

Telefónica is a world leader in the telecommunications sector, with over 154 million accesses and presence in 19 countries

---

# Contents

---

Letter from the chairman	4
Telefónica, motor de progreso for all	6

---

<b>00 Telefónica in 2006</b>	8
World leader in the telecommunications sector	10
Accelerating to strengthen our leaderships	11
International Presence	12
Organisational Profile	14
Driving Progress	15
2005 Highlights	16

---

<b>01 Corporate Governance</b>	20
<b>02 Identity</b>	32
<b>03 Driving progress</b>	66
<b>04 Customers</b>	104
<b>05 Shareholders</b>	168
<b>06 Employees</b>	178
<b>07 Society</b>	226
<b>08 The Environment</b>	252
09 Providers	292
<b>10 Media</b>	304
<b>11 ANNEX I</b>	310



World leader in the telecommunications sector

Accelerating to strengthen our leadership

International Presence

Organisational Profile

Driving Progress

2005 Highlights

## Telefónica is the world leader in the telecommunications sector

Almost 154 million accesses

### Accesses

As at the end of FY 2005, Telefónica Group had a total of 153,5 million accesses. Including customers of O2, whose acquisition materialised in 2006, Telefónica Group's customer base rises to 180.9 million.

4th company in the world in terms of number of customers

The mobile telephony customer base grew to 99.1 million, and fixed telephony reached the figure of 40.9 million customers.

Almost 2,900 million euros invested in technological innovation

Including O2 customers, Telefónica was fourth largest company in the world in terms of number of customers as of FY 2005.

More than 207,000 employees

### Investment

During the last two years, Telefónica has considerably expanded with the acquisition of BellSouth's assets in Latin America in 2004, the acquisition of Cesky Telecom and the purchase of 5% of the share capital of China Netcom in 2005 and the acquisition of the European assets of operator O2 in 2006.

Included in the Dow Jones Global 50 Titans

Telefónica has relevant operations in 19 countries, and is the leading private investor in Latin America.

In the course of 2005, Telefónica assigned almost 2,900 million euros to technological innovation activities.

### Financial Results

Telefónica Group's income increased by 25.1% with respect to 2004, reaching 37,882.1 million euros.

Telefónica Group's OIBDA amounted to 15,276.4 million euros, with an increase of 25.0% compared to 2004.

Telefónica Group's net income rose to 4,445.8 million euros, a 40.0% increase compared to 2004, thanks to the good performance of operations as a whole, and to the positive contribution of the acquisitions made.

### Employees

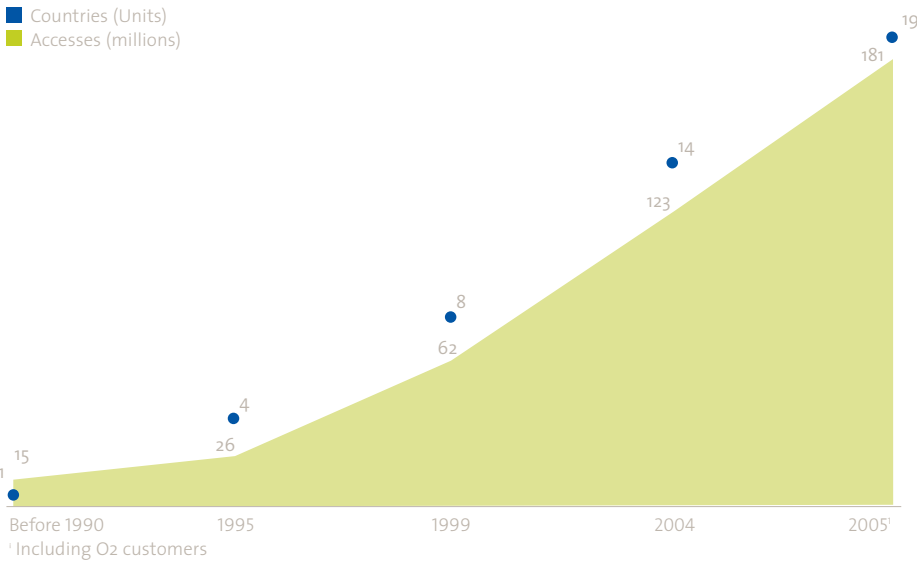
Telefónica's direct staff as a consolidated Group includes over 207,000 employees, of which 37% correspond to Europe and 63% correspond to Latin America.

