>7</sup>.

OIBDA-CapEx stood at 527 million euros in 2009, compared with 87 million euros in 2008, a solid 65.6% increase in organic terms<sup>7</sup> and excluding the purchase of 3G licenses in 2008.

## TELESP

In the second half of 2009, the Company has focused on raising its quality parameters, leading to a significant decline in the fourth quarter of the volume of complaints submitted to public agencies and to the Company itself and a sharp rise in the levels of customer satisfaction.

Commercial activity also recovered in the fourth quarter and is now converging to levels before the emergence of operational problems in prior quarters.

At year-end, Telesp managed 15.2 million accesses compared with 15.8 million at the end of 2008. The reason for this decline was the drop in the number of fixed telephony accesses (down 3.5% year-on-year).

The improved quality is reflected in the trend in fixed telephony accesses in the fourth quarter (-68,917). This was the smallest loss of lines since the third quarter of 2008, declining 53.2% on the third quarter of 2009, due to the reduced number of disconnections.

At year-end 2009, Telesp had some 2.6 million broadband accesses, year-on-year growth of 3.2% and a net gain of 80,678 accesses in 2009. The performance of this business during the year was strongly influenced by the suspension of sales imposed by Anatel in the previous quarter. Once the suspension had been lifted, and thanks to the quality-improvement measures implemented by the Company, there was a recovery to the growth path in the fourth quarter, with a net gain of 58,594 broadband accesses. In this period the service was marketed in successive increments through distribution channels and no advertising campaigns were carried out until December.

In pay TV, Telesp continues to be determined in offering a high quality proposal with a focus on specific customer segments. Commercial activity was down in the second half of the year as a result of Anatel's decision referred to above -given that this product is usually packaged with broadband access through 3P bundles- and the Company's strategy of making a priority of improving its quality. The Company was managing 0.5 million TV accesses at the end of 2009, 3.2% year-on-year increase and net adds of 15,020 accesses in the year.

Telesp's revenue totalled 5,766 million euros in 2009, a 1.8% decrease in local currency (-3.8% year-on-year in the fourth quarter).

The main factor behind this trend is the decline in revenue from traditional wireline telephony, despite the growing contribution from new businesses, which are the focus of the Company's transformation. Revenue from new businesses in 2009 accounted for 14.5% of total revenue, up 1.6 percentage points from 2008. Significantly, year-on-year growth in local currency was 10.3% for revenue from broadband, Pay TV and content in 2009, despite the fourth-quarter trend (-1.3% in local currency), due to the suspension of service and the fact that there was a delay before sales returned to normalcy. Data and IT revenues were still robust, rising by 20.7% in local currency in 2009 (+9.3% in the fourth quarter).

Revenue from traditional wireline telephony decreased by 5.9% year-on-year in 2009, in local currency (-5.7% year-on-year in the fourth quarter). The annual trend in revenue reflects the important fixed-to-mobile substitution, which adversely affects the trend in traditional accesses as well as traffic, which was also hard hit by the surge in wireless on-net traffic. Moreover, revenue reflects the updating of rates. Price increases were significantly lower in 2009 than in 2008 and were applied starting in the third quarter of 2009, whereas in 2008 updates also affected fixed-to-mobile traffic and were applied starting in July.

Operating expenses in 2009 grew 2.8% year-on-year in local currency (+3.1% in the fourth quarter), as the reduction in interconnection costs stemming from decreased traffic failed to offset the higher expenses associated with improving customer-service processes. In addition, bad debt provisions over revenues remained stable compared with 2008, at 3.1%.

As a result, OIBDA reached 2,209 million euros in 2009, down 8.9% year-on-year in local currency (-16.1% in the fourth quarter). The OIBDA margin stood at 38.3% in 2009 (-3.0 percentage points year-on-year) and at 38.0% in the fourth quarter, thus stabilising quarter-on-quarter (37.0% in the third quarter of 2009). The reason for the year-on-year decline is the higher proportion of revenue from new businesses, which require more resources and marketing efforts, and the impact of higher expenses for customer attention service and other costs related to the initiatives undertaken to improve the quality of the Company's services.

CapEx in 2009 totalled 806 million euros (-4.6% year-on-year in local currency), earmarked primarily to the broadband and television businesses as well as on general quality improvements. Operating cash flow (OIBDA-CapEx) totalled 1,403 million euros for the year (-11.2% year-on-year in local currency).

<sup>7</sup> In local currency and including Telemig from January-March de 2008.

## Argentina

The Argentine market registered healthy growth rates in 2009, underpinned by the good performance of the mobile telephony and broadband businesses, its main growth drivers.

In this context Telefónica continues to focus on improving customer value across all its businesses. The community effect and growth of mobile broadband remain the key growth drivers at the mobile business, while service bundling and a differential broadband offering are key drivers in the fixed telephony business.

At the end of 2009 the Company had 21.9 million accesses, up 5.7% year-on-year, underpinned by the mobile business and fixed broadband growth, with fixed telephony accesses virtually unchanged.

**Revenues** showed a strong growth of 15.3% in local currency in 2009 to 2,609 million euros, a rate of growth that remained stable in the fourth quarter.

**Operating income before depreciation and amortisation (OIBDA)** advanced 19.9% year-on-year in local currency to over 986 million euros (+11.6% in the fourth quarter in local currency). As a result the OIBDA margin stood at 36.8% in 2009, an improvement of 1.6 percentage points from 2008 (-0.8 percentage points year-on-year in the fourth quarter to reach 38.3%).

**CapEx** amounted to 319 million euros in 2009 (+3.3% in local currency), leaving **operating cash flow (OIBDA-CapEx)** of 668 million euros, a sharp increase of 29.8% from 2008 in local currency.

### T. Móviles Argentina

The Argentine mobile telephony market reached an estimated penetration rate of 120% in 2009 (+11 percentage points year-on-year).

It is noteworthy the good performance of net adds in the fourth quarter, which totalled 478,534 accesses, 43.4% of net adds for the year (1.1 million accesses) and 2.7 times higher than in the fourth quarter of 2008. Underpinning this improvement were the higher number of gross adds and lower churn, which fell 0.3 percentage points year-on-year to 1.6% and by 0.1 percentage point to 1.9% in the year. Telefónica managed a total of 15.9 million **mobile accesses** at the end of December, up 7.4% year-on-year.

**Traffic** in 2009 reached 15,562 million minutes, a solid year-on-year growth of 20.2% (+15.8% in the fourth quarter), driven by the sharp increase in on-net traffic (+42.2% year-on-year in 2009).

Data revenue posted a strong performance in the fourth quarter of the year, driving the full year data revenues up 38.2%. Thus, data revenues accounted for 29.7% of service revenues in 2009, up 4.3 percentage points year-on-year. This performance was underpinned throughout the year by the good performance of non-P2P SMS data revenues, which accounted for 25.4% of data revenues (+5.2 percentage points from 2008) and reflect the strong uptake for mobile broadband services. The Company is focusing on an offering based on limited use, prioritising service and the value of the product as a complement to the fixed broadband service.

As a result **ARPU** rose 10.7% year-on-year in 2009 in local currency (+9.8% in the fourth quarter).

These healthy operating results are reflected in **revenues**, which rose 15.8% year-on-year in local currency to over 1,643 million euros, driven by the sharp rise in service revenues (+18.1% in the year). Fourth quarter revenues rose 17.7% in local currency, underpinned by higher handset sale revenues (+44.2% year-on-year in local currency) and the solid performance of service revenues (+15.7% year-on-year in local currency).

**Operating income before depreciation and amortisation (OIBDA)** outpaced year-on-year revenue growth rising by 31.8% in local currency (+17.7% in local currency in the fourth quarter) to reach 606 million euros in 2009. This reflects the significant efficiency gains achieved. The OIBDA margin stood at 36.9% in the full year and 40.3% in the quarter, up 4.5 percentage points and 0.8 percentage points respectively, underpinned by contention of commercial expenses resulting from the higher SIM-only gross adds.

**CapEx** in 2009 totalled 141 million euros (+2.6% year-on-year in local currency) and was focused on the expansion of the 3G network with the aim of improving coverage and increasing the capacity of the GSM network. **Operating cash flow (OIBDA-CapEx)** in 2009 stood at 465 million euros, a jump of 44.2% in local currency from 2008.



## Telefónica de Argentina

Telefónica de Argentina managed almost 6 million accesses at the end of 2009, up 1.2% year-on-year, underpinned by sharp growth in broadband accesses (+14.4% year-on-year). Traditional fixed accesses were virtually unchanged, with positive net adds of 10,920 in the fourth quarter.

Telefónica continues to lead the Argentine broadband market, registering net adds of 156,346 accesses in the full year and of 51,868 accesses in the fourth quarter, similar to the third quarter figure and sharply up from the fourth quarter of 2008 (+45.0%). These results were driven by the improvement in churn resulting from the ongoing improvement in the quality of the customer base. This reduced commercial effort required to maintain high growth rates.

Service bundling continues to play a key role in maintaining the stability of the traditional fixed telephony business and the growth of broadband. A total of 78% of broadband gross adds in the year signed up for a "Dúo" service or packages that include TV services, which now account for 67% of total broadband accesses. After the agreement reached with Direct TV and the mass launch of the pay TV service in the third quarter, the number of customers with this service at the end of December totalled 30,000, of whom 82% are migrations from the Dúo service. This way the Company is continuing to pursue its customer loyalty strategy while at the same time improving the unit value of the customer base.

Also worth noting is the ongoing processes improvement drive, which is reflected in the increase in customer satisfaction levels.

**Revenues** stood at 1,047 million euros in 2009, up 13.9% year-on-year in local currency (+10.9% in the quarter) thanks to the transformation process underpinned by the bundling of basic services and an increased focus on broadband. Internet, TV and content revenues accounted for 21.0% of total revenues in 2009 and grew 38.6% year-on-year in local currency (+36.1% in the fourth quarter). Traditional revenues advanced 5.6% year-on-year in local currency (+2.6% in the fourth quarter).

Operating expenses, affected by inflation, advanced 18.7% year-on-year in local currency in 2009 and by 17.9% in the fourth quarter, largely due to a sharp rise in external service expenses, a higher advertising spend and expenses linked to the commercial drive in the quarter. There were also adjustments from the renegotiation of different contracts. Bad debt provision stood at 1.4% of revenues in 2009 (+0.3 percentage points on 2008).

Telefónica de Argentina reported **operating income before depreciation and amortisation (OIBDA)** of 380 million euros in 2009, up 4.9% year-on-year in local currency (+1.6% in the final quarter), leaving an OIBDA margin of 32.3% for the full year (30.7% in the fourth quarter), 2.1 percentage points year-on-year below 2008 figure (-2.9 percentage points year-on-year in the fourth quarter).

**CapEx** in 2009 amounted to 178 million euros (+3.9% year-on-year in local currency) while **operating cash flow (OIBDA-CapEx)** advanced 5.7% in local currency to 203 million euros.

## Chile

The Chilean telecommunications market remains among the most competitive and developed in the region, with high penetration rates for both broadband and mobile telephony.

In this context, and with the objective of capturing profitable growth, Telefónica has focused on attracting the highest number of customers as an integrated player and maintaining its market position while at the same time improving process efficiency.

In 2009 the Company decided to market all its services in the country under the Movistar brand, a move that has already resulted in improved commercial activity and enhanced the Company's image in the market.

Telefónica consolidated its sector leadership in 2009, managing 10.7 million **accesses** at the end of December, up 6.4% year-on-year. This improvement was driven by the mobile business (voice and broadband) and the fixed broadband business. Mobile accesses grew by 9.5% year-on-year while fixed broadband accesses by 9.3% year-on-year.

The Company's financial results in 2009 were significantly impacted by the regulatory decisions on termination rates. On 23 January the new measures entailing a 44.6% cut in mobile termination rates came into effect, while on May 7 the decree governing wireline accesses/operator charges was also enacted. This entailed an additional reduction in wireline termination rates.

Against this backdrop, revenues in 2009 totalled 1,831 million euros, down 3.3% year-on-year in local currency (-7.5% in the fourth quarter). Stripping out the impact of the reduction in termination rates, full year revenues grew by approximately 4.7% in local currency from 2008 (+1.7% in the fourth quarter).

Despite the regulatory pressure on revenues, operating income before depreciation and amortisation (OIBDA) in 2009 stood at 763 million euros, up 5.5% year-on-year in local currency (+3.3% in the fourth quarter), showing the efficiency improvements achieved over the year. This left the OIBDA margin for 2009 at 41.7%, 3.5 percentage points higher than in 2008, and at 46.6% in the fourth quarter (+4.2 percentage points compared with the fourth quarter of 2008).

CapEx in 2009 totalled 347 million euros, down 16.2% year-on-year in local currency, generating operating cash flow (OIBDA-CapEx) of 416 million euros, up 34.5% year-on-year in local currency.

#### T. Móviles Chile

The estimated penetration of the Chilean mobile market stood at 106% at the end of December 2009, up 9 percentage points year-on-year.

Against this backdrop Movistar Chile remained market leader, slightly increasing its market share over the year thanks to its push of mobile broadband.

The Company's mobile customer base stood at 7.5 million accesses in December 2009, up 9.5% year-on-year. In the full year net adds totalled 649,711 accesses (+9.7% year-on-year), with commercial activity rising sharply in the fourth quarter, resulting in net adds of 269,249 (+56.2% year-on-year), 41% of the total for the year.

The strength in net adds was underpinned by the containment of churn, which stood at 1.6% in 2009, down 0.3 percentage points both in the full year and the fourth quarter.

Traffic in 2009 reached 10,521 million minutes, up 8.4% year-on-year, underpinned by outgoing traffic (primarily on-net), which advanced 10.1% year-on-year (+8.8% in the fourth quarter).

Strong customer data usage boosted outgoing ARPU, both in the full year and the fourth quarter. However, this growth was offset by the sharp reductions in termination rates. As a result, full year ARPU declined 10.7% year-on-year in local currency (-13.8% in the fourth quarter).

It is worth to highlight the growing contribution that mobile broadband and 3G services are making to service revenues. Data revenues advanced 28.5% year-on-year in local currency (+29.8% in the fourth quarter), accounting for 11.8% of service revenues (+2.9 percentage points from 2008), of which 52.8% were generated by non-P2P SMS data revenues (+13.2 percentage points from 2008).

In 2009 revenues totalled 1,010 million euros, down 1.8% year-on-year in local currency (-6.0% in the quarter), hit by the reduction in termination rates. Outgoing revenues, which are not affected by regulatory measures, advanced 8.9% in local currency in 2009 (+10.4% in the fourth quarter).

OIBDA in 2009 amounted to 445 million euros, a marked year-on-year increase in local currency of 13.3% (+10.9% in the quarter), reflecting cost efficiencies over the year. This left the OIBDA margin at 44.1%, up 5.9 percentage points from 2008 (+6.9 percentage points in the fourth quarter).

The strength of OIBDA and lower CapEx in 2009, which totalled 185 million euros (-17.3% year-on-year in local currency) underpinned a 53.7% year-on-year jump in operating cash flow (OIBDA - CapEx) to 260 million euros.

#### Telefónica Chile

Telefónica Chile managed 3.1 million accesses at the end of December 2009, virtually unchanged from December 2008.

In 2009 is noteworthy the positive performance of broadband and pay TV accesses, which increased by 9.3% and 8.4% year-on-year, respectively. Broadband net adds totalled 18,666 in the fourth quarter and 66,664 in the full year. Also worth underlining is the improvement in pay TV net adds in the fourth quarter, which were 2.4 times higher than in the first nine months of the year (15,579 accesses in the fourth quarter). Pay TV net adds totalled 22,110 in the full year.

**Bundling** played a key role in maintaining and bolstering the Company's leadership position. At the end of 2009, 95.2% of broadband accesses formed part of a "Dúo" or "Trío" service while 65.8% of total accesses at the traditional business were bundled.

**Revenues** in 2009 totalled 893 million euros, down 6.3% year-on-year in local currency (-11.0% in the fourth quarter), mainly due to the decrees regulating termination rates.

Especially noteworthy is the positive revenue performance of the businesses that are driving the Company's transformation process. Internet, TV and content revenues grew by 10.3% year-on-year in local currency in 2009 (+5.3% in the fourth quarter), accounting for 25.8% of total revenues (+3.9 percentage points from 2008). Revenues from the traditional business fell 16.2% year-on-year in local currency, mainly reflecting the decline in accesses (-4.4%) and the rate reductions set out in the tariff decree.

Operating expenses in 2009 declined by 7.4% from 2008 (-12.6% in the fourth quarter), reflecting cost efficiencies, mainly in supplies, external service expenses and lower bad debt provisions. The latter stood at 4.4% in 2009 (-0.5 percentage points from 2008).

As a result **OIBDA** totalled 326 million euros in 2009 (-1.8% year-on-year in local currency), with an improvement reported in the final quarter (+0.9%). As a result, the OIBDA margin stood at 36.5% (42.2% in the fourth quarter), up 1.7 percentage points year-on-year (+4.5 percentage points in the fourth quarter).

**CapEx** in 2009 totalled 162 million euros, down 15.0% year-on-year in local currency. This drove **operating cash flow (OIBDA-CapEx)** 15.9% higher year-on-year in local currency to 163 million euros.

## Peru<sup>8</sup>

Telefónica's operations in Peru continued to perform well in 2009, reporting significant growth at both the operating and financial levels. At the end of 2009, **accesses** totalled more than 15.9 million, up 6.2% from December 2008 underpinned by growth in mobile and broadband accesses, which increased by 8.0% and by 10.0%, respectively.

**Revenues** totalled 1,716 million euros in 2009, up 4.4% year-on-year in organic<sup>8</sup> terms (+3.0% in local currency), thanks to higher mobile and wireline revenues. In the quarter, revenues declined by 1.7% year-on-year in organic terms<sup>8</sup>.

**Operating income before depreciation and amortisation (OIBDA)** in 2009 stood at 712 million euros, with a strong increase of 13.1% year-on-year in organic<sup>8</sup> terms (+12.0% in local currency) on the back of growth reported at both businesses (wireline and wireless). In the fourth quarter OIBDA rose 1.3% year-on-year in organic<sup>8</sup> terms. As a result, OIBDA margin reached 41.5% in 2009, up 3.2 percentage points year-on-year in organic<sup>8</sup> terms (+3.3 percentage points in local currency), and 42.9% in the quarter (+1.3 percentage points year-on-year in organic<sup>8</sup> terms).

