



FIFTH **INVESTOR** CONFERENCE

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

Telefonica

VALUE ADDITION BY COST SUBTRACTION

Santiago Fernández Valbuena

Chief Financial Officer, Telefónica, S.A.

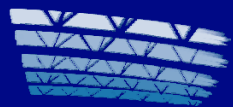


THE BEST COMBINATION OF
GROWTH AND RETURNS

Telefonica

Valencia - May 26, 2006

Telefónica, S.A.
Chief Financial Officer



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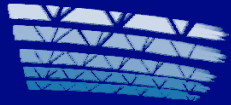


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- 05 Conclusions

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00 Introduction

- **From Bean-Counting to Bean-Growing**
 - Finance helps transform top line growth and operating margins into Free Cash Flow.
- **Finance delivers very visible synergies**
 - Active Management of liabilities, currencies and tax planning boost profits:

**OVERLAYING
BUSINESSES**

**ADDING TO
THE BOTTOM
LINE**

ACHIEVING BETTER RATES, CHEAPER DEBT, LOWER TAXES



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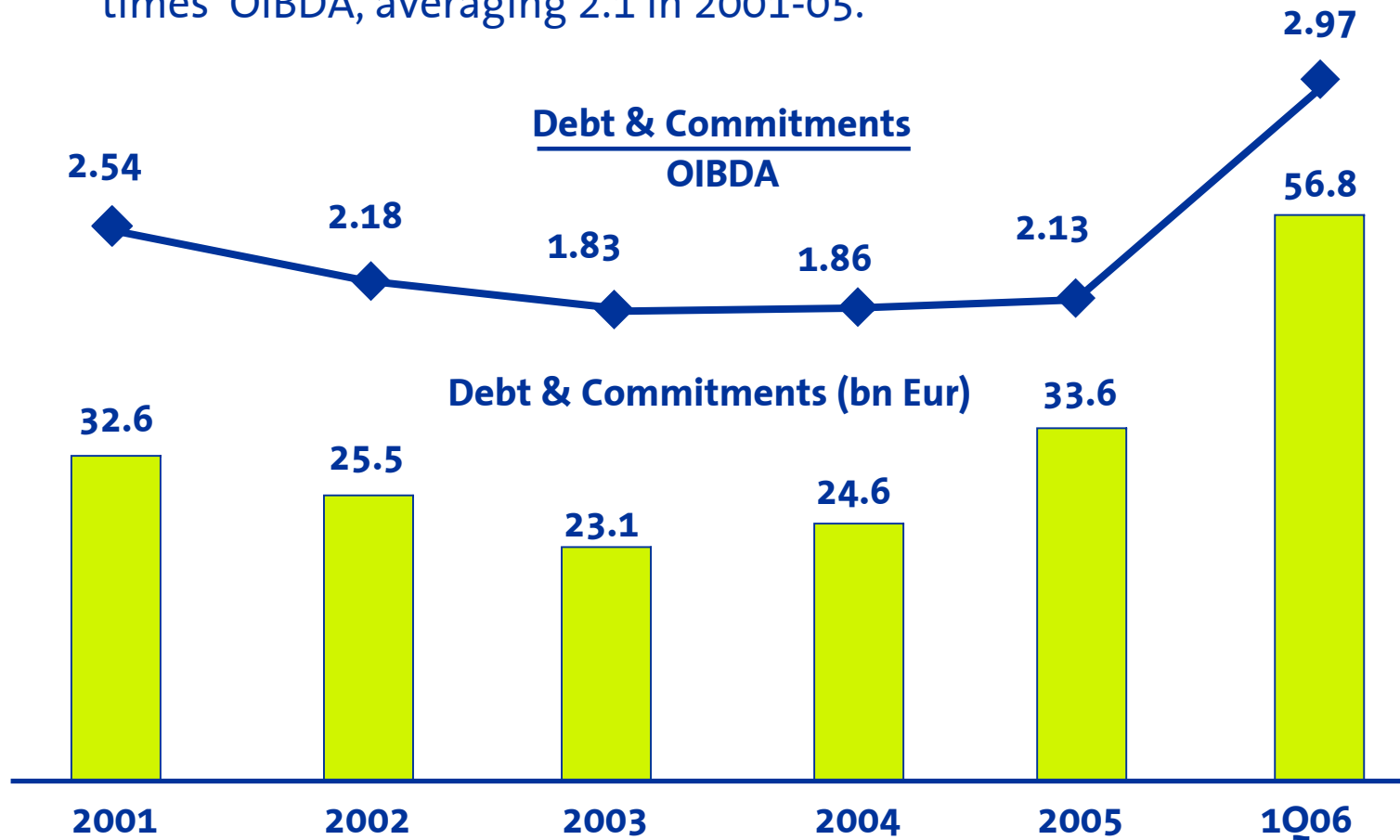
05 Conclusions