### Shareholders

Telefónica is an entirely private company, with over 1.5 million direct shareholders, listed in the main national and foreign stock exchanges.

Telefónica is part of the Dow Jones Global 50 Titans index, which includes the 50 most important companies in the world.

## Transformation of the Telefónica Group



## Accelerating to strengthen our leadership

The desire to become the best combination in the telecommunications sector in terms of growth and profitability is based on a programme of transformation, which, under the motto “Accelerating to strengthen our leadership”, is built on five cornerstones: customer orientation, innovation, operational excellence, commitment, leadership in people and a common Group identity.

In 2005, Telefónica continued in its transformation programme, focused on becoming an integrated Group that satisfies its customers’ overall communication needs, extending innovation from the technological field to different processes in the value chain. The aim is to have the best customer satisfaction levels in its sector, and to be a company which employees are proud to be a part of. It aims to be one company, with a set of values and a common identity shared by all the businesses that comprise the Telefónica Group.

Over the last 20 years, Telefónica has experienced an important process of transformation, which has allowed it to acquire a new dimension, and to strengthen its competitive positioning through the scale of the company:

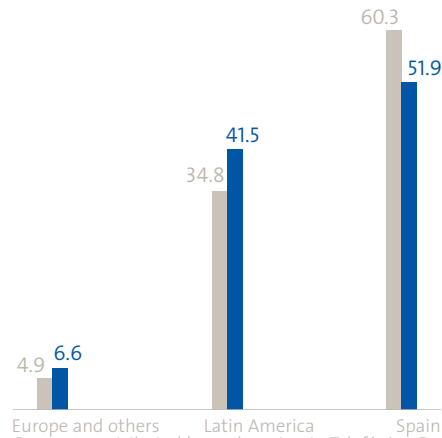
- From operating only in Spain to offering its services in nineteen countries, representing a potential market of 670 million people.
- From offering basic communication services to offering a wide range of communication solutions tailored to the needs of each client.
- Telefónica has increased the value of its assets by seven, has multiplied its revenue by twenty-one, and has increased its market capitalisation by thirty-nine times.
- Telefónica has increased the number of its employees by three times, and its number of clients has increased by twenty times.



### Geographic Distribution of Revenue<sup>1</sup>

Percentages

■ 2004  
■ 2005



<sup>1</sup>Revenue contributed by each region to Telefónica Group's consolidated results

## International Presence

Growth of Telefónica  
2003-2005:

Accesses x2

Countries +10

Employees x1.5

### Global presence, local focus

Telefónica operates in many countries, each one of them with very different challenges and opportunities. The value of a business is not only focused on the penetration into new markets, but rather in the day-to-day management of the companies, thinking globally while keeping the local focus on our operations.

Telefónica will only become a genuinely global company if it acts and manages its affairs as a local company. To this aim, the common focus of Telefónica Group lies in its customers, and the importance of customers for Telefónica Group is what makes Telefónica different from other operators.

### Dimension and scale

The year 2005 has meant an important step ahead in terms of the Group's dimension and scale. The integration of the operations of BellSouth and Cesky Telecom, together with the acquisition of O2, have accelerated its growth profile, increasing its differential factor with regard to its European competitors.

These operations are proof that one of Telefónica's strategic aims is the obtention of synergies. More specifically, and as a result of the integration of BellSouth mobile operators Latin America, Telefónica Group has already met over 50% of its own synergy previsions. In the case of the integration of O2 in Telefónica Group, previsions point to the synergies generated reaching 3,300 million euros in the first year.

As from April 2006, Telefónica is a strategic partner of the State operator Colombia Telecom. In addition, Telefónica owns 5% of the share capital of the Chinese telecommunications company China Netcom, which has allowed Telefónica to start creating a strategic framework for cooperation in fields such as joint acquisition of technology and infrastructures, technology transfers and other fields related to management.

