



FIFTH **INVESTOR** CONFERENCE

Valencia. May 25 th - 26 th. Ciudad de las Artes y las Ciencias

Telefonica



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Building a fully integrated player – Creating the next growth platform

Jaime Smith

Executive Chairman, Český Telecom

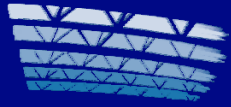


THE BEST COMBINATION OF
GROWTH AND RETURNS

Telefonica

Valencia - May 25, 2006

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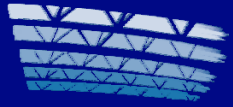
01 ČTc turnaround and Telefónica Group synergies

02 Fixed-mobile integration

- Strategic rationale
- Proposed approach and timing
- Financial synergies

03 Investor guidance

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01 Czech Republic – small country with promising future

Social data

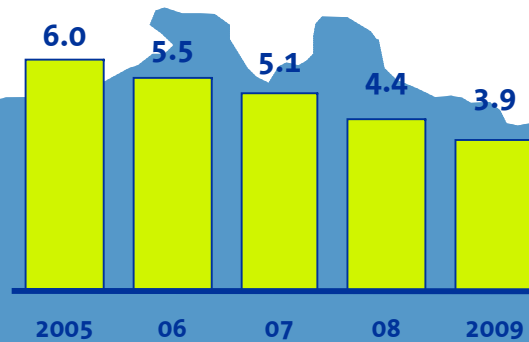


- Population: 10.2 million
- Area: 78,866 km²
- Date of accession to EU: May 04

Macroeconomic data

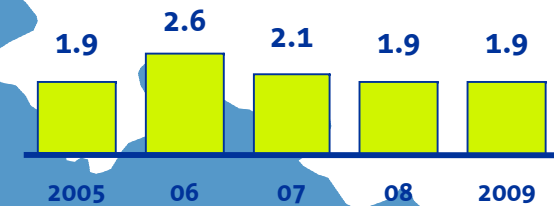
Real GDP growth

Percent



Inflation

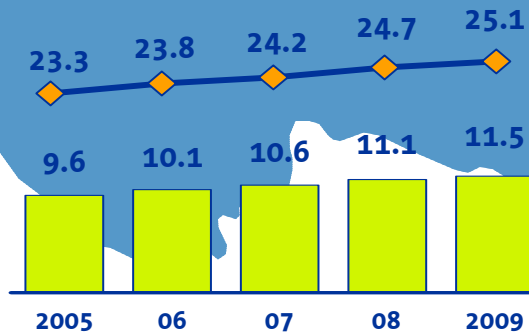
Percent



Real GDP per capita

EUR thousand (2005)

■ Czech Republic ◆ EU average

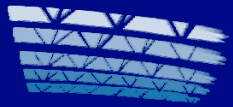


Unemployment rate

Percent

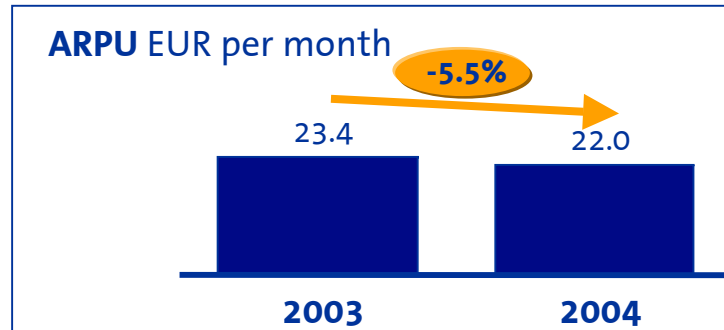
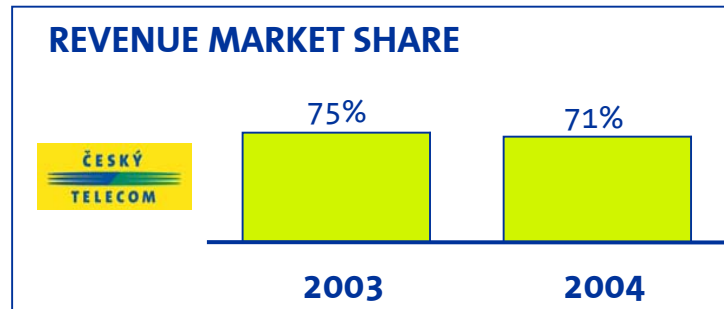
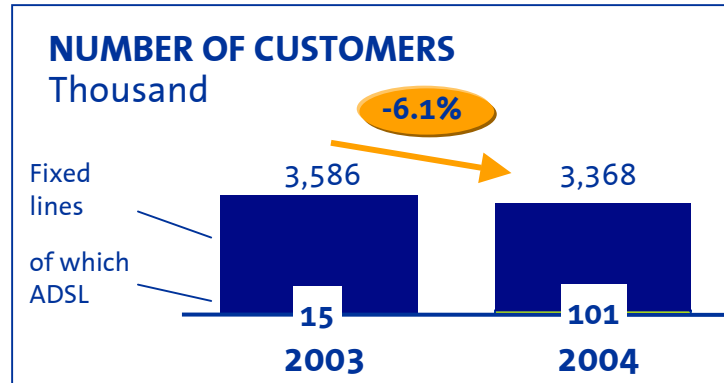


Source: Czech Statistical Office, Economist Intelligence Unit 2006

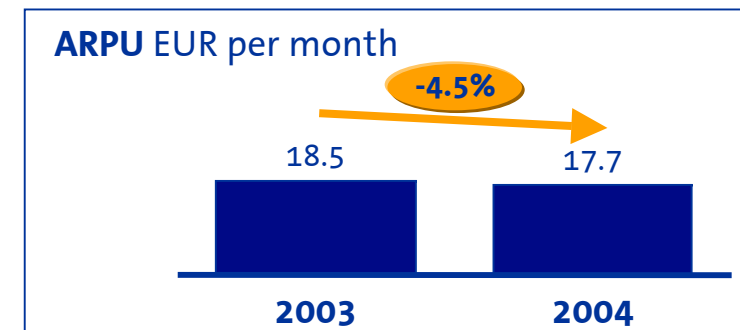
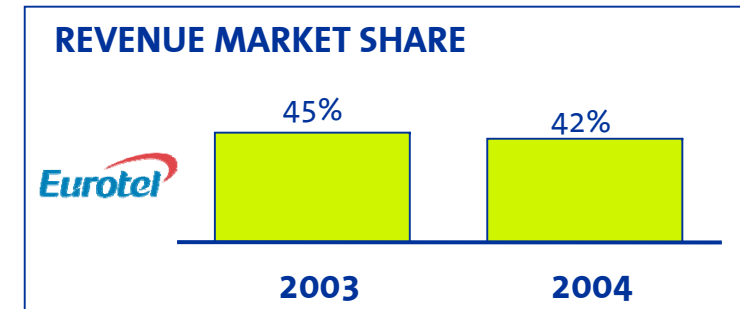
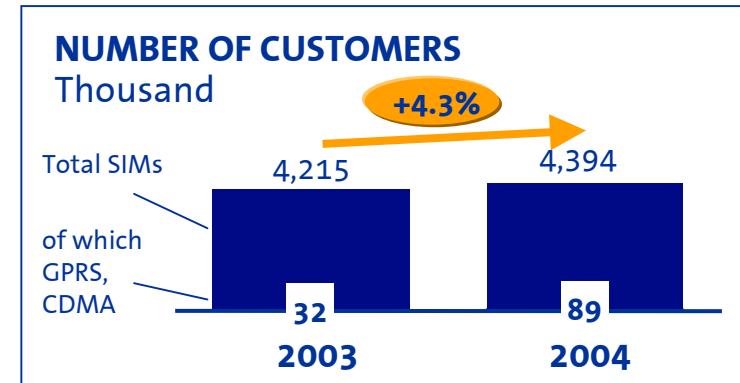


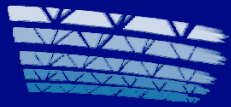
01 Český Telecom was facing several challenges before it was acquired by Telefónica

Fixed – Český Telecom



Mobile – Eurotel





01 Therefore we defined and implemented business initiatives for 2005-06

Consumer

SME

**Corporate/
transversal
/sales channels**

Fixed – Český Telecom

- Redefine the broadband connectivity market ✓
- Redesign the price plan architecture (flat rate, etc.) and improve price perception ✓
- Reverse the negative trend in line churn ✓
- Increase the capacity and reach of sales channels ✓