**Operating cash flow (OIBDA-CapEx)** reached 442 million euros in 2009, showing a significant year-on-year growth in organic<sup>8</sup> terms of 32.1% (+29.7% in local currency), while **CapEx** totalled 271 million euros in 2009 (-8.4% year-on-year in local currency).

### T Móviles Peru

At the end of 2009 the estimated penetration of the Peruvian wireless market stood at 65%, up 4 percentage points from 2008 leaving scope for significant further growth.

In 2009 Telefónica consolidated its market leadership, pursuing a profitable growth strategy focused on value customers.

The Company managed 11.5 million **accesses** at the end of 2009 (+8.0% year-on-year), with net adds of 845,559 accesses in the full year. Almost a quarter of total net adds corresponded to the contract segment. In the fourth quarter net adds totalled 337,447 accesses, showing again an acceleration compared with the prior quarter (up 31.0% on the third quarter). This growth was driven by increased activity associated with the Christmas campaign and the positive impact of the resegmentation of the commercial offering in mid 2009 on gross adds and churn.

<sup>8</sup> From 1 January 2009, Medianetworks is being consolidated as T. Internacional, S.A.U.'s subsidiary (previously consolidated as Telefónica del Perú's subsidiary). For the purpose of presenting comparable information, the year-on-year organic changes of Telefónica del Perú and, as a result, of the country consolidated information, has been calculated in local currency and excluding Medianetworks results in 2008.

Churn in the fourth quarter (2.8%) was lower than in prior quarters, coming in at 3.1% in 2009, in line with the 2008 figure, and showing a significant improvement over the second half of the year.

Traffic through December 2009 stood at 11,460 million minutes, up 14.1% y-o-y (+10.8% year-on-year in the fourth quarter), driven by the increase in on-net traffic, as a result of commercial policies aimed at boosting the community effect.

The sharp growth in the customer base over the year affected ARPU, which fell by 11.5% year-on-year in local currency in 2009, showing an improvement in the fourth quarter (-6.3% year-on-year in local currency).

As a result, revenues in 2009 totalled 840 million euros, a year-on-year increase of 6.1% in local currency. This improvement was primarily driven by higher mobile service revenues (+3.0% year-on-year in local currency), that was positively impacted by data revenues. Data revenues in 2009 accounted for 11.4% of service revenues driven by the promotion of mobile broadband services. Furthermore, mobile handset sale revenues advanced 15.1% in local currency, reflecting the smaller traffic bonus offered to new prepay customers.

The performance of revenues in the fourth quarter (-3.9% year-on-year in local currency) is mainly explained by the lower handset sale revenues (-16.0% year-on-year in local currency compared with +32.4% through September) as a result of the larger weight of SIM-only accesses.

Operating income before depreciation and amortisation (OIBDA) totalled 327 million euros in 2009, showing a solid year-on-year growth of 19.8% in local currency. This improvement reflects efficiency improvements achieved over the year. OIBDA remained stable year-on-year in the fourth quarter (+0.3% in local currency) as the decline in revenues was mitigated by cost efficiencies. As a consequence, OIBDA margin reached 38.9%, up 4.4 percentage points from 2008, and at 41.1% in the fourth quarter (+2.0 percentage points from the same quarter in 2008).

CapEx in 2009 totalled 127 million euros, down 14.2% year-on-year in local currency. Consequently, operating cash flow (OIBDA-CapEx) totalled 200 million euros, a sharp year-on-year increase of 60.1% in local currency.

### Telefónica del Perú<sup>9</sup>

Telefónica del Perú successfully pushed ahead with its strategy to transform the business into a services company with bundling playing as a key role. As a result the Company increased its accesses to 4.5 million at the end of 2009 (vs. 4.4 million in 2008).

The broadband business continued to grow and at the end of December 2009 the Company reached 768,046 accesses, up 10.0% year-on-year. Pay TV accesses totalled 686,295, a comparable<sup>10</sup> year-on-year increase of 15.0% (+4.9% reported) following the disconnection of 66,689 inactive accesses in the fourth quarter.

Fixed telephony accesses remained virtually unchanged in the year (-0.5% vs. 2008) due to the increase in fixed-wireless accesses (+20.0% year-on-year) and despite the impact of fixed-mobile substitution. The lower growth reported in recent quarters by the fixed-wireless accesses is a result of the new marketing model of the service, aimed at improving the quality of gross adds.

Telefónica's commitment to bundling and service segmentation is underlined by the fact that 52% of fixed telephony accesses are now part of a package, and 64% of broadband accesses have a Dúo or Trío service.

Revenues in 2009 totalled 1,006 million euros in 2009, up 2.8% year-on-year in organic<sup>11</sup> terms (+0.6% in local currency), and were virtually unchanged in the fourth quarter (-0.8% year-on-year organic<sup>11</sup>). Growth in new businesses remained solid. Internet, TV and content revenues rose 11.8% year-on-year in 2009 in organic<sup>11</sup> terms (+9.8% in the quarter), while data, IT and capacity rental revenues climbed 29.9% in organic terms<sup>11</sup> over the year (+8.6% in the quarter). Internet, TV and content revenues accounted for 32.4% of total 2009 revenues (+2.6 percentage points year-on-year in organic<sup>11</sup> terms).

Meanwhile, operating expenses increased by 8.8% in organic<sup>11</sup> terms from 2008, mainly as a result of higher interconnection costs. The higher fourth quarter expenses (+10.7% year-on-year in organic terms<sup>11</sup>) were due to increased interconnection and equipment costs, and bad debt provisions. In 2009 bad debt provisions represented 2.6% of revenues (-0.6 percentage points year-on-year in organic<sup>11</sup> terms).

<sup>9</sup> Wireline telephony accesses include all Telefónica's fixed wireless accesses in Peru, both those managed by the wireline business and those managed by the wireless business. However, earnings from fixed wireless accesses are included in the results of the Peruvian wireless business.

<sup>10</sup> For comparison purposes, accesses in December 2009 exclude the disconnection of 66,689 inactive Pay TV accesses.

<sup>11</sup> From 1 January 2009, Medianetworks is being consolidated as T. Internacional, S.A.U.'s subsidiary (previously consolidated as Telefónica del Perú's subsidiary). For the purpose of presenting comparable information, the year-on-year organic changes of Telefónica del Perú and, as a result, of the country consolidated information, has been calculated in local currency and excluding Medianetworks results in 2008.

Operating income before depreciation and amortisation (OIBDA) grew by 8.2% year-on-year in organic<sup>12</sup> terms to 386 million euros (+6.4% in local currency). In the fourth quarter OIBDA grew 1.6% year-on-year in organic terms<sup>12</sup>, leaving an OIBDA margin of 38.3% in 2009 (+1.9 percentage points year-on-year in organic<sup>12</sup> terms; +2.1 percentage points year-on-year reported), and of 38.4% in the fourth quarter (+0.9 percentage points year-on-year in organic<sup>12</sup> terms). In 2009 OIBDA was also positively affected by the revision of the estimated adjustment to workforce provision from the prior year by 9 million euros. Stripping out this impact OIBDA would have risen by 5.6% year-on-year in organic<sup>12</sup> terms in 2009.

CapEx through December 2009 totalled 144 million euros (-2.6% year-on-year in local currency) and was mainly invested in the development of new businesses. As a result, operating cash flow (OIBDA-CapEx) amounted to 241 million euros, up 15.9% year-on-year in organic<sup>12</sup> terms (+12.6% in local currency).

## Colombia

At the end of 2009 Telefónica managed over 11.1 million accesses in Colombia, of which 9.0 million were mobile customers and 2.2 million were wireline customers.

Revenues up to December 2009 totalled 1,269 million euros, down 11.6% year-on-year in local currency (-15.9% in the fourth quarter). This decline is due to lower wireline and wireless revenues, though the pace of decline of revenue in the latter has stabilised thanks to the improvement of commercial activity.

Operating income before depreciation and amortisation (OIBDA) in 2009 stood at 397 million euros (-20.0% year-on-year in local currency), picking up in the final quarter (-14.0% year-on-year in local currency) thanks to the improved performance of the wireless business. The OIBDA margin in the fourth quarter stood at 38.0% (+0.4 percentage points year-on-year), and at 31.3% in the full year (-3.3 percentage points year-on-year).

Operating cash flow (OIBDA-CapEx) amounted to 81 million euros in 2009 (-11.3% year-on-year in local currency), with CapEx down for the year (316 million euros; -21.9% year-on-year in local currency).

## T. Móviles Colombia

The Colombian mobile telecommunications market shrank in 2009, affecting all operators. Nonetheless, accesses growth resumed from mid 2009, reaching an estimated penetration rate of 93% at the end of the year (+2 percentage points year-on-year).

In 2009 Telefónica Móviles Colombia completed the redefinition of its commercial offering and its repositioning in the market, focusing on customer value. As a result, its operating indicators improved overall in the last quarters of the year.

Having reported net adds of 153,705 accesses in the fourth quarter, changing the trend of the three prior quarters, the customer base totalled 9.0 million accesses at the end of 2009 (-10.0% year-on-year). It is worth to highlight the positive evolution of the contract segment with three consecutive quarters of growth, reporting 125,602 new customers in 2009. Contract customers accounted for 19.6% of the total at the end of 2009, up 3.2 percentage points. The prepaid segment registered a quarterly net gain for the first time in the year (104,176 accesses).

Churn continued to improve in the fourth quarter and stood at 2.7%, down 1.0 percentage points year-on-year and 0.5 percentage points from the prior quarter. Churn stood at 3.7% in 2009, stable compared with 2008.

Growth in total traffic consolidated in the fourth quarter, increasing by 3.3% year-on-year. In 2009 traffic totalled 13,665 million minutes (+0.7% year-on-year).

This growth in traffic was reflected in fourth quarter ARPU, which was down 4.1% year-on-year in local currency, a significant improvement from prior quarters. ARPU fell 10.2% year-on-year in local currency in 2009 (-12.1% to September).

Revenues totalled 685 million euros at the end of 2009, posting a year-on-year decline of 12.7% in local currency (-14.3% in local currency in the quarter). In 2009 service revenues were 10.3% down year-on-year in local currency, mainly due to the smaller number of customers, while handset sale revenues ended 40.6% down, posting in the fourth quarter a better performance (-29.8% year-on-year in local currency). In the quarter the higher decline of service revenues (-13.3% in local currency) was affected by the cut of the fixed to mobile termination rates (-49.4%), effective since September.

<sup>12</sup> From 1 January 2009, Medianetworks is being consolidated as T. Internacional, S.A.U.'s subsidiary (previously consolidated as Telefónica del Perú's subsidiary). For the purpose of presenting comparable information, the year-on-year organic changes of Telefónica del Perú and, as a result, of the country consolidated information, has been calculated in local currency and excluding Medianetworks results in 2008.

Data revenues continued to perform well in the fourth quarter, rising 42.7% year-on-year in local currency. In 2009 data revenues advanced 37.5% in local currency from 2008, to account for 8.8% of service revenues (+3.1 percentage points from 2008).

**OIBDA** outperformed revenues, advancing by 3.0% year-on-year in the fourth quarter in local currency. In 2009 OIBDA stood at 194 million euros (-3.4% year-on-year in local currency), affected by the higher bad debt provision associated with the distribution channel booked in the second quarter. As a result, the OIBDA margin stood at 28.3% in 2009, up 2.7 percentage points from 2008 (36.3% in the quarter, +5.5 percentage points year-on-year).

**CapEx** in 2009 fell by 25.7% year-on-year in local currency to 165 million euros, resulting in **operating cash flow (OIBDA-CapEx)** of 29 million euros in the year, a significant improvement from the prior year (-22 million euros)

#### Telefónica Telecom

At the end of 2009, Telefónica Telecom managed 2.2 million accesses (2.8 million in 2008). This decline was largely due to the disconnection of 405,022 inactive accesses in the fourth quarter (wireline, broadband and pay TV accesses), which has no impact on the Company's financial results.

In a market characterised by a high rate of fixed-to-mobile substitution due to the reduced mobility premium, the Company's fixed telephony accesses fell 12.3% year-on-year on a comparable basis<sup>13</sup> (-28.7% reported).

Broadband customer growth remained strong and accesses totalled 420,263 at the end of 2009 (+13.0% vs. 2008 on a comparable basis<sup>13</sup>; +6.7% reported), with comparable<sup>13</sup> net adds over the year of 51,038 accesses. Pay TV accesses stood at 127,201 at year-end (-7.2% on a comparable basis<sup>13</sup>; -10.6% reported).

The Company continued to focus on its strategy of bundling services. Over 72% of wireline accesses formed part of a bundle at the end of December and 100% of broadband accesses (+29 percentage points year-on-year) are part of a Dúo or Trío package.

In 2009 **revenues** totalled 615 million euros, down 10.0% year-on-year in local currency (-17.5% in the quarter), mainly due to lower traditional telephony revenues (-18.7% year-on-year in local currency), a consequence of the smaller customer base and a drop in traffic. Internet, TV and content revenues grew 12.7% year-on-year in local currency in 2009, accounting for 19.8% of total revenues (+4.0 percentage points year-on-year) while revenues from capacity rental, data and IT climbed 3.3% year-on-year in local currency.

Operating expenses in 2009 increased by 1.8% year-on-year in local currency, mainly due to higher supply expenses and an increase in bad debt provisions, which reached 5.7% of total revenues in 2009 (+4.1 percentage points year-on-year).

**OIBDA** in 2009 totalled 203 million euros (-31.2% in local currency; -27.2% in the quarter), leaving an OIBDA margin of 33.0% (-10.2 percentage points from 2008). The margin stood at 37.7% in the quarter (-5.2 percentage points year-on-year).

**CapEx** through 2009 stood at 151 million euros (-17.4% year-on-year in local currency), with **operating cash flow (OIBDA-CapEx)** amounting to 52 million euros (-53.6% year-on-year in local currency).

## Mexico

Mexico showed signs of recovery in the last quarter of 2009, after being one of the countries hit hardest by the economic crisis.

Mobile market growth remained strong, reaching an estimated penetration rate of 75% at the end of 2009, up 4 percentage points from December 2008.

Against this backdrop, Telefónica Móviles México achieved a solid set of results in 2009, combining a marked improvement in its competitive position with high cash flow generation.

During the fourth quarter, the focal point of which was the Christmas campaign, the Company continued to execute its strategy centred on capturing profitable growth. There was strong uptake for the new plans launched over the Christmas period including the "Pagamenos Xtra" ("Payless Xtra") in the prepay segment, which has worked extremely well since its introduction in the market. Thus, at the end of December the Company had 17.7 million **total accesses** and 17.4 million mobile accesses, a year-on-year growth of 14.7% and 13.5%, respectively.

The Company continued to reinforce its competitive position over the year, attaining an estimated 21% share of the mobile market in 2009. This represents an increase of more than 1 percentage point from December 2008.

The growth in commercial activity in the fourth quarter, underpinned by the Christmas campaign and the country's steady economic upturn, is reflected in quarterly gross adds of 1.9 million, a year-on-year advance of 5.1%. This represents a marked improvement compared with prior quarters (gross adds fell by 7.0% year-on-year in 2009).

<sup>13</sup> For comparison purposes, accesses in December 2009 exclude the disconnection of 375,572 fixed telephony accesses, 24,646 broadband accesses and 4,804 Pay TV accesses, all of which were inactive.

Also noteworthy is Telefónica Móviles México's drive to foster prepay to contract migrations. This proved successful, especially in the final months of the year, and is reflected in the 19.4% year-on-year growth in contract customers in 2009, higher than the increase in the total customer base.

The Company's churn rate remains the benchmark in the market and stood at 2.0% in the fourth quarter of 2009, a marked decline of 0.7 percentage points from the fourth quarter of 2008. In 2009 churn stood at 2.2%, a year-on-year improvement of 0.2 percentage points.

The growing trend in mobile net adds along the year was more pronounced in the fourth quarter, when net adds reached 882,095 accesses (+31.9% year-on-year, +53.2% quarter-on-quarter). In the full year net adds stood at 2.1 million accesses.

**Traffic** in 2009 stood at 23,186 million minutes, up 3.4% year-on-year, with a marked acceleration in traffic growth in the fourth quarter (+11.0% year-on-year). This was driven by the rise in outgoing traffic, which grew by 11.5% compared with the same period a year earlier.

**ARPU** in 2009 fell 3.3% year-on-year in local currency (-3.1% in the quarter in local currency).

**Revenues** in 2009 showed a significant 10.0% year-on-year growth in local currency (+10.7% in the fourth quarter) to 1,552 million euros. This improvement was driven by the sharp rise in service revenues, which advanced 17.8% from 2008 in local currency (+15.4% year-on-year in the fourth quarter), and more than offset the lower revenues from handset sales, where the year-on-year decline in the fourth quarter was lower (-17.2% compared with -33.7% in the full year in local currency).

The larger scale of the Mexican business and efficiency gains boosted **operating income before depreciation and amortisation (OIBDA)**, which jumped 55.2% in local currency from 2008 to 564 million euros. This left an OIBDA margin of 36.3% in 2009, a marked year-on-year improvement of 10.6 percentage points.

**CapEx** in 2009 totalled 251 million euros, down 8.6% year-on-year in local currency.

The marked improvement in OIBDA and lower investment underpinned a more than three-and-a-half-fold year-on-year in local currency increase in **operating cash flow (OIBDA-CapEx)** to 313 million euros in 2009.

## Venezuela<sup>14</sup>

Mobile penetration in Venezuela reached an estimated 101% at year-end 2009, slightly up from December 2008.

In 2009, Telefónica Móviles Venezuela continued to post a strong operating performance as a result of a strategy focused on maximising customer loyalty and value by marketing an integrated offering (mobile and fixed telephony, broadband and television) and selective customer-acquisition efforts.

The Company reached 11.8 million accesses and had 10.5 million mobile accesses at year-end 2009.