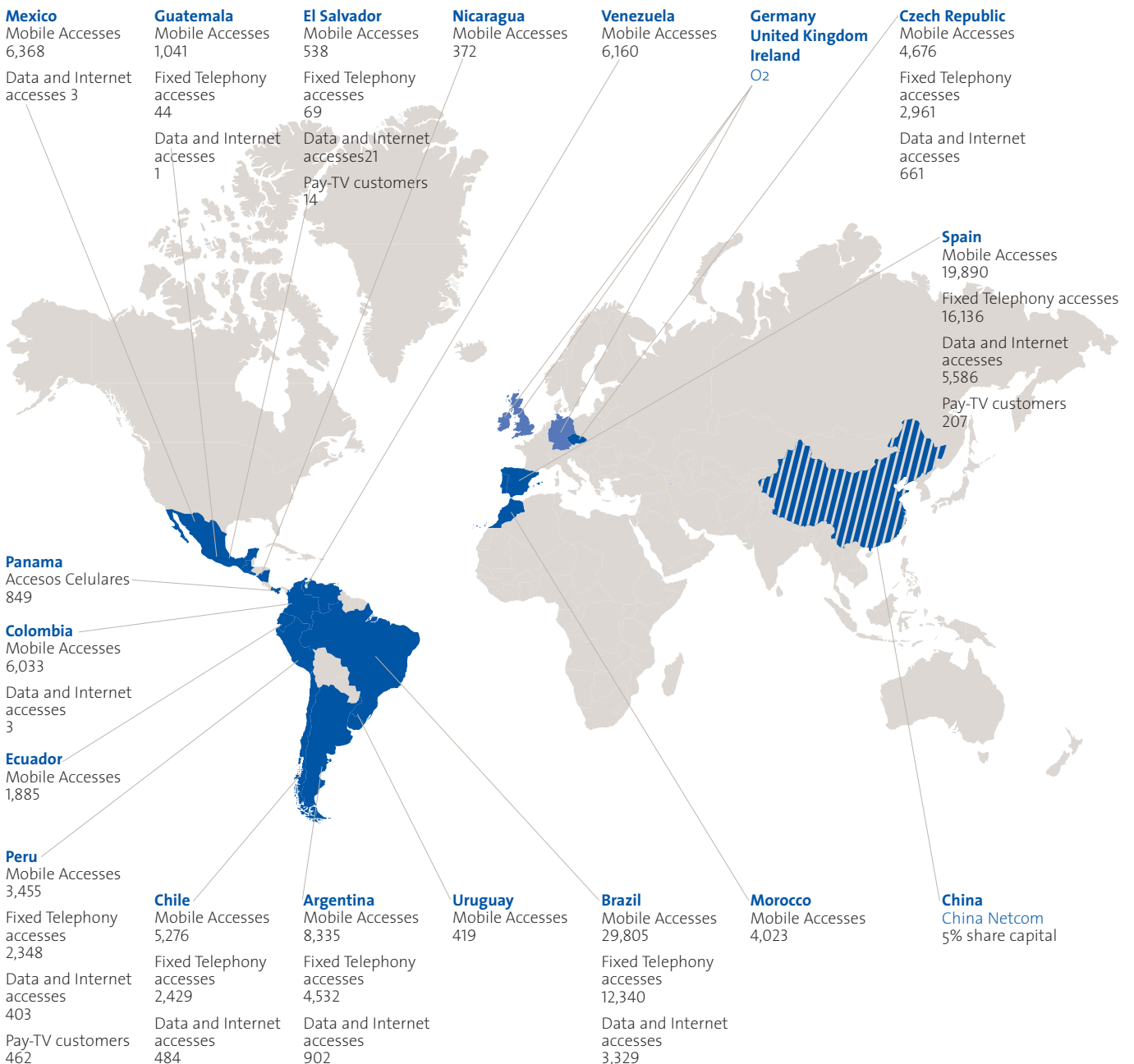
### Integrated Operator: business diversification

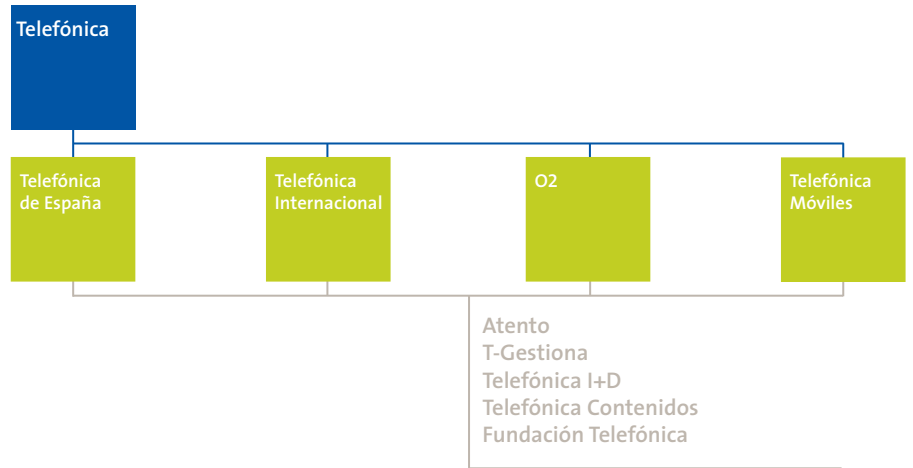
The financial results for 2005 have been strengthened by the diversification brought by being an integrated operator. In this context, the mobile telephone business is the main contributor to the Group's revenue (+38.1%/year) while the fixed telephony business is the most profitable line, having grown by 19.9% in Spain and 14.6% in Latin America with regard to 2004.