- Redesign the price plan architecture and improve price perception ✓
- Build a range of SME business solutions on top of the ADSL offer ✓
- Stimulate performance of the own sales force and develop an indirect channel ✓

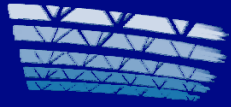
- Corporate**
- Become a personalized, reliable and integrated ICT solutions provider ✓
 - Develop the best commercial sales force ✓
- Transversal**
- Provide the best service to our customers ✓

Mobile – Eurotel

- Redesign prepaid pricing, modify postpaid pricing, and improve price perception ✓
- Redesign handset strategy ✓
- Develop a segmented marketing machine ✓
- Ensure successful 3G launch ✓

- Improve management of frame and binding contracts ✓
- Boost data services with standardized and horizontal business applications ✓
- Optimize use of discounts ✓

- Sales channels**
- Optimize the residential distribution strategy with focusing on POS ✓
 - Develop an aggressive hunting channel ✓
 - Redesign the indirect channel ✓
 - Enhance performance of sales reps ✓



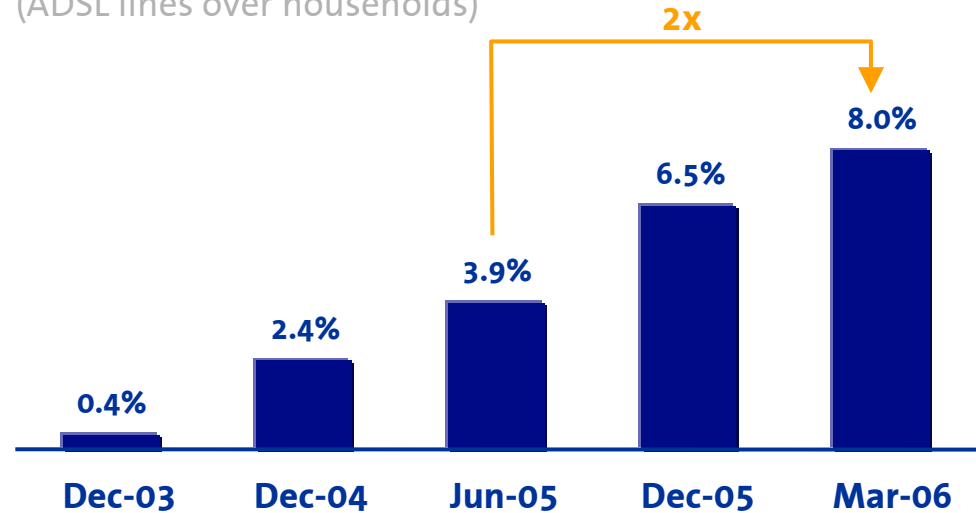
01 Telefónica's know-how is being leveraged to increase ADSL penetration in Czech Republic

OVER THE LAST 9 MONTHS, THE BB VALUE PROPOSITION WAS REDEFINED...

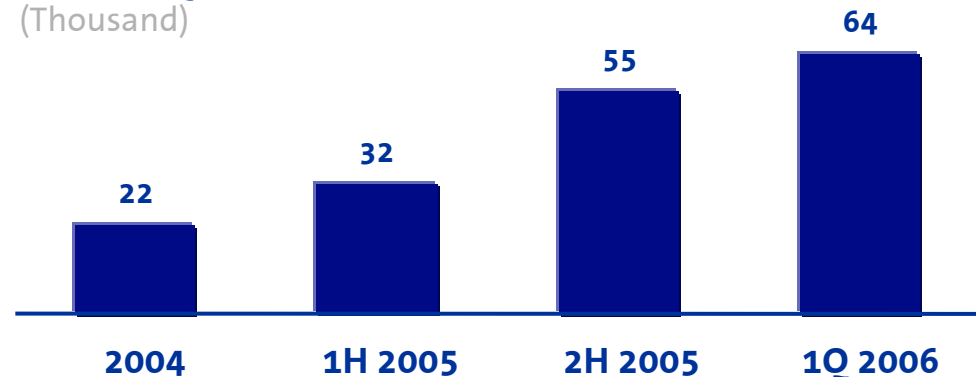
- Redesign of broadband pricing
- Speed upgrade (up to 4x) to deliver a superior offer vis-à-vis competitors
- Aggressive mass media campaign
- Continuous effort to improve service quality and reliability
- Launch of innovative value added services, such as PC security

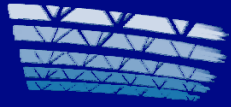
■ The number of ADSL lines has doubled over the last 9 months

ADSL PENETRATION GROWTH (ADSL lines over households)



AVERAGE QUARTERLY NET ADDS (Thousand)





01 Synergies worth operating cash flow of EUR 128 million resulting from being part of the Telefónica Group were identified

SYNERGY AREA

EXAMPLES OF INITIATIVES

Purchasing

- Use of Telefónica’s IPTV solution (HW, SW, ST box)
- Renegotiation of 2G (GSM) technology purchasing, SIM card purchasing and cooperation with Telefónica in vendor negotiations
- IT and VAS infrastructure purchasing from 3rd parties
- Network infrastructure – price reduction of DSLAMs and splitters, PDH and SDH

Products

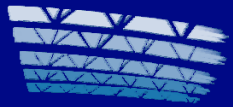
- Roaming – directing roaming traffic of Group customers through Group networks, resulting in decrease of 3rd party roaming fees
- E-office – launch of broadband VAS products for SMEs
- Shorter time to market for IPTV

Other

- Use of Telefónica’s insurance subsidiary (Pleyade) to buy insurance originally contracted to 3rd parties
- Quick-win utilization of selected common network platforms

**Total operation cash flow
2005-2009 of synergies:
EUR 128 million**

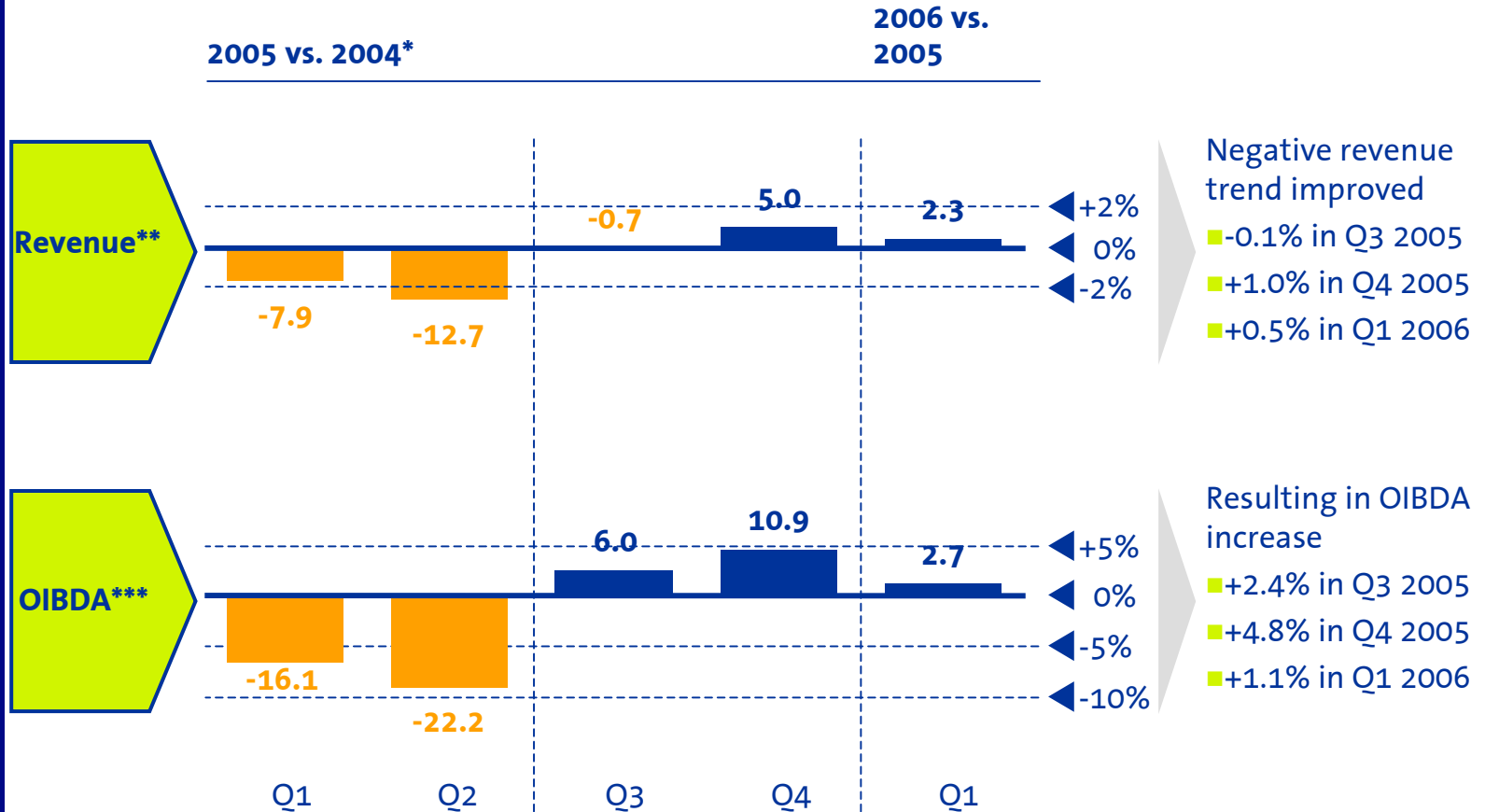
2H 2005 and 2006 synergies
■ By end of Q1 realized EUR 9.5 million (~50% of total)