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01 Telefónica has historically kept leverage under control...

■ Debt & Commitments have been moving between 1.8 and 2.6 times OIBDA, averaging 2.1 in 2001-05.





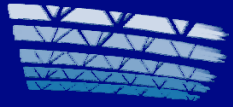
01 ...and we will bring it back to normal

Our updated Financial Policy rests on two pillars

Telefónica targets:

BBB+/Baa1 as rating floor

$$\frac{\text{Net debt + cash commitments}}{\text{Operating Income before D\&A}} \leq 2.5X$$
 } **over the medium term**



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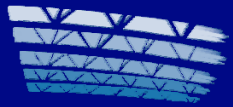
03 Liability and FX Management

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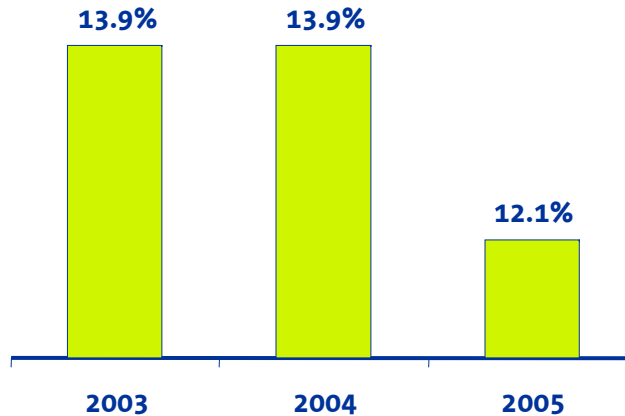
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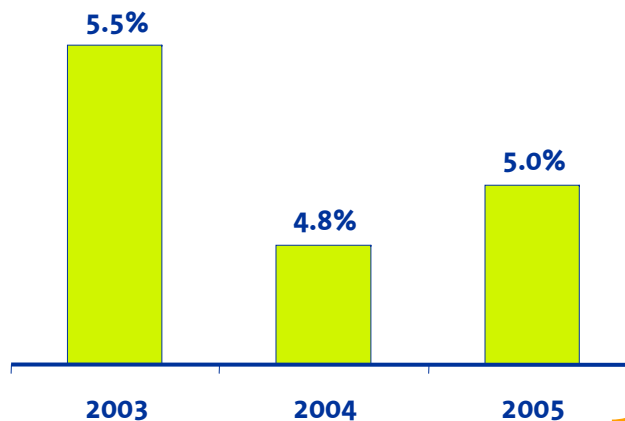


02 Decreasing financial expenses

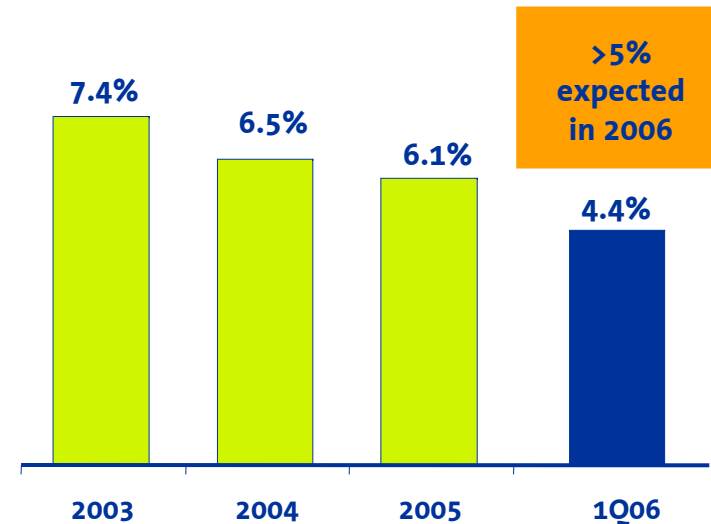
Evolution of Latam cost



Evolution of ex-Latam cost



Evolution of average cost



■ Decreasing trend pushed by:

- Refinancing at low rates in the last 3 years in Spain
- Diversification of Latam debt outside Brazil and Argentina at lower rates
- 400 bps SELIC rate reduction in Brazil since September 2005.
- Higher weight of Eur and GBP debt following O2 acquisition.



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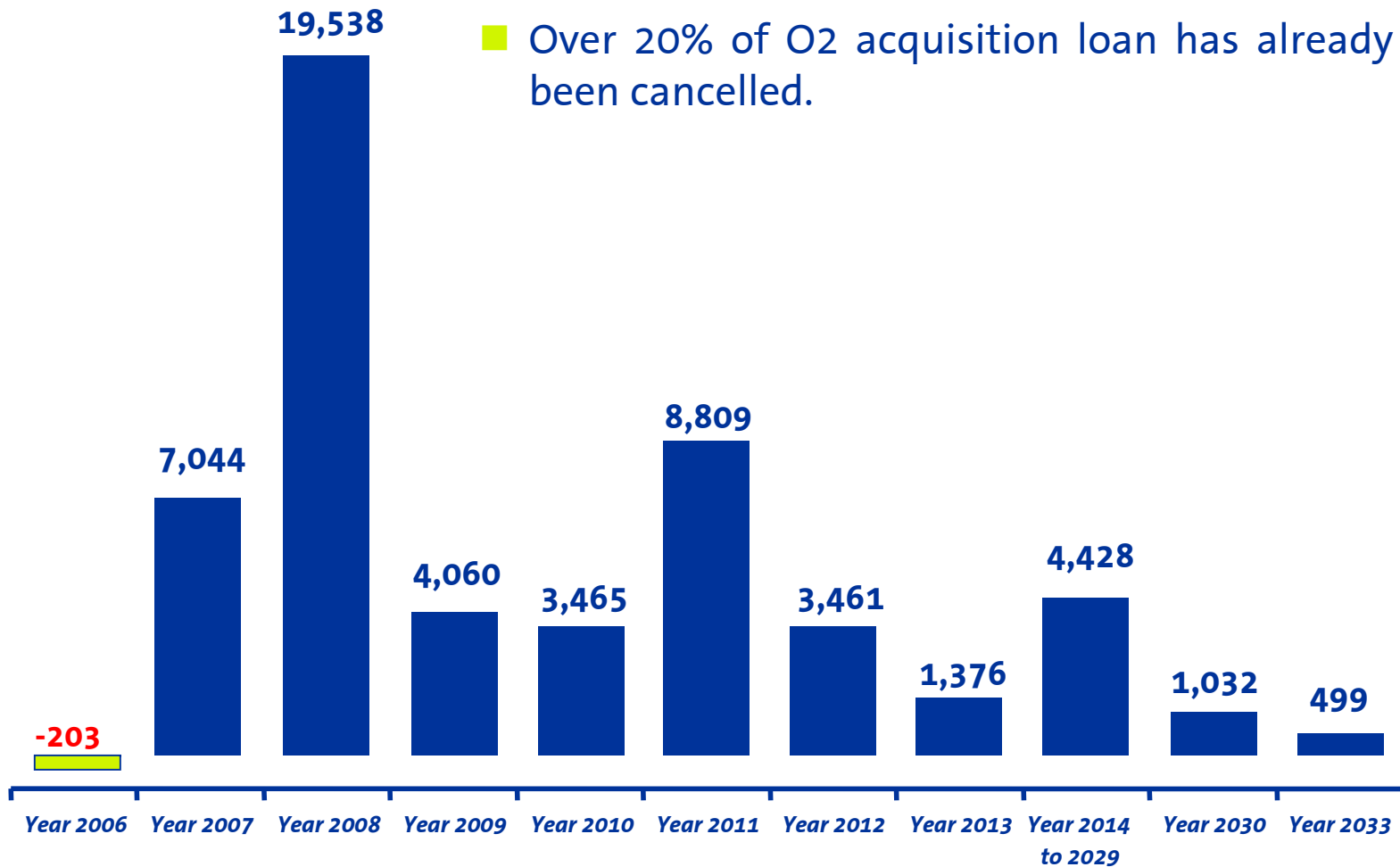