Thanks to the selective customer-acquisition strategy, the trend in **churn** remained positive, declining 0.3 percentage points year-on-year in both the quarter and the full year. It stood at 2.4% in 2009 (2.6% for the quarter). Despite the better performance in churn, the reduction in gross adds drove net losses in mobile accesses in 2009 of 52,622 (-82,397 accesses in the quarter).

Regarding network usage, **traffic** in 2009 stood at 14,951 million minutes, practically unchanged from 2008 (-5.1% for the quarter).

The trend in **ARPU** remained positive, with year-on-year organic growth<sup>14</sup> of 19.8% in the fourth quarter of 2009 and 19.2% for the year, driven mainly by solid growth in data services.

**Revenues** reached 3,773 million euros in 2009, a year-on-year growth of 20.4% in organic terms<sup>14</sup>, thanks to the strong increase in service revenue, which rose 24.2% for the full year, also in organic terms<sup>14</sup>. In the fourth quarter, revenue rose by 9.4% year-on-year in organic terms<sup>14</sup>. Revenues were adversely affected by lower sales of handsets, given that service revenue continued to grow considerably (+17.6% in organic terms<sup>15</sup>).

The mobile data business has consolidated as one of the main drivers of the Company's growth and is continuing to post a strong performance. Organic growth<sup>14</sup> in data revenue from 2008 to 2009 stood at 52.4%, accounting for 27.1% of service revenue (up 5.0 percentage points compared with 2008).

Thanks to the Company's focus on profitable growth, **operating income before depreciation and amortisation (OIBDA)** reached 1,818 million euros in 2009, with year-on-year organic growth<sup>14</sup> of 25.4% for the full year and virtually flat in the last quarter (-0.9%). The OIBDA margin in 2009 stood at 48.2% (45.0% in the fourth quarter), 2.0 percentage points higher than in 2008 in organic terms<sup>14</sup>.

<sup>14</sup> For comparison purposes and to facilitate the interpretation of the year-on-year changes vs. 2008, variations in local currency of the headings affected by the hyperinflation adjustment are reported excluding the impact of this adjustment.

# 04/6 Results by regional business units

## Telefónica Latinoamérica

Operating cash flow (OIBDA-CapEx) was 1,395 million euros in 2009, resulting in an outstanding organic growth<sup>15</sup> (+19.9%) over 2008, in a year in which a considerable investment effort was made. CapEx in 2009 increased by 45.2% in organic terms<sup>15</sup> from the year before, as a result of improved coverage and the rollout of GSM and 3G networks and the satellite TV service.

Hyperinflation adjustments led revenue to increase by 263 million euros, OIBDA by 64 million euros.

### Central America

Estimated mobile penetration in the Central American markets in which Telefónica operates reached 90% at the end of 2009 (+9 percentage points year-on-year).

At the end of December, Telefónica Centroamérica managed 6.3 million accesses, up 1.8% from December 2008. Mobile accesses stood at 5.8 million, with net adds of 220,495<sup>16</sup> over the year. Particularly noteworthy are the improved commercial results in the fourth quarter, resulting in a sharp rise in net adds after net losses were reported through September. In the fourth quarter the mobile customer base in the region increased by 150,690, after disconnecting 116,000 inactive CDMA lines in Guatemala, with no impact on revenues. The Company plans to switch off its CDMA network in Guatemala in the first quarter of 2010.

Revenues in 2009 totalled 565 million euros, down 2.5% year-on-year in constant currency, after rising sharply in the fourth quarter (+7.6% year-on-year in constant currency) thanks to increased commercial activity. The ongoing drive to generate synergies underpinned a sharp year-on-year rise in operating income before depreciation and amortisation (OIBDA) to 241 million euros in 2009, up 9.0% in constant currency (and by 7.5% in the quarter). The OIBDA margin stood at 42.6% for the full year (43.4% in the quarter), a sharp rise of 4.4 percentage points year-on-year.

Operating cash flow (OIBDA – CapEx) totalled 154 million euros in the year, up 49.7% from 2008 in constant currency, driven by the improvement in OIBDA and lower CapEx (down 26.4% year-on-year versus 2008 in constant currency).

During the fourth quarter of 2009, the license in Nicaragua has been renewed for an amount of 10 million euros. Excluding this impact, the operating cash flow would have increased by 59.2% in constant currency vs. 2008 and the CapEx would have decreased by 35.0% in constant terms y-o-y.

### Ecuador

Mobile penetration in the Ecuadorian mobile market stood at an estimated 93% at the end of December.

The customer base of Telefónica Móviles Ecuador at December 2009 stood at 3.8 million total accesses and 3.7 million mobile accesses, up 18.5% and 19.2% year-on-year respectively.

Against a backdrop of higher commercial activity, mobile net adds continued to rise, totalling 269,928 in the fourth quarter (+63.5% year-on-year) and 599,239 in the full year (+10.7% from 2008).

This performance was underpinned by the improvement in churn, which stood at 2.1% in the fourth quarter, down 2.1 percentage points year-on-year, and at 2.4% in the year, down 1.2 percentage points from 2008.

In terms of usage, traffic in 2009 increased by 33.7% (+23.2% in the fourth quarter) year-on-year to 3,744 million minutes, an improvement driven by the sharp rise in outgoing traffic (+41.6% from 2008).

ARPU fell 3.8% year-on-year in local currency, thanks to an improved fourth quarter performance (-5.1% in local currency versus -6.3% in the third quarter).

Revenues totalled 337 million euros, virtually unchanged from 2008 (+0.6% year-on-year in local currency), and were affected by lower handset sales. Service revenues advanced by a noteworthy 9.5% in local currency in 2009, with growth picking up in the fourth quarter (+12.3% from 2008, more than doubling the third quarter growth rate).

The Company's scale and its efficiency improvement drive a 3.0% year-on-year rise in local currency in operating income before depreciation and amortisation (OIBDA) to 100 million euros in 2009. The OIBDA margin stood at 29.7% in 2009, a year-on-year improvement of 0.7 percentage points.

CapEx in 2009 totalled 83 million euros, down 36.8% year-on-year in local currency. It is worth recalling that in 2008 the Company booked 61 million euros associated with the renewal of the concession for its mobile telephony and international long-distance licences until 2023. Stripping this investment out (61 million euros), CapEx in local currency would have grown by 25.0%.

Operating cash flow (OIBDA-CapEx) in the full year stood at 17 million euros (compared to a reported -32 million euros in 2008, or +29 million euros stripping out the abovementioned licences).

<sup>15</sup> For comparison purposes and to facilitate the interpretation of the year-on-year changes vs. 2008, variations in local currency of the headings affected by the hyperinflation adjustment are reported excluding the impact of this adjustment.

<sup>16</sup> For comparison purposes, net adds in 2009 exclude the disconnection of 116,000 inactive prepaid mobile accesses in Guatemala.



## Telefónica Latinoamérica Accesses

	2008		2009			% Chg y-o-y
	December	March	June	September	December	
Unaudited figures (thousands)						
<b>Final Clients Accesses</b>	<b>158,200.1</b>	<b>159,401.5</b>	<b>160,749.5</b>	<b>163,656.9</b>	<b>168,531.1</b>	<b>6.5</b>
Fixed telephony accesses <sup>1</sup>	25,644.5	25,517.1	25,391.2	25,108.4	24,578.3	(4.2)
Internet and data accesses	7,629.8	7,611.1	7,662.5	7,555.5	7,605.2	(0.3)
Narrowband <sup>2</sup>	1,445.8	1,306.4	1,207.7	1,147.4	1,070.6	(25.9)
Broadband <sup>3,4</sup>	6,067.0	6,208.9	6,352.2	6,304.1	6,426.8	5.9
Other <sup>5</sup>	117.0	95.8	102.6	104.0	107.8	(7.8)
Mobile accesses	123,385.2	124,658.3	126,016.4	129,300.0	134,698.9	9.2
Pre-Pay	102,329.7	103,333.4	104,298.9	107,017.2	111,503.6	9.0
Contract	21,055.5	21,324.9	21,717.5	22,282.9	23,195.4	10.2
Pay TV	1,540.5	1,615.1	1,679.4	1,692.9	1,648.6	7.0
<b>Wholesale Accesses</b>	<b>59.0</b>	<b>58.5</b>	<b>58.1</b>	<b>57.1</b>	<b>56.1</b>	<b>(4.9)</b>
<b>Total Accesses</b>	<b>158,259.0</b>	<b>159,460.0</b>	<b>160,807.7</b>	<b>163,714.0</b>	<b>168,587.2</b>	<b>6.5</b>

1 PSTN (including Public Use Telephony) x1; ISDN Basic access x1; ISDN Primary access; 2/6 Access x30. Company's accesses for internal use included. Total "fixed wireless" accesses included.

2 Includes narrowband ISP of Terra Brasil and Terra Colombia.

3 Includes broadband ISP of Terra Brasil and Terra México.

4 Includes ADSL, optical fiber, cable modem and broadband circuits.

5 Retail circuits other than broadband.

Note:

December 2009 includes the disconnection of inactive customers in Colombia, Peru and Guatemala.

## Telefónica Latinoamérica Consolidated income Statement

	January - December			October - December		
	2009	2008	% Chg	2009	2008	% Chg
Unaudited figures (Euros in millions)						
<b>Revenues</b>	<b>22,983</b>	<b>22,174</b>	<b>3.7</b>	<b>6,334</b>	<b>5,863</b>	<b>8.0</b>
Internal exp capitalized in fixed assets	112	108	3.8	31	27	16.5
Operating expenses	(14,274)	(14,098)	1.2	(4,016)	(3,629)	10.7
Other net operating income (expense)	308	180	71.6	171	81	111.1
Gain (loss) on sale of fixed assets	15	81	(81.8)	7	74	(90.6)
Impairment of goodwill and other assets	(2)	(0)	n.m.	3	(0)	c.s.
<b>Operating income before D&amp;A (OIBDA)</b>	<b>9,143</b>	<b>8,445</b>	<b>8.3</b>	<b>2,529</b>	<b>2,416</b>	<b>4.7</b>
<b>OIBDA Margin</b>	<b>39.8%</b>	<b>38.1%</b>	<b>1.7 p.p.</b>	<b>39.9%</b>	<b>41.2%</b>	<b>(1.3 p.p.)</b>
Depreciation and amortization	(3,793)	(3,645)	4.1	(1,014)	(928)	9.3
<b>Operating income (OI)</b>	<b>5,350</b>	<b>4,800</b>	<b>11.5</b>	<b>1,515</b>	<b>1,488</b>	<b>1.8</b>

Notes:

- OIBDA and OI before management and brand fees.
- Starting April 2008, Vivo's consolidation perimeter includes Telemig.
- 2009 figures impacted by the hyperinflation in Venezuela.

Telefónica Latinoamérica  
Accesses by countries (I)

	2008	2009				% Chg y-o-y
	December	March	June	September	December	
Unaudited figures (Thousands)						
<b>Brazil</b>						
Final Clients Accesses	60,704.9	61,332.8	62,418.5	64,119.3	66,925.7	10.2
Fixed telephony accesses <sup>1</sup>	11,661.9	11,578.3	11,469.9	11,322.8	11,253.8	(3.5)
Internet and data accesses	3,625.8	3,610.7	3,615.0	3,440.5	3,440.2	(5.1)
Narrowband	996.4	882.9	811.5	785.2	723.1	(27.4)
Broadband <sup>2</sup>	2,557.8	2,659.2	2,728.7	2,579.8	2,638.4	3.2
Other <sup>3</sup>	71.6	68.6	74.8	75.5	78.7	9.8
Mobile accesses	44,945.0	45,641.5	46,819.3	48,847.2	51,744.4	15.1
Pre-Pay	36,384.0	36,847.3	37,775.5	39,580.5	41,960.7	15.3
Contract	8,561.0	8,794.1	9,043.8	9,266.7	9,783.7	14.3
Pay TV	472.2	502.4	514.3	508.8	487.2	3.2
Wholesale Accesses	34.1	34.9	34.7	34.6	34.2	0.0
<b>Total Accesses</b>	<b>60,739.1</b>	<b>61,367.7</b>	<b>62,453.2</b>	<b>64,153.9</b>	<b>66,959.8</b>	<b>10.2</b>
<b>Argentina</b>						
Final Clients Accesses	20,717.0	20,856.7	20,969.9	21,360.8	21,890.7	5.7
Fixed telephony accesses <sup>1</sup>	4,603.1	4,592.3	4,585.6	4,596.8	4,607.7	0.1
Fixed wireless	22.4	26.0	31.2	33.4	36.2	61.7
Internet and data accesses	1,284.3	1,262.0	1,267.9	1,310.6	1,351.0	5.2
Narrowband	182.8	156.0	140.7	124.1	112.7	(38.4)
Broadband <sup>2</sup>	1,082.0	1,106.0	1,127.2	1,186.5	1,238.3	14.4
Other <sup>3</sup>	19.5	0.0	0.0	0.0	0.0	n.m.
Mobile accesses	14,829.6	15,002.4	15,116.4	15,453.4	15,931.9	7.4
Pre-Pay	9,687.6	9,889.2	10,057.7	10,349.7	10,736.8	10.8
Contract	5,142.0	5,113.2	5,058.7	5,103.8	5,195.2	1.0
Wholesale Accesses	10.0	9.5	9.7	9.8	9.3	(6.8)
<b>Total Accesses</b>	<b>20,726.9</b>	<b>20,866.1</b>	<b>20,979.5</b>	<b>21,370.6</b>	<b>21,900.0</b>	<b>5.7</b>
<b>Chile</b>						
Final Clients Accesses	10,002.7	10,078.5	10,208.5	10,364.0	10,645.0	6.4
Fixed telephony accesses <sup>1</sup>	2,121.0	2,088.5	2,069.2	2,048.9	2,028.0	(4.4)
Internet and data accesses	743.8	741.3	767.2	790.2	807.2	8.5
Narrowband	18.7	20.1	18.7	17.4	15.9	(15.2)
Broadband <sup>2</sup>	716.6	712.8	740.3	764.6	783.2	9.3
Other <sup>3</sup>	8.6	8.5	8.3	8.3	8.1	(5.2)
Mobile accesses	6,875.0	6,986.0	7,104.4	7,255.4	7,524.7	9.5
Pre-Pay	4,956.0	5,030.6	5,078.0	5,179.8	5,435.9	9.7
Contract	1,919.0	1,955.3	2,026.4	2,075.7	2,088.8	8.8
Pay TV	263.0	262.8	267.6	269.5	285.1	8.4
Wholesale Accesses	11.5	10.5	10.0	8.9	8.9	(23.2)
<b>Total Accesses</b>	<b>10,014.3</b>	<b>10,089.1</b>	<b>10,218.5</b>	<b>10,373.0</b>	<b>10,653.8</b>	<b>6.4</b>

1 PSTN (including Public Use Telephony) x1; ISDN Basic access x1, ISDN Primary access, 2/6 Access x30. Company's accesses for internal use included. Total "fixed wireless" accesses included.

2 Includes ADSL, cable modem and broadband circuits.

3 Retail circuits other than broadband.

## Telefónica Latinoamérica Accesses by countries (II)

	2008	2009				% Chg y-o-y
	December	March	June	September	December	
Unaudited figures (Thousands)						
<b>Peru</b>						
Final Clients Accesses	14,982.6	15,221.8	15,414.6	15,680.8	15,916.3	6.2
Fixed telephony accesses <sup>1</sup>	2,986.5	3,029.3	3,068.7	3,041.6	2,971.2	(0.5)
Fixed wireless	485.5	555.5	610.5	620.1	582.7	20.0
Internet and data accesses	728.9	755.4	779.4	795.0	800.6	9.8
Narrowband	17.7	22.5	20.3	17.5	16.9	(4.4)
Broadband <sup>2</sup>	698.4	719.0	745.0	762.5	768.0	10.0
Other <sup>3</sup>	12.8	13.8	14.2	15.0	15.6	22.1
Mobile accesses	10,612.7	10,756.2	10,863.2	11,120.8	11,458.2	8.0
Pre-Pay	9,575.2	9,667.4	9,726.9	9,940.0	10,214.2	6.7
Contract	1,037.5	1,088.9	1,136.3	1,180.8	1,244.1	19.9
Pay TV <sup>4</sup>	654.5	680.9	703.2	723.4	686.3	4.9
Wholesale Accesses	0.4	0.4	0.5	0.5	0.5	21.9
<b>Total Accesses</b>	<b>14,983.0</b>	<b>15,222.3</b>	<b>15,415.0</b>	<b>15,681.2</b>	<b>15,916.8</b>	<b>6.2</b>
<b>Colombia (5)</b>						
Final Clients Accesses	12,800.5	12,625.5	11,792.4	11,462.3	11,159.9	(12.8)
Fixed telephony accesses <sup>1</sup>	2,299.2	2,247.2	2,182.9	2,074.4	1,639.8	(28.7)
Internet and data accesses	395.9	427.0	437.7	441.2	428.4	8.2
Narrowband	0.3	8.9	7.7	6.4	5.9	n.m.
Broadband <sup>2</sup>	393.9	416.0	427.8	432.6	420.3	6.7
Other <sup>3</sup>	1.7	2.0	2.2	2.2	2.2	26.7
Mobile accesses	9,963.1	9,805.8	9,028.0	8,810.9	8,964.6	(10.0)
Pre-Pay	8,327.3	8,206.1	7,409.6	7,099.0	7,203.2	(13.5)
Contract	1,635.8	1,599.6	1,618.4	1,711.8	1,761.4	7.7
Pay TV	142.3	145.6	143.8	135.9	127.2	(10.6)
Wholesale Accesses	2.9	3.2	3.2	3.3	3.3	13.0
<b>Total Accesses</b>	<b>12,803.4</b>	<b>12,628.7</b>	<b>11,795.6</b>	<b>11,465.6</b>	<b>11,163.2</b>	<b>(12.8)</b>
<b>Mexico</b>						
Mobile accesses	15,330.6	15,517.7	15,942.5	16,518.4	17,400.5	13.5
Pre-Pay	14,432.4	14,623.0	15,026.6	15,557.1	16,328.3	13.1
Contract	898.1	894.7	915.9	961.2	1,072.1	19.4
Fixed Wireless	133.6	167.9	203.3	249.8	334.3	150.3
<b>Total Accesses</b>	<b>15,464.2</b>	<b>15,685.6</b>	<b>16,145.9</b>	<b>16,768.1</b>	<b>17,734.8</b>	<b>14.7</b>
<b>Venezuela</b>						
Mobile accesses	10,584.0	10,679.5	10,752.9	10,613.8	10,531.4	(0.5)
Pre-Pay	9,970.7	10,070.2	10,139.0	9,988.7	9,891.1	(0.8)
Contract	613.3	609.3	613.9	625.1	640.3	4.4
Fixed Wireless	1,312.8	1,291.5	1,290.3	1,237.7	1,214.3	(7.5)
Pay TV	8.5	23.4	50.4	55.4	62.8	n.m.
<b>Total Accesses</b>	<b>11,905.3</b>	<b>11,994.4</b>	<b>12,093.5</b>	<b>11,906.9</b>	<b>11,808.5</b>	<b>(0.8)</b>

1 PSTN (including Public Use Telephony) x1; ISDN Basic access x1, ISDN Primary access, 2/6 Access x30. Company's accesses for internal use included. Total "fixed wireless" accesses included.