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01 These initiatives have already led to an improvement of financial performance

EUR million



Negative revenue trend improved

- 0.1% in Q3 2005
- +1.0% in Q4 2005
- +0.5% in Q1 2006

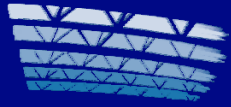
Resulting in OIBDA increase

- +2.4% in Q3 2005
- +4.8% in Q4 2005
- +1.1% in Q1 2006

Acquired by Telefónica

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* Actuals restated for accounting policy change
 ** Business and other revenues
 *** OIBDA before one-off items
 Exchange rate 1 EURO: 29.77963 CZK



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01 ČTc turnaround and Telefónica Group synergies

02 Fixed-mobile integration

- Strategic rationale

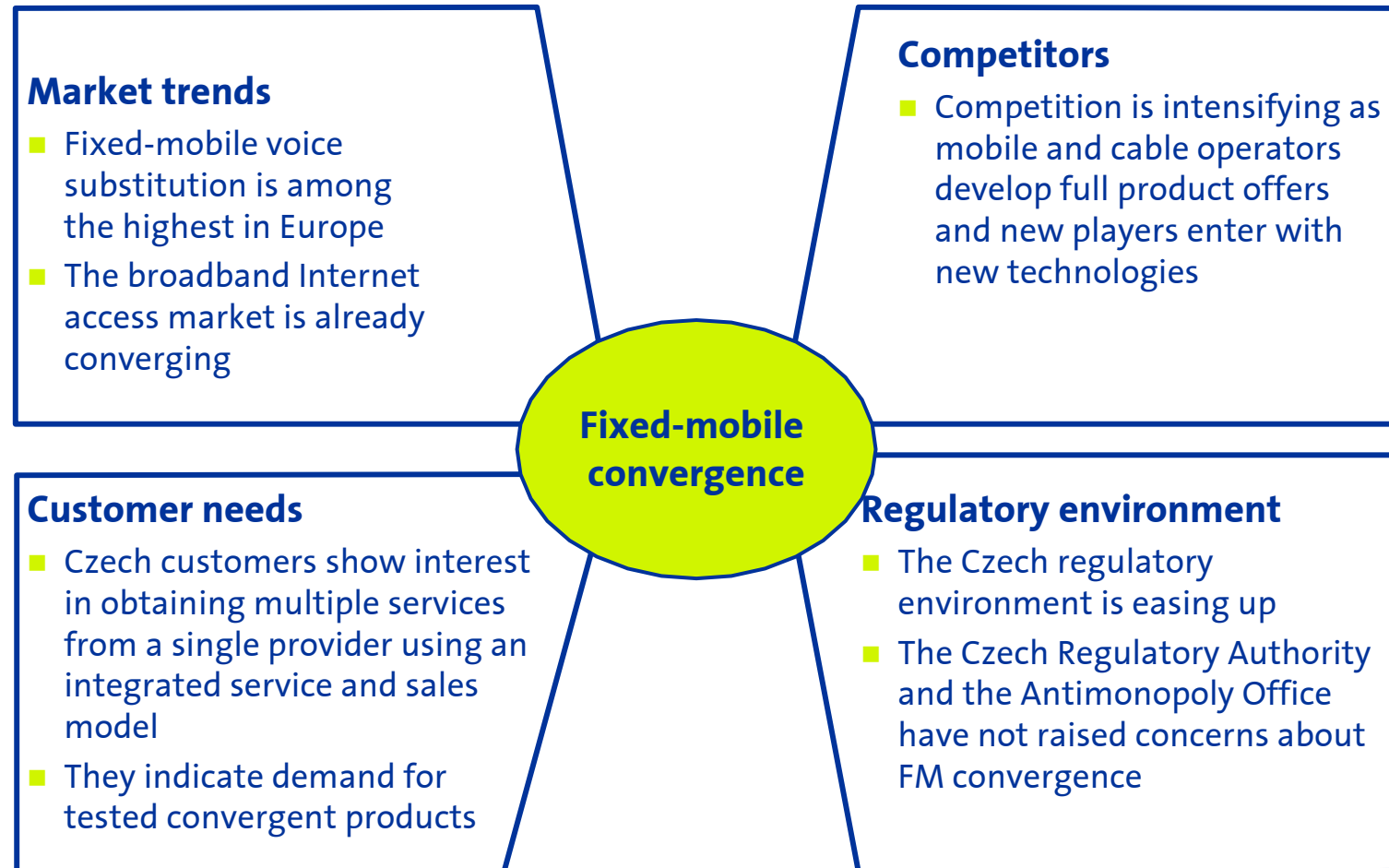
- Proposed approach and timing

- Financial synergies

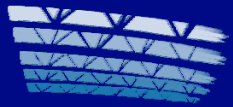
03 Investor guidance



02 The unique situation in the Czech market calls for a fixed-mobile convergence strategy



We want to be the leaders of the fixed-mobile trend

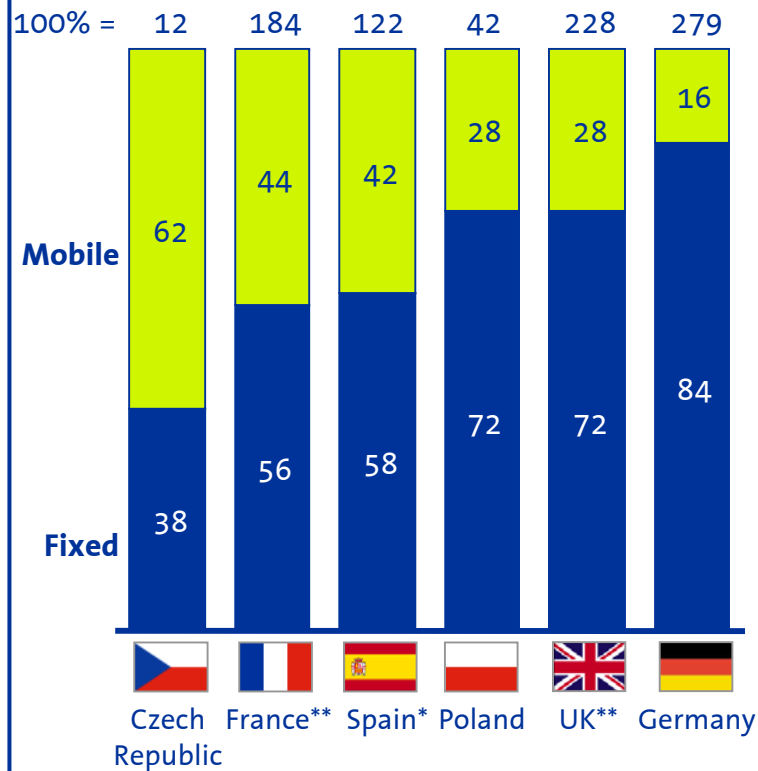


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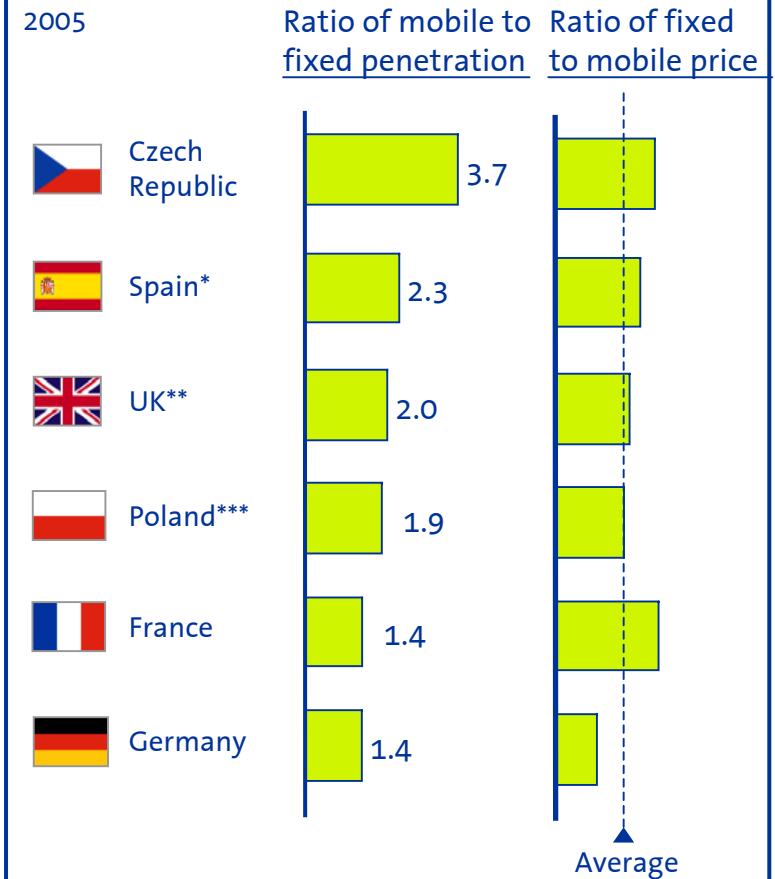
02 The Czech Republic is at the forefront of fixed-mobile convergence...

The Czech market is one of the most advanced in fixed-mobile substitution

Total traffic, 2005
Billion minutes



This is driven by a unique situation in mobile penetration and relative F-M prices