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03 Average financial debt maturity close to 5 years

- After Q1 6.6 bn Eur refinancing, we face negative 2006 maturities.
- Over 20% of O2 acquisition loan has already been cancelled.

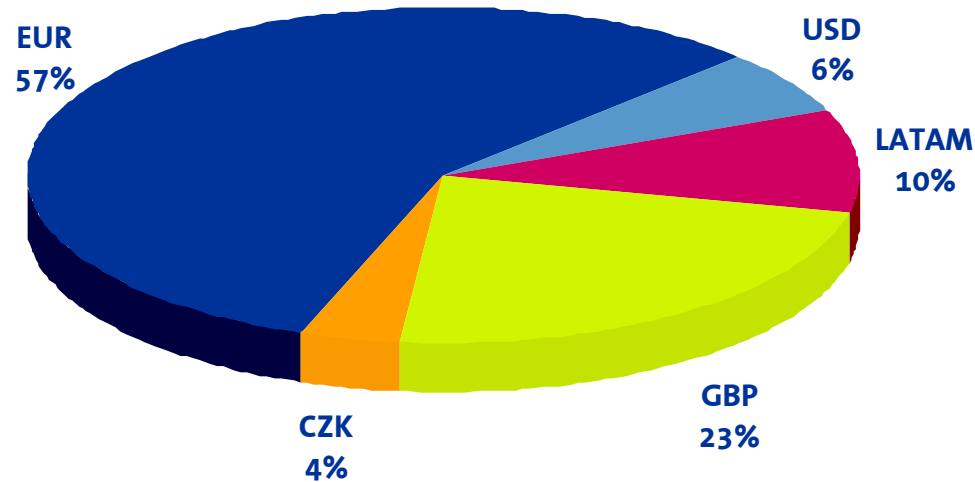


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03 Currency diversification in liability portfolio

- Latam hedging: 9 bn Eur denominated in USD and Latam currencies
- Europe hedging: 12 bn Eur in sterling, 2 bn eur in Czech Koruna
- 57% (30 bn Eur) denominated in Euros

