

2011 Review



In 2011 decisive progress was made in Telefónica's transformation process, leaving the Company better placed to meet the challenges and to leverage the opportunities afforded by the growth of the digital world beyond communication needs, evolving towards a smart, hyper-connected world.

The new digital world offers a unique opportunity to consolidate Telefónica's leadership and to enhance its relationships with its customers. To take full advantage of these opportunities, Telefónica has undertaken a wide-ranging transformation of the Company's organisational structure, creating two common units (Telefónica Digital and Telefónica Global Resources) in order to leverage the efficiency and opportunities offered by its global scale and two business units for the two major regions in which we operate (Europe and Latin America).

To attain these goals, Telefónica has rolled out the Bravo!+ programme, which is based on five behaviours: +customer, +digital, +global, +agile and +leader.

The Bravo!+ Programme

strategic renewal driver

In 2010, Telefónica undertook the transformation process in the digital world and customer service.

In March 2010, Telefónica launched the bravo! programme to implement the Telefónica vision. The programme was divided into four transformative pillars, each of which contained various initiatives to bring about change. In 2011, an exercise in strategic renewal conducted by Telefónica, drawing on a long-term vision of the dynamics of the business, resulted in an updated vision as well as new action plans and implementation processes. The new program is named bravo!+.

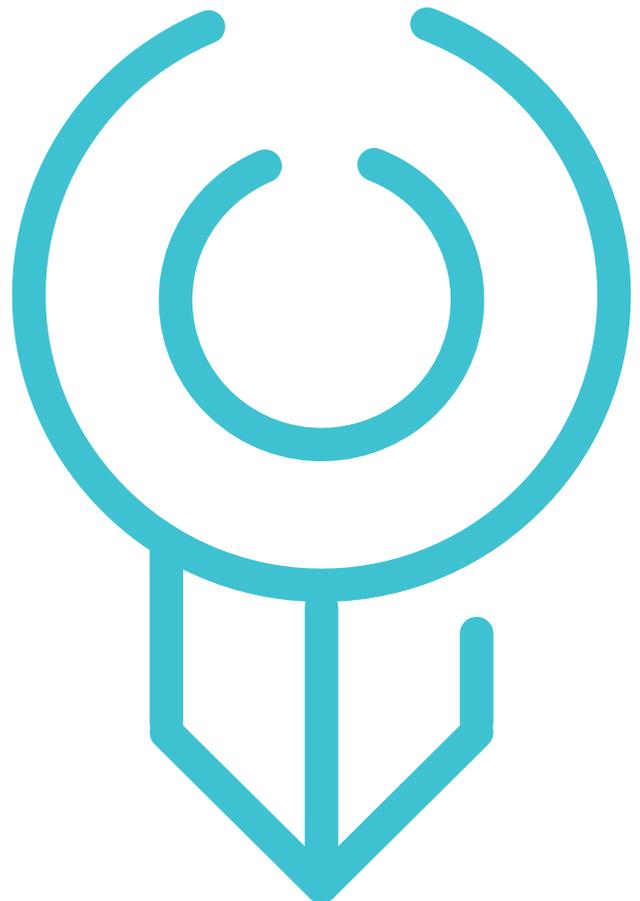
Telefónica's strategic transformation process

This process, underpinned by a profound strategy debate on trends within the sector and by Telefónica's distinctive capacities, was initiated in early 2011 and continued through the summer. During this period, the dynamics of the new environment in terms of demand for connectivity, business models, network solutions, the evolution of value chains and the personalisation of services were evaluated. Plenary sessions, online debates and workgroup sessions were held, resulting in:

- ↳ **A long-term vision**—"Telefónica 2020"—through which Telefónica makes clear its aspiration to strengthen its customer relations and to lead the distribution and aggregation of digital experiences. Its success hinges upon driving the digital ecosystem forward and instilling enthusiasm among customers through a comprehensive product offering.
- ↳ **A new organisation** in two regional areas and two cross-departmental areas, with their respective strategic objectives:
 - ↳ **Regional areas: Telefónica Europe and Telefónica Latin America**, with the mission of coming even closer to customers and making Telefónica the best services distributor in the digital world within our geographic areas.
 - ↳ **Cross-departmental areas: Telefónica Digital**, which focuses on bolstering Telefónica's position in the digital world, seizing growth opportunities in the expanded sector and on promoting innovation and strengthening the lineup of products and services. And **Global Resources**, which has taken up the challenge of leading the Company to a much more global level. To this end, it will increase the benefits obtained from its global scale with better global tools and decision-making processes while simplifying processes to increase operational flexibility and responsiveness.

This organisation also affects the Corporative Global Unit, transforming it into a more agile and lightweight one, with the aim to manage common critical areas and provide with unique services to businesses.

- ↳ **A transformative agenda** that begins with the key aspects that were debated on in seven workgroups and which resulted in the seven framework strategic initiatives: Customer-centric, Products and Services, Prices, Internet Model, Networking, Efficiency, and Capacities. Follow-up is carried out in a structured manner, and the strategy is regularly updated.



A new Bravo+ programme

Being the leader means being the trend-setter, staying one step ahead of the competition in the digital world—and that is what Telefónica has set out to do. The sixth executive summit, in late October 2011, established the guidelines and marked the start of a period of transformation. The bravo! programme was renewed and adapted in accordance with the pressing need for transformation, and the programme was renamed bravo!+. Subsequently, the regional management summits of Telefónica Europa and Telefónica Latin America consolidated the Bravo!+ approach in prioritising and managing projects.

The strategic priorities that have been reinforced with the new bravo!+ programme are:

- ↳ **Seizing digital opportunities**
- ↳ **Strengthening the business's profitability and sustainability**
- ↳ **Streamlining decision-making by simplifying processes**

Bravo!+ Programme

The transformation with bravo!+ is deployed around **five new forms of conduct**:

+ *customer*

Towards a knowledge-based company

Target: To offer the best customer experience and turn our knowledge of customers into an advantage for them as well as Telefónica. To this end, we will transform customer information into a new asset that will lead our evolution into a knowledge-based company.

+ *digital*

A growth opportunity

Target: To adopt the most innovative technologies in order to seize future opportunities in our sector. In this manner, we intend to enhance Telefónica's position in the digital world and to make the most of the growth opportunities that arise in the sector, as well as to drive innovation.

+ *global*

The best service to businesses

Target: To provide the best service to our businesses in order to increase profitability by extracting all the value implicit in that scale.

+ *agile*

Prompt response and decision

Target: To take decisions and implement them promptly and in a straightforward and focused manner. This allows for simplicity and clarity in our organisation and decision-making processes, as well as for less bureaucracy, and ensures that we have motivated and committed professionals.

+ *leader*

The inspiration of excellence

Target: to set trends in order to be the best communications company in the world. Our intention is to inspire others to seek excellence in order to achieve improvement: by challenging ourselves and "going a step further", and by transmitting passion and positive energy to others.

+ Customer...

Telefónica reaches 307 million accesses



Telefónica is the world's fifth-largest operator by number of customers as well as the world's largest integrated company. It holds the first-or second-largest market share in most countries where it operates. The Group's strategy is based on capturing growth in our markets and especially on attracting high-value-added customers.



Stores of Telefónica's three commercial brands (Vivo, and Brazil; O2 in Europe, except Spain; Movistar, Spain and Latin America).

The Company ended 2011 with close to 7% growth in accesses amid a complicated setting in terms of the macroeconomic scenario and the negative effects of regulation as well as intense competition. Most of this growth has been seen in the mobile business, in particular in mobile broadband and in the greater penetration of contract accesses. The Group had 38 million mobile broadband customers at 31 December 2011, for a penetration rate of 16% of the Group's total mobile access base. Mobile broadband accesses were 1.6 times higher than at year-end 2010.

The Company's activity soared in the second half of 2011, as a result of commercial repositioning and the changes in the Company's commercial offering in the main countries in which it operates. In the second half of the year, access growth accelerated, for a net gain of close to 13 million accesses (72% higher than in the first half of 2011, and more than twice as high as in the second half of 2010).

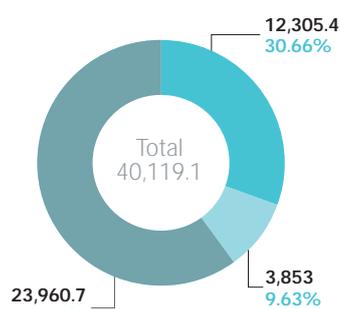
The basis of the Company's success are its customers, and Telefónica's growth strategy for the coming years is centred on improving the customer experience in order to continue increasing the number of accesses and to spearhead growth through:

- ↳ The emphasis on the penetration of smart phones in all markets in order to raise the rate of growth of mobile data by monetising their increasingly widespread use.
- ↳ The defence of the Company's competitive position in the fixed-line business with a focus on broadband, offering increasingly higher speeds, comprehensive packages and IP services for voice and video.
- ↳ The development of the growth opportunities that have arisen in an increasingly digital context: video, OTT, financial services, cloud, e-Health, media, etc.

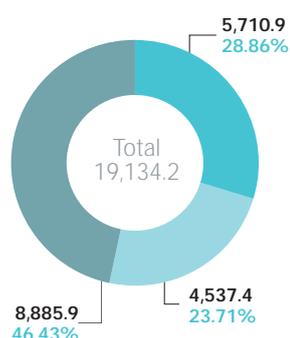
2011

■ Spain
■ Europe
■ Latin America
Thousands

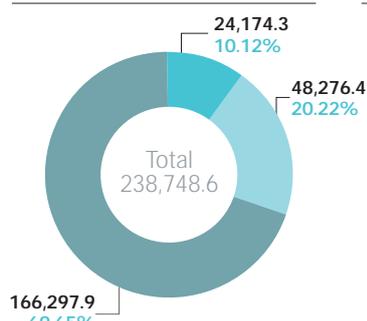
Fixed telephony accesses



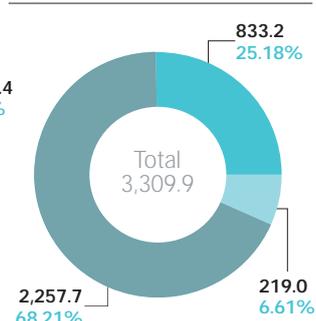
Internet and data accesses



Mobile accesses



Pay TV



Mobile telephony

At year-end 2011, Telefónica had 238.7 million mobile phone customers, with 8.4% year-on-year organic growth. The largest share of this growth took place in Latin America (+11.4%). Overall, mobile phone clients now represent 69.6% of the total.

The Company has focused on attracting high-value-added customers, that is, those in the contract segment. This higher-value segment experienced 11% year-on-year growth, and now represents close to one third of the total mobile access base.