* Based on data for first half of 2005

** Based on data for 1-3Q 2005

*** Based on 2004 data

Source Regulators; company annual reports; IDC; Pyramid; analysis

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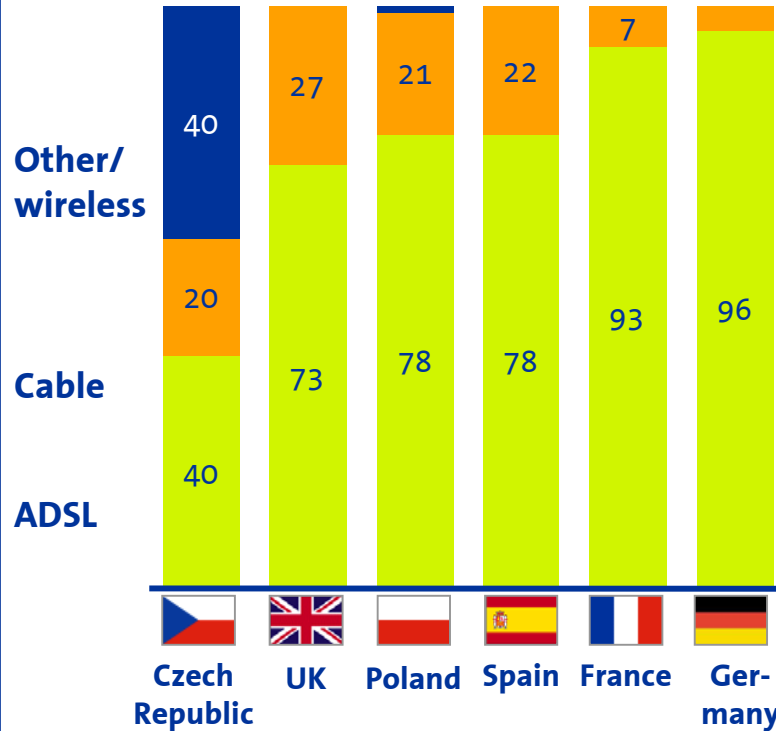
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02 ...which together with advanced broadband convergence results in fixed line churn

The broadband market convergence is advanced due to late ADSL introduction

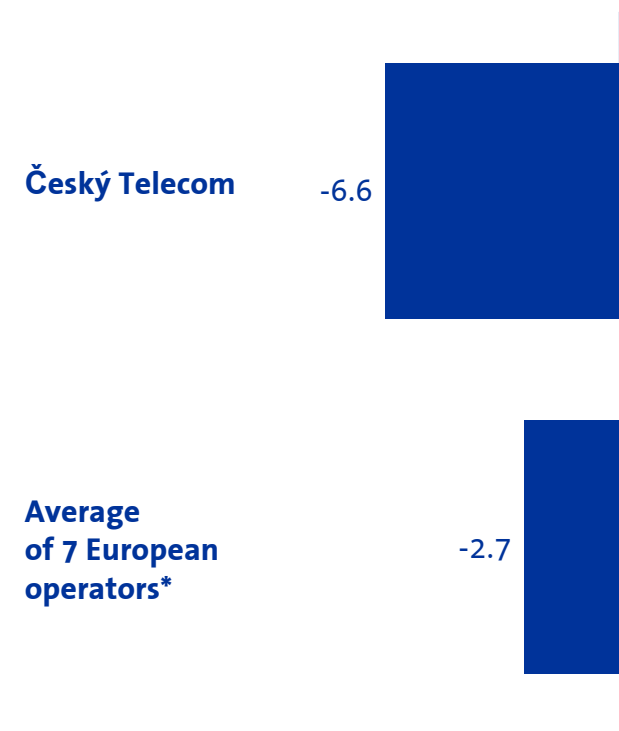
Broadband connections by access technology, 2005

Percent



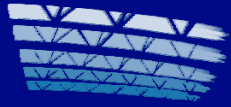
As a consequence of this access line churn becomes a reality

Incumbent	PSTN+ISDN channels change CAGR 2003-2005
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* Includes Telefónica de España, France Telecom, Deutsche Telekom, British Telecom, Telecom Italia, Portugal Telecom and TPSA

Source: Analysis – March 2006; Company annual reports



02 Competition is intensifying as operators develop full product offers and new players enter

Cable operators/ fixed players

- Cable operators are moving from TV-only offers to 2P and 3P value propositions
- Other fixed players are building full-scale voice and data offers



Mobile players

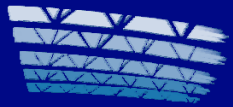
- Mobile players are building full-scale voice, Internet access and content offers for consumers and corporate clients



