Telefónica: Extracting the value of a new integrated management

Julio Linares
Managing Director for Coordination, Business Development and Synergies

THE BEST COMBINATION OF GROWTH AND RETURNS

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The new Telefónica has great growth opportunities and benefits from its scale and diversity

Growth opportunities
- Telefónica has unique growth opportunities well ahead of peers
  - Position in Latam
  - Momentum in Europe
  - Distinctive leadership in Spain

Scale and diversity
- Scale
  - >180 million accesses
  - 19 countries
- Diversity*
  - Businesses
    - 44% Fixed
    - 56% Mobile
  - Geographies
    - 43% Spain
    - 24% Europe
    - 33% Latam

New integrated management

Business guidelines**
- TEM: 8-12%
- O2: 7-11%
- TdE: 3-6%
- T-Latam: 6-9%

* Based on revenues pro forma 2005
** OIBDA growth (CAGR 2006-09)
Content

Our new integrated management is...

01 ... driven by a shared customer value proposition

02 ... being developed based on a dual approach

03 ... allowing us to capture the maximum value from our scale and diversity
Our new integrated management is driven by a shared value proposition: to serve the full set of customer needs

Integrated communication, information and entertainment solutions

- **Individuals**
- **Households**
- **Businesses**

Highly attractive *brand*

Distinctive wireless, wireline and convergent services and contents *portfolio* (voice, data, broadband, TV, VAS, outsourcing and operating facilities)

Enhanced customer experience driven by motivated *people*

Efficient BB all-IP and IT *infrastructures*
We are pursuing our shared value proposition in every market independently of the organizational model ...

<table>
<thead>
<tr>
<th>Collaboration among market leaders</th>
<th>Current situation</th>
<th>Market approach</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spain, Brazil, Argentina, Chile, Peru, Colombia</td>
<td>Leading position in both fixed and mobile</td>
<td>Develop cross-selling and resource sharing programs (network, IT, purchasing)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Fully integrated telco</th>
<th>Czech Republic</th>
<th>Intense fixed to mobile substitution</th>
<th>Pursue fixed-mobile integration to reinforce commercial approach and efficiency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mexico, Venezuela, Morocco, Rest of only mobile countries</td>
<td>Convergence in broadband market</td>
<td>Continue growth in customer base and selective expansion into broadband services (e.g., WiMax)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Emerging markets mobile-based operations</th>
<th>Market approach</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spain, Brazil, Argentina, Chile, Peru, Colombia</td>
<td>Leading position in both fixed and mobile</td>
</tr>
<tr>
<td>Mexico, Venezuela, Morocco, Rest of only mobile countries</td>
<td>#1 or #2 competitive position in the market</td>
</tr>
<tr>
<td>Europe mobile-based operations</td>
<td>Strong position in the market</td>
</tr>
<tr>
<td>UK, Germany, Ireland</td>
<td>Large potential growth in market share and broadband</td>
</tr>
<tr>
<td>Integrate broadband offer on top of existing mobile (e.g., mobile + ADSL)</td>
<td></td>
</tr>
</tbody>
</table>
... with a pragmatic and flexible approach that will gradually evolve

The evolution of our model will be driven by:

- **Client interest in convergence**: Customer demand and response for segmented bundles or integrated fixed-mobile offers

- **New value creation opportunities**: new businesses or products & services that could be captured through a stronger businesses cooperation or integration

- **Market development**: competitive movements or regulatory changes that may require a new market approach

Best approach to:

- Strengthening competitiveness
- Delivering benefits from convergent options
- Capturing growth and opportunities
Our new integrated management is...

01 ... driven by a shared customer value proposition

02 ... being developed based on a dual approach

03 ... allowing us to capture the maximum value from our scale and diversity
Our new integrated management is being developed based on a dual approach

- Horizontal actions guiding our evolution to extract maximum value from our scale and diversity
- Focus on delivering growth and performance
Specific horizontal actions focused on our strategic priorities are guiding our common evolution

### Specific horizontal actions

- **Customers**
  - Multi business customer insight
  - Integrated channel management
  - Refreshed and segmented brand strategy

- **Innovation**
  - Convergent services
  - Personal TV services
  - New Internet-based business models
  - Shared broadband all-IP network

- **Efficiency**
  - Opex and Capex improvements from NGN
  - IT consolidation and standardization
  - Evolved procurement model

- **People**
  - Compensation based on share performance
  - Talent retention
  - New working culture
Multi business customer insight allows us to identify new growth opportunities

Example of identification of opportunities
Spanish residential market segmentation based on current P&S

- Focused commercial actions
  - Up selling within fixed and mobile businesses (e.g. 2P/3P)
  - Cross selling between them (e.g. FM bundles in Telefónica stores)
  - Delivering our integrated solutions

Customers

50% of revenues by 2009 will come from bundles and integrated solutions
To capture these opportunities, we are evolving towards a more integrated channel management...