2 Includes ADSL, optical fiber, cable modem and broadband circuits.

3 Retail circuits other than broadband.

4 66,689 inactive Pay TV accesses were disconnected in December 2009.

5 375,572 fixed telephony accesses, 24,646 broadband accesses and 4,804 Pay TV accesses in Colombia, all of them inactive, were disconnected in December 2009.

Telefónica Latinoamérica  
Accesses by countries (III)

	2008	2009				% Chg y-o-y
	December	March	June	September	December	
Unaudited figures (Thousands)						
<b>Central America<sup>1</sup></b>						
Fixed telephony accesses <sup>2</sup>	437.2	441.1	444.9	456.0	444.5	1.7
Fixed Wireless	278.7	288.7	288.3	287.6	331.9	19.1
Internet and data accesses	18.4	17.6	16.6	15.7	14.7	(20.3)
Broadband <sup>3</sup>	16.5	15.6	14.6	13.5	12.6	(23.8)
Other <sup>4</sup>	1.9	2.0	2.0	2.2	2.1	9.3
Mobile accesses	5,702.0	5,630.2	5,605.7	5,655.8	5,806.5	1.8
Pre-Pay <sup>5</sup>	5,315.3	5,242.7	5,213.4	5,252.7	5,385.2	1.3
Contract	386.7	387.5	392.3	403.1	421.3	8.9
<b>Total Accesses</b>	<b>6,157.6</b>	<b>6,089.0</b>	<b>6,067.3</b>	<b>6,127.5</b>	<b>6,265.8</b>	<b>1.8</b>
<b>Ecuador</b>						
Mobile accesses	3,122.5	3,179.2	3,253.3	3,451.8	3,721.8	19.2
Pre-Pay	2,650.5	2,711.6	2,772.1	2,952.9	3,193.9	20.5
Contract	472.0	467.6	481.2	499.0	527.9	11.8
Fixed Wireless	89.4	81.0	76.3	80.6	84.7	(5.3)
<b>Total Accesses</b>	<b>3,211.9</b>	<b>3,260.2</b>	<b>3,329.6</b>	<b>3,532.5</b>	<b>3,806.4</b>	<b>18.5</b>
<b>Uruguay</b>						
Mobile accesses	1,420.7	1,459.9	1,530.8	1,572.5	1,614.9	13.7
Pre-Pay	1,030.6	1,045.4	1,100.1	1,116.8	1,154.3	12.0
Contract	390.1	414.5	430.7	455.7	460.6	18.1
<b>Total Accesses</b>	<b>1,420.7</b>	<b>1,459.9</b>	<b>1,530.8</b>	<b>1,572.5</b>	<b>1,614.9</b>	<b>13.7</b>

1 Includes Guatemala, Panama, El Salvador and Nicaragua.

2 PSTN (including Public Use Telephony) x1; ISDN Basic access x1; ISDN Primary access, 2/6 Access x30. Company's accesses for internal use included. Total "fixed wireless" accesses included.

3 Includes optical fiber, cable modem and broadband circuits.

4 Retail circuits other than broadband.

5 116,000 inactive mobile accesses were disconnected in Guatemala in December 2009.

## Telefónica Latinoamérica

### Selected mobile business operating data by country

	2008	2009				% Chg y-o-y
	Q4	Q1	Q2	Q3	Q4	
Unaudited figures						
<b>Brazil</b>						
Traffic (Million minutes)	10,990	10,344	10,918	12,689	18,181	65.4
ARPU (EUR)	10.0	9.0	9.7	10.2	10.4	(9.5)
<b>Argentina</b>						
Traffic (Million minutes)	3,673	3,485	3,744	4,080	4,253	15.8
ARPU (EUR)	9.8	9.3	8.6	8.1	8.5	9.8
<b>Chile</b>						
Traffic (Million minutes)	2,583	2,537	2,553	2,632	2,799	8.4
ARPU (EUR)	11.7	11.0	10.4	10.5	11.0	(13.8)
<b>Peru</b>						
Traffic (Million minutes)	2,745	2,809	2,792	2,817	3,042	10.8
ARPU (EUR)	6.1	5.5	5.6	5.3	5.6	(6.3)
<b>Colombia</b>						
Traffic (Million minutes)	3,585	3,265	3,208	3,489	3,703	3.3
ARPU (EUR)	6.2	5.4	5.7	6.3	6.2	(4.1)
<b>Mexico</b>						
Traffic (Million minutes)	5,591	5,378	5,720	5,881	6,208	11.0
ARPU (EUR)	7.9	6.7	7.3	6.8	6.7	(3.1)
<b>Venezuela</b>						
Traffic (Million minutes)	3,958	3,767	3,692	3,735	3,758	(5.1)
ARPU (EUR) <sup>1</sup>	20.3	21.0	20.6	21.1	22.2	19.8
<b>Central America</b>						
Traffic (Million minutes)	1,724	1,690	1,691	1,722	1,766	2.4
ARPU (EUR)	7.9	7.5	7.2	6.6	6.5	(8.8)
<b>Ecuador</b>						
Traffic (Million minutes)	869	802	902	970	1,071	23.2
ARPU (EUR)	7.4	7.3	6.9	6.6	6.3	(5.1)
<b>Uruguay</b>						
Traffic (Million minutes)	643	616	628	685	718	11.6
ARPU (EUR)	8.7	8.9	8.1	8.2	9.4	4.8

<sup>1</sup> For comparative purpose and in order to facilitate the interpretation of the year-on-year change versus 2008 results, the variation in local currency of the ARPU in Venezuela is reported excluding the impact of the hyperinflation adjustment.

Notes:

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

Telefónica Latinoamérica  
Selected mobile business operating data by country

	January - December		
	2009	2008	% Chg Local Cur
Unaudited figures			
<b>Brazil<sup>1</sup></b>			
Traffic (Million minutes)	52,134	40,547	28.6
ARPU (EUR)	9.9	11.2	(8.6)
<b>Argentina</b>			
Traffic (Million minutes)	15,562	12,941	20.2
ARPU (EUR)	8.6	8.7	10.7
<b>Chile</b>			
Traffic (Million minutes)	10,521	9,703	8.4
ARPU (EUR)	10.7	12.3	(10.7)
<b>Peru</b>			
Traffic (Million minutes)	11,460	10,039	14.1
ARPU (EUR)	5.5	6.0	(11.5)
<b>Colombia</b>			
Traffic (Million minutes)	13,665	13,568	0.7
ARPU (EUR)	5.9	6.8	(10.2)
<b>Mexico</b>			
Traffic (Million minutes)	23,186	22,431	3.4
ARPU (EUR)	6.9	8.2	(3.3)
<b>Venezuela</b>			
Traffic (Million minutes)	14,951	14,993	(0.3)
ARPU (EUR) <sup>2</sup>	21.2	16.9	19.2
<b>Central America</b>			
Traffic (Million minutes)	6,868	7,174	(4.3)
ARPU (EUR)	6.9	7.4	(8.7)
<b>Ecuador</b>			
Traffic (Million minutes)	3,744	2,800	33.7
ARPU (EUR)	6.8	6.7	(3.8)
<b>Uruguay</b>			
Traffic (Million minutes)	2,646	1,823	45.1
ARPU (EUR)	8.7	8.4	5.2

1 Includes Telemig from April 2008.

2 For comparative purpose and in order to facilitate the interpretation of the year-on-year change versus 2008 results, the variation in local currency of the ARPU in Venezuela is reported excluding the impact of the hyperinflation adjustment.

Notes:

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

## Telefónica Latinoamérica Selected financial data (I)

	January - December				October - December			
	2009	2008	% Chg	% Chg y-o-y Local Cur	2009	2008	% Chg	% Chg y-o-y Local Cur
Unaudited figures (Euros in millions)								
<b>Brazil</b>								
Revenues	8,376	8,606	(2.7)	0.9	2,305	2,041	12.9	(2.2)
OIBDA	3,139	3,359	(6.6)	(3.1)	845	826	2.2	(11.2)
OIBDA margin	37.5%	39.0%	(1.6 p.p.)		36.7%	40.5%	(3.8 p.p.)	
CapEx	1,228	1,614	(23.9)	(21.1)	438	507	(13.7)	(20.8)
OpCF (OIBDA-CapEx)	1,911	1,745	9.5	13.5	407	319	27.5	3.0
<b>Vivo<sup>1</sup></b>								
Revenues	3,036	2,932	3.6	7.4	851	730	16.6	1.9
OIBDA	949	825	15.0	19.2	271	209	29.5	13.6
OIBDA margin	31.2%	28.2%	3.1 p.p.		31.9%	28.7%	3.2 p.p.	
CapEx	422	739	(42.9)	(40.8)	129	210	(38.6)	(45.0)
OpCF (OIBDA-CapEx)	527	87	n.m.	n.m.	142	(1)	c.s.	c.s.
<b>Telesp</b>								
Revenues	5,766	6,085	(5.3)	(1.8)	1,568	1,405	11.6	(3.8)
OIBDA	2,209	2,515	(12.1)	(8.9)	596	617	(3.4)	(16.1)
OIBDA margin	38.3%	41.3%	(3.0 p.p.)		38.0%	43.9%	(5.9 p.p.)	
CapEx	806	875	(8.0)	(4.6)	309	297	3.9	(3.4)
OpCF (OIBDA-CapEx)	1,403	1,639	(14.4)	(11.2)	287	320	(10.2)	(27.0)
<b>Argentina</b>								
Revenues	2,609	2,527	3.2	15.3	661	725	(8.9)	15.3
OIBDA	986	919	7.3	19.9	260	291	(10.9)	11.6
OIBDA margin <sup>2</sup>	36.8%	35.2%	1.6 p.p.		38.3%	39.1%	(0.8 p.p.)	
CapEx	319	344	(7.5)	3.3	125	157	(20.4)	(5.2)
OpCF (OIBDA-CapEx)	668	574	16.2	29.8	135	134	0.2	32.1
<b>T. Móviles Argentina</b>								
Revenues	1,643	1,585	3.6	15.8	426	457	(6.8)	17.7
OIBDA	606	514	18.0	31.8	172	181	(4.8)	17.7
OIBDA margin	36.9%	32.4%	4.5 p.p.		40.3%	39.5%	0.8 p.p.	
CapEx	141	154	(8.2)	2.6	54	99	(45.4)	(35.7)
OpCF (OIBDA-CapEx)	465	360	29.1	44.2	118	82	44.4	86.3
<b>Telefónica de Argentina</b>								
Revenues	1,047	1,027	1.9	13.9	254	291	(12.8)	10.9
OIBDA	380	405	(6.1)	4.9	88	111	(20.7)	1.6
OIBDA margin <sup>2</sup>	32.3%	34.4%	(2.1 p.p.)		30.7%	33.6%	(2.9 p.p.)	
CapEx	178	191	(7.0)	3.9	71	58	22.3	48.7
OpCF (OIBDA-CapEx)	203	214	(5.4)	5.7	17	53	(67.8)	(50.7)
<b>Chile</b>								
Revenues	1,831	1,936	(5.4)	(3.3)	480	474	1.3	(7.5)
OIBDA	763	740	3.1	5.5	224	201	11.4	3.3
OIBDA margin	41.7%	38.2%	3.5 p.p.		46.6%	42.4%	4.2 p.p.	
CapEx	347	423	(18.1)	(16.2)	121	134	(9.5)	(14.5)
OpCF (OIBDA-CapEx)	416	316	31.5	34.5	103	67	53.1	37.1
<b>T. Móviles Chile</b>								
Revenues	1,010	1,051	(3.9)	(1.8)	271	264	2.5	(6.0)
OIBDA	445	402	10.8	13.3	135	114	19.0	10.9
OIBDA margin	44.1%	38.2%	5.9 p.p.		49.9%	43.0%	6.9 p.p.	
CapEx	185	228	(19.1)	(17.3)	50	70	(28.2)	(32.8)
OpCF (OIBDA-CapEx)	260	173	50.3	53.7	85	44	94.1	78.8
<b>Telefónica Chile</b>								
Revenues	893	974	(8.4)	(6.3)	228	233	(2.2)	(11.0)
OIBDA	326	339	(4.0)	(1.8)	96	88	9.4	0.9
OIBDA margin	36.5%	34.8%	1.7 p.p.		42.2%	37.7%	4.5 p.p.	
CapEx	162	195	(16.8)	(15.0)	71	64	11.0	5.5
OpCF (OIBDA-CapEx)	163	144	13.4	15.9	25	24	5.3	(10.5)

Note:

OIBDA is presented before management and brand fees.

1 50% of Vivo. Includes Telemig from April 2008.

2 Margin over revenues includes fixed to mobile interconnection.

Telefónica Latinoamérica  
Selected financial data (II)

	January - December				October - December			
	2009	2008	% Chg	% Chg y-o-y Local Cur	2009	2008	% Chg	% Chg y-o-y Local Cur
Unaudited figures (Euros in millions)								
<b>Peru</b>								
Revenues	1,716	1,627	5.5	3.0	430	459	(6.4)	(3.0)
OIBDA	712	621	14.7	12.0	184	189	(2.4)	0.6
OIBDA margin	41.5%	38.2%	3.3 p.p.		42.9%	41.1%	1.7 p.p.	
CapEx	271	289	(6.2)	(8.4)	144	160	(9.8)	(10.3)
OpCF (OIBDA-CapEx)	442	332	32.8	29.7	40	29	38.9	73.7
<b>T. Móviles Peru</b>								
Revenues	840	773	8.6	6.1	213	229	(6.9)	(3.9)
OIBDA	327	266	22.6	19.8	87	89	(2.2)	0.3
OIBDA margin	38.9%	34.4%	4.4 p.p.		41.1%	39.1%	2.0 p.p.	
CapEx	127	144	(12.2)	(14.2)	76	85	(11.5)	(12.3)
OpCF (OIBDA-CapEx)	200	122	63.9	60.1	12	4	199.2	n.m.
<b>Telefónica del Perú<sup>1</sup></b>								
Revenues	1,006	977	3.0	0.6	248	266	(6.7)	(3.1)
OIBDA	386	354	8.9	6.4	95	99	(3.4)	0.1
OIBDA margin	38.3%	36.2%	2.1 p.p.		38.4%	37.1%	1.3 p.p.	
CapEx	144	144	(0.3)	(2.6)	69	75	(7.9)	(8.1)
OpCF (OIBDA-CapEx)	241	209	15.3	12.6	27	24	10.4	29.1
<b>Colombia</b>								
Revenues	1,269	1,490	(14.9)	(11.6)	315	359	(12.3)	(15.9)
OIBDA	397	515	(23.0)	(20.0)	120	135	(11.4)	(14.0)
OIBDA margin	31.3%	34.6%	(3.3 p.p.)		38.0%	37.6%	0.4 p.p.	
CapEx	316	420	(24.8)	(21.9)	152	168	(9.5)	(9.2)
OpCF (OIBDA-CapEx)	81	95	(14.6)	(11.3)	(32)	(33)	(1.4)	13.1
<b>T. Móviles Colombia</b>								
Revenues	685	815	(16.0)	(12.7)	172	192	(10.6)	(14.3)
OIBDA	194	208	(7.0)	(3.4)	62	59	5.3	3.0
OIBDA margin	28.3%	25.6%	2.7 p.p.		36.3%	30.8%	5.5 p.p.	
CapEx	165	230	(28.4)	(25.7)	88	100	(12.0)	(11.2)
OpCF (OIBDA-CapEx)	29	(22)	c.s.	c.s.	(26)	(41)	(37.2)	(33.0)
<b>Telefónica Telecom</b>								
Revenues	615	710	(13.4)	(10.0)	152	177	(14.1)	(17.5)
OIBDA	203	307	(33.8)	(31.2)	57	76	(24.6)	(27.2)
OIBDA margin	33.0%	43.2%	(10.2 p.p.)		37.7%	42.9%	(5.2 p.p.)	
CapEx	151	190	(20.5)	(17.4)	64	68	(5.8)	(6.2)
OpCF (OIBDA-CapEx)	52	117	(55.3)	(53.6)	(7)	8	c.s.	c.s.
<b>Mexico (T. Móviles Mexico)</b>								
Revenues	1,552	1,631	(4.8)	10.0	416	427	(2.4)	10.7
OIBDA	564	420	34.2	55.2	162	137	17.8	35.0
OIBDA margin	36.3%	25.7%	10.6 p.p.		38.9%	32.2%	6.7 p.p.	
CapEx	251	317	(20.9)	(8.6)	119	161	(26.1)	(14.9)
OpCF (OIBDA-CapEx)	313	103	204.5	252.1	43	(23)	c.s.	c.s.
<b>Venezuela (T. Móviles Venezuela)<sup>2</sup></b>								
Revenues	3,773	2,769	36.3	20.4	1,129	898	25.7	9.4
OIBDA	1,818	1,328	36.8	25.4	508	462	9.8	(0.9)
OIBDA margin	48.2%	48.0%	0.2 p.p.		45.0%	51.5%	(6.5 p.p.)	
CapEx	423	287	47.6	45.2	230	144	60.4	64.7
OpCF (OIBDA-CapEx)	1,395	1,042	33.9	19.9	277	319	(13.0)	(32.0)
<b>Central America<sup>3</sup></b>								
Revenues	565	568	(0.6)	(2.5)	149	157	(5.4)	7.6
OIBDA	241	217	10.9	9.0	65	68	(5.6)	7.5
OIBDA margin	42.6%	38.2%	4.4 p.p.		43.4%	43.5%	(0.1 p.p.)	
CapEx	86	116	(25.5)	(26.4)	60	62	(3.2)	21.5
OpCF (OIBDA-CapEx)	154	101	52.7	49.7	5	6	(28.6)	(127.9)
<b>Ecuador (T. Móviles Ecuador)</b>								
Revenues	337	318	5.9	0.6	88	93	(5.1)	4.9
OIBDA	100	92	8.5	3.0	23	31	(26.5)	(19.5)
OIBDA margin	29.7%	29.0%	0.7 p.p.		26.1%	33.7%	(7.6 p.p.)	
CapEx	83	124	(33.4)	(36.8)	51	90	(43.0)	(44.4)
OpCF (OIBDA-CapEx)	17	(32)	c.s.	c.s.	(28)	(59)	(51.8)	(56.4)

## Note:

• OIBDA is presented before management and brand fees.