New entrants

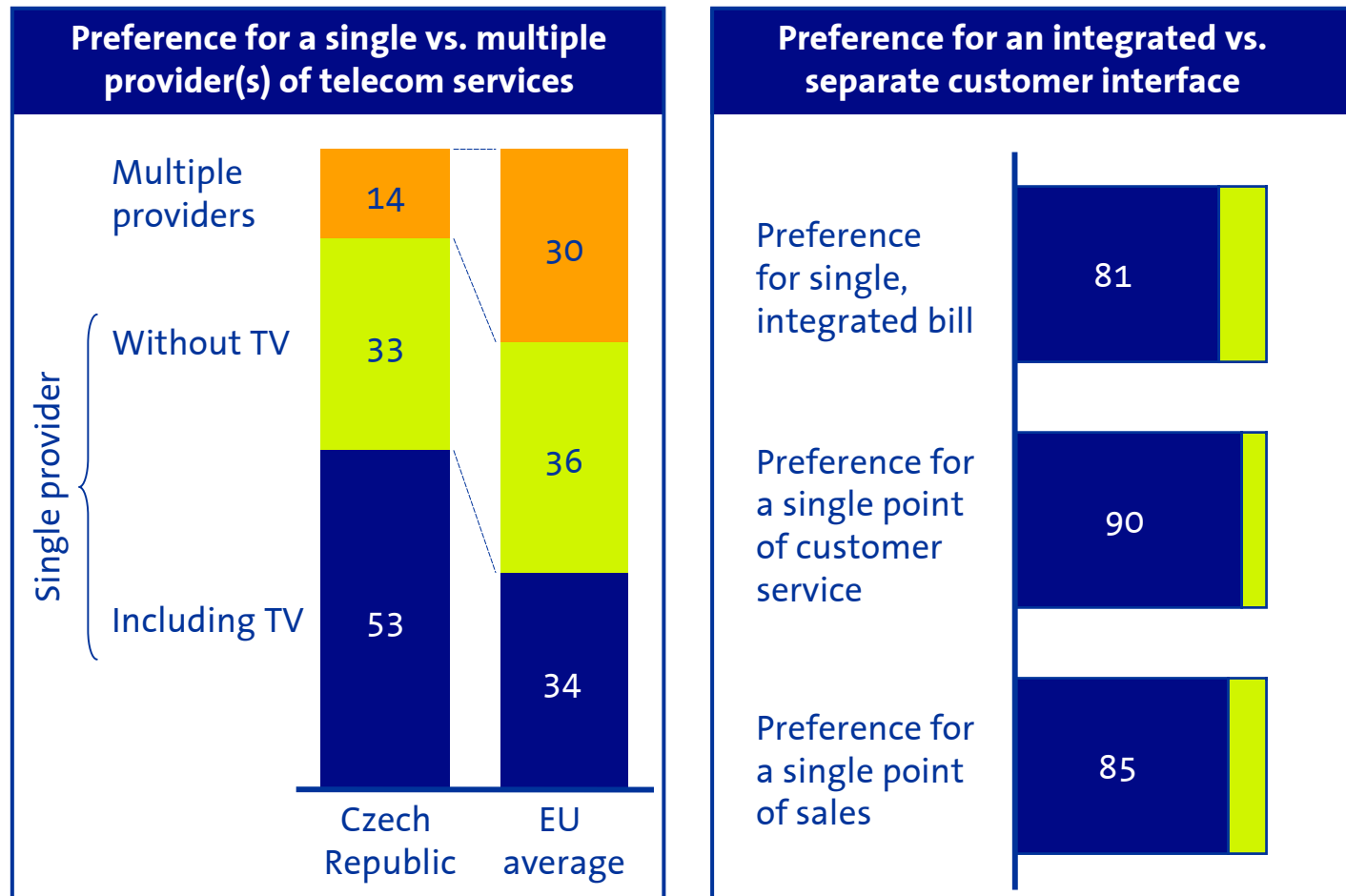
- New players are entering with innovative business models and technologies (e.g., free voice services, VoIP-based offers)



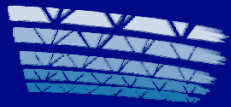


02 Czech customers are interested in an integrated value proposition

Percent

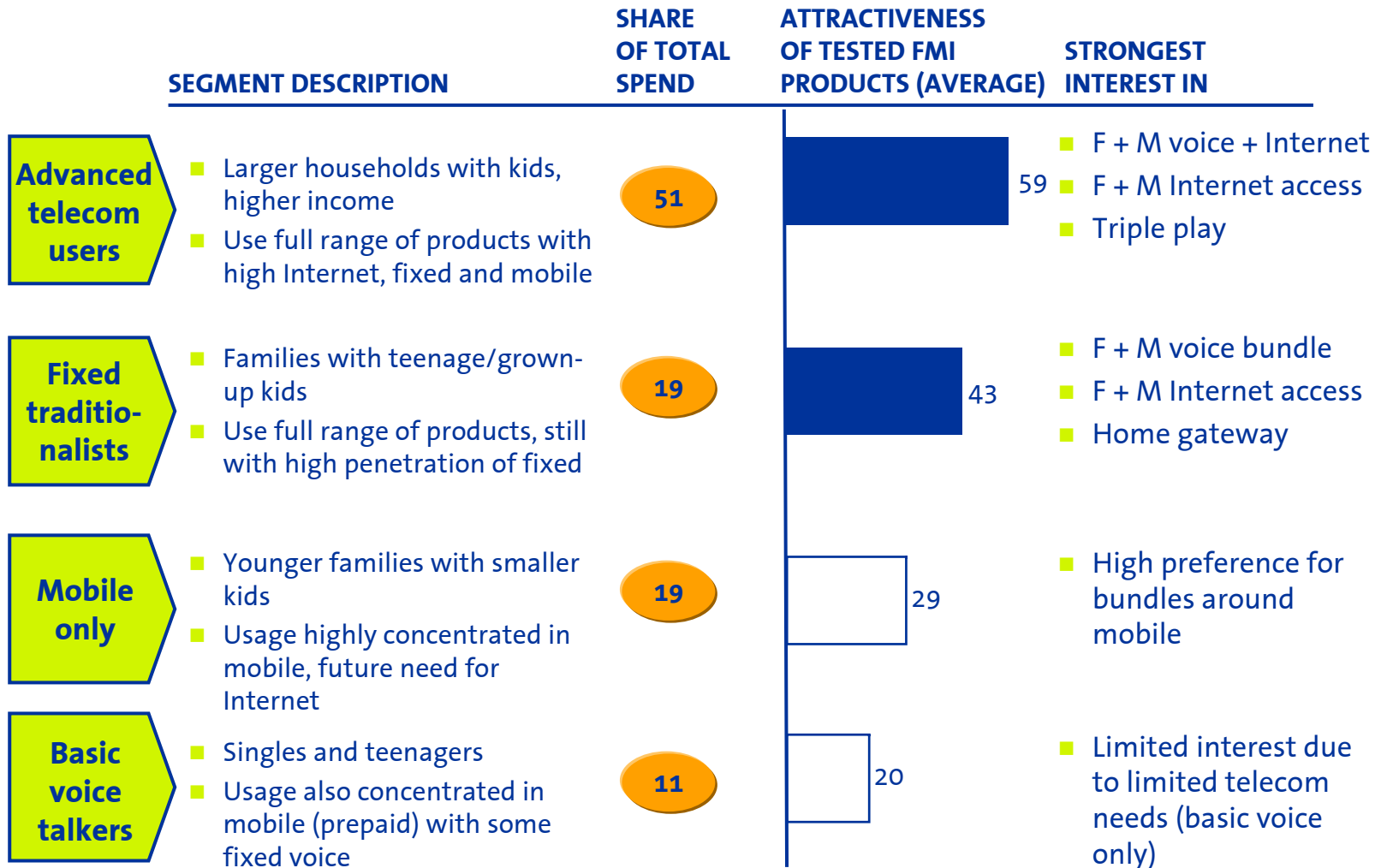


Source: Quantitative market research in the Czech Republic, N=700; Factum Invenio, in 2006; EU results from fixed-mobile market research in 8 European countries, N=5,364, in 2004



02 And 2 target segments indicate high demand for fixed-mobile convergent offers

Percent





02 The Czech regulatory environment indicates support for fixed-mobile convergence

During ongoing analysis of 18 relevant markets, the Czech regulator has been easing selected regulatory measures

- In the markets of the fixed public telephony access (markets 1 and 2) and the fixed local, national and international telephone services for residential (markets 3 and 4) Český Telecom found in an SMP position, therefore
 - CS/CPS offer and wholesale line rental regulatory measures required, however retail price regulation eliminated
- Analysis of the wholesale broadband access (market 12) is currently ongoing
- Mobile access and call origination (market 15) found competitive, no regulation imposed on Eurotel, MVNO not required
- All operators found in SMP on the market of mobile voice call termination on individual networks (market 16), therefore interconnect fees remain regulated

- The Czech Regulatory Authority and the Antimonopoly Office have not raised concerns about fixed-mobile convergence
- New convergent products will not be subject to any additional regulation on top of current regulations for fixed and mobile services (the general condition of offer replicability still holds)
- Legal requirements for customer data-sharing will be eased as a consequence of legal integration into a single company