**Customer reach evolution**

- Sales forces collaboration for SMEs and Corporate clients
- Cross-selling and customer care interoperability between fixed and mobile call centers
- Complete fixed and mobile portfolio available in own stores and in exclusive and non-exclusive dealers and retailers
- One single access point to fixed and mobile online stores

**Channel mix evolution**

<table>
<thead>
<tr>
<th>Present</th>
<th>Weight in the future mix</th>
</tr>
</thead>
<tbody>
<tr>
<td>~10,500 sales representatives</td>
<td>~30,000 call center positions</td>
</tr>
<tr>
<td>~3,000 call center positions</td>
<td>~65,000 POS both exclusive and non exclusive</td>
</tr>
<tr>
<td>~3% of sales</td>
<td>~3% of sales</td>
</tr>
</tbody>
</table>

- Higher collaboration among channels
- Transfer of best practices
- 100% of Telefónica products available at almost every point of contact

Increase activity in sales reps, exclusive POS and on-line channel
... reinforced with a refreshed and segmented brand strategy

Telefónica brand awareness

| 1st | 1st | 1st | 1st | 2nd | 2nd | 2nd | 2nd | 3rd | 2nd |

Brand strategy

Leverage awareness and image of our master brand at every opportunity

In Spain and Latam...
- Reinforce Movistar as the reference brand for individuals
- Consolidate current commercial brands for households into one single brand
- Maintain Telefónica as the prestigious, innovative and excellent quality brand for businesses

In European operations...
- Maintain and capitalize on O2’s cut through with customers while building on the institutional strength of Telefónica

Telefónica S.A.
To sustain our commercial leadership, we are innovating in our P&S portfolio

**Main innovation initiatives**

- **Convergent services**
  - Fixed and mobile convergence
    - Voice VPNs, home zone and single handsets
    - Wireline and wireless Internet access anywhere
  - Telecom and IT convergence
    - Integrated IP-based services
    - Network-based solutions

- **Personal TV services**
  - Flexible content selection
  - TV experience: DVR, past TV, shift TV, picture in picture,…
  - Interactive services: Messaging, videoconference
  - Mobile TV

- **New Internet-based business models**
  - Advertisement-based model: Portal and TV services through PC and mobile
  - User payment model: Legal P2P, advanced VAS (blogs, etc.)

**Top-notch content**

- Aggregation and distribution for portals, TV and mobiles
- Preferred revenue-sharing model
- Agreements with multiple vendors:
  - VoD: Warner, Paramount, Sogecable
  - TV channels: Disney Channel, Fox, HBO, Paramount Comedy, Sogecable
  - PPV: Spanish football league
  - Football World Cup rights for mobile and Internet
  - Music download for mobile and Internet (Pix Box platform): Universal Music, Sony BMG
To support new P&S, we are evolving towards a shared broadband all-IP network

NGN = IP network + NGA

- **IP network** provides a great opportunity for convergence, developing new services and efficiency improvements

- **Next generation access** is a “must” to support new customer demands with competitive and differentiated services
To support new P&S, we are evolving towards a shared broadband all-IP network

**Fixed next generation access**

<table>
<thead>
<tr>
<th>Coverage</th>
<th>2005</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spain</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Basic (1 MB)</td>
<td>89%</td>
<td>&gt;90%</td>
</tr>
<tr>
<td>Standard (&gt;10 MB)</td>
<td>49%</td>
<td>&gt;70%</td>
</tr>
<tr>
<td>Premium (&gt;25 MB)</td>
<td>-</td>
<td>&gt;40%</td>
</tr>
<tr>
<td>Latam</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Basic (1 MB)</td>
<td>78%</td>
<td>&gt;90%</td>
</tr>
<tr>
<td>Standard (&gt;10 MB)</td>
<td>30%</td>
<td>&gt;50%</td>
</tr>
<tr>
<td>Premium (&gt;25 MB)</td>
<td>-</td>
<td>&gt;20%</td>
</tr>
</tbody>
</table>