By geographic regions, Spain represents 51.9% of the Group's consolidated revenue, while Latin America represents 41.5%. The acquisition of Cesky Telecom, in July 2005, has brought increased geographic diversification, with the Czech Republic representing 2.7% of the consolidated revenue.

## Telefónica: Market size (2005)

Figures in thousands





## Organisational Profile

Throughout recent years, Telefónica has concentrated its telecommunications business, strengthening its presence in fixed and mobile telephony markets, and focusing its business model on satisfying all its customers' communication needs.

### Telefónica de España

Its main activity is providing fixed telephony and broadband services in Spain. Telefónica Empresas, Telefónica Soluciones and Terra in Spain are also integrated in this business unit, offering value-added services to its customers.

### Telefónica Internacional

Telefónica's investments in the fixed telephony sector in Latin America are managed through Telefónica Internacional (also known as Telefónica Latinoamérica). Its activities are carried out mainly in Argentina (TASA), Brazil (Telesp), Chile (CTC), Peru (TdP). Telefónica Empresas América, Terra Latinoamérica and Telefónica International Wholesale Services are also integrated in this business unit.

### Telefónica Móviles

Telefónica Móviles leads the Spanish- and Portuguese-speaking markets. As at December 2005 Telefónica Móviles offered its services to over 94 million clients, being present in all key markets in Latin America, and achieving a leading position in the region.

### O2

At the start of 2006 Telefónica concluded a tender offer to buy the operator O2, with significant operations in Germany, Ireland and the United Kingdom.

As a result of the reorganisation carried out by Telefónica in December 2005, Cesky Telecom and Telefónica Deutschland are also integrated within this Business Unit.

### Atento

Provides customer assistance service through contact centres or multi-channel platforms (telephone, fax, Internet...).

### Telefónica I+D

Oriented towards the creation of services, the management of networks, services and businesses, with special attention to technological innovation of a strategic nature or new to the market.

### T-Gestiona

Administrative support for the Group related to non-strategic activities common to the different business units.

### Fundación Telefónica

Channels all the non-profit social and cultural activities.

### Centro Corporativo

Responsible for the definition of global strategy and corporate policies, for the management of common activities and the coordination of the activities of the business units.

## Driving Progress

Telefónica is an important driving force for economic, social and technological development in the countries where it is present.

### Driving Economic Development

In 2005 Telefónica distributed over 51,000 million euros among its stakeholder groups, of which over 4,000 million euros were used for employee remuneration; almost 5,000 million euros were distributed among shareholders and over 19,000 million euros went to suppliers. It is important to note the collecting role of Telefónica which, through fees, licenses, consumer taxes and indirect taxes, has channelled over 8,500 million euros for the Public Administrations.

Telefónica's revenue represents an average of 1.7% of the Gross Domestic Product of the economies of the main countries where it is present.

Over 18,000 suppliers collaborate with Telefónica worldwide, with a high percentage of contracts being awarded to local suppliers (an average of 85% in 2005).

### Driving Technological Development

During 2005, Telefónica earmarked almost 2,900 million euros for technological innovation activities.

Telefónica further increased its investment in R&D activities in 2005, reaching a total of 530 million euros, which amounts to 1.4% of Telefónica Group's total revenue.

### Driving Social Development

Telefónica wishes to be perceived as a group that is responsible and committed towards its stakeholders.

Telefónica is increasingly customer-oriented, and committed to excellency in quality and services. As a result of this effort, in 2005, Telefónica has reached a customer satisfaction level in Spain of 83%.

During 2005, Fundación Telefónica carried out a strategic revision of all its projects, focusing its efforts on two areas of activity: Education (Educared) and the integration of children into society (Proniño). It is important to note the commitment of employees to volunteer activities, and their commitment towards disabled people through ATAM.

The digital inclusion of people with low economic resources (over 5 million prepaid and controlled lines in Latin America) or people with disabilities (via the project Telefónica Accesible) are initiatives which show Telefónica's commitment to social inclusion.