Mobile broadband accesses—e.g., with a data rate attached and therefore made by active users of the service—stood at more than 38 million at year-end 2011 (+61% year-on-year). This represents a penetration rate of 16% of Telefónica's total mobile access base (+5 percentage points from December 2010). Telefónica Europe reached a penetration rate of 31%, followed by Telefónica España (29%). There is enormous potential to increase penetration at Telefónica Latinoamérica (10%).

Data and Internet

The number of data and Internet accesses stood at 19.1 million in 2011, for 2.8% year-on-year growth. Of this total, 18.0 million were broadband-based, for 5% year-on-year growth. The most important growth was in Latin America (+7.9%).

An important element of the trend in the number of data and Internet accesses is the success of bundling voice, broadband and television services, which has gradually increased in both Spain and Latin America. At year-end 2011, close to 90% of the customer base making retail fixed broadband accesses had dual or triple service packages.

Accesses by Country

Figures in millions

Latin America	
Brazil	87.2
Argentina	23.0
Mexico	20.5
Peru	18.8
Colombia	13.8
Chile	12.7
Venezuela	10.4
Central America	8.1
Ecuador	4.5
Uruguay	1.8
Europe	
Germany	24.5
United Kingdom	23.0
Czech Republic	7.8
Ireland	1.6
Eslovaquia	1.2
Spain	
	47.1
Total	306^(*)

(*) 116,000 accesses from Costa Rica are not included as service launching took place at the end of 2011 (November). Terra accesses to Internet are not included in the split for countries.

Pay TV accesses rose by 18.7%, owing largely to the successful commercial repositioning of the service and Latin America

Pay TV

The growth rate of TV accesses rose sharply, to 18.7%. The higher growth rate was due primarily to the successful commercial repositioning in Latin America, where net additions in 2011 were three times higher than in 2010, as well as the inclusion of TVA clients in Brazil in June and the strong commercial performance in Spain in the second half of the year.

Fixed telephony

The fixed-line market continues to show that it has matured, as net accesses for the consolidated total once again dropped. The number of total fixed-line accesses declined at a stable rate throughout the year (-3.0%), with a total decline of 40.1 million in the year.

Of total fixed-line accesses, 60% are in Latin America, one percentage point higher than the total for Telefónica the previous year.

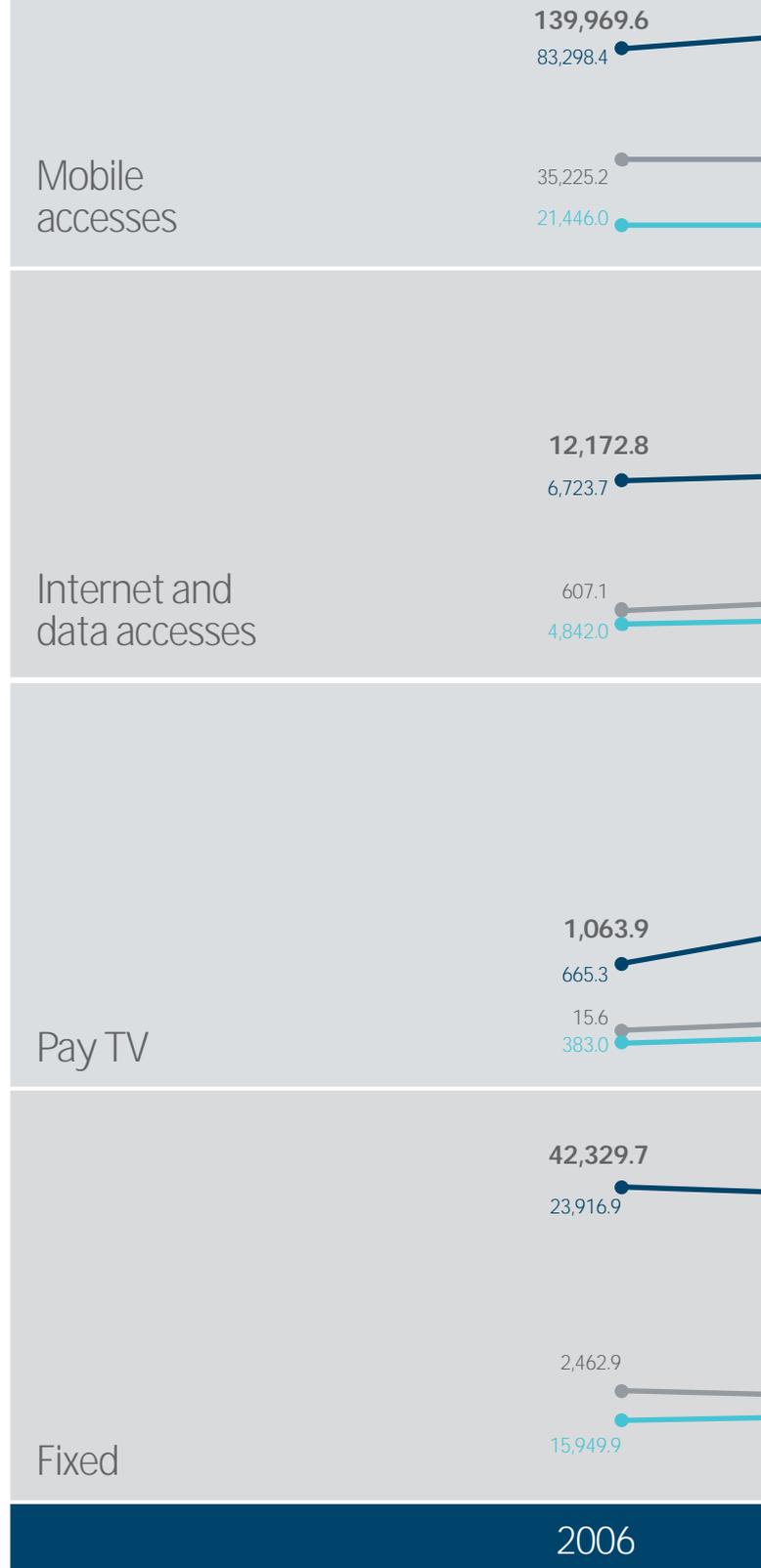
Customer satisfaction

The Telefónica Customer Satisfaction Index (CSI) stood at 7.13 in 2011, and was unchanged from 2010. Telefónica thus ended the year as the market leader in customer satisfaction, with a 0.04 point advantage over our closest competitor.

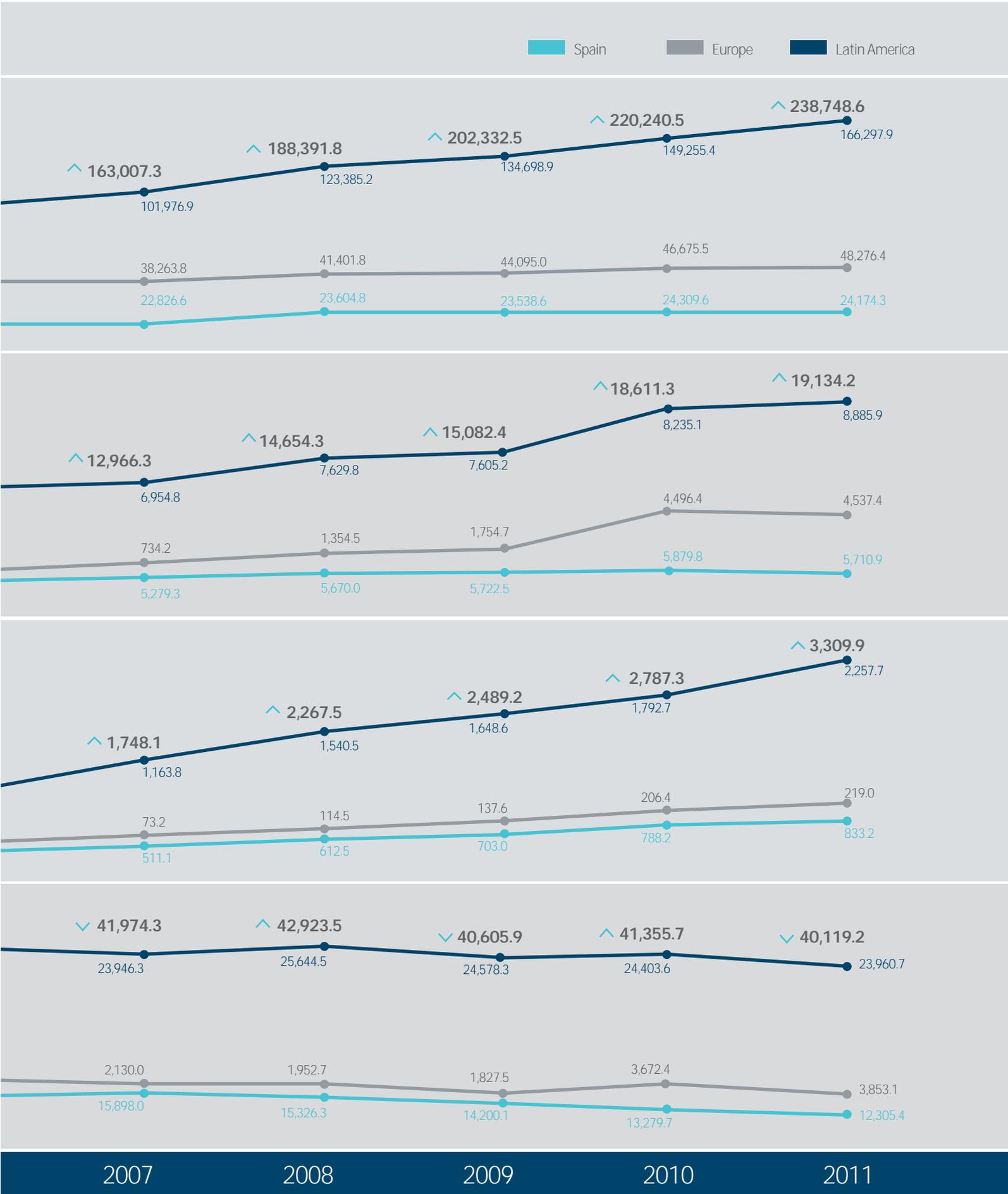
By region, in Spain the Company had a score of 6.4 out of ten; in Europe, 7.3; and in Latin America, 7.6. The businesses whose customer satisfaction levels improved the most in 2011 were corporate services in Brazil, followed by the mobile businesses in El Salvador and Guatemala.

Accesses trend by segment

Thousands of accesses



2006



+ Digital... open innovation



The Company strengthened its open-innovation model in the digital world, and the creation in 2011 of a new business unit, Telefónica Digital and the increase in the investment in R&D&I to reach 5,091 million euros are clear signs of it.



Wayra Academy, Madrid.