Selective deployment of new multimedia fixed access network through an optimized mix of technologies (ADSL2+, VDSL2, Fiber)
To support new P&S, we are evolving towards a shared broadband all-IP network

Mobile next generation access

<table>
<thead>
<tr>
<th>Coverage*</th>
<th>2005</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Europe</td>
<td>50%</td>
<td>80%</td>
</tr>
<tr>
<td>Latam</td>
<td>5%</td>
<td>50%</td>
</tr>
</tbody>
</table>

Selective deployment of new mobile access network through an optimized mix of technologies (UMTS, HSxPA)

* Population coverage
To support new P&S, we are evolving towards a shared broadband all-IP network

A single IP network for fixed and mobile services
- Based on common backbone and O&M
- Featured with IMS as a key element to:
  - Support all data, multimedia and convergent services
  - Differentiate level of QoS and security among customers

Common and integrated fixed-mobile network with higher level of intelligence
To support new P&S, we are evolving towards a shared broadband all-IP network

- Fixed voice network evolution
  - TDM network investments frozen and secured
  - Starting in 2007, an increasing number of new adds in new areas will be delivered via broadband

Progressive evolution towards voice over BB
To support new P&S, we are evolving towards a shared broadband all-IP network

A more efficient model to manage customer network based on “plug & play” concept taking advantage of home networking possibilities (e.g. home plug, PLC, WiFi, ...)

Additionally, new services will be delivered for the advanced digital home (e.g. domotics, tele-assistance services)

Plug & play multimedia customer network
Our shared NGN will also have a significant impact on our efficiency...

**Economic benefits from NGN**

- **Customer premises** (Opex reduction)
  - Foster self installation
  - One single visit for any installation activity

- **New access infrastructure** (Opex reduction)
  - Decrease in maintenance costs
  - Increase of automated processes

- **IP technology** (Optimization of Opex and Capex)
  - Single and simpler architecture to deliver all services
  - Remote monitoring

---

**Network operating cost per access**

<table>
<thead>
<tr>
<th>Total 2005-09E change</th>
</tr>
</thead>
<tbody>
<tr>
<td>-15/-20%</td>
</tr>
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</table>

2005  | 2009E  |

**Capex control**

<table>
<thead>
<tr>
<th>Capex to revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td>14.1%</td>
</tr>
<tr>
<td>No more than 13.0%</td>
</tr>
</tbody>
</table>

2005  | 2009E  |
... reinforced by a common vision and evolution of our IT systems ...

Infrastructures

- Reduced number of data centers in two macro-regions: Latam and Europe (from +50 to less than 8)
- Desktop services standardization (e.g. Distrito C)

Applications

- Completed first phase of SAP (ERP) multi-company integration in Spain and in progress in Latam
- Extensive roll-out of management tools (e-procurement, HR)
- Progressive shared development of new systems: customer care and billing systems evolution (e.g. ATIS)

IT expenses over revenues
Total 2005-09E change

-15/-20%

2005 2009E

- Productivity improvement
- Shorter time-to-market
- Higher flexibility
... and an evolved procurement model to maximize savings in the purchase area

**Procurement categorization**
- Items classification in different categories:
  - Align business priorities with purchase process
  - Rationalize number and quality of suppliers
  - Avoid redundant activities

**Shared purchase process**
- Shared and unique purchase process to leverage our scale (volume of ~ EUR 24 bn in purchases – #1/#2 in global ranking):
  - Better pricing conditions
  - Faster access to new technologies

**E-procurement**
- Online e-commerce suite of tools for the whole company:
  - Cost savings (better prices and terms, less stock, fewer licenses and less maintenance)
  - Higher flexibility and faster time-to-market

---

We have achieved significant savings from integrating new companies*:
- 15% on first year of implementation
- 5% recurrently every year

* Based on past acquisitions experience
Motivated and talented people will make our common strategy a reality

Aligning management with company objectives...
- Compensation based on Telefónica’s share performance
  - 1,900 top managers
  - Indexed to relative performance versus FTSE global telecom index
  - Total compensation limited

... developing and retaining our talent...
- Creation of the “Universidad Corporativa Telefónica”
- Career paths for key managers to develop individual capabilities
- Retention plans and special focus on maintaining knowledge and expertise from acquisitions

... while taking a step forward in our culture transformation
- Fostering a new working culture
  - Distrito C concept with non-exclusive and paper-free offices
  - Risk taking, innovation and entrepreneur encouragement
- Flatter organizational structures
  - Team work promotion
  - 360º evaluation for 100% of the managers
Our new integrated management is...