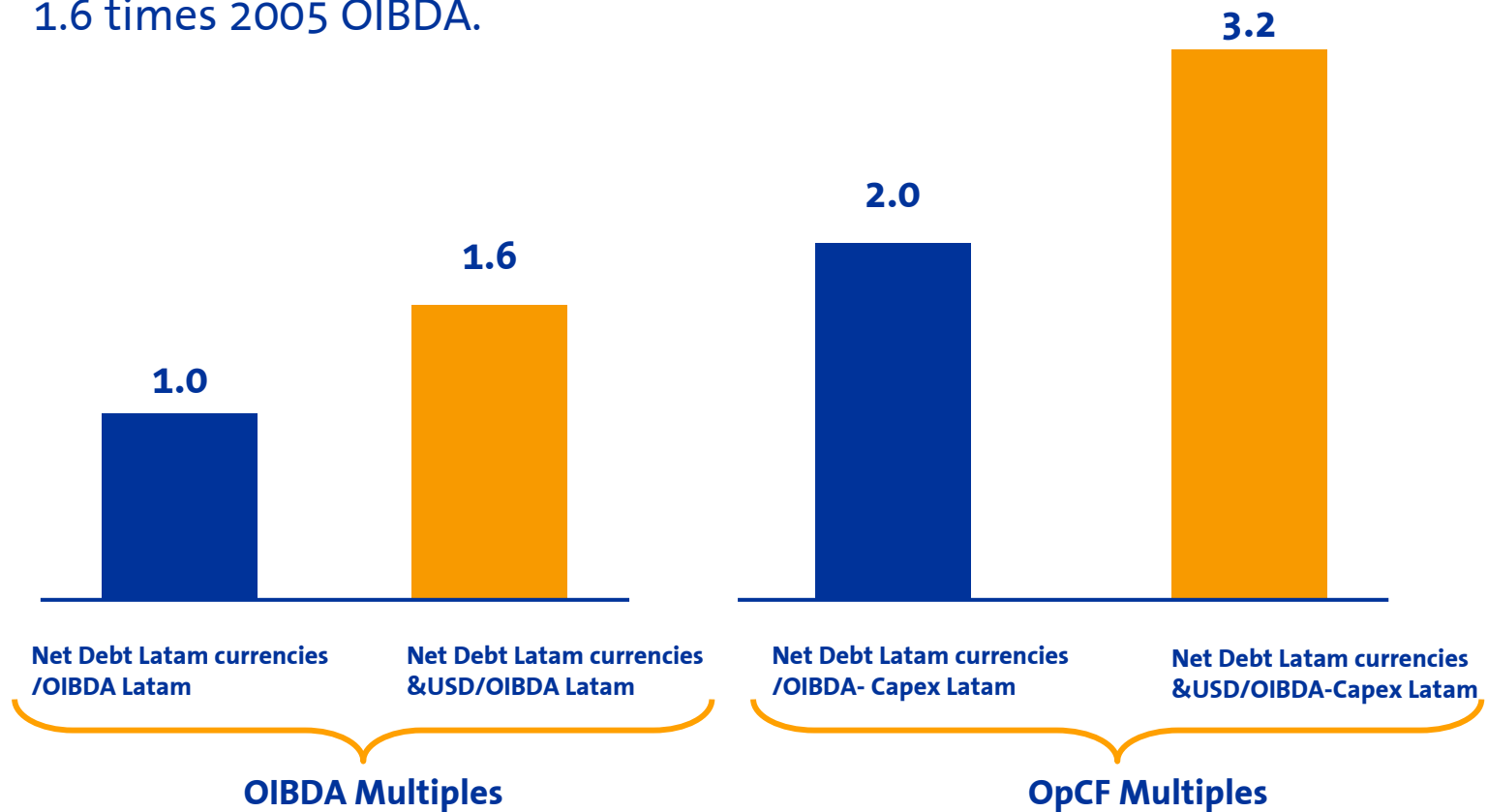


**Our strategy is not focused on debt percentages, but on
Cash-Flow, and
Assets....**

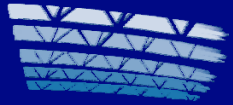


03 FX risk of Latam CF hedged for around 3 years

- Debt in Latam currencies as of March-06 reached 2.0 times 2005 operating CF, and 1.0 times 2005 OIBDA.
- When adding USD debt hedge ratios (*) rise to 3.2 times 2005 OpCF and 1.6 times 2005 OIBDA.