Implementation of Telefónica Group's Code of Ethics.

Publication of annual reports on Corporate Responsibility in Argentina, Brazil, Chile and Peru.

Presence of Telefónica in the main sustainability indices: DJSI and FTSE4good, among others.

51,000 million euros redistributed among stakeholder groups

Revenue / GDP = 1.7% for main countries

Over 18,000 suppliers

533 million euros on R&D

83% customer satisfaction in Spain

5.5 million accesses for low income households in Latin America

Over 54 million euros on social and cultural action





# 2005 Highlights

## Profitable Growth\*

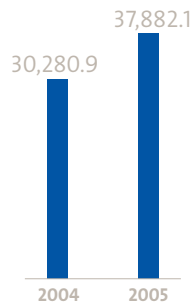
+40%

### Results

4,445.8 Million Euros

#### Revenue

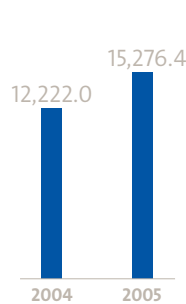
Millions of Euros



+25.1%

#### OIBDA

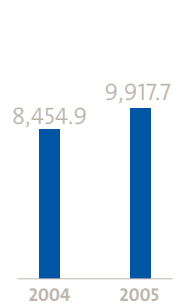
Millions of Euros



+25.0%

#### Cash flow generation

Millions of Euros



+17.3%

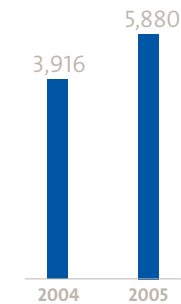
+24%

### Clients

154 million accesses (not incl. O2)

#### ADSL Lines

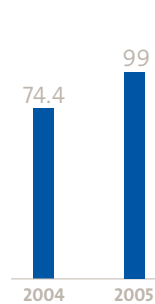
Thousands of clients



+50.2%

#### Mobiles

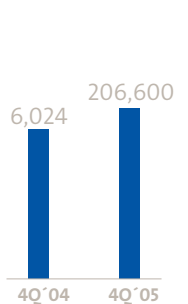
Millions of clients



+33.2%

#### Imagenio

Clients

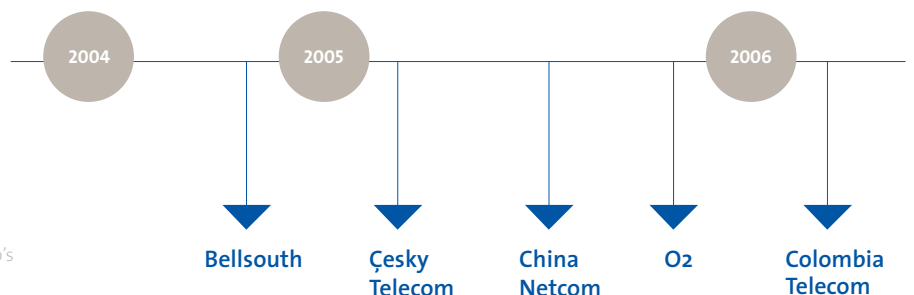


+200.6%

### Growth

5 corporate acquisitions in 2 years

#### Growth due to acquisition 2004-2005



\*For a broken down, detailed analysis of Telefónica Group's consolidated financial statements, please refer to the audited information in the annual statement of accounts