01 ... driven by a shared customer value proposition

02 ... being developed based on a dual approach

03 ... allowing us to capture the maximum value from our scale and diversity
The development of our horizontal strategic priorities will allow us to extract the maximum value from our scale and diversity.

Horizontal actions to develop our strategic priorities...

- Customers
- Innovation
- Efficiency
- People

... will have a positive impact on:

- Revenues (+)
- OPEX (-)
- CAPEX (-)

This positive impact will be captured through 3 types of plans:

- Business unit plans
- Country plans
- Latest acquisitions integration plans

The valuable results of our new integrated management.
We will continue moving forward with our business unit plans started in 2004

- Main business unit plans:
  - Mobile Latam regionalization
  - Fixed Latam regionalization (Candelaria)
  - Integration of Spanish fixed assets
  - Fixed Spain-Latam resources sharing

- Main common actions:
  - New P&S roadmap
  - Network and IT evolution
  - Resources sharing
    - Operating network centers
    - Services platforms
    - Support functions
Continuing previous efforts, we have launched new business unit plans sharing resources between fixed operations in Spain and Latam

IPTV services

- TdE is transferring its knowledge in Imagenio service
  - Network deployment
  - Service operation
  - Commercial approach

- Lucent agreement is supporting platform development

- A single competence center will be responsible for:
  - Services roadmap
  - Technical providers management
  - Commercial and operating best practice transferring

Reduction of time-to-market
- Reduction of ~12 months in IPTV service launch, getting income in advance

Faster learning curve
- Churn reduction ~1 p.p./month

Cost efficiency
- Savings up to EUR 30M/year in platform evolution
All business unit plans will deliver ~EUR 2.5 bn in operating cash flow

Business unit plans operating cash flow (OIBDA-CAPEX) 2006-2009

EUR Billion

- Mobile Latam regionalization: ~1.8
- Fixed Latam regionalization (Candelaria): ~0.4
- Spain integration of fixed assets (TdE-TData-Terra): ~0.1
- Fixed Spain-Latam resources sharing: ~0.2
- Total: ~2.5

Started in...
- Fixed Latam regionalization (Candelaria): (2005)
- Spain integration of fixed assets (TdE-TData-Terra): (2005)
- Fixed Spain-Latam resources sharing: (2006)
Country plans will deliver the value from fixed and mobile cooperation

- Country plans in Spain, Brazil, Argentina, Chile, Peru, Colombia and Czech Republic
- Main common actions:
  - Roadmap for convergent P&S
  - Resources sharing
    - Sales channels
    - Network and IT infrastructures
    - Support functions
Spain plan: a clear example of fixed and mobile cooperation

**Products and services**

- **Convergent offer**
  - Creation of voice solutions for groups: integrated price plans based on flat rate VPNs
  - Internet anywhere
  - Video services from/to fixed/wireless

- **Loyalty program**: Introduction of TdE products in Movistar’s loyalty program

**Network**

- Network elements sharing
- Integration of IP backbones
- Common IMS development
- Imagenio 3G

**Support functions**

- Centralized in t-Gestiona

**Channels**

- **Sales forces**: joint effort focused on win-back and cross-selling
- **Call Centers**: cross selling through transferring inbound calls
- **Retail**: joint management of retailers (portfolio, negotiation, logistics...)
- **On-line**: integration of homepages of three major commercial sites

**IT**

- Adjustments in commercial systems for provisioning and billing to deliver convergent products
- Homogenization of desktop management (Distrito C)
- One single maintenance contract

In the next six months 8 new convergent products will be launched

Collaboration channel efforts in execution stage
All country plans will deliver ~EUR 1.5 bn in operating cash flow

Country plans operating cash flow (OIBDA-CAPEX) 2006-2009
EUR Billion

Spain ~1.0
Latam* ~0.3
Czech Republic ~0.2
Total ~1.5

* Includes Brazil, Argentina, Chile, Peru and Colombia
Latest acquisitions integration plans will deliver the value from our new scale

- Corporate functions alignment
- Coordinated management of services
  - Roaming
  - International traffic
- Resource sharing
  - Purchasing and R&D
  - New services development
  - Network and IT infrastructures

Latest acquisitions integration plans will deliver the value from our new scale.
O₂ integration plan is running at full speed