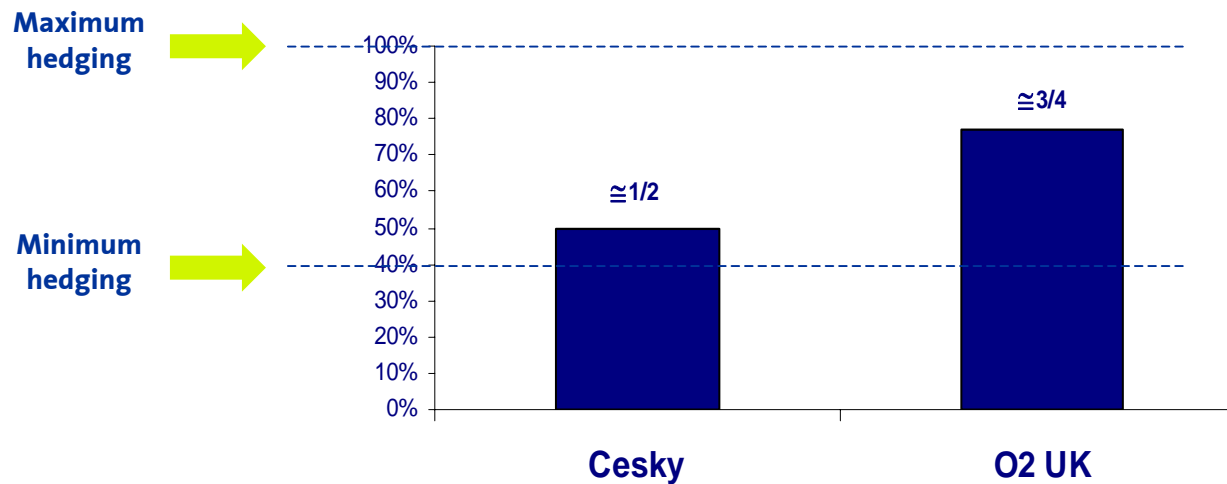


* Hedging degree varies across countries in the region



03 Hedging asset value of European acquisitions

- Risk reduction requires lower than 100% hedging due to the lack of perfect correlation between foreign asset and liabilities values in Euro terms.
- Hedging degree higher than in Latam as interest rate differentials are smaller.



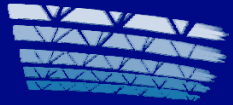
Close to 200 M Eur savings

O2 UK hedging degree

Euro funding of O2 Germany and Ireland by buying pounds for acquisition payment at rates cheaper than the one at announcement

Cesky hedging degree

6% Czech Koruna appreciation since acquisition while Czech Koruna liabilities kept at around 50% of the purchase price for playing convergence within EU

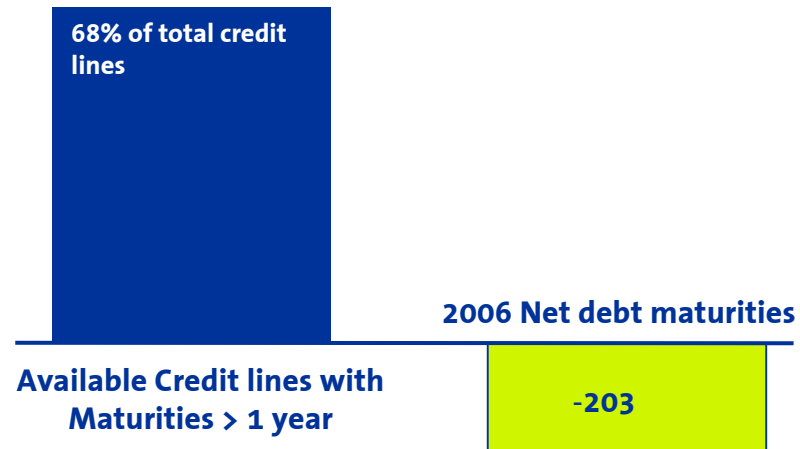


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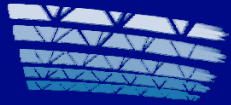
03 Healthy Liquidity Position

No Liquidity
risk in 2006

More than 8.2 billion
in credit lines



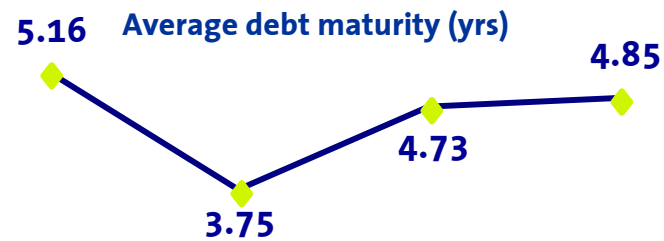
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03 Liquidity increased through refinancing

Refinancing Plan already in progress



Pre O2	O2 acquisition	Q1 2006	April 2006
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- ✓ 7.3 billion Euro long term refinancing executed
- ✓ More than 1 year average debt maturity extension

Keeping open access to capital markets

	Peers (1)	Telefónica at O2 acquisition	Telefónica as of Q1
Banking Debt	25%	73%	60%
Capital Markets	75%	27%	40%

(1) Arithmetic average of Telecom Italia, France Telecom, Deutsche Telecom and Verizon debt structure. Source: Annual Reports.