# Driving Progress

## Economic progress

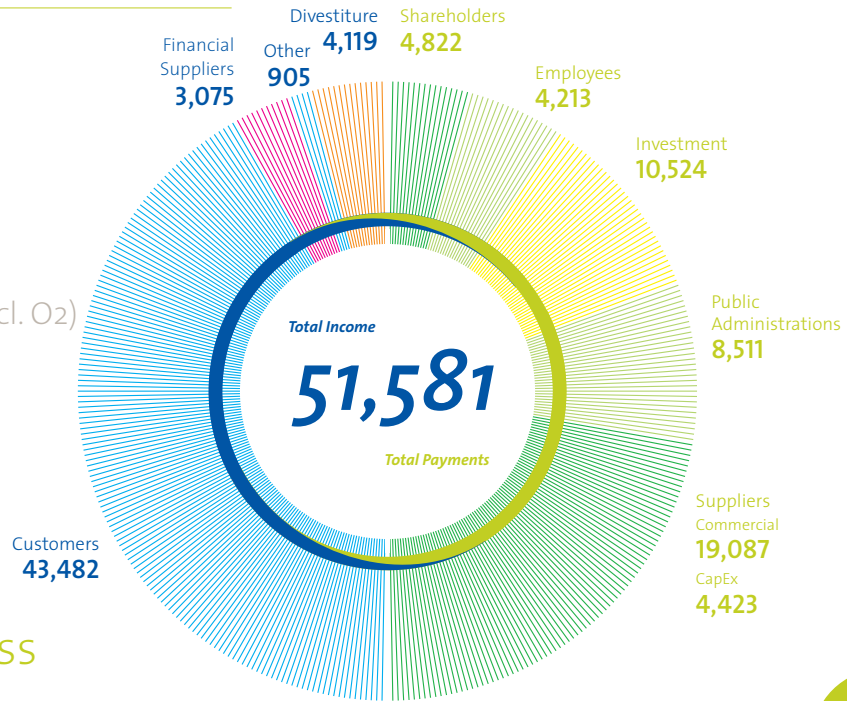
18,000 suppliers

1.7% Contribution of income to National GDP

154 Million accesses (not incl. O2)

1.5 Million shareholders

207,000 Employees



## Tecnological Progress

2,900 million euros on innovation

+21%

### Innovation

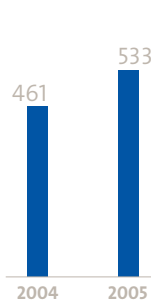
Millions of Euros



+20.9%

### R&D

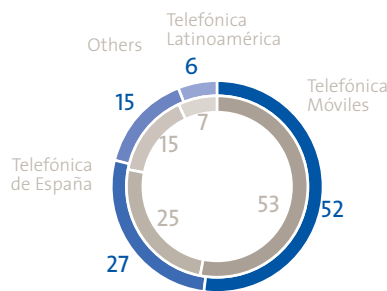
Millions of Euros



+16.6%

### Who innovates?

In percentages



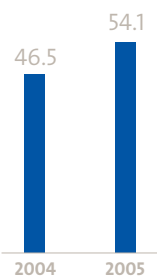
## Social progress

54 million euros in social action

+16%

### Social action

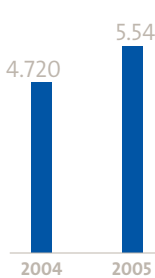
Millions of Euros



+16.6%

### Digital inclusion

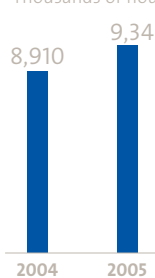
Thousands of lines in low income homes LATAM



+17.4%

### Employee Training

Thousands of hours



+5%

# Credits

## Departments that collaborated in the preparation of the report

Capítulo	Áreas implicadas
01 Corporate Governance	Secretariat General / Internal Auditing Department
02 Identity	Communication (Brand, Reputation and CSR) / Human Resources Office / Sponsorship / Internal Auditing Department
03 Driving Force for Progress	Finance (Consolidation, Management Control), Tax, Regulatory Affairs, Innovation, Telefónica I+D, Institutional Relations, Information Systems, Investor Relations
04 Customers	Corporate Marketing Development / Quality, marketing and customer service departments of the main business lines (Telefónica de España, Telefónica Móviles, Telefónica Latinoamérica) / Secretariat General / Communication / Security
05 Shareholders	Shareholders' Office / Investor Relations / Secretariat General
06 Employees	Corporate Human Resources / Human Resources Departments of the main lines of business (Telefónica de España, Telefónica Móviles, Telefónica Latinoamérica, TPI, Terra, Atento, T-Gestiona) / Communication / Health and Safety / Fundación Telefónica / ATAM / Fonditel
07 Society	Main lines of business (Telefónica de España, Telefónica Latinoamérica, Telefónica Móviles) / Institutional Relations / Management Control / Regulatory Affairs / Reputation and Corporate Social Responsibility / Fundación Telefónica / ATAM / Sponsorship
08 Environment	Internal Auditing / Reputation and Corporate Social Responsibility / Environmental Departments of the main lines of business (Telefónica de España, Telefónica Móviles, Telefónica Latinoamérica)
09 Suppliers	Purchasing / Internal Auditing / Reputation and Corporate Responsibility
10 Media	Communication
Annex 1: About the Report	Reputation and Corporate Responsibility
Annex 2: Verification Report	Ernst&Young. Report
Coordination	Reputation, Brand and Corporate Social Responsibility (G.D. of Communication)