The digital world is a very dynamic environment characterised by three major trends: the rising demand for digital services (no matter where they are, people want to be connected); the smartphones are being massmarketed, allowing high-speed data networks to be accessed; and companies in every sector are using digital technology to transform their way of doing business (radically changing the customer experience, operating processes and business models).

This translates into significant opportunities and challenges for our industry. This is why Telefónica continued with its transformation process in 2011, making important strides in taking advantage of the digital world with the creation of Telefónica Digital.

Its mission is to seize the opportunities offered by the new environment and drive Telefónica's growth through innovation and development, venture capital, global alliances and digital services in areas such as cloud computing, mobile advertising, M2M, e-health and financial services.

At Telefónica Digital, we have combined all of the components of the product lifecycle for digital services:

- ↳ **Innovation:** a 1,200 person R&D team in Europe, Israel, Brazil and Silicon Valley that, in addition, knows how to leverage the opportunities in the environment when working with the developer community, and how to invest in digital companies, through seed capital, venture capital or acquisitions.
- ↳ **Development:** a clear emphasis so as to have a global approach, and more flexibility, in order to carry out one-step testing, learning and constructing and significantly improve our speed in the market.
- ↳ **Rollout:** both within and outside of Telefónica's sphere of action, and working with new allies around the world, to extend our product and service distribution to current and future customers.

Our strategy depends on speeding up the pace of growth, adding new capabilities and utilising synergies. We have very valuable assets with which to achieve this—networks, customers, distribution channels—as well as resources and the capacity to do things differently.

Investments in ICT companies

In 2011, Telefónica made equity investments in technology-based companies, giving it access to latest-generation technologies, including, most notably:



Quantenna Communications.

In November 2011, Telefónica

Digital announced that it had signed an agreement with this leading entertainment services company on strategic collaboration through maximum fidelity Wi-Fi networks. Our investment in the firm gives us access to the latest technology in order to offer high performance video services to households.

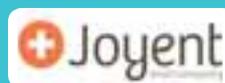


FeedHenry.

In early 2012, Telefónica Digital signed an exclusive collaboration

agreement with this leading developer of solutions for mobile phone applications in the cloud, in order to launch a platform in the United Kingdom that will enable companies of any size to create their own mobile applications and implement them on Android,

iOS, BlackBerry, Windows Phone 7 and Nokia operating systems as well as on the Mobile Web. This agreement follows the successful partnership between FeedHenry and O2 in Ireland.



Joyent.

As part of the strategic collaboration agreement reached in 2012

with this leading cloud technologies and services company, we will make a strategic investment in its share capital. For its part, Joyent will give us access to the latest breakthroughs in technology and software in order to deploy profitable, high performance services in the cloud. Unlike other suppliers in the technology cloud, Joyent developed its line of cloud solutions from scratch, significantly lowering costs. The Company has demonstrated experience in defining, exploiting, commercialising and operating a business in the cloud with more than 12,000 customers in the United States.

Technological innovation

Investment in R&D

The aim of technological innovation at Telefónica is to bring about digital construction so as to harness the opportunities offered by new production tools and technologies in the development of software and creative talent.

In 2011, we increased our investment in this area to €5,090 million (€4,814 million in 2010), of which €983 million will be earmarked for R&D, 23% more than the previous year.

At Telefónica, we consider that differentiation is the key, and that it cannot be based exclusively on acquired technology. For this reason, we encourage R+D activities through our company, Telefónica R&D.

Last year we continued to promote our "open innovation" model—a strategy that allowed us to become a global standard-bearer. Indeed, this was acknowledged by the OECD when it selected Telefónica as one of the three companies invited to participate in an R&D&I seminar on the new economic setting held in Paris in December.

Global innovation with a regional focus

In 2011, one of the reasons for which Telefónica was reorganised was to concentrate most internal R&D for developing new networks in the Global Resources division, and to concentrate R&D for developing products and services in the digital environment in Telefónica Digital.

This dovetails with our strategy of going beyond the operation of networks and providing complete technology services to business customers and individuals to achieve higher added value than that offered by fixed or mobile connectivity alone.

According to this organization model, Telefónica R&D plays a double role in the areas of Product Development & Innovation at Telefónica Digital, and Transversal Projects & Innovation at Telefónica Global Resources. Telefónica R&D is the heir of the research and development investigations that the Company started more than 30 years ago.

In 2011, we earmarked 983 million euros to I+D, 23% more than the previous year

Digital Services



Financial services



eHealth



M2M



Cloud computing



Video and Smart Home



Security



Applications



Advertising

Digital Companies & Alliances

Telefónica Digital's open approach enables us to collaborate with other companies and thus make the most of our assets and create value for our customers, shareholders and partners.

In addition, we are not a new player in the digital world; we now have several digital businesses that are leaders in their fields, as well as a broad spectrum of capabilities, that are part of Telefónica Digital. This includes, in particular: Terra, the leading online media company in Latin America; Media Networks, the largest satellite pay TV television wholesaler in the same region; Tuenti, the leading social network in Spain; and giffgaff, an innovative community-based mobile operator.



Tuenti. Consolidated its position in 2011 as the premier social network in Spain, reaching 12 million registered users. Its most important innovations included developing a mobile telephone service, the first such service of a social nature in the Spanish market with a data-centric approach. In addition, in 2011 it launched new mobile applications (mobile application use grew by 330% that year) and a new video portal that reached 7 million playbacks per day.

terra



Terra. With a more than 20% increase in its audience in 2011, Terra ended the year with over 90 million visitors a month. Also in 2011, it was named one of the most innovative companies in the world by the leading US magazine "Fast Company" and acknowledged for its commitment to innovation in the 2011 User Experience Awards. For its part, Terra Sonora consolidated its leadership in Latin America, with 500,000 subscribers and an audience of six million.

giffgaff

Giffgaff. Was created as a disruptive innovation 2.0 in the mobile market in the United Kingdom, with a business model that places the community at the centre of everything. In 2011, Giffgaff's strong growth continued, and the company received the top scores in the Customer Satisfaction Index and the NPS (Net Promoter Score) loyalty indicator. Its most noteworthy innovations include the site Unlockapedia to help dispel myths and support customers through the telephone-unlocking process; a mobile site; and the new gigabags, a customised product for iPads and tablet PCs.



Open HTML5 devices.

In early 2012, Telefónica Digital and Mozilla announced an ambitious strategy to create a new mobile-telephony platform making it possible to offer the first open devices. The Open Web Devices (OWD) platform, to be launched in 2012, is an important step for making HTML5 the next major smartphone ecosystem, making it possible to offer capabilities typically associated with smartphones at reduced prices.

R+D activities

The R+D activities that were carried out focused on:

- ↳ **Interpersonal communication in the future** in a natural manner, through the utilization of the Internet and smartphones.
- ↳ **Video and multimedia services** (combining text, audio, images and video) offering user experiences on all connected devices.
- ↳ **Advanced solutions in emerging ICT businesses**, such as tele-health, remote surveillance and support platforms for patients or platforms for monitoring.
- ↳ **Management services between machines (M2M)** related to energy efficiency and the mobility of persons.
- ↳ **Cloud computing** that makes intensive use of resources available on the Web in order to publish, market and distribute applications.
- ↳ **Analysis of users' profile** according to their use of communications, providing opportunities for business models and services (marketing campaigns, targeted advertising and personalised contextual services, lower turnover, cross-selling, etc.)
- ↳ **Evolution of the network** and services in a new global infrastructure, common to all of the business lines, in order to reduce operating and maintenance costs, offering more capacity in response to the explosion of mobile data, video content and the evolution from an Internet of People to an Internet of Things.

In Telefónica we are aware of the importance of the innovation as a developer driver. That is the reason why we decided to promote the carrying out of Innovalatino with OECD and INSEAD in order to know the technological innovation trends in Latin America.

Innovation model at Telefónica

Telefónica's innovation model bases itself in the internal activities of Telefónica R&D, in the alliances with third parties and through seed capital, venture capital or acquisitions.

Public programs to promote R&D&I

In 2011, Telefónica headed up several projects related to developing the Internet of the Future organised by the European Commission within the Seventh Framework Programme for Research. These initiatives are being developed through a public-private partnership (PPP) model with partial funding from the European Commission.

Telefónica's most important venture in 2011 was related to its leadership in the FI-WARE project, which involves more than twenty-five partners and is a key element of the Internet of the Future PPP. The initiative entails developing the benchmark architecture, as well as handling the practical implementation, of an open platform for creating, deploying and rendering services.



Agile Customer Driven Innovation Methodology

The Agile culture promotes a new way of working based on regular communication, transparency, respect and trust among the people involved in the development of a project (clients, developers, etc.). It also involves minimising the impact of adapting those projects in light of changing circumstances (market, competitors, and so on).

One of the main breakthroughs in 2011 was the convergence between the Agile culture and Customer Driven Innovation, leading to the Agile CDI (Customer Driven Innovation) methodology. Thanks to our use of customer-centric research methods and immersion practices on a specific topic, users tell us of their perceptions, providing crucial contributions in the different phases of the processes for innovating, conceptualising and developing products and services. The process involves professionals from every discipline (design, research, engineering, product management, marketing, as well as partners and, at times, experts from industry).

Corporate incubator program

Online advertising network

As a result of our innovation model, we released our first spin-off, named Catchoom—an online advertising network that connects marketing agencies with applications developers. This software's visual recognition technology was developed by Telefónica R+D and is sold under a license arrangement.

Ideas for Ferran Adrià's new Bulli

Telefónica and Ferran Adrià have launched the Ideas for Transformation contest, in which MBA students from ten of the world's top business schools will design proposals for the new Bulli starting in 2014, to be known as the eBullifoundation.

The schools chosen for this year's contest, to be held during the 2011-2012 school year, were Harvard (Cambridge - Boston, USA), Columbia (New York, USA), Berkeley's Haas School of Business (Berkeley, USA), the London Business School (London, UK) and ESADE (Spain).

Seed and Venture capital programs

Telefónica Digital has a corporate venture capital programme focused on acquiring non-controlling interests in innovative companies with capabilities (products, services, technology) that allow them to help accelerate revenue generation for our Company in new and adjacent business areas.



Wayra

The Wayra initiative is intended to act as a technology accelerator, supporting newly created companies during their earliest stages or providing them with seed capital. In some cases, this might mean a single individual with a great idea who has not even established a company.

After a selection process, we support entrepreneurs from the beginning, giving them a work space, the opportunity to collaborate with other, like-minded innovators, startup financing, and access to technological know-how and mentoring within Telefónica—at the Wayra Academies—to allow them to develop and perfect their business idea.

In less than ten months, we have implemented Wayra in eight countries—Colombia, Spain, Mexico, Argentina, Peru, Brazil, Chile and Venezuela—and by late 2011 we had received more than 6,000 applications and financed more than 80 start-ups.