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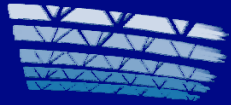


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04 Recorded Tax Credits

December 2005	
ASSETS	LIABILITIES
Investments including:	Long term liabilities including:
Net Tax credits	Deferred Taxes*
4,020 MM €	2,477 MM €
Deferred Taxes	
4,365 MM €	

* Increase due to goodwill allocated to assets

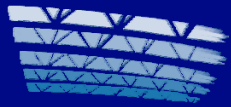
Spain	3,520 MM €
Latam	209 MM €
Móviles	195 MM €
Others	96 MM €

88%

TEF expects to offset it during the period 2006-2008



BEFORE FINAL TAX RATE CONVERGENCE



04 Tax Outlook:

Tax and accounting reforms in progress

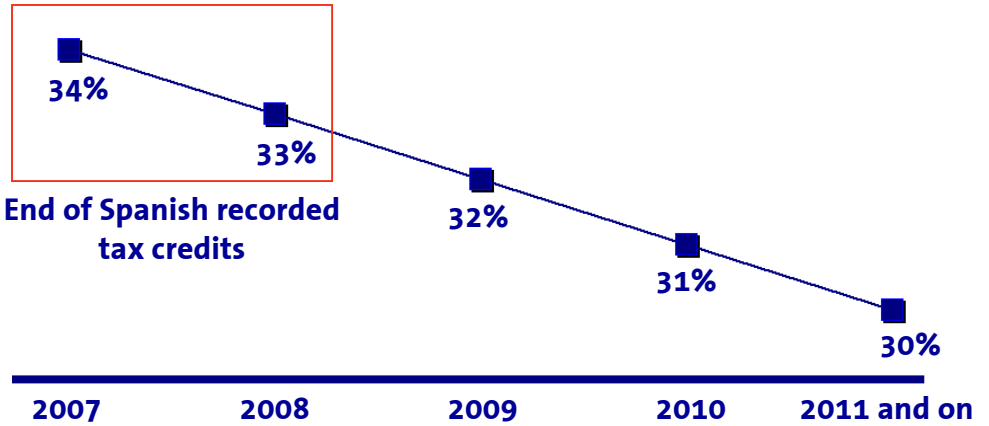
Milestones

May – June 2006

Definitive ruling on the Tax allowance for Export Activities (DAEX) case (European Union)

2007 CIT reform

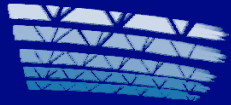
Proposal to amend Corporate Income Tax in Spain: gradual reduction of tax rates and phasing out of tax credits (allowances)



2007-on

- Final Resolution on UK UMTS VAT claim in European Tax Court.
- Accounting and tax reforms: Tax alignment to IFRS rules (2007-2008?). [IFRS currently applies to listed companies + consolidated groups only].





04 Tax Outlook (cont.)

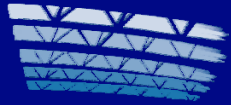
The current nominal tax rate in Spain is the highest in Europe (*)



Country	CIT (%) 2006
Spain	35%
France	33.83%
Belgium	33%
Italy	33%
Greece	32%
United Kingdom	30%
Netherlands	29.6%
Norway	28%
Sweden	28%
Denmark	28%
Finland	26%
Germany	26%
Austria	25%
Portugal	25%
Czech Republic	24%
Poland	19%
Hungary	16%
Bulgaria	15%
Ireland	12.50%