1 From 1 January 2009, Medianetworks is being consolidated as T. Internacional, S.A.U.'s subsidiary (previously consolidated as Telefónica del Perú's subsidiary).

2 For comparison purposes and to facilitate the interpretation of the year-on-year changes vs. 2008, variations in local currency of the headings affected by the hyperinflation adjustments are reported excluding the impact of this adjustment.

3 Includes Guatemala, Panama, El Salvador and Nicaragua.



## Telefónica Latinoamérica Selected financial data (III)

	January - December				October - December			
	2009	2008	% Chg	% Chg y-o-y Local Cur	2009	2008	% Chg	% Chg y-o-y Local Cur
Unaudited figures (Euros in millions)								
<b>Uruguay (T. Móviles Uruguay)</b>								
Revenues	175	150	16.2	18.9	49	43	13.6	11.0
OIBDA	69	48	43.5	46.8	24	17	36.6	35.1
OIBDA margin	39.2%	31.7%	7.5 p.p.		48.4%	40.3%	8.1 p.p.	
CapEx	24	24	0.6	2.9	11	12	(8.1)	(8.1)
OpCF (OIBDA-CapEx)	44	24	87.6	91.9	13	6	123.7	118.9
<b>TIWS</b>								
Revenues	391	324	20.5	17.8	121	89	35.3	40.4
OIBDA	94	102	(7.8)	(11.2)	23	27	(14.9)	(7.6)
OIBDA margin	24.0%	31.3%	(7.3 p.p.)		18.9%	30.0%	(11.1 p.p.)	
CapEx	71	51	37.5	30.6	23	25	(9.7)	(4.3)
OpCF (OIBDA-CapEx)	23	50	(54.1)	(54.0)	(0)	1	c.s.	c.s.

Note:

OIBDA is presented before management and brand fees.

## Results by regional business units

### Telefónica Europe

Against a difficult economic and trading environment in 2009, Telefónica Europe had a very solid financial and operating performance, sequentially improving top line growth and further delivering on efficiencies from a more diversified asset portfolio.

At the end of December 2009, Telefónica Europe's total customer base reached 49.2 million (+6.9% year-on-year) on the back of the steady expansion of the mobile base, mainly in the UK and Germany. Mobile customer net additions for the year were 2.9 million<sup>1</sup>, with 1.0 million<sup>1</sup> in the fourth quarter, reaching a total **mobile customer base** of 44.1 million (+6.5% year-on-year). The contract segment had a very strong performance, adding 2.3 million customers in 2009 (+10.7% year-on-year), with 617,951 customers in the fourth quarter (+42.8% year-on-year). Net additions in the contract segment represented 80.2%<sup>1</sup> of total mobile net additions in the year.

**Revenue** growth in the fourth quarter of the year accelerated from the previous quarter to 3.9% year-on-year, in constant currency and excluding mobile termination rate cuts, a sequential improvement from the 1.8% and 3.0% growth rates registered in the second and third quarter, respectively.

In 2009, revenues reached 13,533 million euros, a 1.1% year-on-year growth in constant currency, with mobile termination rates cuts in Germany, UK and in the Czech Republic dragging 2.1 percentage points off growth. Revenues reflected Telefónica Europe's outperformance in its key markets and the increasing demand for data services, which helped improvement in ARPU trends. This compensated the negative contribution to revenue growth from the Czech and Irish businesses, both affected by a very tough macroeconomic environment.

Operating expenses amounted to 9,856 million euros in 2009, virtually flat over the previous year (+0.3% year-on-year in constant currency), reflecting the increased commercial activity to maintain momentum in the market, compensated by ongoing efficiency measures and further savings in mobile retention activities. The total amount of restructuring costs for the year was 44 million euros.

**Operating income before depreciation and amortization (OIBDA)** stood at 3,910 million euros in 2009, a 4.1% year-on-year growth in organic terms<sup>2</sup> (+5.0% year-on-year, excluding the restructuring costs above mentioned), Telefónica O2 Germany being the main contributor to growth. OIBDA margin improved 0.8 percentage points year-on-year in organic terms<sup>2</sup> in 2009.

Reported revenues and OIBDA in 2009 showed a year-on-year decline of 5.4% and 6.4%, respectively (-3.9% and -6.8% in the fourth quarter), mainly impacted by British Sterling and Czech Koruna depreciations against the euro in the period. Reported OIBDA margin in 2009 was 28.9% (29.2% in 2008), while in the fourth quarter of 2009 OIBDA margin was 29.7% (30.6% in the same period of 2008).

**CapEx** in 2009 declined year-on-year by 12.4% in constant currency, as the 2G network deployment in Germany and major IT projects across the Group were reaching an end. This, combined with the solid OIBDA performance above mentioned, resulted in a very strong **operating cash flow (OIBDA-CapEx)** of 2,183 million euros in 2009 (+21.7% year-on-year in organic terms<sup>2</sup>).

<sup>1</sup> For comparison purposes, net customer additions exclude the disconnection of 450 thousand inactive prepaid customers from Telefónica O2 Germany's base in December, 2009, and more than 240 thousand in December, 2008.

<sup>2</sup> Assuming constant exchange rates. The impacts derived from past disposals of assets (174 million euros in 2008 from Airwave) are also excluded from the calculation.

## Telefónica O2 UK

Telefónica O2 UK outperformed competitors in 2009 in a declining mobile market, maintaining a strong market momentum driven by smartphones, also delivering a remarkable non-P2P SMS revenue performance.

The Company's total **mobile customer base** (excluding Tesco Mobile) at the end of December 2009 reached 21.3 million lines, up 5.1% year-on-year, with net customer additions of 1.0 million in the year (338,455 in the fourth quarter), sustaining its leadership in the UK market. The contract segment continued driving growth, adding 1.1 million customers in 2009 (+18.6% year-on-year), and 235,486 customers in the fourth quarter (+5.6% year-on-year). The contract segment made up 44.9% of the total customer base at the end of December 2009 (41.5% a year ago). This positive evolution was mainly due to churn reduction and increased commercial activity on a wide range of devices, with a particular focus on smartphones. "Simplicity" propositions and prepay to contract migrations also contributed to growth in this segment in the year.

**Churn** in the contract segment sustained its solid evolution, decreasing to a low record level of 1.0% in the fourth quarter (-0.2 percentage points year-on-year and over the previous quarter). The contract churn in 2009, at 1.1%, was 0.1 percentage points lower than in the previous year. Total churn in 2009 remained stable over the previous year, at 2.6%, showing a 0.1 percentage point year-on-year improvement in the fourth quarter.

In terms of usage, **traffic** in 2009 grew 15.6% year-on-year to 53,856 million minutes (+15.4% year-on-year in the fourth quarter). This performance is explained by contract customer base increase, coupled with continued utilisation of their voice bundle, as well as the higher year-on-year usage of voice packages from prepay customers due to the adoption of tariffs such as "Unlimited".

Voice ARPU in 2009 decreased 8.7% year-on-year in local currency to 15.5 euros (-10.5% in the fourth quarter), mainly due to mobile termination rate cuts (from August), continued usage optimisation from customers, and the increasing number of non-voice accesses and "Simplicity" tariffs in the base. Data ARPU increased 3.7% year-on-year in local currency in 2009 to reach 9.3 euros (+6.2% in the fourth quarter), with the strong contribution from data package sales compensating year-on-year declines in SMS related revenues.

As a result, Telefónica O2 UK's **total ARPU** for 2009 showed a 4.4% year-on-year decline in local currency to 24.7 euros (-4.5% year-on-year in local currency in the fourth quarter).

Telefónica O2 UK's DSL **broadband** service added 250,648 lines in 2009, reaching 591,514 lines at the end of December (+73.5% year-on-year). In the fourth quarter, 64,388 lines were added, ahead of the "O2 Home Phone" service to be launched by March 2010, which will enhance the O2 fixed broadband proposition with a very competitive voice package.

Telefónica O2 UK had a strong financial performance in 2009, growing **revenues** in 2009 by 3.5%, year-on-year, in local currency (+1.2% in the fourth quarter) to reach 6,512 million euros, clearly outperforming the UK mobile market.

The strong year-on-year performance of mobile service revenues in 2009 is worth highlighting. In local currency terms, and excluding the impact from mobile termination rate cuts<sup>3</sup>, year-on-year growth accelerated from 6.1% in the third quarter to 8.2% in the fourth quarter, reaching 5,936 million euros in 2009 (+3.1% year-on-year growth in local currency; +6.4% excluding mobile termination rate cuts<sup>3</sup>). The main factors driving mobile service revenues in 2009 were the year-on-year increase in the contract segment and continued growth in non-P2P SMS data revenues (+49.7% year-on-year in local currency in the fourth quarter; +52.0% in 2009) on the back of an increased usage of mobile Internet.

**Operating income before depreciation and amortization (OIBDA)** totalled 1,680 million euros in 2009, a 2.3% year-on-year growth in local currency. Excluding the impacts from restructuring charges booked in the third quarter, OIBDA would have grown by 4.0% year-on-year, exceeding revenue growth. In the fourth quarter, OIBDA grew 4.2% year-on-year in local currency, predominantly driven by additional efficiencies, fuelling increased commercial activity, mainly in the contract segment, as well as targeted customer retention activities, which are helping to deliver market leading churn.

As a result, reported OIBDA margin for 2009 was 25.8% (-0.3 percentage points year-on-year), with a year-on-year improvement of 0.8 percentage points in the fourth quarter to 28.1%. Excluding restructuring charges, OIBDA margin in 2009 would have remained broadly stable over the previous year.

**Operating cash flow (OIBDA-CapEx)** for 2009 totalled 1,078 million euros, a year-on-year increase of 7.7% in local currency (+10.5% year-on-year growth excluding restructuring costs), on the back of the already mentioned OIBDA performance and a 6.0% year-on-year decrease of **CapEx** in local currency, totalling 602 million euros despite higher network investment to deliver coverage and quality improvements.

<sup>3</sup> Impacts from termination rate cuts (August, 2009) in mobile service revenue growth (year-on-year, local currency) were 3.3 and 6.5 percentage points in the year and in the fourth quarter, respectively.

## Telefónica O2 Germany

In 2009, Telefónica Europe significantly improved its business in Germany, with its major transformational projects already finalised, fuelling profitable growth through a best-in-class network and improved distribution franchise that helped the Company to gain market share in a very competitive market.

Telefónica O2 Germany's **mobile customer base** significantly increased in 2009, adding 1.5 million customers<sup>4</sup> to reach a customer base of 15.5 million at the end of December (+9.2% year-on-year). Mobile contract customers drove 48.4%<sup>4</sup> of this growth, increasing by 733,352 in the year to reach 7.7 million customers (+10.5% year-on-year), with 259,945 net additions in the fourth quarter (triple the net additions in the fourth quarter of 2008) mainly driven by the success of the innovative propositions "O2o" and "My Handy". Partner channels also contributed positively to customer growth, as well as the Fonic brand.

The **churn** rate for the year reached 2.3%, showing an increase of 0.3 percentage points year-on-year, and 3.3% in the fourth quarter (+0.9 percentage points, year-on-year), mainly affected by the adjustment to the prepay base made in December 2009.

**Traffic** carried in the fourth quarter continued to accelerate (+12.0% year-on-year and +5.8% over the previous quarter), leading to a +4.2% year-on-year growth in 2009 to 23,257 million minutes, mainly driven by the increased contract customer base.

Voice ARPU stood at 11.0 euros in 2009 (-12.6% year-on-year), showing a year-on-year decline of 13.1% in the fourth quarter, mainly affected by mobile termination rate cuts from April and the increase of customers from partner brands in the base. Data ARPU stood at 4.7 euros for the full year. Whilst this is a year-on-year decline of 2.9%, the fourth quarter showed an improving trend (+0.5% year-on-year).

**Total ARPU** for the year was down 9.9% year-on-year to 15.6 euros, with a year-on-year decline of 9.2% in the fourth quarter.

Telefónica O2 Germany's ULL lines stood at 1.6 million as of December, 2009 (+19.3% year-on-year) which includes 285,082 O2 DSL customers (+32.7% year-on-year), an increase of 70,299 customers in the year and 12,747 in the fourth quarter, ahead of the integration of Hansenet in the business.

**Revenues** for the year continued to be strong, totalling 3,746 million euros in 2009, a year-on-year increase of 4.2%, with a 7.2% year-on-year growth in the fourth quarter, driven by the success of the "O2o" and "My Handy" propositions, as well as the good performance of the fixed and DSL business.

Mobile service revenues reached 2,861 million euros in 2009 (-0.3% year-on-year; +1.6% year-on-year excluding mobile termination rate cuts). It's important to highlight the healthy year-on-year trend in mobile service revenues, excluding mobile termination rate cuts: +0.6% in the first quarter; +1.2% in the second quarter; +2.1% in the third quarter and +2.5% in the fourth quarter. This was mainly due to the increase in the customer contract base and the positive contribution from mobile data services: non-P2P SMS data revenues increased 35.7% year-on-year in 2009, ramping up in the fourth quarter (+42.7% year-on-year).

The fixed and DSL businesses contributed 556 million euros to revenues in 2009, growing by 12.1% over 2008.

**Operating Income before depreciation and amortization (OIBDA)** showed a remarkable growth of 19.3% year-on-year to 918 million euros in 2009, and a 6.1% year-on-year growth in the fourth quarter. This strong performance is fuelled by revenue growth and efficiency improvements as a result of the national roaming activity reaching to an end at December 2009 following the successful rollout of the own network. Also noteworthy were reductions in acquisition and retention costs driven by the introduction of the new commercial model from the fourth quarter of 2008. OIBDA margin for 2009 was 24.5% (+3.1 percentage points increase year-on-year), and 25.2% in the fourth quarter.

As a result of the outstanding OIBDA performance in 2009, **operating cash flow (OIBDA-CapEx)** remained positive at 122 million euros, a significant improvement over the negative figure of 154 million euros in 2008. **CapEx** declined 13.8% year-on-year to 796 million euros following the completion of its own network rollout.

<sup>4</sup> For comparison purposes, net customer additions exclude the disconnection of 450 thousand inactive prepay customers from Telefónica O2 Germany's base in December, 2009, and more than 240 thousand in December, 2008.

## Telefónica O2 Ireland

Despite the difficult trading environment in 2009, Telefónica O2 Ireland traded well, with commercial activity focused on mobile contract and broadband, while posting a significant improvement in operating cash flow generation.

The total **mobile customer base** reached 1.7 million customers at the end of December 2009, quite stable compared to 2008 (-0.8% year-on-year). The contract customer base had a strong 7.6% year-on-year increase, to represent 40.4% of the total base. Telefónica O2 Ireland recorded 48,674 contract net additions in 2009, with a consistent increase in the quarterly figures throughout the year (15,400 net additions in the fourth quarter of 2009; 11.9% more than in the third quarter), mobile broadband being a significant driver.

**Churn** declined to 2.6% in 2009 and in the fourth quarter of the year, 0.2 and 0.3 percentage points lower, respectively, than in the same periods of the previous year, with significant improvement of prepay disconnections.

**Traffic** carried in 2009 declined year-on-year by 4.0% to 4,672 million minutes (-5.8% year-on-year in the fourth quarter). This was driven by an increasing number of customers optimising their usage, the continued trend of voice to text substitution as a result of the value for money price plans in the marketplace (such as "O2 Experience" and "O2 Clear" on contract), as well as a decrease of roaming activity from customers.

Voice ARPU posted a year-on-year decline of 14.1% in 2009 (-13.5% year-on-year in the fourth quarter of 2009), mainly due to the better value for money propositions, customer managing their spend and reduced roaming out activity.

Data ARPU increased its rate of growth in the fourth quarter of 2009 (+10.9% year-on-year), driving year-on-year growth in 2009 to 9.1%. This was mainly due to the continued growth of the mobile broadband market.

As a result, **total ARPU** recorded a year-on-year reduction of 8.3% in 2009 to reach 39.6 euros (-7.3% year-on-year in the fourth quarter).

**Revenues** for 2009 were 905 million euros, a year-on-year decline of 5.5% (-6.0% year-on-year in the fourth quarter). Mobile service revenues for the year declined 7.4% year-on-year to 842 million euros (-8.8% in the fourth quarter).

**Operating income before depreciation and amortization (OIBDA)** increased 6.5% year-on-year in the fourth quarter to reach 302 million euros in 2009 (+0.3% year-on-year), as the lower revenue was mitigated by a shift to lower cost channels and continued focus on efficiency. The OIBDA margin had a solid year-on-year performance, with a 4.0 percentage points increase in the fourth quarter to 34.3%, while for the year it reached 33.4% (+1.9 percentage points year-on-year).

The efficient **CapEx** management achieved by the Company (-23.5% year-on-year to 63 million euros in 2009), and the already mentioned evolution of the OIBDA allowed **operating cash flow (OIBDA-CapEx)** to increase 9.2% year-on-year, reaching 239 million euros.