Our goal for 2012-2013 is to open new Wayra Academies in the United Kingdom, Germany, Ireland, the Czech Republic and Slovakia.

Amérigo

This network of mutual funds that invest in innovation was launched by Telefónica to accelerate the growth of high-added-value companies. The platforms in question are open and have several coinvestors who share the same objective.

In addition, we have stakes in technology companies offering solutions that are complementary to our activity in areas of interest to us. For example, we made a strategic acquisition of Joyent's share capital in order to promote technology and software breakthroughs to deploy profitable, high performance services in the cloud.

Corporate incubator program

In 2011, Telefónica relaunched the incubation program to develop new business ideas with the market potential that complement our innovation processes. Five initiatives for new "out of the box" developments, which were based on ideas of our employees and may lead to new disruptive services, were selected. Some of these results came out in the Mobile World Congress 2012

Innvierte

Within the framework of this programme, we will collaborate with the Spanish Ministry of Science and Innovation (MICINN) to promote investment in innovation in order to foster the development and consolidation of innovative technology-based companies with high economic-growth potential in Spain's ICT sector.

This agreement comes following the award to Telefónica of the selection process opened by the Centre for Industrial Technological Development (CDTI) to implement the "INNVIERTE" Sustainable Economy programme. The aim of this initiative is, in addition, to take technological development in Spain a step further, raising the country to the highest levels of business competitiveness, innovation and cutting-edge developments, on a par with other European countries or the United States, among other countries.

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Public initiatives to foster I+D+i

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10 Fridays free for inventing

Telefónica I+D has rolled out the 10 Fridays programme, through which our engineers can use up to ten Fridays to develop their own ideas during hours that are not necessarily for conducting their regular work at the Company. The purpose



Campus Party Brazil.

of this initiative is to encourage engineers' creativity and to motivate them by allowing them to work on topics that they put forth in areas of their interest.

The programme makes room for projects in e-health, analysis of psychometric data, game development in HTML5 or projects with fashion and advertising enterprises.

In addition, some ideas that prove successful may receive financing, be turned into prototypes and even become final products.

Campus Party

Movistar has, since Campus Party began fifteen years ago, continued providing support which has contributed to making this Internet gathering a technological reference worldwide and enabling parallel projects - such as Wayra or Bluevia - to become sources of innovation and success for participants' projects.

Campus Party was one of the events chosen to draw up the shortlist of projects. On the one hand, Movistar deployed in Campus Party Valencia the new IPv6 technology at the Campus Party for the first time. This new Internet protocol permits end-to-end connectivity, enabling the development of the "Internet of Things", through which current or future machines and

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numerous devices, such as computers, smartphones, PDAs, cars, refrigerators, washing machines or any other appliance, will offer data and Internet connections.

On the other hand, the Fundación Telefónica presented the EducaParty project. At this event, hundreds of technology teachers, innovators and enthusiasts took part in debates and workshops to analyse the development and benefits of technology in education.

In addition, Telefónica I+D and the Arduino free hardware platform presented Arduino Shield, a product containing a modem that can connect to Internet, the fruit of months of collaboration between the two companies. The users of Campus Party were invited to try it and give their impressions, to help with future versions.

Finally, Ferran Adrià explained his personal vision of creativity and the importance of considering young people as real innovators.

+ Global...

global resources in Telefónica



Taking advantage of the benefits of our scale means to generate efficiency through simplification, standardisation and consolidation, to provide the most competitive platforms and the best team in order to grow and innovate and to accelerate the profitable growth of our international businesses.



Telefónica Leadership Conference, Miami 2012.

In September 2011, Telefónica carried out a thorough restructuring. Among the changes introduced was the creation of the Global Resources operating unit, designed to ensure the profitability and sustainability of the businesses by leveraging and unlocking economies of scale as well as by accelerating Telefónica's transformation into a fully global company.

Global Resources' mission is to provide the best service to Telefónica's businesses and to help them increase their profitability and sustainability, unlocking and taking advantage of the benefits of our scale in a context fraught with important challenges. In fulfilment of this mission, the first step that has been taken is the launch of four flagship projects:

- ↳ **Global standardisation and supplies** in all categories (handsets, mobile communications networks, fixed-network equipment, services platforms, etc.)
- ↳ **Reaching our natural market share** in multinationals (MNCs) by relying on the opportunities afforded by our geographic presence
- ↳ **Global Shared Services Centre**, which allows for increased efficiency in operational-type processes and tasks.
- ↳ **New global Human Resources** operating model.

The six areas that compose Global Resources and that are responsible for carrying out this mission (Operations and Network, IT, Procurement, Global Solutions, Group Services, Human Resources) will help Telefónica's businesses by generating efficiency and economies of scale through simplification, standardisation and consolidation; providing the most competitive platforms and the best team in order to grow and innovate; and accelerating the profitable growth of our international businesses.

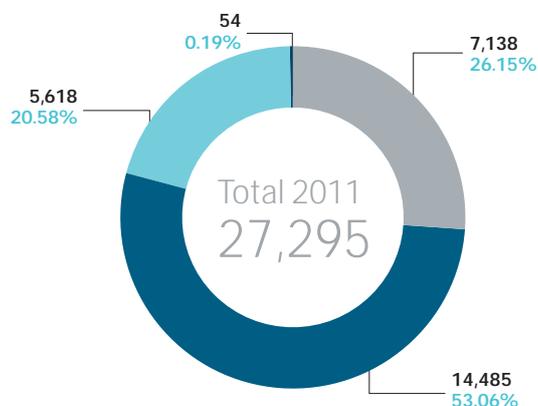
A global network

Having an open, scalable global communications network sets us apart in the value chain by allowing us to complement our digital assets with a unique combination of high-speed connectivity and storage and computing capacities and thus excel in the digital world. Indeed, our network resources, including both physical assets (fibre, equipment, etc.) and intangible ones (the radioelectric spectrum, telephone numbering range, etc.) are a key to ensuring the control and end-to-end quality of our services.

In this sense, Telefónica has invested 31 billion euros in Radio-electric spectrum and networks during the last 4 years.

Purchases awarded by region

In thousands



	2010	2011	%chg
Spain	7,738	7,138	-7.7%
Latin America	13,363	14,485	8.4%
Europe	5,724	5,618	-1.9%
Other	141	54	-61.9%
Total Telefónica	26,966	27,295	1.2%

Our IP network spans more than 5 million kilometers of fiber optics, with a transfer capacity of more than 2 Tbps and connecting more than 1000.000 servers.

The main global initiatives of the Operations and Network area are:

- ↳ **Rationalisation of NGA rollouts** (FTTx, LTE, etc.) in order to optimise from end to end, starting at design and through rollout and operation.
- ↳ **Simplification and standardisation** of requirements and technologies in order to become more efficient. By way of example, the global RAN (Radio Access Network) initiative, the evolution of the transmission network, or network intelligence stand out.
- ↳ **In the sphere of operations**, the drive to automate processes and systems is noteworthy. One of the relevant initiatives in this regard is Global NOCs (Network Operation Centres).
- ↳ **Review of the ownership model** of certain assets, most notably actions relating to network sharing and the evaluation of the sale of non-strategic mobile telephony sites.

IT

The main challenges faced by the IT global area are the complexity of the processes of a company of Telefónica's size, in addition to the development, rollout and operation of new products and services and the integration of these services into both legacy and new systems.

For this reason, and given our flexible and global approach centred on a fast return on investment, the three IT initiatives underway are:

- ↳ **Facilitating the growth of the businesses** by accelerating the rollout of new services, the use of open platforms, online capacities and Business Intelligence.
- ↳ **Generating efficiencies of scale** through an intelligent supply strategy, infrastructure optimisation, digital global workstation, etc.
- ↳ **Transforming capacities and skills:** investing in differentiating areas for the (digital) future, strengthening alliances and relations with our partners, etc.

Procurement

The main new features implemented by the new global Procurement unit to unlock the greatest value from the Company's size have to do with simplifying specifications with a global approach (standardisation and alignment), including the specifications of our allies (e.g., China Unicom or Telecom Italia); alignment, in terms of timing and processes, in global procurement; and establishing a cross-department procurement team that will ensure the involvement of all units that are relevant for the procurement process (GCTO, GCIO, T-Digital, business units and global and regional management-control areas).

So as to bring about the greatest possible efficiencies from the outset, the following steps were taken in 2011:

- ↳ **Identifying the 150 main negotiations**, which account for approximately 50% of the value of the Company's global purchases, in order to implement key improvements beyond the procurement process—for example, standardisation, aggregation, consideration of new suppliers, streamlining certifications, etc.).
- ↳ **Global purchases of handsets and devices:** A joint task force involving Telefónica Digital (Global Devices) and Global Purchases has been formed, to design, validate and subsequently purchase a global handset catalogue for the entire Company.
- ↳ **Regarding the remaining negotiations**, work is underway to improve the "purchases desk" and to raise efficiency by reducing reduce the number of needed processes.

Total amount of purchase splits in 49% in Latin America and 51% in Europe, in a similar proportion than revenues in each region. It is worth highlighting that close to two thirds of the purchases were devoted to the core business: network + IT + mobile.

Telefónica has invested 31,000 million euros in the radioelectric spectrum and networks in the last four years