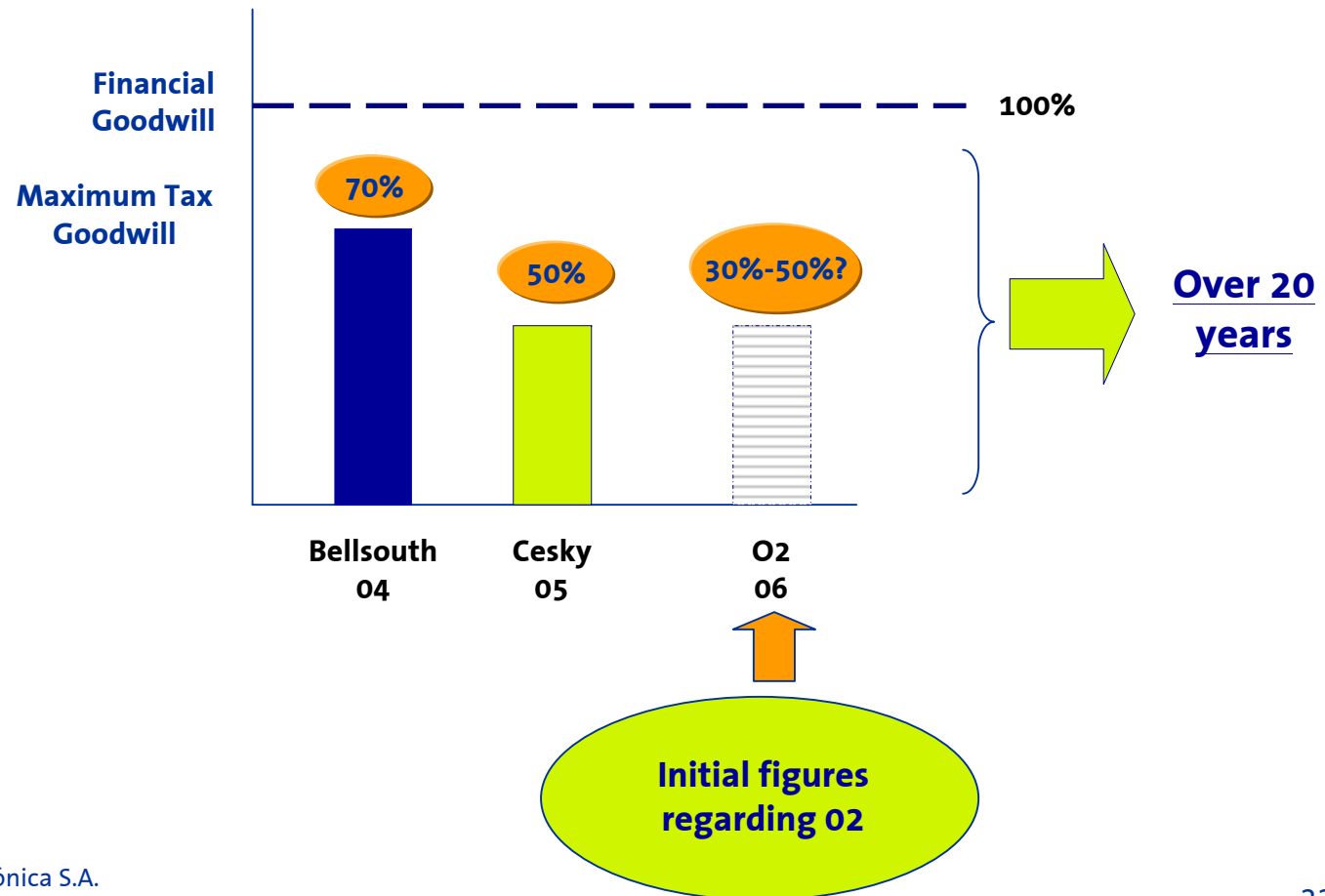
...and the planned reduction will be insufficient to catch up with the “leaders”

(*) Local taxes not included



04 Goodwill: Amortization taxwise

Financial Goodwill arising out of the acquisition of a foreign entity can be amortized taxwise in Spain under certain and **exceedingly strict circumstances** once an allocation analysis for the underlying assets, rights and contingent liabilities has been produced (PPA).



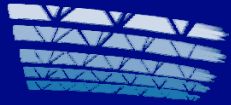


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05 CONCLUSIONS

Debt targets and metrics clearly defined:

- ✓ BBB+Baa1 rating
- ✓ 2.5x leverage

Unit cost of debt falling:

- ✓ More Eurocentric Debt
- ✓ Falling Latam costs
- ✓ Successful Risk Mgmt.

Tax outlook encouraging:

- ✓ Timing of Tax Credit exhaustion and Corporate Tax Reform boosting C-F

**HIGHER CASH FLOWS
AND
LOWER DISCOUNT RATES**

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