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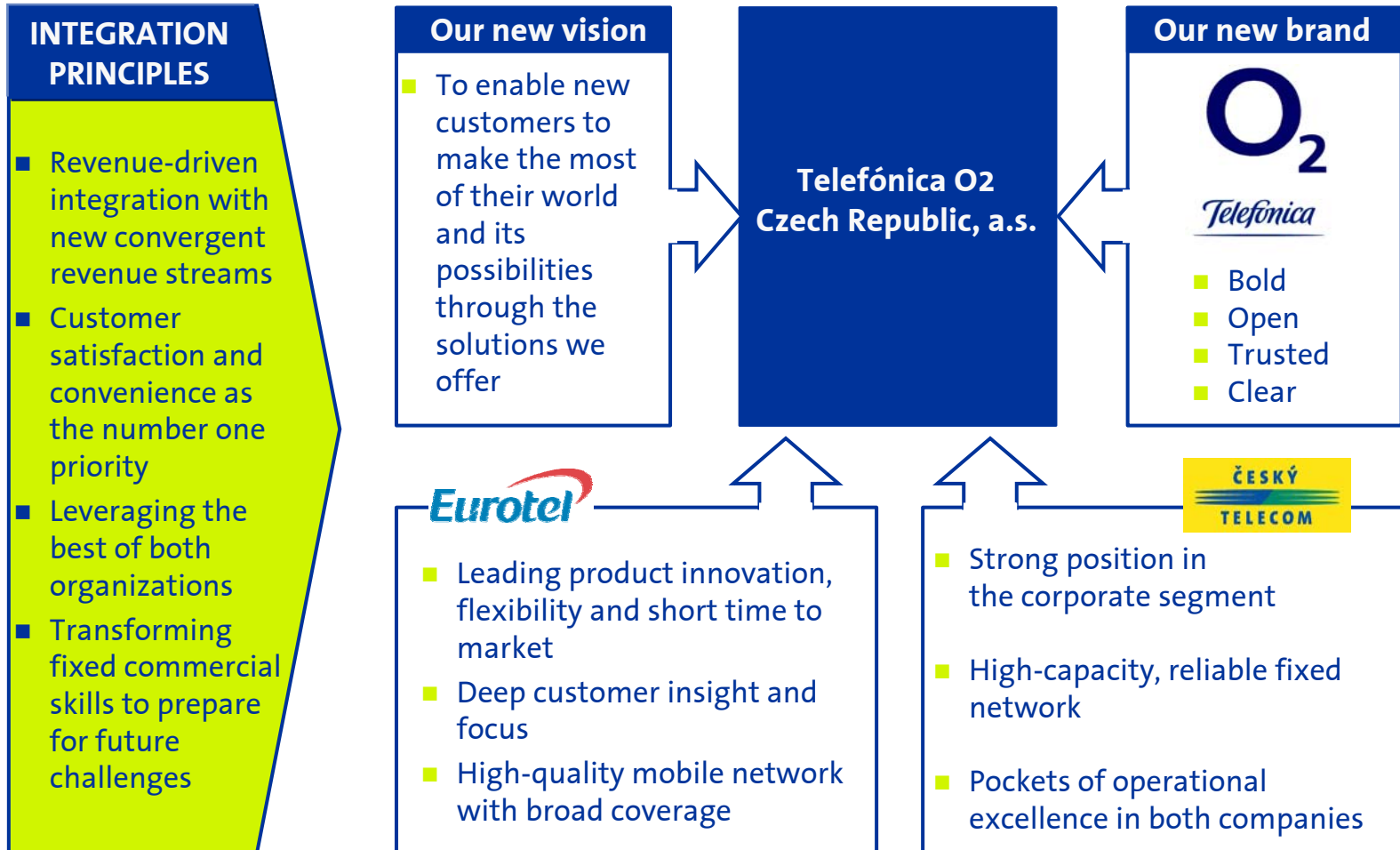
- Proposed approach and timing

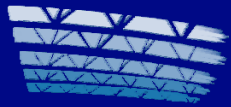
- Financial synergies

03 Investor guidance

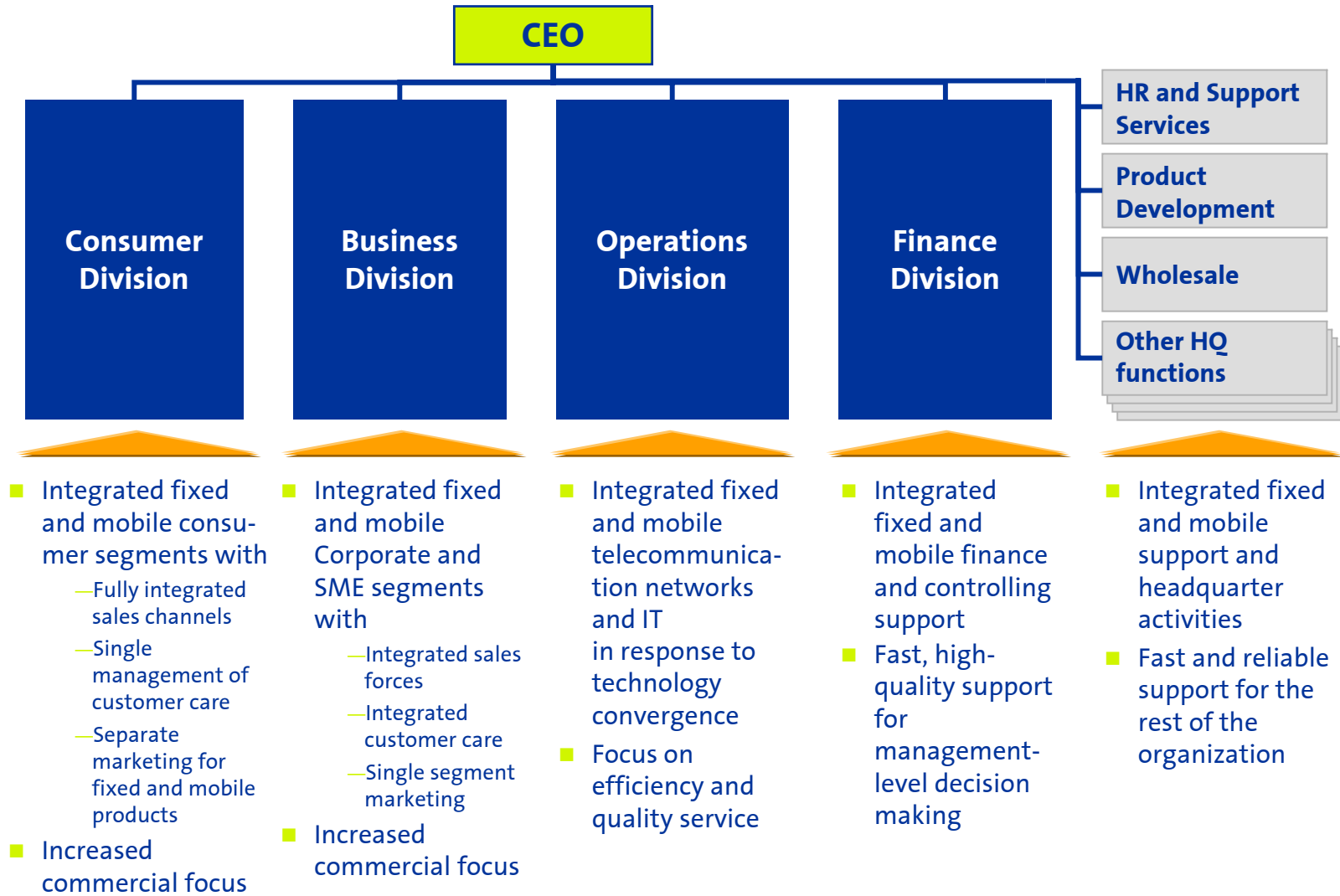


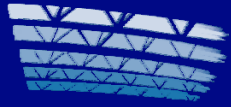
02 Our fully integrated organization is designed around customer segments