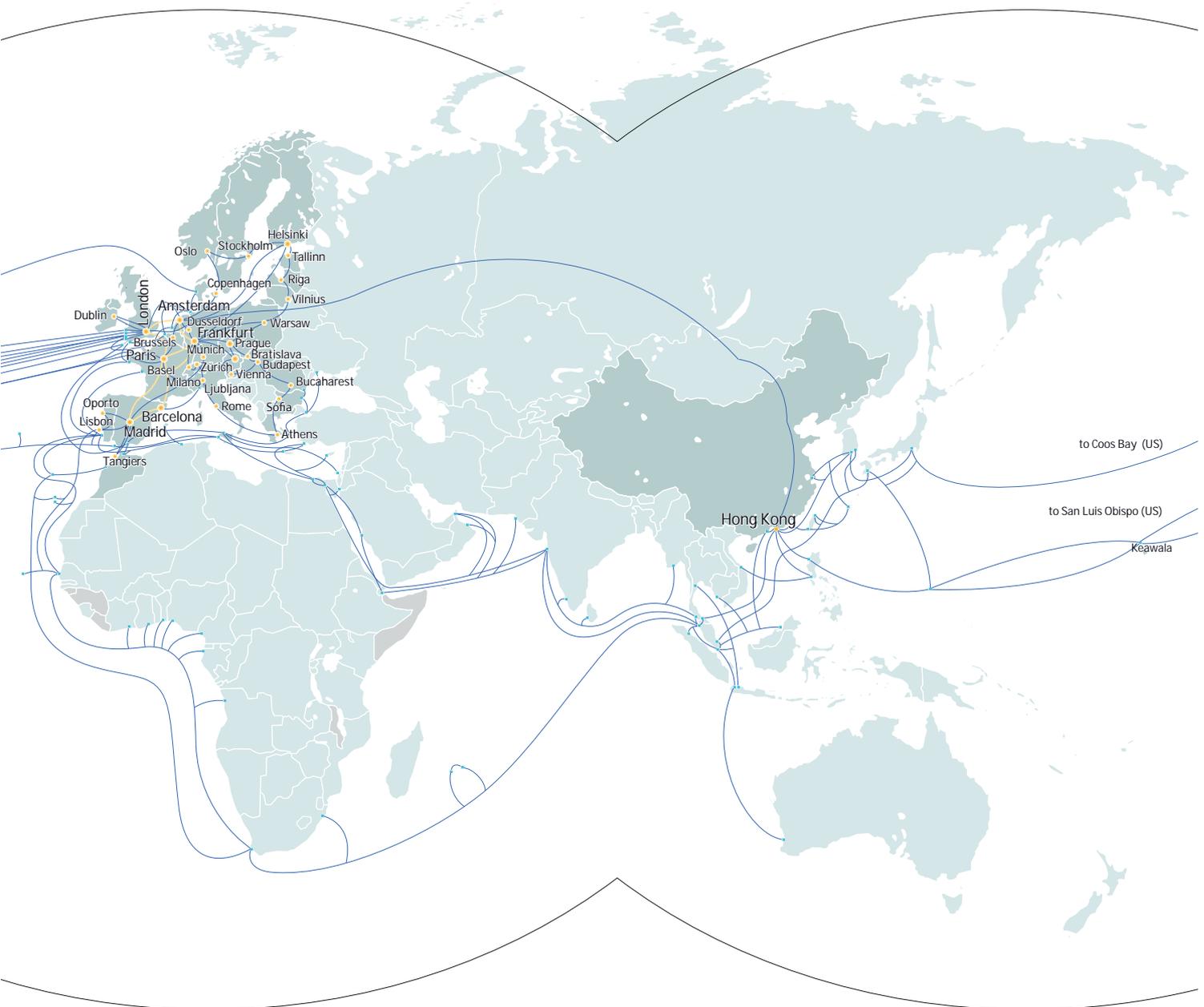
Dr. Yan Bo, GM - Global Business Department and Juan Carlos López-Vives, Chairman of Telefónica Global Solutions.

Global Solutions

The Global Solutions area comprises Telefónica's multinational clients (MNCs) business, the international wholesale business (voice, data and IP capacity) through TIWS (Telefónica International Wholesale Services) and the roaming business through TGR (Telefónica Global Roaming). Its primary objective is to consolidate the global scale of our international services and reach our natural share of this market. Some significant data are:

- ⇒ **45,000 km of fiber optic network**, connecting the main cities in Latin America, USA and Europe.
- ⇒ **More than 100 PoPs** in more than 40 countries
- ⇒ **More than 20 billion minutes** of international voice.

In addition, it seeks to continue consolidating the current model, including the globalisation of wholesale services and international services. The short-term initiatives carried out to meet this challenge are:



- ↳ **Strengthening and optimising** our sales network in Europe and the United States
- ↳ **Extending our perimeter** to the Asia-Pacific (APAC) region with an approach based on investing only in essential assets ("asset-light approach")
- ↳ **Giving an impetus** to our products and services catalogue, by standardising and unifying our core services—for example, Managed WAN
- ↳ **Strengthening customer service** in Europe and the United States.

Telefónica, through its Telefónica International Wholesale Services subsidiary, and China Unicom have signed a strategic agreement to extend and bolster their global presence by sharing their use of points of presence (PoPs) in their international networks.

Group Services

This unit incorporates the customer services business (Atento) and the management services offered (T-Gestiona). This area faces challenges relating to the search for consistency and control in support processes, cost reduction and efficiency, and efforts to leverage the use of new technologies (social networks, online capacities, multichannel approach, etc.). The unit's primary objective is to move forward in establishing an authentic Global Shared Services Centre. Its key initiatives can be classified into two groups:

- ↳ **Activities related to Finance, Administration and Human Resources:** concentrating transactional and back-office activities, standardising and simplifying processes, implementing a global reporting system, and so on.
- ↳ **Sales and customer service**—aligning contact centre operations with the priorities of the business lines.

+ Agile...

a new, simpler and more effective model



Following Telefónica's structural changes, the role of the Human Resources Department has become, if possible, even more crucial. Consequently, the main step that has been taken is the launch of a new global HR operating model, to increase the positive impact on the businesses of the Company's recent restructuring.



Summit for Telefónica Executives, Madrid 2011.

The global HR unit is the catalyst of the Company's operating and cultural transformation and is responsible for ensuring that it becomes more responsive. The main units that will support efforts to meet this challenge are the Global Excellence Centres and the Global Shared Services Centres (which are intricately linked to the initiatives of Group Services).

The Global Excellence Centres allow us to manage people in a more efficient manner that is conducive to our becoming a more global company.

The centres of excellence (Talent, Compensation and International Mobility, Universitas and Organisation) that we have launched require specific expertise and define global policies and tools based on best practices, while avoiding duplication.

The Global Shared Services Centres, on the other hand, aim to take advantage of our scale and increase efficiency. They take on the more transactional activities and/or those that can be consolidated.

Employees

The Telefónica Group, including the Atento Group, had 291,105 employees at year-end 2011, 2.1% more than the previous year. Excluding the Atento Group, Telefónica's staff numbered more than 134,000 in 25 countries, 1% above the figure for 2010. This growth is all the more noteworthy when viewed against the backdrop of the challenging economic environment and sweeping changes in the telecommunications market.

An examination of employee breakdown by region reveals that Latin America continues to account for the bulk of the Telefónica Group's headcount—71%. This region is followed by Spain (19%) and the rest of Europe (9%). The remaining 1% is distributed across a number of countries not included within the defined core regions.

Ninety-six per cent of Telefónica's workforce, excluding Atento, have permanent employment contracts. When Atento is included, this figure falls to 81%.

The Telefónica Group increase the size of its workforce by 2.1% in 2011, to 291,027 employees

At year-end 2011, 37% of Telefónica's workforce was female (excluding Atento); the figure rises to 54% when Atento is factored in. In 2011, Telefónica increased the percentage of women in management positions to 19.1%.

Social dialogue and collective bargaining agreements

At Telefónica, all efforts related to social dialogue and to our employees' rights of association, participation and collective bargaining are based on our Corporate Guidelines, on the Social Protocol on International Agreements and on the related Code of Conduct in effect between the Union Network International (UNI) and the Company.

In 2011, 77,736 Telefónica employees—or 27% of the total workforce—voted in union elections. In addition, 207,126 of the Company's employees, or 71% of the total, were covered by collective bargaining agreements.

Telefónica de España completed the negotiation of its collective bargaining agreement covering 2011-2013 and of the

Restructuring Plan (ERE), which sets a limit on the number of redundancies to no more than 6,500. The agreement reached with worker representatives allows employees to voluntarily sign up for the redundancy packages set forth in the Restructuring Plan. Under the agreement, redundancies must be voluntary, universal and non-discriminatory.

It should be mentioned that the Redundancy Plan secured a high level of acceptance, and a total of 2,359 employees had opted for the scheme by the end of the year, of which 1,925 left in 2011.

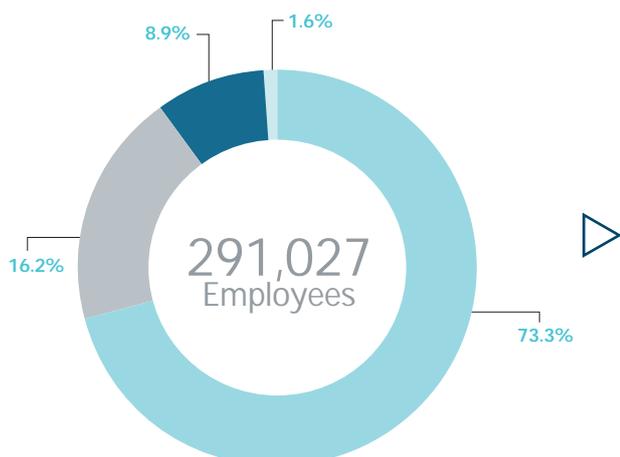
Also in 2011, the collective bargaining agreement of Telefónica Soluciones in effect for 2011 was signed, as well.

Union elections also took place at Telefónica de España to choose worker representatives. In the March 2011 elections to appoint the members of the company's provincial worker committees, 81.64% of employees participated. No incidents were recorded and all rights were duly guaranteed.

Employees per region

Workforce at 31 December 2012

■ Telefónica España ■ Telefónica Latin America ■ Telefónica Europe ■ Others



	2009	2010	2011	% chg
Spain	52,060	54,879	47,186	-14.0%
Latin America	175,350	201,074	213,215	6.0%
Europe	27,964	27,171	26,014	-4.3%
Other	2,052	1,982	4,612	131.5%
Telefónica Total	257,426	285,106	291,027	2.1%

The work climate index improved by two percentage points in 2011

Workplace Satisfaction and Motivation Index	Percentage		
	2009	2010	2011
Performance by region			
Spain	60%	63%	65%
Latin America	83%	84%	83%
Europe	76%	75%	76%
TSA and Subsidiaries	67%	66%	71%
Overall Telefónica	73%	74%	76%

Work climate

The employee workplace satisfaction and motivation index rose to 76% in 2011 from 74% in 2010.

The results of this survey, which does not include Atento, improved once again, yielding a score of 76% in 2011, two points above the result for 2010 and two points better than the target set for 2011, which was to maintain the 74% achieved in 2010.

By regions, the index for Spain stood at 65% (2 p.p. over 2010); for Latin America, 83% (-1 p.p. from 2010); for Europe, 76% (1 p.p. over 2009). The level of participation was still quite low. In 2011, 75% of the workforce took part (+0.5 p.p. from 2010), that is, over 108,000 employees in 24 countries.

In addition, in 2011 the Great Place to Work Institute named Telefónica as one of the world's 25 best companies to work at. Specifically, Telefónica ranked 17 among 350 shortlisted multinationals from 45 countries. Atento, a Telefónica subsidiary, has also ranked among the top 25 best places to work, coming in twenty-fourth. Telefónica is the only telecommunications operator appearing on the global ranking, and Telefónica and Atento are the only Spanish companies included. Moreover, 30 Telefónica companies in the world (including Atento) were listed on Great Place To Work's regional and/or local rankings, and fifteen of them were in the top five spots on those lists.