## Telefónica O2 Czech Republic

In 2009, the financial performance of Telefónica O2 Czech Republic was negatively impacted by a challenging trading environment and by mobile termination rate cuts, though the Company kept solid operating performance in both fixed broadband and contract mobile segments. In Slovakia the Company accelerated its commercial momentum and delivered good financial performance.

The total number of **accesses** for Telefónica O2 Czech Republic at the end of 2009, including Slovakia, stood at 8.4 million, a year-on-year increase of 4.2%.

In December 2009, **fixed telephony accesses** reached 1.8 million (-6.5% year-on-year) with a significant improvement in net fixed line losses (-122,752) compared to 2008 (-30.2% year-on-year). Net line losses reached 19,347 in the fourth quarter of 2009.

**Retail Internet broadband accesses** showed good growth (+17.0% year-on-year) to reach 683,108, with 99,410 net additions in 2009 (+33.8% year-on-year) and 26,775 in the fourth quarter (+57.6% over the previous quarter), leveraging continued strong commercial activity around the new broadband centric propositions. The total number of **O2 TV customers** reached 137,630 at the end of December, up 20.2% year-on-year.

The total **mobile customer base** in the Czech Republic reached 4.9 million at the end of December 2009 (+3.0% year-on-year), driven by the 11.7% year-on-year increase in the contract segment. Mobile net adds stood at 142,484 in 2009 (compared to 21,931 in 2008), with 21,825 in the fourth quarter. This evolution was driven by the good performance of contract net adds along the year, which reached 295,072 in 2009 (+7.1% year-on-year) and 68,350 in the fourth quarter, due to the success of "O2 Neon" flat rate tariffs and by prepay to contract migrations. At the end of 2009, contract customers represented 56.9% of the base (4.5 percentage points higher than in 2008).

## 04/7 Results by regional business units

### Telefónica Europe

Telefónica O2 Slovakia accelerated its commercial momentum leveraging on successful customer propositions based on value and simplicity, which delivered a strong financial performance. The mobile customer base reached 552,853 at the end of December 2009, up 69.9% year-on-year. In the fourth quarter, the Company reported its best ever quarterly net additions of 89,773 lines (+86.9% year-on-year). The contract customer base almost doubled in 2009 (+97.6% year-on-year) and reached 195,648 with 38,421 net adds in the quarter (+83.7% year-on-year). Contract customers represented 35.4% of total customer base at the end of 2009, up 4.9 percentage points, year-on-year.

Churn in the Czech mobile business totalled 2.1% in 2009 (+0.1 percentage points higher year-on-year) and increased in the fourth quarter (+0.7 percentage points year-on-year) largely due to the higher prepaid churn. Contract churn in 2009 improved 0.1 percentage points to 1.0% (+0.2 percentage points in the fourth quarter).

Mobile traffic carried in the Czech Republic grew by 11.0% year-on-year to 8,232 million minutes in 2009 (+12.7% year-on-year in the fourth quarter) due to higher contract base and the successful proposition of flat rate tariffs ("O2 Neon").

In 2009, voice ARPU declined 11.6% year-on-year in local currency (-13.4% in the fourth quarter in local currency), largely due to customers optimizing their behaviour and mobile termination rate cuts in 2009.

Data ARPU decreased 6.9% year-on-year in local currency in 2009 and by 14.1% in the fourth quarter, driven by a decline in both the volume of outgoing SMS and its pricing within the bundled proposition of "O2 Home".

As a result, in 2009 total mobile ARPU in the Czech Republic went down 10.5% year-on-year in local currency to reach 19.3 euros (-13.6% year-on-year in the fourth quarter).

Revenues went down 7.5% year-on-year in constant currency to 2,260 million euros in 2009 (-9.3% year-on-year in the fourth quarter). Excluding the impact of Universal Service Obligation in both years<sup>5</sup>, revenues declined 6.1% year-on-year in 2009 in constant currency and by 7.6% year-on-year in the fourth quarter.

Fixed revenues in the Czech Republic declined by 9.3% year-on-year in local currency to 1,000 million euros in 2009, a 10.8% year-on-year decline in the fourth quarter in local currency (-6.4% in 2009 year-on-year and -7.0% year-on-year in the fourth quarter excluding Universal Service Obligation impact, respectively), due to the lower fixed access base and the decrease of traffic volume.

Mobile service revenues in the Czech Republic declined year-on-year by 6.3% in local currency to 1,123 million euros in 2009 (-8.8% year-on-year in the fourth quarter), mainly impacted by the optimisation of usage, decreasing roaming revenues and additional mobile termination rate cuts. Excluding the impact of MTR cuts, mobile service revenues would have declined 5.4% and 3.8% year-on-year in local currency for the fourth quarter and for the full year, respectively. On the other hand, revenues from Telefónica O2 Slovakia increased by 62.3% year-on-year in 2009 (+68.3% year-on-year in the fourth quarter of 2009).

Operating income before depreciation and amortization (OIBDA) went down 3.7% year-on-year in constant currency to 1,053 million euros in 2009 (-2.0% in the fourth quarter). OIBDA margin reached 46.6% in the year and 45.3% in the fourth quarter of 2009, a year-on-year improvement of 1.7 percentage points and 3.4 percentage points, respectively. In comparable terms<sup>6</sup>, OIBDA decline was 5.3% year-on-year.

Operating cash flow (OIBDA-CapEx) in 2009 showed a 2.6% year-on-year growth in constant currency to reach 807 million euros, with a 20.2% year-on-year decline in CapEx in constant currency, totalling 245 million euros.

<sup>5</sup> USO impacts were 52 million euros in 2008 and 14 million euros in 2009.

<sup>6</sup> Assuming constant exchange rates. 2009 excludes proceeds of 58 million euros in 2009 from real estate disposals and the settlement agreement with T-Mobile, as well as the impact from the Universal Service. In 2008 it excludes 46 million euros from the sale of real estate and the impacts from the Universal Service.

## Telefónica Europe Accesses

	2008	2009				% Chg y-o-y
	December	March	June	September	December	
Unaudited figures (thousands)						
<b>Final Clients Accesses</b>	<b>44,823.5</b>	<b>45,356.5</b>	<b>46,197.4</b>	<b>47,182.1</b>	<b>47,814.9</b>	<b>6.7</b>
Fixed telephony accesses <sup>1</sup>	1,952.7	1,909.6	1,861.8	1,847.1	1,827.5	(6.4)
Internet and data accesses	1,354.5	1,463.7	1,555.4	1,656.8	1,754.7	29.5
Narrowband	163.4	155.4	148.7	142.6	137.3	(16.0)
Broadband	1,158.7	1,277.8	1,375.9	1,483.6	1,589.1	37.1
Other <sup>2</sup>	32.4	30.4	30.9	30.6	28.3	(12.6)
Mobile accesses <sup>3</sup>	41,401.8	41,855.5	42,647.5	43,542.3	44,095.0	6.5
Pre-Pay <sup>4</sup>	22,729.4	22,673.4	22,916.5	23,163.8	23,098.5	1.6
Contract	18,672.4	19,182.1	19,731.1	20,378.6	20,996.5	12.4
Pay TV	114.5	127.8	132.6	135.9	137.6	20.2
<b>Wholesale Accesses<sup>5</sup></b>	<b>1,237.9</b>	<b>1,324.4</b>	<b>1,381.3</b>	<b>1,403.2</b>	<b>1,425.2</b>	<b>15.1</b>
<b>Total Accesses</b>	<b>46,061.4</b>	<b>46,680.9</b>	<b>47,578.8</b>	<b>48,585.3</b>	<b>49,240.1</b>	<b>6.9</b>

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

2 Retail circuits other than broadband.

3 As of 31 December 2007, in order to align the criteria for the key performance indicators of the mobile operations of the Group, the series of mobile accesses, and therefore, of total accesses, have been revised, including machine to machine accesses. In addition, the accounting criteria for prepaid access in the Czech Republic and Slovakia have been modified to align them, changing from 13 months (registered) to three months (active).

4 December 2008 and 2009 include the disconnection of inactive mobile prepaid customers in Germany.

5 Includes Unbundled Lines by T. O2 Germany.

Note:

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

## Telefónica Europe Consolidated income Statement

	January - December			October - December		
	2009	2008	% Chg	2009	2008	% Chg
Unaudited figures (Euros in millions)						
<b>Revenues</b>	<b>13,533</b>	<b>14,308</b>	<b>(5.4)</b>	<b>3,477</b>	<b>3,618</b>	<b>(3.9)</b>
Internal exp capitalized in fixed assets	213	175	21.7	56	43	28.2
Operating expenses	(9,856)	(10,514)	(6.3)	(2,505)	(2,616)	(4.2)
Other net operating income (expense)	5	181	(97.4)	2	63	(97.1)
Gain (loss) on sale of fixed assets	16	32	(48.6)	2	(1)	c.s.
Impairment of goodwill and other assets	(1)	(3)	(75.0)	0	0	n.m.
<b>Operating income before D&amp;A (OIBDA)</b>	<b>3,910</b>	<b>4,180</b>	<b>(6.4)</b>	<b>1,032</b>	<b>1,107</b>	<b>(6.8)</b>
<b>OIBDA margin</b>	<b>28.9%</b>	<b>29.2%</b>	<b>(0.3 p.p.)</b>	<b>29.7%</b>	<b>30.6%</b>	<b>(0.9 p.p.)</b>
Depreciation and amortization	(2,895)	(3,035)	(4.6)	(707)	(730)	(3.1)
<b>Operating income (OI)</b>	<b>1,015</b>	<b>1,144</b>	<b>(11.3)</b>	<b>325</b>	<b>377</b>	<b>(13.8)</b>

Notes:

- OIBDA and OI before management and brand fees.
- 2008 includes a positive impact of 174 million euros derived from Airwave disposal.
- OIBDA and OI include 44 million euros from restructuring costs registered in 2009.

Telefónica Europe  
Accesses by countries

	2008	2009				% Chg y-o-y
	December	March	June	September	December	
Unaudited figures (Thousands)						
<b>Telefónica O2 UK</b>						
Final Clients Accesses	20,615.6	20,821.0	21,125.6	21,487.9	21,890.8	6.2
Internet and data accesses	340.9	404.5	456.9	527.1	591.5	73.5
Broadband	340.9	404.5	456.9	527.1	591.5	73.5
Mobile accesses <sup>1</sup>	20,274.7	20,416.5	20,668.7	20,960.8	21,299.3	5.1
Pre-Pay	11,862.5	11,718.0	11,657.6	11,637.4	11,740.3	(1.0)
Contract	8,412.2	8,698.5	9,011.1	9,323.5	9,558.9	13.6
<b>Total Accesses</b>	<b>20,615.6</b>	<b>20,821.0</b>	<b>21,125.6</b>	<b>21,487.9</b>	<b>21,890.8</b>	<b>6.2</b>
<b>Telefónica O2 Germany</b>						
Final Clients Accesses	14,413.3	14,737.6	15,186.1	15,672.6	15,792.5	9.6
Internet and data accesses	214.8	231.7	253.4	272.3	285.1	32.7
Broadband	214.8	231.7	253.4	272.3	285.1	32.7
Mobile accesses <sup>1</sup>	14,198.5	14,506.0	14,932.7	15,400.3	15,507.4	9.2
Pre-Pay <sup>2</sup>	7,231.5	7,420.7	7,708.1	7,959.9	7,807.0	8.0
Contract	6,967.0	7,085.2	7,224.5	7,440.4	7,700.4	10.5
Wholesale Accesses <sup>3</sup>	1,128.4	1,215.7	1,273.1	1,295.4	1,316.8	16.7
<b>Total Accesses</b>	<b>15,541.7</b>	<b>15,953.3</b>	<b>16,459.2</b>	<b>16,968.0</b>	<b>17,109.3</b>	<b>10.1</b>
<b>Telefónica O2 Ireland</b>						
Mobile accesses <sup>1</sup>	1,727.7	1,710.6	1,716.7	1,717.5	1,714.3	(0.8)
Pre-Pay	1,084.6	1,059.4	1,054.0	1,041.1	1,022.5	(5.7)
Contract	643.1	651.2	662.6	676.4	691.8	7.6
<b>Total Accesses</b>	<b>1,727.7</b>	<b>1,710.6</b>	<b>1,716.7</b>	<b>1,717.5</b>	<b>1,714.3</b>	<b>(0.8)</b>
<b>Telefónica O2 Czech Republic</b>						
Final Clients Accesses	7,589.5	7,564.7	7,590.5	7,678.0	7,701.5	1.5
Fixed telephony accesses <sup>4</sup>	1,893.4	1,851.0	1,803.9	1,790.0	1,770.6	(6.5)
Naked ADSL	0.0	0.0	0.0	29.8	62.1	n.m.
VoIP	0.0	0.0	0.0	14.0	16.9	n.m.
Internet and data accesses	779.5	803.2	818.9	829.5	848.7	8.9
Narrowband	163.4	155.4	148.7	142.6	137.3	(16.0)
Broadband	583.7	617.3	639.3	656.3	683.1	17.0
Other <sup>5</sup>	32.4	30.4	30.9	30.6	28.3	(12.6)
Mobile accesses <sup>1</sup>	4,802.1	4,782.8	4,835.1	4,922.7	4,944.6	3.0
Pre-Pay <sup>6</sup>	2,282.8	2,186.7	2,172.5	2,176.7	2,130.2	(6.7)
Contract	2,519.3	2,596.1	2,662.6	2,746.0	2,814.4	11.7
Pay TV	114.5	127.8	132.6	135.9	137.6	20.2
Wholesale Accesses	109.5	108.7	108.2	107.9	108.4	(1.0)
<b>Total Accesses</b>	<b>7,698.9</b>	<b>7,673.4</b>	<b>7,698.7</b>	<b>7,785.9</b>	<b>7,810.0</b>	<b>1.4</b>
<b>Telefónica O2 Slovakia</b>						
Mobile accesses <sup>1</sup>	325.3	365.2	417.0	463.1	552.9	69.9
Pre-Pay <sup>6</sup>	226.3	247.6	281.2	305.9	357.2	57.8
Contract	99.0	117.6	135.8	157.2	195.6	97.6
<b>Total Accesses</b>	<b>325.3</b>	<b>365.2</b>	<b>417.0</b>	<b>463.1</b>	<b>552.9</b>	<b>69.9</b>

1 As of 31 December 2007, in order to align the criteria for the key performance indicators of the mobile operations of the Group, the series of mobile accesses, and therefore, of total accesses, have been revised, including machine to machine accesses.

2 450,000 inactive prepay accesses were disconnected in December 2009 and more than 240,000 in December 2008.

3 Includes Unbundled Lines by T. O2 Germany.

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

5 Retail circuits other than broadband.

6 The accounting criteria for Pre-Pay access in the Czech Republic and Slovakia have been modified to align them, changing from 13 months (registered) to three months (active).



## Telefónica Europe

### Selected mobile business operating data by country

	2008	2009				% Chg y-o-y Local Cur
	Q4	Q1	Q2	Q3	Q4	
Unaudited figures						
<b>Telefónica O2 UK</b>						
Traffic (Million minutes)	12,281	12,798	13,304	13,579	14,176	15.4
ARPU (EUR)	27.1	24.2	25.3	25.5	24.0	(4.5)
Pre-Pay	14.4	12.3	12.8	12.4	11.7	(12.3)
Contract	45.1	40.6	41.6	42.0	39.1	(6.3)
Data ARPU (EUR)	9.7	8.8	9.2	9.6	9.5	6.2
% non-P2PSMS over data revenues	22.0%	23.9%	26.6%	29.3%	29.4%	7.4 p.p.
<b>Telefónica O2 Germany</b>						
Traffic (Million minutes)	5,454	5,555	5,819	5,775	6,108	12.0
ARPU (EUR)	16.9	15.9	15.7	15.7	15.3	(9.2)
Pre-Pay	5.8	5.4	5.5	5.9	5.8	1.1
Contract	28.3	26.8	26.5	26.1	25.2	(11.0)
Data ARPU (EUR)	4.8	4.7	4.6	4.6	4.8	0.5
% non-P2PSMS over data revenues	31.7%	33.5%	34.8%	37.4%	40.7%	9.0 p.p.
<b>Telefónica O2 Ireland</b>						
Traffic (Million minutes)	1,250	1,158	1,170	1,166	1,177	(5.8)
ARPU (EUR)	42.6	39.3	39.8	39.9	39.5	(7.3)
Pre-Pay	26.7	24.2	25.6	25.8	26.5	(0.9)
Contract	69.2	64.5	62.5	62.1	58.8	(14.9)
Data ARPU (EUR)	10.9	11.6	11.9	11.6	12.1	10.9
% non-P2PSMS over data revenues	32.6%	35.8%	36.4%	36.2%	38.3%	5.7 p.p.
<b>Telefónica O2 Czech Republic<sup>1</sup></b>						
Traffic (Million minutes)	1,911	1,940	2,085	2,054	2,153	12.7
ARPU (EUR)	22.5	18.7	19.4	19.9	19.1	(13.6)
Pre-Pay	11.5	8.0	8.6	8.7	8.7	(23.1)
Contract	32.6	28.2	28.4	29.0	27.1	(14.9)
Data ARPU (EUR)	5.5	4.7	4.7	4.9	4.6	(14.1)
% non-P2PSMS over data revenues	43.5%	45.5%	43.1%	45.7%	43.9%	0.4 p.p.

<sup>1</sup> KPIs for Mobile business in Czech Republic do not include Slovakia.