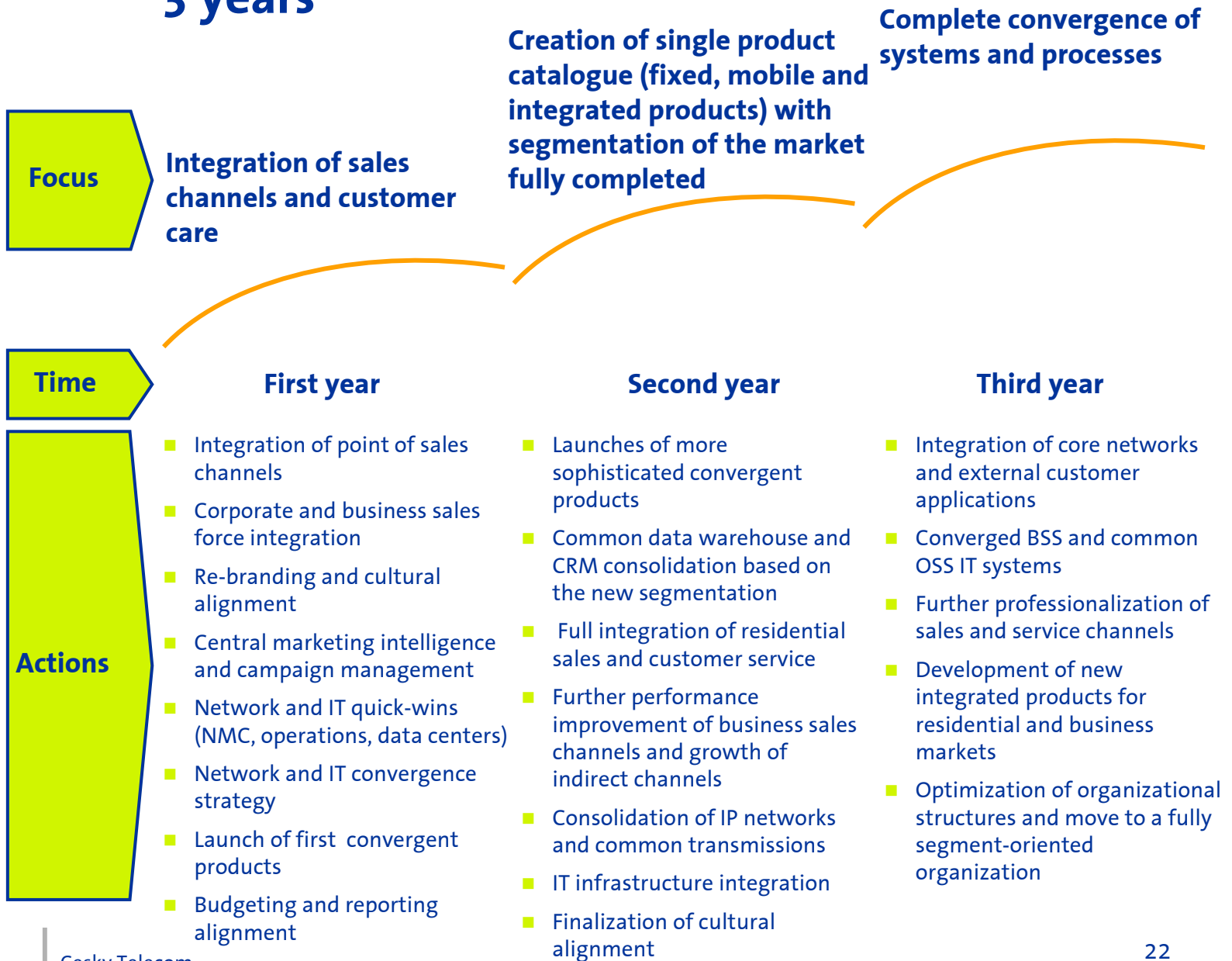


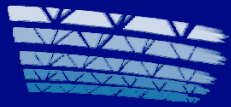
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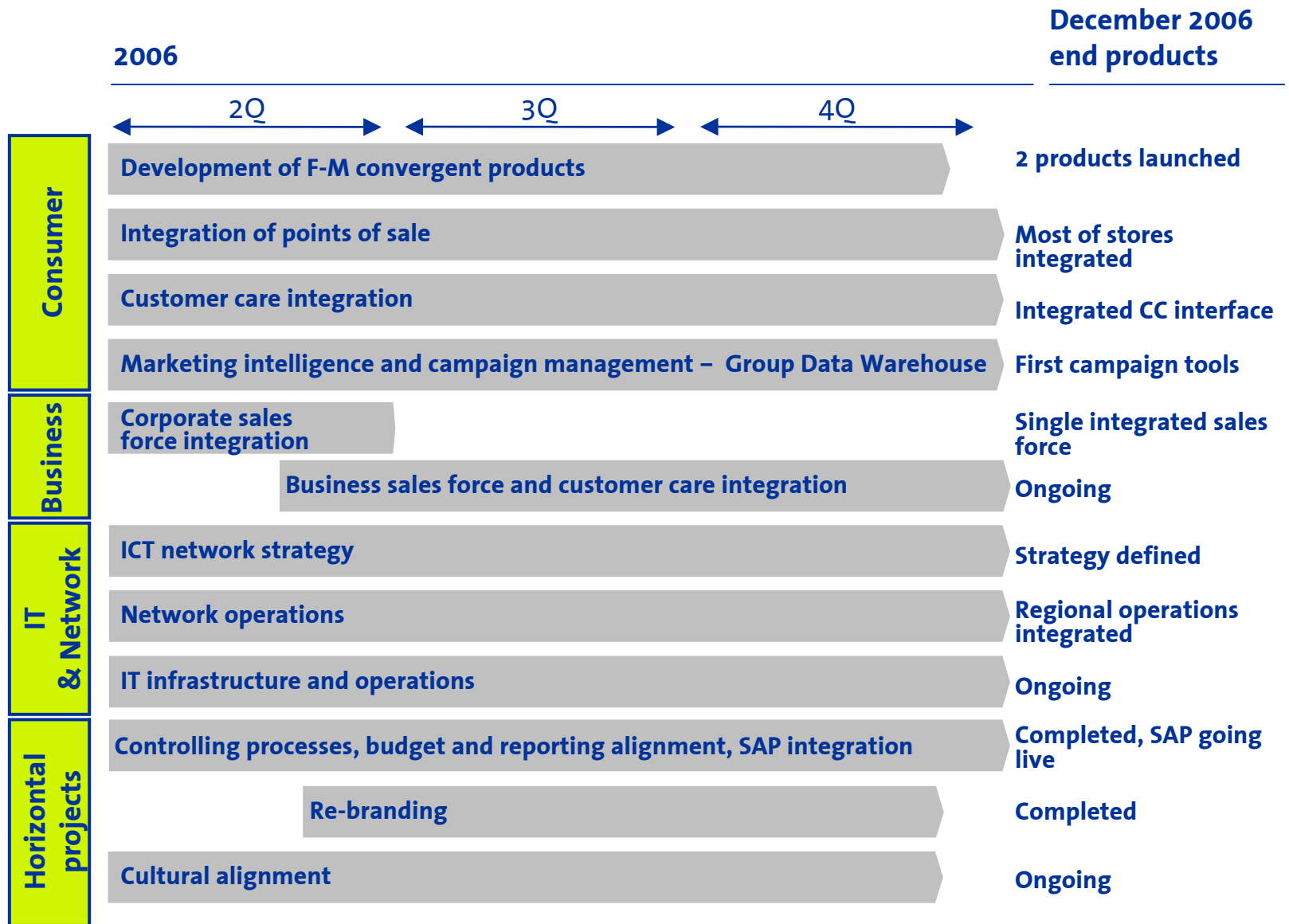


02 The integration program is scheduled over 3 years





02 Management will focus on 12 priorities in 2006





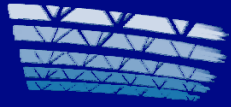
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- Proposed approach and timing
- **Financial synergies**