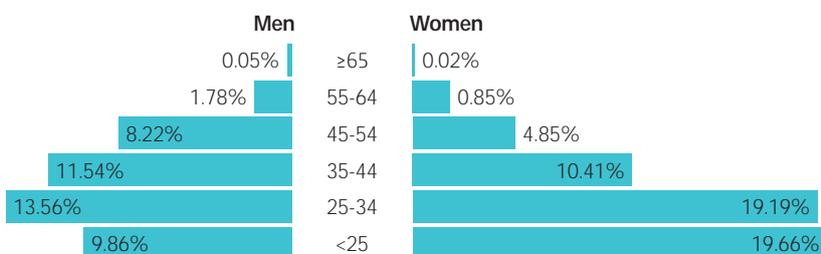


Universitas Telefónica.

Telefónica invested 67.4 million euros in training, 14% more than the year before

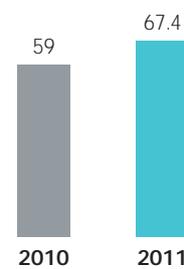
Employee permit, by gender and age

Percentage



Investment in training

Millions



High performance integrated processes

On the talent front, one of the major milestones of 2011 was the design of a new Global Performance and Talent Management Model which will be rolled out in all Telefónica companies in the course of 2012. The key aspects of this new model are based in individual targets and the Bravo!+ new forms of conduct: +Customer, +Global, +Digital, +Agile, +Leader.

Talent mobility

Telefónica prioritises talent mobility based on its view that it represents a key factor in personal and organisational development by fostering the exchange of know-how and best practices among the various companies. This was the reason for the launch in 2008 of the Global International Placement Management Model.

According to the kind of international movements, 44.06% of them were long term (more than one year), 43.75% were short term (not more than 6 months) and the remaining 12.19% were medium term (between 6 to 12 months).

Of the new assignments arranged in 2011, 35.26% were taken up by women and 64.74% by men, a decline with respect to participation in 2010 (41% women; 59% men) and more in line with the 2009 figures (35%/65%).

Development and training

In 2011, Telefónica invested €67.4 million in employee training (including at Atento), an increase of more than 13% over 2010. Also in 2011, employees received over 18 million hours of training, for an average of 62 hours per employee (including those at Atento). This marks a 38% increase over the number of hours of training provided in 2010, significantly outstripping the growth in investment, largely due to the ongoing boost to e-learning initiatives in 2011, which enabled Telefónica to manage the resources it devotes to training efforts in an increasingly effective manner.

With **Universitas Telefónica**—in the words of César Alierta, “the most important tool at our disposal for meeting the challenge of globalisation and winning in the digital world”—crucial steps are being taken to train and develop the Company’s employees. In 2011, the new Universitas team devised its vision and strategic focus for the coming years. Universitas’ strategic focus was redesigned so as to emphasise excellence, present relevant content for Telefónica and encourage networking among and the diversity of its participants. In addition, 43 versions of 14 different programmes have been introduced and have been attended by 2,674 professionals (106% more than in 2010). The average overall score given by participants at Universitas Telefónica was 9.0 out of 10 (one one-tenth higher than in 2010). Finally, we have continued to focus on e-learning as a global training tool for the launch of a new version of the platform intended to promote “social learning” and the implementation of model schools (English, finance and TIC) that have achieved excellent results and received high marks from their attendees.

+ Leader... worldwide scale of Telefónica is reinforced



Leader in... shareholder remuneration. Telefónica stands in seventh position in the sector Telco worldwide in terms of market capitalisation, and allocated more than 7.2 billion euros to remunerate shareholders



Distrito Telefónica.

In 2011, the Company earmarked €7.24 billion in shareholder remuneration overall, equivalent to 78% of free cash flow during the year and 9% of its market capitalisation. The shareholder remuneration was carried out through a cash dividend payment (€6.852 billion) and a share buyback (€386 million).

Whereas at 31 December 2011 Telefónica held 84.2 million treasury shares, representing 1.8% of its share capital, in 2012 it held 90.2 million treasury shares, equivalent to 1.975% of share capital.

2011 dividend payment: €1.60 per share

On 7 November 2011, Telefónica paid a dividend charged to unrestricted reserves for a fixed gross amount of €0.77 per outstanding share carrying dividend rights.

The remaining amount (€0.83 per share) will be distributed on 18 May 2012, through a combination of a cash payment (€0.53 per share) and a scrip dividend.

Shareholder remuneration policy

Although In December 2011, Telefónica's Board of Directors approved a revision of the shareholder remuneration targets announced in October 2009, the economic and operating environment on which these targets were based has changed significantly.

In the current climate, and given Telefónica's share valuation, the Company decided to "move up the flexible shareholder remuneration scheme initially set for 2013, while maintaining an attractive remuneration for its shareholders compatible with the strategy of sustained investments in the business -including spectrum

At year-end 2011, the value of Telefónica's share capital, subscribed and fully paid up, stood at €4,563,996,485

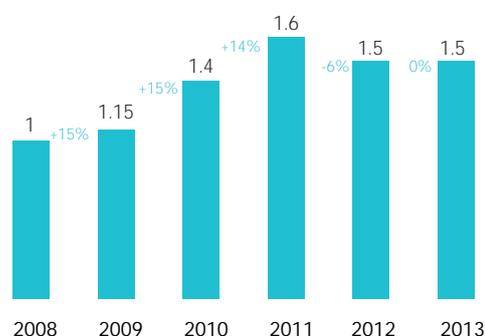
acquisition- to capture growth opportunities in our markets and enhance the Company's financial flexibility".

Total shareholder remuneration for 2012 will amount to €1.50 per share, including the payment of a cash dividend of €1.30 per share and a share buyback for the remaining amount. The repurchased shares will be cancelled. The term for carrying out the buyback will end in May 2013.

The minimum total per-share remuneration established for 2013 is similar to that of 2012 (€1.50 per share). The type of remuneration (dividend, share buyback or a combination of the two) will be decided based on prevailing market conditions and investor preference when the remuneration is paid.

Dividend-per-share performance

In euros



Relevant figures

Numbers of shareholders. Telefónica had 1,468,677 shareholders at 3 April 2011, according to the individual records issued to natural and legal persons, as well as from Sociedad de Gestión de los Sistemas de Registro, Compensación y Liquidación de Valores (Iberclear).

Stock markets. Telefónica trades on the Spanish continuous market (specifically, on the selective Ibex-35 index) and on Spain's four stock markets (Madrid, Barcelona, Bilbao and Valencia), as well as on the London, Tokyo, New York, Buenos Aires, São Paulo and Lima markets.

Share capital. At year-end 2011, the value of Telefónica's share capital, subscribed and fully paid up, stood at €4,563,996,485, and was divided into 4,563,996,485 ordinary shares, all of the same series and class, having a par value of one euro each, and represented by book entries.

Significant shareholdings. According to information available from the Company, no natural or legal person exercises, or may exercise, directly or indirectly, either alone or in conjunction with another party, control over Telefónica.

Thus, at 31 December 2011, Banco Bilbao Vizcaya Argentaria, S.A. (BBVA) held 5.658% of Telefónica's share capital; Caja de Ahorros y Pensiones de Barcelona (la Caixa) held 5.410%; and Blackrock Inc. held 3.884%, either directly or indirectly.

Performance of share price

The main European markets declined across the board in 2011 (Athex Composite -51.9%; PSI-20 -27.6%; FTSEMIB -25.2%; EStoxx-50 -17.1%; CAC-40 -17.0%; DAX -14.7%; Ibex-35 -13.1% and FTSE-100 -5.6%) as a result of the sovereign debt crisis throughout Europe. The crisis came to a head with the Portuguese bailout and Greece's request for a second rescue package. The financial stability of other peripheral countries remains in doubt, and concerns on global economic growth increases.

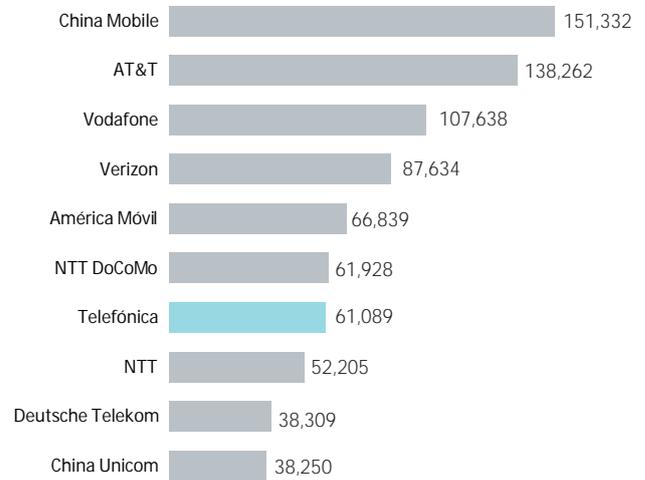
Telefónica's share price fell by 21.1% (to €13.39 per share at year-end 2011), underperforming the European telecommunications sector overall (-6.2%). The main reason for the decline was Spain's macroeconomic risk owing to its exposure in southern Europe and the rise in the British Telcos (Vodafone +7.9%, BT +5.6%) given its considerable weight on the index. The other leading European operators were also down in year-on-year terms: France Telecom: -22.2%; KPN: -15.3%; Telecom Italia: -14.1%; Deutsche Telekom: -8.2%. Nevertheless, the total return on Telefónica shares in 2011 stood at -12.1% (taking into account dividends paid).

At year-end 2011, Telefónica was the seventh largest telecommunications company in the world by market capitalization (€61,089 billion) and the sixty-fifth largest company in the world overall.

Telefónica's daily trading volume on the Spanish continuous market was 56.4 million shares in 2011 (59.8 million in 2010).