We have achieved significant milestones during the last four months …

- Relevant progress in all functional teams:
  - Centralization of cash pooling
  - Single Brussels Office
  - Agreement in brand
  - Inclusion of O₂ managers into compensation system based on share performance
  - First people exchange

- Several work streams in place:
  - Joint cooperation agreements with major device suppliers
  - Launch first roaming service (e.g. “My Europe”, joint promotions with TME for summer 2006 and high roamers proposition)
  - First integrated offer for multinational clients
  - Progressive portfolio alignment

... and we continue working in additional efforts

- Full unification of functional processes

- Product and services best practice transfer (e.g. ADSL, Genion, MVNO management, Airwave)

- Launch of additional segmented value propositions (e.g. foreigners)

- Continue working on take advantage of scale
  - Networks
  - Content
  - R&D

- Development of convergent DSL-Mobile offers

- Enhance position in business segment

- Integration into O₂ processes and systems

- New brand launch

- Joint negotiation with international traffic wholesalers

- T.Deutschland fully integrated into O₂

- Cesky Telecom integrated into O₂ organization

- International traffic routed via TIWS
Latest acquisitions integration plans will deliver ~EUR 1.3 bn in operating cash flow
Our scale and diversity will create ~EUR 5.3 bn in operating cash flow through the three types of plans:

Operating Cash flow (OIBDA-CAPEX) 2006-2009

<table>
<thead>
<tr>
<th>EUR Billion</th>
<th>Business unit plans</th>
<th>~ 2.5</th>
<th>Country plans</th>
<th>~ 1.5</th>
<th>Latest acquisitions integration plans</th>
<th>~ 1.3</th>
<th>Total</th>
<th>~ 5.3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capex</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>24%</td>
<td></td>
</tr>
<tr>
<td>Opex</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>51%</td>
<td></td>
</tr>
<tr>
<td>Revenues</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>25%</td>
<td></td>
</tr>
</tbody>
</table>

These cash flows are included in the guidance provided by each business unit.
We have a rigorous follow-up scheme to control and measure the performance of the plans.

<table>
<thead>
<tr>
<th>Plans</th>
<th>Main initiatives</th>
<th>OCF 2006-09</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mobile Latam regionalization</td>
<td>Bell South integration, Network and devices, Etc</td>
<td>1.8</td>
</tr>
<tr>
<td>Fixed Latam regionalization (Candelaria)</td>
<td>Data center consolidation, O&amp;M centralization, Etc</td>
<td>0.4</td>
</tr>
<tr>
<td>Spain integration of fixed assets (Tde-TData-Terra)</td>
<td>TData integration, Terra integration, Etc</td>
<td>0.1</td>
</tr>
<tr>
<td>Fixed Spain-Latam resources sharing</td>
<td>IPTV best practices transfer, ADSL solutions, Etc</td>
<td>0.2</td>
</tr>
<tr>
<td>Spain</td>
<td>Convergent products and services, Channels cooperation, Network and IT cooperation</td>
<td>1.0</td>
</tr>
<tr>
<td>Latam</td>
<td>Convergent products and services, Channels cooperation, Network and IT cooperation</td>
<td>0.3</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>Convergent products and services, Channels cooperation, Network and IT cooperation</td>
<td>0.2</td>
</tr>
<tr>
<td>O2</td>
<td>Devices and infrastructures, Roaming wholesale, Etc</td>
<td>1.1</td>
</tr>
<tr>
<td>Cesky Telecom</td>
<td>Roaming, Technology, IPTV launching</td>
<td>0.1</td>
</tr>
<tr>
<td>Colombia Telecom</td>
<td>Commercial, Network and IT, Etc</td>
<td>0.1</td>
</tr>
</tbody>
</table>

Specific teams
Clear milestones
Managers’ compensation linked to achievements
In summary ...

- We have a new pragmatic and flexible integrated management driven by a shared customer value proposition as the best approach to:
  - Strengthen competitiveness
  - Deliver the benefits of convergent options
  - Capture growth opportunities

- Specific strategic horizontal actions around customers, innovation, efficiency and people are guiding our common evolution and will have a significant impact on our results

- To capture the value from our scale and diversity we have put in motion plans for cooperation and integration that will deliver EUR 5.3 bn in operating cash flow during the 2006-09 period

This distinctive approach enables the new Telefónica to deliver the best combination of growth and returns in the industry
Telefónica