Notes:

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

Telefónica Europe  
Selected operating mobile business data by countries

	January - December		
	2009	2008	% Chg Local Cur
Unaudited figures			
<b>Telefónica O2 UK</b>			
Traffic (Million minutes)	53,856	46,585	15.6
ARPU (EUR)	24.7	29.0	(4.4)
Pre-Pay	12.3	15.5	(11.0)
Contract	40.8	48.6	(5.9)
Data ARPU (EUR)	9.3	10.0	3.7
% non-P2PSMS over data revenues	27.4%	19.8%	7.5 p.p.
<b>Telefónica O2 Germany</b>			
Traffic (Million minutes)	23,257	22,313	4.2
ARPU (EUR)	15.6	17.4	(9.9)
Pre-Pay	5.7	5.9	(4.4)
Contract	26.1	29.0	(10.0)
Data ARPU (EUR)	4.7	4.8	(2.9)
% non-P2PSMS over data revenues	36.7%	29.2%	7.6 p.p.
<b>Telefónica O2 Ireland</b>			
Traffic (Million minutes)	4,672	4,867	(4.0)
ARPU (EUR)	39.6	43.2	(8.3)
Pre-Pay	25.5	27.0	(5.7)
Contract	62.0	72.5	(14.6)
Data ARPU (EUR)	11.8	10.8	9.1
% non-P2PSMS over data revenues	36.7%	31.1%	5.6 p.p.
<b>Telefónica O2 Czech Republic<sup>1</sup></b>			
Traffic (Million minutes)	8,232	7,420	11.0
ARPU (EUR)	19.3	22.8	(10.5)
Pre-Pay	8.5	11.4	(21.9)
Contract	28.2	33.5	(12.0)
Data ARPU (EUR)	4.7	5.4	(6.9)
% non-P2PSMS over data revenues	44.6%	43.0%	1.6 p.p.

<sup>1</sup> KPIs for Mobile business in Czech Republic do not include Slovakia.

## Notes:

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

## Telefónica Europe Selected financial data

	January - December				October - December			
	2009	2008	% Chg	% Chg Local Cur	2009	2008	% Chg	% Chg Local Cur
Unaudited figures (Euros in millions)								
<b>Telefónica O2 UK</b>								
Revenues	6,512	7,052	(7.7)	3.5	1,642	1,755	(6.5)	1.2
OIBDA	1,680	1,839	(8.7)	2.3	461	479	(3.8)	4.2
OIBDA margin	25.8%	26.1%	(0.3 p.p.)		28.1%	27.3%	0.8 p.p.	
CapEx	602	717	(16.1)	(6.0)	177	198	(10.7)	(3.1)
OpCF (OIBDA-CapEx)	1,078	1,122	(3.9)	7.7	284	281	1.1	9.2
<b>Telefónica O2 Germany</b>								
Revenues	3,746	3,595	4.2	4.2	998	931	7.2	7.2
OIBDA	918	770	19.3	19.3	252	237	6.1	6.1
OIBDA margin	24.5%	21.4%	3.1 p.p.		25.2%	25.5%	(0.3 p.p.)	
CapEx	796	924	(13.8)	(13.8)	250	304	(17.9)	(17.9)
OpCF (OIBDA-CapEx)	122	(154)	c.s.	c.s.	2	(67)	c.s.	c.s.
<b>Telefónica O2 Ireland</b>								
Revenues	905	957	(5.5)	(5.5)	228	243	(6.0)	(6.0)
OIBDA	302	301	0.3	0.3	78	74	6.5	6.5
OIBDA margin	33.4%	31.5%	1.9 p.p.		34.3%	30.3%	4.0 p.p.	
CapEx	63	83	(23.5)	(23.5)	25	29	(14.0)	(14.0)
OpCF (OIBDA-CapEx)	239	219	9.2	9.2	53	44	20.0	20.0
<b>Telefónica O2 Czech Republic<sup>1</sup></b>								
Revenues	2,260	2,581	(12.4)	n.c.	579	651	(11.1)	n.c.
OIBDA	1,053	1,159	(9.2)	n.c.	262	273	(3.9)	n.c.
OIBDA margin	46.6%	44.9%	1.7 p.p.		45.3%	41.9%	3.4 p.p.	
CapEx	245	324	(24.2)	n.c.	75	157	(52.2)	n.c.
OpCF (OIBDA-CapEx)	807	835	(3.3)	n.c.	187	116	61.2	n.c.

Note:

OIBDA before management and brand fee.

<sup>1</sup> Includes Slovakia.

## Results by regional business units

### Other Companies

#### Atento Group

In accordance with International Financial Reporting Standards (IFRS), the Venezuelan economy must be considered hyperinflationary in 2009. This means that the financial results of Atento Group are affected by the designation of Venezuela as a hyperinflationary economy.

For comparison purposes and to facilitate the interpretation of the year-on-year changes vs. 2008, variations in constant currency of the headings affected by the hyperinflation adjustments and the other financial and operating indicators are reported in organic terms, excluding the impact of this adjustment for hyperinflation.

In a challenging economic and operating environment, the Atento Group delivered a solid set of financial results in 2009.

**Revenues** increased 1.6% year-on-year (+5.1% year-on-year in organic terms<sup>1</sup>) to 1,321 million euros, growing 6.6% year-on-year in the fourth quarter. This advance was mainly due to the increase in volumes from the Atento Group's biggest customers, especially in the financial sector, in Brazil and Mexico.

The diversification of the customer portfolio continued in line with 2008, with multisector customers (outside the Telefónica Group) accounting for 53% of revenues at year-end. These customers were mainly from the telecommunications and financial sectors in Mexico, Brazil, Spain and Venezuela.

With regard to the geographical breakdown of revenues, Brazil was the largest contributor to total revenues, with 50% (46% in 2008), followed by Spain with 15% (down from 17% in 2008 due to impact of the current economic situation and the exit of BBVA) and Mexico with 12% (unchanged from 2008). Atento Group's offshored revenues accounted for 8% of the total (7% in 2008), mainly from Spain to Latin America and Morocco and from Mexico to Central America.

**Operating income before depreciation and amortisation (OIBDA)** fell 17.4% in 2009 to 154 million euros (-14.6% in organic terms<sup>1</sup>), although the fourth quarter saw a 1.9% year-on-year increase. Throughout the year, this evolution was largely due to increased price pressure in the current economic context, higher personnel costs as a result of regulatory and labour changes in several Latin American countries and higher rental and maintenance costs in customer service centres, especially in Brazil.

The **OIBDA margin** in 2009 stood at 11.6%, down 2.7 percentage points from 2008, although the margin in the quarter had a better year-on-year performance (-0.7 percentage points) to 14.9%.

**CapEx** in 2009 amounted to 52 million euros, a decline of 7.5% year-on-year and down 3.4% in organic terms<sup>1</sup>, mainly due to lower investment in Chile, Colombia and Spain.

**Operating cash flow (OIBDA-CapEx)** totalled 102 million euros in 2009 (-21.7% year-on-year from 2008 and -19.4% in organic terms<sup>1</sup>).

The Atento Group ended 2009 with 66,736 positions in place, 10% more than at the end of 2008.

<sup>1</sup> Assuming constant exchange rates and excluding the impact of the hyperinflation in Venezuela.

## Grupo Atento Consolidated income Statement

	January - December			October - December		
	2009	2008	% Chg	2009	2008	% Chg
Unaudited figures (Euros in millions)						
Revenues	1,321	1,301	1.6	351	329	6.6
Internal exp capitalized in fixed assets	-	-	-	-	-	-
Operating expenses	(1,167)	(1,117)	4.5	(299)	(279)	7.2
Other net operating income (expense)	(0)	2	c.s.	0	1	(82.9)
Gain (loss) on sale of fixed assets	0	(0)	c.s.	0	(0)	c.s.
<b>Operating income before D&amp;A (OIBDA)</b>	<b>154</b>	<b>186</b>	<b>(17.4)</b>	<b>52</b>	<b>51</b>	<b>1.9</b>
<b>OIBDA margin</b>	<b>11.6%</b>	<b>14.3%</b>	<b>(2.7 p.p.)</b>	<b>14.9%</b>	<b>15.6%</b>	<b>(0.7 p.p.)</b>
Depreciation and amortization	(32)	(33)	(1.0)	(6)	(8)	(32.5)
<b>Operating income (OI)</b>	<b>122</b>	<b>154</b>	<b>(20.9)</b>	<b>47</b>	<b>43</b>	<b>8.5</b>

Note:

2009 figures impacted by the hyperinflation in Venezuela.



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Risk  
management

## Risk management

### Derivative financial instruments and risk management policies

Telefónica is exposed to various financial market risks as a result of: (i) its ordinary business activity, (ii) debt incurred to finance its business, (iii) its investments in companies, and (iv) other financial instruments related to the above commitments.

The main market risks affecting Telefónica are as follows:

- 1. Exchange rate risk**  
Exchange rate risk arises primarily from (i) Telefónica's international presence, through its investments and businesses in countries that use currencies other than the euro (primarily in Latin America, but also in the United Kingdom and the Czech Republic), and (ii) debt denominated in currencies other than that of the country where the business is conducted or the home country of the company incurring such debt.
- 2. Interest rate risk**  
Interest rate risk arises primarily from changes in interest rates affecting (i) financial expenses on floating rate debt (or short-term debt likely to be renewed), due to changes in interest rates and (ii) the value of long-term liabilities at fixed interest rates.
- 3. Share price risk**  
Share price risk arises primarily from changes in the value of our equity investments that may be bought, sold or otherwise involved in transactions, from changes in the value of derivatives associated with such investments, from changes in the value of our treasury shares and from equity derivatives.

Telefónica is also exposed to liquidity risk if a mismatch arises between its financing needs (including operating and financial expense, investment, debt redemptions and dividend commitments) and its sources of finance (including revenues, divestments, credit lines from financial institutions and capital

market transactions). The cost of finance could also be affected by movements in the credit spreads (over benchmark rates) demanded by lenders.

Finally, Telefónica is exposed to "country risk" (which overlaps with market and liquidity risks). This refers to the possible decline in the value of assets, cash flows generated or cash flows returned to the parent company as a result of political, economic or social instability in the countries where Telefónica operates, especially in Latin America.

Telefónica actively manages these risks through the use of derivatives (primarily on exchange rates, interest rates and share prices) and by incurring debt in local currencies, where appropriate, with a view to stabilizing cash flows, the income statement and partially, albeit to a lesser extent, investments. In this way, Telefónica attempts to protect its solvency, facilitate financial planning and take advantage of investment opportunities.

Telefónica manages its exchange rate risk and interest rate risk in terms of net debt and net financial debt as calculated by them. Telefónica believes that these parameters are more appropriate to understanding its debt position. Net debt and net financial debt take into account the impact of our cash balance and cash equivalents including derivatives positions with a positive value linked to liabilities. Neither net debt nor net financial debt as calculated by Telefónica should be considered an alternative to gross financial debt (the sum of current and non-current interest-bearing debt) as a measure of our liquidity. For a more detailed description on reconciliation of net debt and net financial debt to gross financial debt (see Note 2).

#### **Exchange rate risk**

The fundamental objective of our exchange rate risk management policy is that, in event of depreciation in foreign currencies relative to the euro, any potential losses in the value of the cash flows generated by our businesses in such currencies, caused by depreciation in exchange rates of a foreign currency relative to the euro, are offset (to some extent) by savings from the reduction in the euro value of our debt denominated in such currencies. The degree of exchange rate hedging we employ varies depending on the type of investment.

*Note: The notes that are referred to this part are included in the 2009 Financial Report of Telefónica, S.A.*



At December 31, 2009, net debt in Latin American currencies was equivalent to approximately 5,622 million euros. However, the composition of this net debt in the various Latin American currencies is not proportional to the cash flows generated at any given moment. The future effectiveness of the strategy described above as a hedge of exchange rate risks therefore depends on which currencies depreciate relative to euro.

Telefónica aims to protect itself against declines in Latin American currencies relative to the euro affecting our asset values through the use of dollar-denominated debt, incurred either in Spain (where such debt is associated with an investment as long as it is considered to be an effective hedge) or in the country itself, where the market for local currency financing or hedges may be inadequate or non-existent. At December 31, 2009, Telefónica net debt denominated in dollars was equivalent to 1,744 million euros, of which 981 million euros was related to assets in Latin America and the remaining 763 million euros was related to its investment in China Unicom.

At December 31, 2009, pound sterling-denominated net debt was approximately 2.3 times the value of our 2009 OIBDA from the Telefónica Europe business unit in the United Kingdom. Telefónica's aim is to maintain this same proportion of pound sterling-denominated net debt to OIBDA as the Telefónica net debt to OIBDA ratio, on a consolidated basis, in order to help them to reduce its sensitivity to changes in the pound sterling to euro exchange rate. Pound sterling-denominated net debt at December 31, 2009, was equivalent to 3,799 million euros, less than the 3,855 million euros at December 31, 2008.

To protect our investment in the Czech Republic, Telefónica has net debt denominated in Czech crowns, which at December 31, 2009 was equivalent to 2,513 million euros, almost 59% of the original cost of the investment and less than 2.3 times the OIBDA of Telefónica Europe's business in the Czech Republic, down from approximately 3,034 million euros at December 31, 2008.

We also manage exchange rate risk by seeking to minimize the negative impact of any remaining exchange rate exposure on the income statement, regardless of whether we have open positions. Such open position exposure can arise for any of three reasons: (i) a thin market for local derivatives or difficulty in sourcing local currency finance which makes it impossible to arrange a low-cost hedge (as in Argentina and Venezuela), (ii) financing through intra-group loans, where the accounting treatment of exchange rate risk is different from that for financing through capital contributions, and (iii) as the result of a deliberate policy decision, to avoid the high cost of hedges that are not warranted by expectations or high risk of depreciation.

In 2009, exchange rate management resulted in negative exchange rate differences totaling 209 million euros, compared to 24 million euros in positive differences in 2008.

To illustrate the sensitivity of exchange gains or losses to variability in exchange rates, assuming the exchange rate position affecting the income statement at the end of 2009 were constant during 2010 and Latin American currencies depreciated against the dollar and the rest of the currencies against the euro by 10%, Telefónica estimates that exchange gains or losses recorded for 2010 would be 46 million euros less. Nonetheless, Telefónica manages its exposure on a dynamic basis to mitigate their impact.

### Interest rate risk

Telefónica financial expenses are exposed to changes in interest rates. In 2009, the rates applied to the largest amount of our short-term debt were mainly based on the Euribor, the Czech crown Pribor, the Brazilian SELIC, the dollar Libor and the Colombian UVR. In nominal terms, at December 31, 2009, 52.6% of Telefónica's net debt (or 50% of long-term net debt) was at rates fixed for more than one year, compared to 43.8% of net debt (46.3% of long-term net debt) in 2008. Of the remaining 47.4% (net debt at floating or fixed rates maturing in less than one year), the interest rate on 24 percentage points was set for a period of more than one year (10.7% of long-term net debt), compared to 28 percentage points on debt at floating or fixed rates maturing in less than one year (17% of long-term debt) at December 31, 2008. This decrease in 2009 from 2008 is due to the cancellation and maturity (without renewal) of an amount equivalent to 2,234 million euros of caps and floors euros, US dollars and pounds sterling in anticipation of a fall in interest rates.

In addition, early retirement liabilities were discounted to present value over the year, using the curve on the swap rate markets. The decrease in interest rates has increased the market value of these liabilities. However, this increase was nearly completely offset by the increase in the value of the hedges on these positions.

Net financial expenses rose 18.2% to 3,307 million euros in 2009 from 2,797 million euros de 2008, mainly due to the impact of Venezuela. Stripping out exchange-rate effects, net financial expense for 2009 totaled 2,767 million euros, a 1.9% decrease from the 2,821 million euros recorded in 2008.

To illustrate the sensitivity of net financial expense to variability in short-term interest rates, assuming a 100 basis point increase in interest rates in all currencies in which there are financial positions and no change in the currency make-up and balance of the position at year end, we estimate that net financial expense at December 31, 2009 would have been 124 million euros higher.

*Note: The notes that are referred to this part are included in the 2009 Financial Report of Telefónica, S.A.*

## Share price risk

Telefónica is exposed to changes in the value of our equity investments that may be bought, sold or otherwise involved in transactions, from changes in the value of derivatives associated with such investments, from treasury shares and from equity derivatives.

As part of the shareholder remuneration policy, in 2008, Telefónica announced plans to buy back up to 150 million of our shares. This buyback plan was finished on March 31, 2009.

According to the Telefónica, S.A. share option plan, *Performance Share Plan* (PSP) - (see Note 20) - the shares delivered under such plan may be either the parent company treasury shares, acquired by them or any of its Group companies; or newly-issued shares. The possibility of delivering shares to employees in the future, in accordance with relative total shareholders' return, implies a risk since there could be an obligation to hand over a maximum number of shares at the end of each cycle, whose acquisition (in the event of acquisition in the market) in the future could imply a higher cash outflow than required on the start date of each cycle if the share price is above the corresponding price on the phase start date. In the event that new shares are issued for delivery to the beneficiaries of the plan, there would be a dilutive effect for our ordinary shareholder as a result of the higher number of shares delivered under such plan outstanding.

To reduce the risk to us associated with variations in share price under this plan, Telefónica has acquired derivatives that replicate the risk profile of some of the shares derivable under the plan as explained in Note 20.

In addition, part of the 6,329,530 treasury shares of the parent company held at December 31, 2009 may be used to cover shares deliverable under the PSP. The net asset value of the treasury shares could increase or decrease depending on variations in Telefónica, S.A.'s share price.

Additionally, at the Ordinary General Shareholders' Meeting of 2009, an incentive plan for Group employees to purchase Telefónica shares was approved. The cost of this plan will not exceed 60 million euros. The plan is expected to be implemented during the first half of 2010. Telefónica will assess if will have to take any action in order to reduce any risk related to the future delivery of shares.

## Liquidity Risk

Telefónica seeks to match the schedule for its debt maturity payments to its capacity to generate cash flows to meet these maturities, while allowing for some flexibility. In practice, this has been translated into two key principles:

1. The average maturity of our net financial debt is intended to stay above 6 years, or be restored above that threshold in a reasonable period of time if it eventually falls below it. This principle is considered as a guideline when managing debt and access to credit markets, but not a rigid requirement. When calculating the average maturity for the net financial debt and part of the undrawn credit lines can be considered as offsetting the shorter debt maturities, and extension options on some financing facilities may be considered as exercised, for calculation purposes.
2. Telefónica must be able to pay all commitments over the next 12 months without accessing new borrowing or accessing the capital markets (although including firm credit lines arranged with banks), assuming budget projections are met.