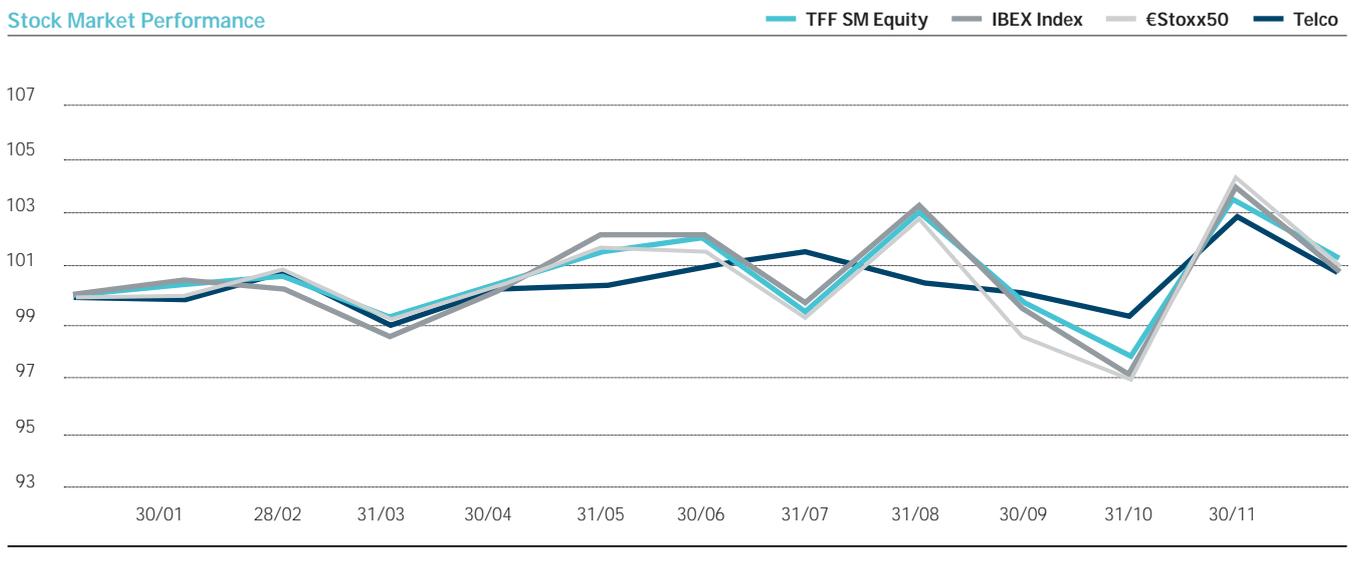
Sector Ranking by market capitalisation at December 31, 2011

millions of euros



Source: Information taken from Bloomberg

Stock Market Performance





Stand Bolsalia, Madrid 2011.

Telefónica's Investor Relations Office

Through our Investor Relations Office, we ensure transparent and fluid communication with our individual shareholders. At year-end 2011, more than 200,000 shareholders were registered in the Shareholder Service, and were thus eligible to receive the Shareholder Card identifying them as Company shareholders, in addition to the quarterly magazine *Acción Telefónica*.

Communication channels with shareholders are:

Our Investor Office's toll-free number (900 111-004)

In 2011, it received 63,142 calls in 2011, or an average of 5,262 calls per month. During the period when our General Shareholders' Meeting was being held, the monthly average number of calls rose to 19,000.

The topics on which our shareholders most frequently inquired were:

- ↳ **16,832 inquiries** on the General Shareholders' Meeting
- ↳ **20,505 inquiries** on stock market trends and share prices
- ↳ **6,555 inquiries** on earnings and significant events
- ↳ **68 inquiries** on capital increases and special financial transactions

Online channel

During 2011, the Shareholders & Investors website registered a total of 1,924,144 visits, compared to 1,439,537 in the year before. In this site we offer information regarding:

- ↳ **Stoke Exchange.** Online prices, with graphic resources, return calculators, weighting indexes, peer group performances, etc.
- ↳ **Dividends, results and relevant information.** Regarding the Corporate Governance, relevant facts, etc.
- ↳ **Documents.** Financial Reports and Official Filings from the Company
- ↳ **Shareholders' Corner.** To get timely access to up-to-date operating and financial information about Telefónica Shareholder's Corner provides a personal mailbox, a alerts service and personalized information.

The Investor Office has an e-mail address (accion.telefonica@telefonica.es) through which more than 2,500 queries were answered during the year.

Acción Telefónica magazine

This publication provides financial information and reports on current events and on campaigns exclusively for our shareholders. In 2011, we mailed 597,582 copies of the magazine to our shareholders

+ Leader in... strategic alliances. Telefónica reinforces its strategic and industrial alliances to consolidate its leadership as a global player.

Telefónica's global reach has been enhanced by its strategic and industrial alliances with China Unicom and Telecom Italia. On the basis of these alliances, Telefónica now has access to a combined total of 808 million customers of the three operators. Through Zon Multimedia, its industrial alliances also give Telefónica a foothold in Portugal.

In addition, in 2011 Telefónica launched its Partners Program to expand its alliances with other operators without cross holdings in markets in which the Company does not operate.

China Unicom

On 23 January 2011, Telefónica strengthened its strategic alliance with China Unicom, agreeing on a new share swap. The aim of this stronger alliance is to enhance strategic cooperation in areas including procurement, mobile-services platforms, provision of services to multinationals, wholesale services, roaming and technology in which the companies had already been working jointly since signing their strategic alliance.

In addition, the two companies bolstered their alliance through a new reciprocal investment in which each of them will acquire a shareholding in the other equivalent to US\$500 million. China Unicom is raising its shareholding through the acquisition of 21,827,499 Telefónica treasury shares. For its part, Telefónica bought China Unicom shares on the stock market. After the swap has been carried out, Telefónica's stake in China Unicom will climb to about 9.57%, while China Unicom's stake in Telefónica will total 1.37%.

The agreement also calls for the naming of a new member on Telefónica's Board of Directors representing China Unicom.

The joint development of the Internet of Things

Telefónica, through the newly created Telefónica Digital unit, and China Unicom entered into a strategic agreement to promote the development of the Internet of Things from a global perspective. The objective is to make progress toward improving machine-to-

machine connections, or M2M, through various technologies such as radio-frequency identification, sensors or global positioning systems (GPS).

More specifically, China Unicom and Telefónica have agreed to cooperate on the construction, maintenance and operation of M2M platforms and the development of the related technological specifications, which should significantly boost both companies' capacity to offer winning proposals to their customers in the different markets and sectors.

M2M solutions can improve efficiency and economic sustainability ratios and reduce costs, as well as provide new technological dynamics that will contribute to the overall economic recovery. They represent a new wave of innovation in the technology and information industry after those spearheaded by IT, the Internet and mobile-communication networks.

From a commercial standpoint, both companies will participate in purchasing, testing and market-analysis processes. Eventually they will establish alliances with customers and suppliers to leverage their economies of scale so as to improve conditions and accelerate standardisation processes. In this manner, they will provide clients with strategic global M2M solutions in order to jointly develop business opportunities in the new digital era and to make the most of those opportunities: smart mobility, energy efficiency, connected cars, consumer electronics, smart cities and intelligent production systems.

Another facet envisioned by Telefónica and China Unicom has to do with roaming, which involves agreeing on special conditions related to the needs of M2M, thus increasing the quality of the service, and promoting international M2M communications standards.

The important scale resulting from the cooperation between the two groups will enable joint testing and joint technological certifications throughout the world. Regarding certifications, the teams from China Unicom and Telefónica will work with the International Organization for Standardization and will take part in its most important forums.



Telefónica Ambassadors Event, Beijing 2012.
 From left to right: César Alierta (Chairman of Telefónica);
 Ferran Adrià (el Bulli); Lang Lang (pianist); Chang Xiaobing (Chairman of China Unicom).

Telecom Italia

Telefonica holds 10.5% of the voting rights in Telecom Italia through its 46.2% stake in Telco. The alliance between Telefonica and Telecom Italia is the largest in Europe with more than 60 million customers in Italy and presence in 8 European countries. The Industrial Alliance has laid the foundations for the development of an operational synergies program to take advantage of the scale of both companies.

Between 2008 and 2010 the program generated synergies of over €1,300 million. This has been extended for three more years with the aim of achieving continued synergies of approximately €500 million a year. The results are based on increased technical alignment, using best operational practice, alignment of marketing strategies and implementing best business practice, as well as work done on leadership and innovation projects.

Specifically we are developing a wide range of initiatives within infrastructure, particularly in the next generation networks of

fixed and mobile. This facilitates the exchange of best practice in relation to new technologies, deployment plans and the optimization of the processes.

The alliance is also working hard on the development of innovation projects in areas as diverse as Cloud Services, M2M and the internet of things, unified communications, financial services and content services. The main objectives are the transfer of knowledge and the development of joint projects like those that are currently underway as part of the collaboration with the European Union.

Telefónica Partners Program

Telefónica Partners Program is the Company's tool for expanding its alliances into new markets. Utilizing the experience gained through its strategic alliances with China Unicom and Telecom Italia, in 2011 Telefónica implemented this ambitious programme in order to extend its alliances to operators with which Telefónica has no shareholding relationship and that are in markets where it does not operate but that are of interest to it.

+ Leader in brand portfolio. **Movistar and O2 among the 100 Most Valuable Brands.**



Telefónica yacht, which competed in the Volvo Ocean Race.

Telefónica's brand strategy is differentiated into different roles: Telefónica plays an institutional-brand role, and is responsible for overseeing relations with employees, shareholders, global customers, suppliers, public institutions and society at large; while Movistar, O2, and Vivo are the commercial brands that interact with customers of the residential and corporate segments in each of their benchmark markets.

Evolution of the Implementation of the Brand Strategy

In 2011, we completed the implementation of Telefónica's role as an institutional brand, moved forward with the commercial rebranding of Movistar and developed the new strategy for Vivo to gradually transform its mobile-business brand into a convergent brand in the Brazilian market. In addition, we have broadened our portfolio with successful brands in the digital segments (Tuenti, Jajah) and created new brands that will allow us to compete with other brands in the digital environment and that will exist side-by-side our commercial brands.

Institutional Brand: Telefónica

To strengthen the vision of the "The power to transform" brand as well as its values and its institutional role in society, we have developed a communication strategy that includes advertising, the alignment of the Telefónica Foundation's social actions under the company's brand, and the "Brand Ambassadors" programme. This programme has been

consolidated and promoted with the inclusion of the Chinese pianist Lang Lang in 2011. In addition, we have taken part in the institutional sponsoring of the Volvo Ocean Race 2011-2012.

In 2011, we finished implementing the Telefónica institutional brand, with its launch in Latin America and the new operations in Costa Rica and Brazil (in particular, outside of the state of São Paulo, following the acquisition of Vivo).

In Europe, Telefónica has become the sole-employer brand for 25,977 employees. This was disseminated through the "Did you know?" internal campaign, winner of the Digital Impact Awards in the 'Best Digital Employee Communication' category and the European Excellence Awards in the 'Best Change Communication' category.

Commercial brands: Movistar, O2 and Vivo

In 2011, we successfully completed the commercial rebranding of the new Movistar, a process that began in 2010. This change was carried out progressively in the different markets.

In January, Peru implemented the new brand for all of its services. In the second and third quarters, the mobile-business brand was repositioned in Argentina, Colombia, El Salvador, Panama, Nicaragua and Guatemala and a new launch was carried out in Costa Rica. In 2012, in Colombia, all services are expected to be integrated under the Movistar brand.