03 Investor guidance



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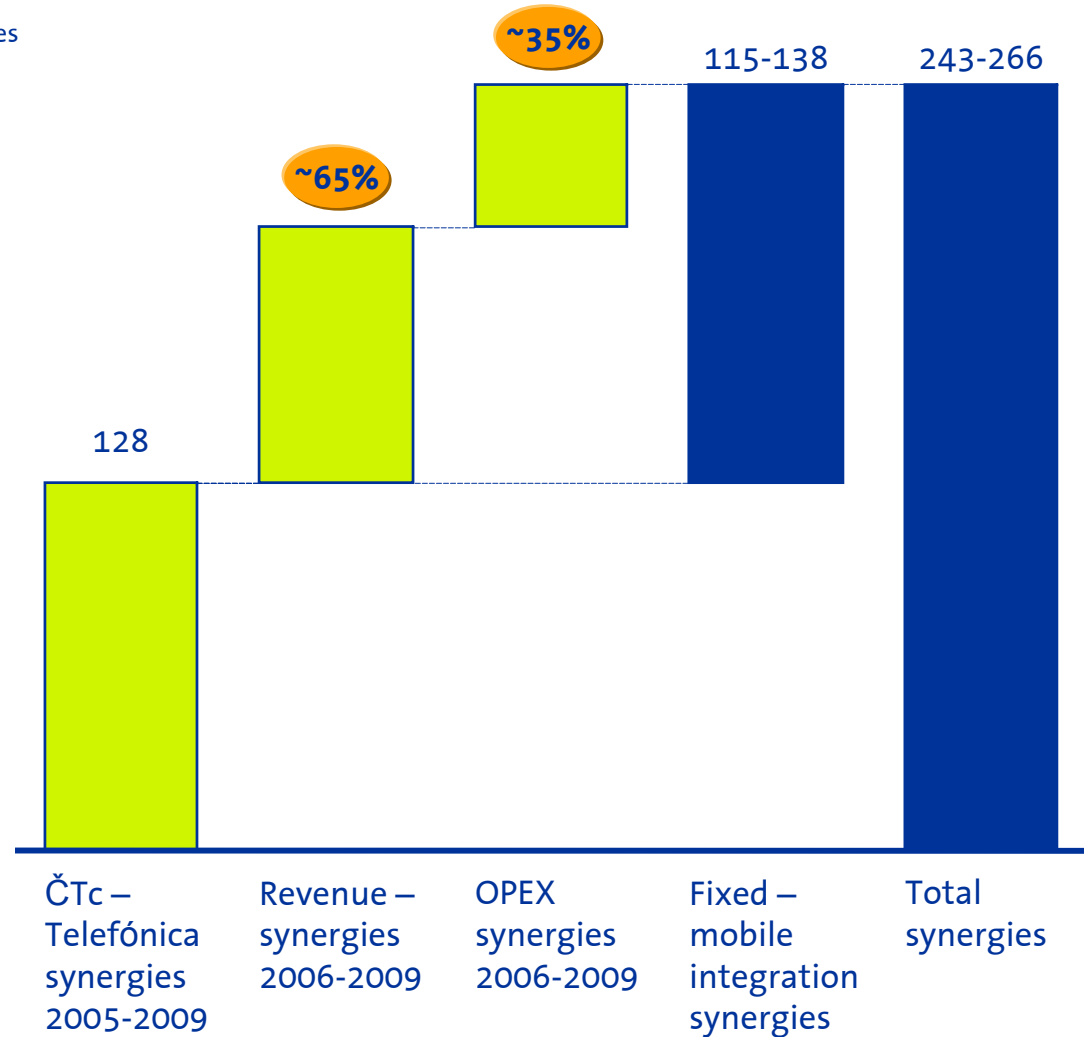
02 Substantial financial synergies related to fixed-mobile integration exist

EUR million

X% Share of expected FMI synergies

FINANCIAL IMPACT

- Expected FMI synergies amounting to OpCF* = EUR 115-138 million
- In addition to the already announced synergies resulting from being part of Telefónica Group OpCF* = EUR 128million
- Neutral OIBDA impact in Year 1 (2006)

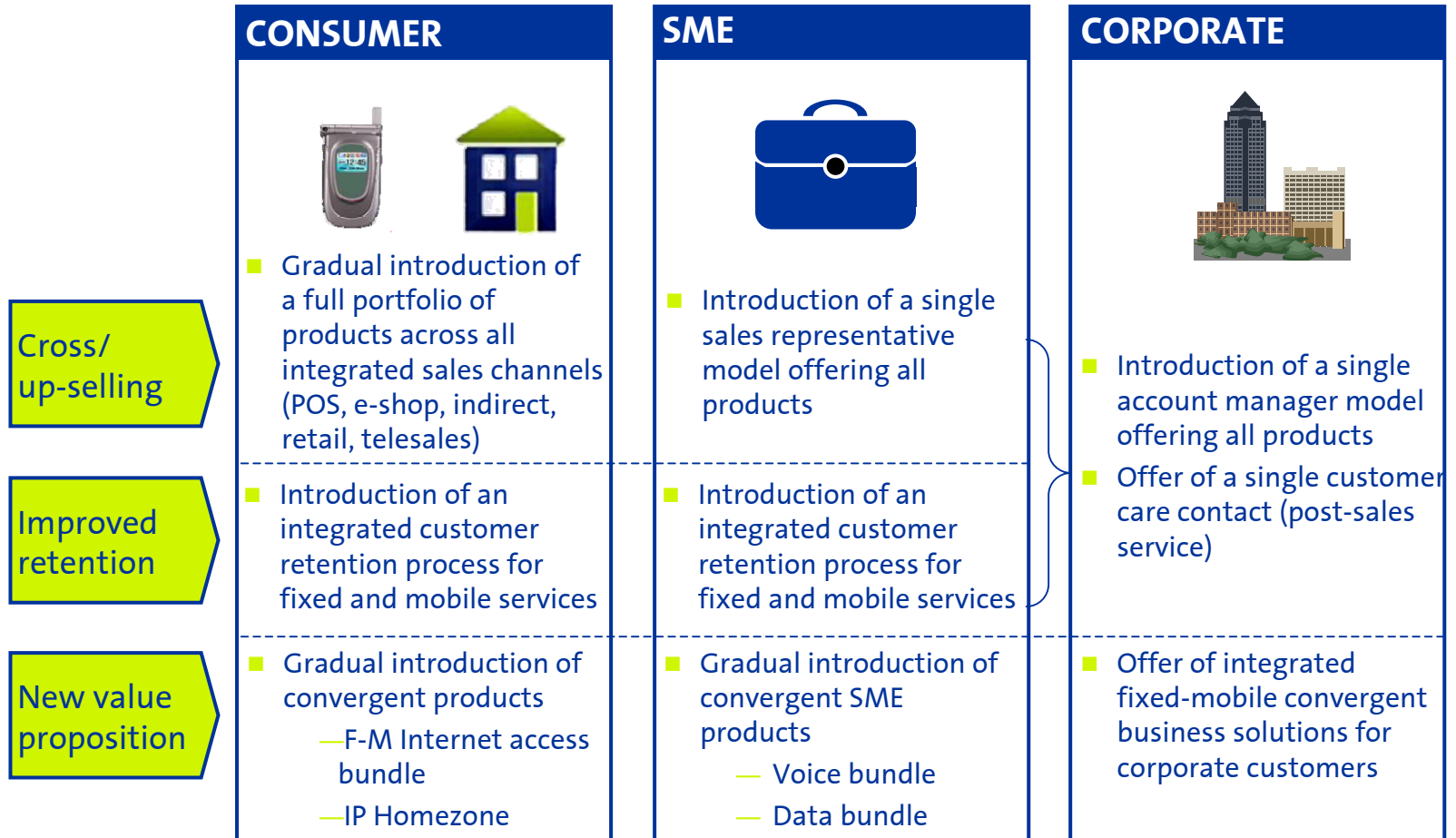


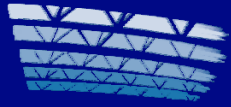
·In terms of guidance calculation, operating Income before D&A excludes other exceptional revenues/expenses not foreseeable in 2006-09; for comparison purpose, the equivalent other exceptional revenues/expenses registered in 2005 are also deducted from reported figures
Exchange rate 1 EURO: 29.77963 CZK





02 Creating shareholder value – revenue synergies account for ~65%





02 Creating shareholder value – OPEX synergies account for ~35%

SYNERGY AREA

Sales and marketing

- Optimization of sales channel structure with single management
- Streamlining and customer care performance improvement
- Integration of back office sales channels

Network

- Operational savings from
 - Integrated network operations and maintenance
 - Single network supervision
 - Integrated core network planning and coordination in access network planning

IT

- Operational savings from
 - Using an integrated infrastructure and middleware
 - Using unified IT service platforms
 - Selective integration of Business Support Systems

Support and HQ functions

- Leveraging scale and eliminating duplications in
 - Support functions such as Procurement, Logistics, Real Estate, Security, etc.
 - Headquarter functions such as Finance, HR, Controlling, Legal, Communications, etc.

■ **Operating cash flow of total OPEX synergies: EUR 40-49 million**



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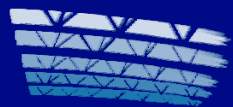
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03 Telefónica O2 Czech Republic financial commitments

EUR million	FY 2005	CAGR 2002-05	2005-09E CAGR*
Revenues	2,049	-2%	0-2%
Operating Income before D&A**	970	-4%	1-3%
Operating Income**	371	-2%	14-18%
			EUR million 2006-2009
CAPEX	204	-23%	900-1,000

* CAGR 2005-2009E guidance assumes constant exchange rates as of 2005 and excludes changes in consolidation

** In terms of guidance calculation, Operating Income before D&A and Operating Income excludes other exceptional revenues/expenses not foreseeable in 2006-2009. For comparison purpose, the equivalent other exceptional revenues/expenses registered in 2005 are also deducted from reported figures

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