As of December 31, 2009, the average maturity of 43,551 million euros of net financial debt was 6.55 years. Telefónica would need to generate approximately 6,649 million euros per year to repay the debt in this period if we used all our cash for this purpose.

At December 31, 2009, gross financial debt scheduled maturities in 2010 amounted to approximately 8,647 million euros (including the net position of derivative financial instruments), which is lower than the amount of funds available, calculated as the sum of: (i) current financial assets and cash at December 31, 2009 (10,482 million euros excluding derivative financial instruments), (ii) annual cash generation projected for 2010; and (iii) undrawn credit facilities arranged with banks whose original maturity is over one year (an aggregate of more than 4,480 million euros at December 31, 2009). This gives us flexibility with regard to accessing capital or credit markets in the next 12 months. For a further description of our liquidity and capital resources, see Note 13.2 Financial Liabilities and Appendix III.

*Note: The notes that are referred to this part are included in the 2009 Financial Report of Telefónica, S.A.*

## Country risk

Telefónica managed or mitigated country risk by pursuing two lines of action (in addition to its normal business practices):

1. Partly matching assets to liabilities (those not guaranteed by the parent company) in its Latin American companies such that any potential asset impairment would be accompanied by a reduction in liabilities; and,
2. Repatriating funds generated in Latin America that are not required for the pursuit of new, profitable business development opportunities in the region.

Regarding the first point, at December 31, 2009, its Latin American companies had net financial debt not guaranteed by the parent company of 4,044 million euros, which represents 9.29% of our consolidated net financial debt.

Regarding the repatriation of funds to Spain, it has received 1,790 million euros from our Latin America companies in 2009, of which 766 million euros was from dividends and 1,024 million euros from intra-group loans (payments of interest and repayments of principal) and capital reductions. These amounts were equally offset by additional amounts invested in its Latin American companies, mainly in Peru (27 million euros), in Argentina (2 million euros) and in Colombia (1 million euros). As a result of the foregoing, net funds repatriated to Spain from our Latin America companies amounted to the equivalent of 1,760 million euros as of December 31, 2009.

In this regard, it is worth noting that since February 2003, Venezuela has had an exchange control mechanism in place, managed as indicated above by the Currency Administration Commission (CADIVI). The body has issued a number of regulations ("*providencias*") governing the modalities of currency sales in Venezuela at official exchange rates. Foreign companies which are duly registered as foreign investors are entitled to request approval to acquire currencies at the official exchange rate by the CADIVI, in line with regulation number 029, article 2, section c) "Remittance of earnings, profits, income, interest and dividends from international investment." Telcel, its subsidiary in Venezuela, obtained the aforementioned requested approval on Venezuelan Bolivar fuerte 295 million in 2006, Venezuelan Bolivar fuerte 473 million in 2007 and Venezuelan Bolivar fuerte 785 million in 2008. At December 31, 2009, payment of a dividend in the amount of Venezuelan Bolivar fuerte 1,152 million is pending approval.

## Credit risk

Telefónica is exposed to credit risk through its trading in derivatives with counterparties of high creditworthiness and senior debt ratings of at least "A". In Spain, where it holds most of Telefónica's derivatives portfolio, it has netting agreements with financial institutions, with debtor or creditor positions offset in case of bankruptcy, limiting the risk to the net position. For other subsidiaries, particularly those in Latin America, given the stable sovereign rating provides a ceiling and is below "A," trades are with local financial entities whose rating by local standards is considered to be of high creditworthiness.

Meanwhile, with credit risk arising from cash and cash equivalents, Telefónica places its cash surpluses in high quality and highly liquid money-market assets. These placements are regulated by a general framework, revised annually based on the conditions of the market and countries where Telefónica operates. The general framework sets: (i) the maximum amounts to be invested by counterparty based on its rating (long-term debt rating); (ii) the maximum tenor of the investment; and (iii) the instruments in which the surpluses may be invested. For the parent company, which places the bulk of Telefónica surpluses, the maximum placement in 2009 was 180 days and the creditworthiness of the counterparties used, measured by their debt ratings, remained above A- and/or A3 by Standard & Poor's and Moody's, respectively.

These placements are regulated by a general framework, authorization procedures and homogeneous management practices within Telefónica, based on particular conditions and best international practices observed in the telecom sector, and incorporating this commercial credit risk management approach to Telefónica's decision policy both from a strategic and operating (in the ordinary course of business) perspective.

Telefónica also considers managing commercial credit risk as crucial to meeting its business and customer base growth targets in a manner that is consistent with Telefónica's risk management policy.

Therefore, Telefónica's commercial credit risk-management approach is based on continuous monitoring of the risk assumed and the resources necessary to manage its various units, in order to optimize the risk-reward relationship in its operations and the assessment, particularly, those clients that could cause a material impact on Telefónica's financial condition.

Telefónica's maximum exposure to credit risk is initially represented by the carrying amounts of the assets (see Notes 11 and 13) and the guarantees given by Telefónica.

*Note: The notes that are referred to this part are included in the 2009 Financial Report of Telefónica, S.A.*

## Capital management

Telefónica's corporate finance department, which is in charge of Telefónica's capital management, takes into consideration several factors when determining Telefónica's capital structure, with the aim of ensuring sustainability of the business and maximizing the value to shareholders.

Telefónica monitors its cost of capital with a goal of optimizing its capital structure. In order to do this, Telefónica monitors the financial markets and updates to standard industry approaches for calculating weighted average cost of capital, or WACC "weighted average cost of capital". Telefónica also uses a gearing ratio that enables it to obtain and maintain the desired credit rating over the medium term, and with which Telefónica can match its potential cash flow generation and the alternative uses of this cash flow at all times.

These general principles are refined by other considerations and the application of specific variables, such as country risk in the broadest sense, tax efficiency and volatility in cash flow generation, when determining our financial structure.

## Derivatives policy

At December 31, 2009, the nominal value of outstanding derivatives with external counterparties amounted to 131,614 million equivalent, a 7.3% decrease from December 31, 2008 (141,984 million euros equivalent). This figure is inflated by the use in some cases of several levels of derivatives applied to the nominal value of a single underlying liability. For example, a foreign currency loan can be hedged into floating rate, and then each interest rate period can be fixed using a fixed rate hedge, or FRA (forward rate agreement). Even using such techniques to reduce the position, it is still necessary to take extreme care in the use of derivatives to avoid potential problems arising through error or a failure to understand the real position and its associated risks.

Telefónica's derivatives policy emphasizes the following points:

### 1 Derivatives based on a clearly identified underlying.

Acceptable underlyings include profits, revenues and cash flows in either a company's functional currency or another currency. These flows can be contractual (debt and interest payments, settlement of foreign currency payables, etc.), reasonably certain or foreseeable (investment program, future debt issues, commercial paper programs, etc.). The acceptability of an underlying asset in the above cases does not depend on whether it complies with accounting rules requirements for hedge accounting, as is required in the case of certain intra-group transactions, for instance. Parent company investments in subsidiaries with functional currencies other than the euro also qualify as acceptable underlying assets.

Economic hedges, which are hedges with a designated underlying asset and which in certain circumstances offset fluctuations in the underlying asset value, do not always meet the requirements and effectiveness tests laid down by accounting standards for treatment as hedges. The decision to maintain positions that cease to qualify as effective or fail to meet other requirements will depend on the marginal impact on the income statement and how far this might compromise the goal of a stable income statement. In any event, the variations are recognized in the income statement.

### 2 Matching of the underlying to one side of the derivative.

This matching basically applies to foreign currency debt and derivatives hedging foreign currency payments by Telefónica's subsidiaries. The aim is to eliminate the risk arising from changes in foreign currency interest rates. Nonetheless, even when the aim is to achieve perfect hedging for all cash flows, the lack of liquidity in certain markets, especially in Latin American currencies, has meant that historically there have been mismatches between the terms of the hedges and those of the debts they are meant to hedge. Telefónica intends to reduce these mismatches, provided that doing so does not involve disproportionate costs. In this regard, if adjustment does prove too costly, the financial timing of the underlying asset in foreign currency will be modified in order to minimize interest rate risk in foreign currency.

In certain cases, the timing of the underlying as defined for derivative purposes may not be exactly the same as the timing of the contractual underlying.

*Note: The notes that are referred to this part are included in the 2009 Financial Report of Telefónica, S.A.*

### **3 Matching the company contracting the derivative and the company that owns the underlying.**

Generally, the aim is to ensure that the hedging derivative and the hedged asset or liability belong to the same company. Sometimes, however, the holding companies (Telefónica, S.A. and Telefónica Internacional, S.A.) have arranged hedges on behalf of a subsidiary that owns the underlying asset. The main reasons for separating the hedge and the underlying asset were possible differences in the legal validity of local and international hedges (as a result of unforeseen legal changes) and the different credit ratings of the counterparties (whether Telefónica group companies or the banks).

### **4 Ability to measure the derivative's fair value using the valuation systems available to us.**

Telefónica uses a number of tools to measure and manage risks in derivatives and debt. The main ones are Kondor+, licensed by Reuters, which is widely used by financial institutions, and MBRM specialist financial calculator libraries.

### **5 Sale of options only when there is an underlying exposure.**

Telefónica considers the sale of options when: i) there is an underlying exposure (on the consolidated statement of financial position or associated with a highly probable cash outflow) that would offset the potential loss for the year if the counterparty exercised the option, or ii) the option is part of a structure in which another derivative offsets any loss. The sale of options is also permitted in option structures where, at the moment they are taken out, the net premium is either positive or zero.

For instance, it would be possible to sell short-term options on interest rate swaps that entitle the counterparty to receive a certain fixed interest rate, below the level prevailing at the time the option was sold. This would mean that if rates fell and the counterparty exercised its option, we would swap part of our debt from floating rate to a lower fixed rate, having received a premium.

### **6 Hedge accounting.**

The main risks that may qualify for hedge accounting are as follows:

- Variations in market interest rates (either money-market rates, credit spreads or both) that affect the value of the underlying asset or the measurement of the cash flows;
- Variations in exchange rates that change the value of the underlying asset in the company's functional currency and affect the measurement of the cash flow in the functional currency;

- Variations in the volatility of any financial variable, asset or liability that affect either the valuation or the measurement of cash flows on debt or investments with embedded options, whether or not these options are separable; and
- Variations in the valuation of any financial asset, particularly shares of companies included in the portfolio of "Available-for-sale financial assets".

Regarding the underlying:

- Hedges can cover all or part of the value of the underlying;
- The risk to be hedged can be for the whole period of the transaction or for only part of the period; and
- The underlying may be a highly probable future transaction, or a contractual underlying (loan, foreign currency payment, investment, financial asset, etc.) or a combination of both that defines an underlying with a longer term.

This may on occasion mean that the hedging instruments have longer terms than the related contractual underlying. This happens when we enter into long-term swaps, caps or collars to protect ourselves against interest rate rises that may raise the financial expense of our promissory notes, commercial paper and some floating rate loans which mature earlier than their hedges. These floating rate financing programs are highly likely to be renewed and Telefónica commits to this by defining the underlying asset in a more general way as a floating rate financing program whose term coincides with the maturity of the hedge.

Hedges can be of three types:

- Fair value hedges.
- Cash flow hedges. Such hedges can be set at any value of the risk to be hedged (interest rates, exchange rates, etc.) or for a defined range (interest rates between 2% and 4%, above 4%, etc.). In this last case, the hedging instrument used is options and only the intrinsic value of the option is recognized as an effective hedge. Changes in the time value of options are recognized in the income statement. To prevent excessive swings in the income statement from changes in time value, the hedging ratio (amount of options for hedging relative to the amount of options not treated as hedges) is assigned dynamically, as permitted by the standard.

*Note: The notes that are referred to this part are included in the 2009 Financial Report of Telefónica, S.A.*

- Hedges of net investment in consolidated foreign subsidiaries. Generally such hedges are arranged by the parent company and the other Telefónica's holding companies. Wherever possible, these hedges are implemented through real debt in foreign currency. Often, however, this is not always possible as many Latin American currencies are non-convertible, making it impossible for non-resident companies to issue local currency debt. It may also be that the debt market in the currency concerned is too thin to accommodate the required hedge (for example, the Czech crown and pounds sterling), or that an acquisition is made in cash with no need for market finance. In these circumstances derivatives, either forwards or cross-currency swaps are used to hedge the net investment.

Hedges can comprise a combination of different derivatives.

Management of accounting hedges is not static, and the hedging relationship may change before maturity. Hedging relationships may change to allow appropriate management that serves our stated principles of stabilizing cash flows, stabilizing net financial income/expense and protecting our share capital. The designation of hedges may therefore be cancelled, before maturity, because of a

change in the underlying, a change in perceived risk on the underlying or a change in market view. Derivatives included in these hedges may be reassigned to new hedges where they meet the effectiveness test and the new hedge is well documented. To gauge the efficiency of transactions defined as accounting hedges, we analyze the extent to which the changes in the fair value or in the cash flows attributable to the hedged item would offset the changes in fair value or cash flows attributable to the hedged risk using a linear regression model.

The main guiding principles for risk management are laid down by Telefónica's Finance Department and implemented by company chief financial officer (who is responsible for balancing the interests of each company and those of Telefónica as a whole). The Corporate Finance Department may allow exceptions to this policy where these can be justified, normally when the market is too thin for the volume of transactions required or on clearly limited and small risks. New companies joining us as a result of mergers or acquisitions may also need time to adapt.

The breakdown of the financial results recognized in 2009, 2008 and 2007 is as follows:

	2009	2008	2007
Millions of euros			
Interest income	528	589	524
Dividends received	45	67	72
Other financial income	151	217	107
Interest expenses	(3,036)	(3,333)	(3,175)
Ineffective portion of cash flow hedges	(17)	(71)	(43)
Accretion of provisions and other liabilities	(254)	(453)	(200)
Changes in fair value of financial assets at fair value through profit or loss	124	341	25
Changes in fair value of financial liabilities at fair value through profit or loss	(132)	(115)	(4)
Transfer from equity to profit and loss from cash flow hedges	77	(50)	(17)
Transfer from equity to profit and loss from available-for-sale assets	4	(2)	(107)
(Gain)/loss on fair value hedges	(427)	912	75
Loss/(gain) on adjustment to items hedged by fair value hedges	439	(883)	(102)
Other expense	(269)	(40)	(6)
<b>Net finance costs excluding foreign exchange differences</b>	<b>(2,767)</b>	<b>(2,821)</b>	<b>(2,851)</b>

Note: The notes that are referred to this part are included in the 2009 Financial Report of Telefónica, S.A.

The breakdown of Telefónica's derivatives at December 31, 2009, their fair value at year-end and the expected maturity schedule is as set forth in the table below:

Derivatives	Fair value: at 12/31/09**	Maturity (notional amount)*				Total
		2010	2011	2012	Subsequent	
Millions of euros						
Interest rate hedges	(282)	3,044	(103)	163	(2,520)	584
Cash flow hedges	147	1,769	1,143	659	3,024	6,595
Fair value hedges	(429)	1,275	(1,246)	(496)	(5,544)	(6,011)
Exchange rate hedges	1,055	1,792	788	112	4,900	7,592
Cash flow hedges	1,055	1,797	788	112	4,900	7,597
Fair value hedges	-	(5)	-	-	-	(5)
Interest and exchange rate hedges	157	14	(419)	(314)	(281)	(1,000)
Cash flow hedges	152	51	(426)	(171)	(360)	(906)
Fair value hedges	5	(37)	7	(143)	79	(94)
Hedge of net investment in foreign operations	(276)	(2,555)	(958)	(113)	(868)	(4,494)
Derivatives not designated as hedges	(612)	6,110	341	388	(744)	6,095
Interest rate	(299)	5,532	413	483	(1,770)	4,658
Exchange rate	(270)	738	(9)	(28)	1,026	1,727
Interest and exchange rate	(43)	(160)	(63)	(67)	-	(290)

\* For interest rate hedges, the positive amount is in terms of fixed "payment."

\*\* For exchange rate hedges, a positive amount means payment in functional vs. foreign currency.

Positive amounts indicate payables.

The Company also has debt assigned to the investment of 944 million dollars, 2,643 million pound sterling and 302 million Czech crowns (data in equivalent euros).

The breakdown of Telefónica's derivatives at December 31, 2008, their fair value at year-end and the expected maturity schedule is as set forth in the table below:

Derivatives	Fair value: at 12/31/08**	Maturity (notional amount)*				Total
		2009	2010	2011	Subsequent	
Millions of euros						
Interest rate hedges	(612)	2,031	1,747	520	72	4,370
Cash flow hedges	183	2,028	493	1,749	3,505	7,775
Fair value hedges	(795)	3	1,254	(1,229)	(3,433)	(3,405)
Exchange rate hedges	519	985	2,382	793	3,717	7,877
Cash flow hedge	519	985	2,382	793	3,717	7,877
Fair value hedges	0	0	0	0	0	0
Interest and exchange rate hedges	(173)	12	458	18	399	887
Cash flow hedge	(71)	18	232	4	288	542
Fair value hedges	(102)	(6)	226	14	111	345
Hedge of net investment in foreign operations	(546)	(2,830)	(517)	(1,125)	(751)	(5,223)
Derivatives not designated as hedges	(868)	7,328	(627)	(578)	(164)	5,959
Interest rate	(271)	8,587	(303)	(609)	(1,100)	6,575
Exchange rate	(395)	(839)	(137)	96	1,026	146
Interest and exchange rate	(202)	(420)	(187)	(65)	(90)	(762)

\* For interest rate hedges, the positive amount is in terms of fixed "payment."

\*\* For exchange rate hedges, a positive amount means payment in functional vs. foreign currency.

\*\* Positive amounts indicate payables.

A list of derivative products entered into at December 31, 2009 and 2008 is provided in Appendix III.

Note: The notes that are referred to this part are included in the 2009 Financial Report of Telefónica, S.A.

**Telefónica, S.A.**

Annual Report 2009

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

Shareholders may also request copies of this report from the **Shareholders' Office** by using the free phone number 900 111 004 (in Spain) or by sending an e-mail to: [accion.telefonica@telefonica.es](mailto:accion.telefonica@telefonica.es)

Likewise, the mandatory information that must be provided under prevailing legislation is also available to shareholders and the general public.

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