Brand awareness

Spontaneous awareness of the Telefónica Brand, total number of mentions

Mobile Telephony

Country	Top of mind Percentage	Total number of mentions Percentage	Ranking
Spain	41	92	1
Chile	30	68	1
Peru	54	93	2
Argentina	41	95	1
Mexico	31	94	2
Uruguay	48	98	1
El Salvador	25	97	1
Guatemala	28	99	1
Nicaragua	52	100	1
Venezuela	38	100	1
Colombia	15	93	1
Ecuador	40	99	1
Panama	44	99	1
Costa Rica	4	69	2
Brazil	28	72	3
Ireland	41	95	2
Slovakia	22	88	3
Czech Republic	34	92	2
England	26	71	2
Germany	20	66	2

Fixed Telephony

Country	Top of mind Percentage	Total number of mentions Percentage	Ranking
Spain	60	97	1
Chile	30	68	1
Peru	44	60	2
Brazil	47	69	1
Argentina (Broadband)	59	89	1
Colombia	17	48	1

Data from TPSM (ATP) of MillwardBrown, cumulative as of Q4 2011

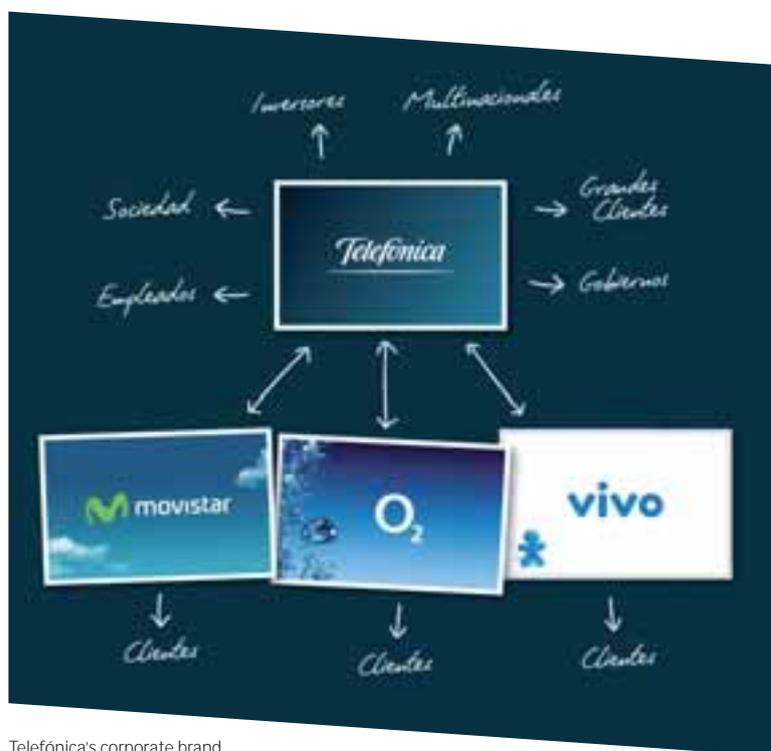
O2 and Vivo have also held onto their position as the sole brands for the residential and corporate segments in their markets (Europe and Brazil, respectively).

Although O2's positioning and visual identity remained unchanged in 2011, the group has been developing a new strategy for Vivo to gradually transform the mobile-business brand into a convergent brand under the concept of "Connected for a better life". In these efforts, we remain committed to the values of innovation, simplicity, proximity, enthusiasm and trust ahead of the April 2012 launch.

Brand Ranking

In 2011, we successfully completed the commercial rebranding of the Movistar, O2 and Vivo are among the brands most highly regarded by customers in every country where we operate. Various

In 2011, we completed the implementation of Telefónica's role as an institutional brand, moved forward with the commercial rebranding of Movistar and developed a new strategy for Vivo



Telefónica's corporate brand.

studies published in 2011 and carried out by large global consulting firms such as Interbrand and MillwardBrown placed our commercial brands among the top brand-valuation rankings.

In its 2011 ranking, Interbrand, which focuses on the Spanish market, rated Movistar as the most highly regarded Spanish brand.

In addition, MillwardBrown's prestigious 'Brandz Top 100 Most Valuable Global Brands 2011' ranked Movistar twenty-first, making it the top Spanish brand. This is the first time a Spanish brand has had one of the twenty-five top spots. In the same ranking, O2, Telefónica's commercial brand for Europe, also had a relatively high standing, as it placed seventy-fourth.

This significant climb in brand value underscores the strategic rebranding of Telefónica's brands and the consistent implementation of this rebranding in the countries.

+Leader in... sustainability. Risk and opportunities management of Telefónica is internationally recognized.

In 2011, Telefónica was once again among the world's leading companies in terms of sustainability criteria, according to the **Dow Jones Sustainability Index (DJSI)**, while improving its position by four points from 2010.

In 2011, Telefónica was once again among the world's leading companies in terms of sustainability criteria, according to the Dow Jones Sustainability Index (DJSI), while improving its position by four points from 2010.

In its annual review, Sustainable Asset Management (SAM)—the rating agency that evaluates companies in terms of sustainability management—gave the Group a score of 88 out of 100 based on economic, environmental and social criteria. This is 23 percentage points above the sector average and places Telefónica among the top five companies in the sector.

Telefónica, which has been listed on this index—one of the most demanding in the world—for four years, once again heads up the list in the social category and raised its score in the other two categories.

For the DJSI, "Corporate Sustainability is a business approach that creates long-term shareholder value by embracing opportunities and managing risks deriving from economic, environmental and social developments". And Telefónica has formulated its sustainability strategy according to this definition.

Telefónica is recognised as the company in its sector with the best practices in six key categories, and is ahead of the South Korean company KT Corp by 90 points. For the second year in a row, Telefónica scored first in risk and crisis management; environmental management; human capital development; impact of telecommunication services; and stakeholder engagement. And for the first time it was the top-ranked company in digital inclusion issues.

Economic dimension (87 points)

Telefónica received a score of 87 points for its economic impact, a 4-point improvement and 18 percentage points above the sector average. This part of the index examines issues relating to customer relations management; privacy; risk management; corporate governance; corporate guidelines and anticorruption; brand management; and innovation management. In addition, in what is a new category this year, it places more emphasis on the development of services.

One of the most prominent aspects is Telefónica's Risk Management model, which was awarded the highest score (100 out of 100). The model provides us with a high level of awareness about the possible risks specific to our activity (business, financial, operational and global risks), which ensures greater efficiency when allocating resources to manage the risks identified. Standing out among the global risks are reputational risks and risks associated with breach of the Business Principles, for which improvement plans, mitigation projects, regulations and procedures are defined which ensure appropriate management

through a specific projects unit at the company, which is responsible for articulating correct internal conduct relating to responsibility for the supply chain, human rights, integrity, privacy and data protection, health and safety, electromagnetic fields, child protection, responsible advertising and diversity, etc.

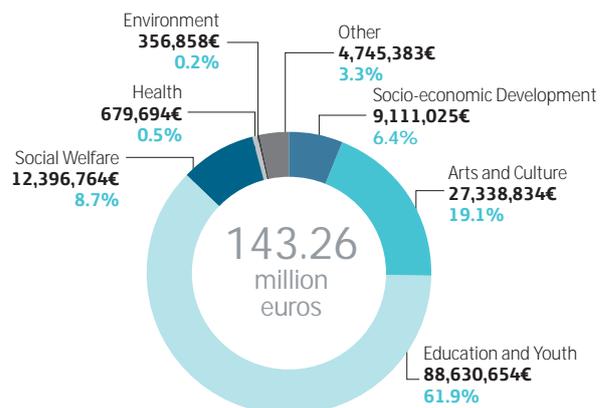
Noteworthy in innovation is the utilisation of opportunities for growth offered by the digital world through widening the portfolio of products and services, as well as the commitment shown to technological development through BlueVia (Telefónica's platform for developers), investment in social and environmental innovation, Movilforum and Wayra (an initiative launched by the company in 2011 to help talented entrepreneurs to accelerate their ICT-related business ideas).

Social Dimension (90 points)

In social issues, Telefónica remained at 90 points, the highest score in the sector and 27 points above average. We should stress the Telefónica Foundation's Debate and Knowledge programme, which aims to foster social awareness of and discussion on the impact of ICTs; the internal push for telework or teleconferences; the efforts to ensure that the supply chain acts responsibly and guarantees respect for human rights and the corporate guidelines (in 2010, more than 1,100 supplier audits were conducted); and Telefónica Foundation's programmes, in particular, Proniño.

We should also stress the improvement in talent retention and human capital development—areas in which the Company has the highest score in the industry. This effort regarding our employees was channelled through the new bravo! People programme, which launched a Global Share Purchase Plan in which more than 40,000 employees are registered. The programme gave awards for employee commitment and good performance. In addition, the Company moved forward with its training effort, investing €56.4 million in e-learning programmes and a Corporate University.

Investment in social projects



The rating agency that evaluates companies' sustainability gave the Telefónica Group a score of 88 out of 100, 23 points higher than the sector average

Regarding stakeholder engagement, in which Telefónica is rated Best in Class, the Company stepped up its use of social networking in order to improve service and forge trust-based relationships with stakeholders such as its customers.

Environmental dimension (87 points)

The Company's environmental score was 87 points, 14 higher than last year and 30 points above the average. This category covers issues related to environmental policy, ecoefficiency, environmental information and climate change. Telefónica continues to lead the sector in environmental management, thanks to the implementation of its Global Environmental Management System, which is now in place at 80% of its operations, and the ISO 14001 certification, which has now been awarded to more than 65% of its companies.

Telefónica made significant improvement—115%—in ecoefficiency thanks to proper management of resources (energy, CO2 emissions, waste). Indeed, by 2010 the Company was halfway to meeting its goal of reducing network energy consumption by 30% by 2015.



II Global Energy and Climate Change Workshop Lima, September 2011.

Leadership 2011 in Green ICT In Energy and Carbon management

For the second consecutive year, Telefónica received the highest score in the telecommunications sector in the Carbon Disclosure Project (CDP), composed of two indexes which list 551 institutional investors with US\$71 trillion under management and rate companies' transparency and performance vis-à-vis climate change.

With a score of 90 points out of 100—one point higher than last year—Telefónica is the only Spanish company listed on the Carbon Disclosure Leadership Index (CDLI), which measures the quantity and quality of the information that companies provide on climate change. The 52 best companies in the world are listed on it.

Energy management and CO2 emissions, green services, and, in general, the utilisation of opportunities and the minimisation of risks associated with climate change are the keys for the Company's attainment of this position on the leading investment index on carbon.

We attained merely 20% of the goal we set in 2007 of reducing our network electricity consumption by 30% by 2015 (Kwh/access eq).

In Green ICT services

In 2011, we were recognised as a leading ICT company in Europe based on our provision of energy-efficient services, according to the "green quadrant", by Verdantix, a firm of analysts of the global industry. In 2011, who worked with the business lines to expand our portfolio of Green ICT services globally. In 2011, Telefónica invested 15 million euros in I+D processes for energy efficient services (transports, utilities, smart buildings) in particular and solutions based on M2M. Our "Green ICT" services help promote an ecoefficient, low-carbon economy. The consolidated our global smart city model in which Green ICT services play an important role for energy management, the environment and local transportation.