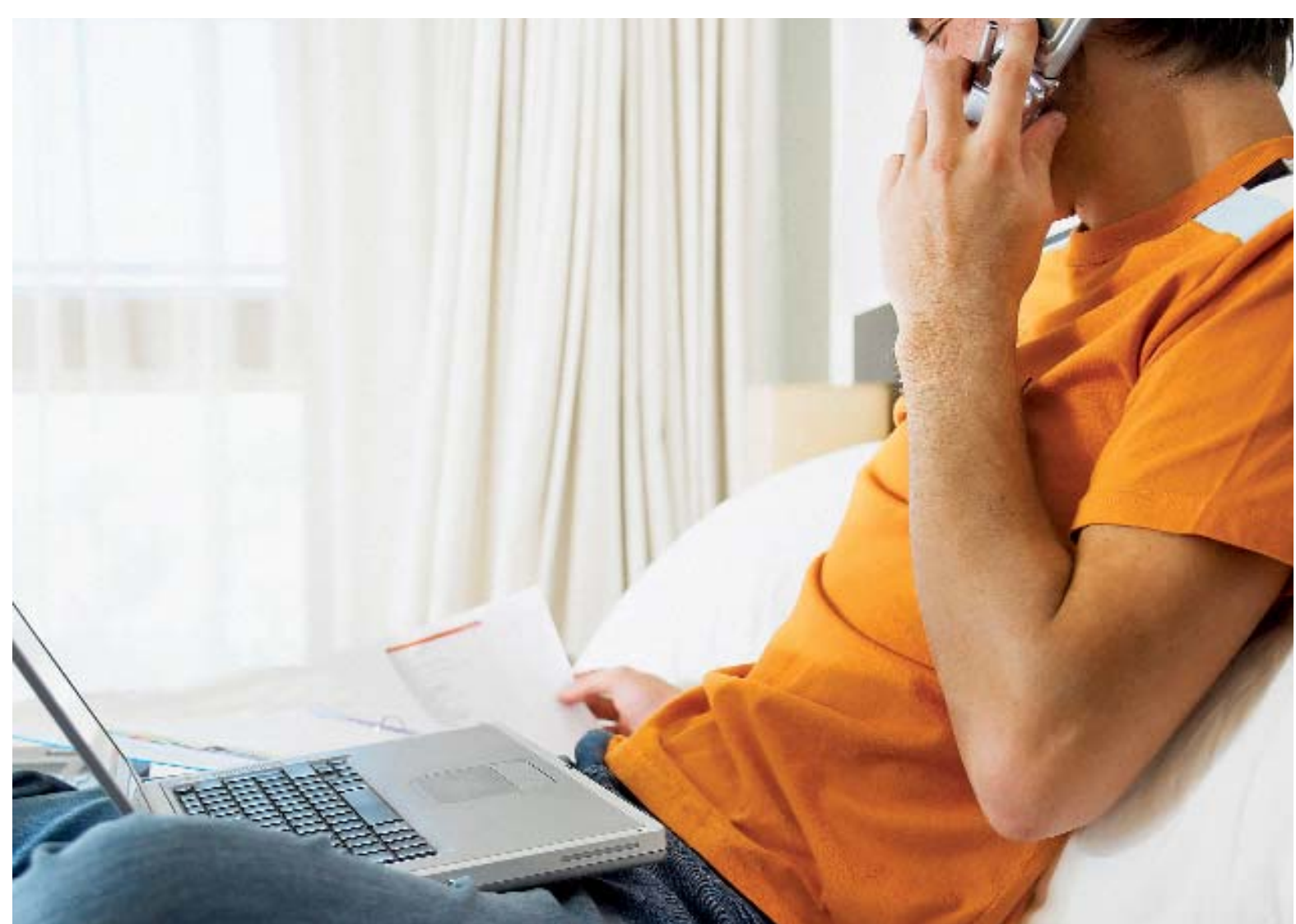


# The Telefónica Group in 2005

01

In 2005, Telefónica acquired a new dimension, with a new size on a regional scale and a wider diversification of its businesses.

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“Telefónica is world leader in the telecommunications sector, with over 181\* million accesses and presence in 19 countries”

## About Telefónica 2006

Over 181\* million accesses

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

Almost 2.9 billion euros invested in technological innovation

More than 207,000 employees

Listed in the Dow Jones Global 50 Titans

### Telefónica is world leader in the telecommunications sector

#### 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.

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

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

#### 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 O2 in 2006.

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

In the course of 2005, Telefónica assigned almost 2.9 billion euros to technological innovation activities.

#### R&D

In the course of 2005, R&D rose to 311 million euro in Spain, and over 533 million euro worldwide.

In 2005, Telefónica assigned almost 2.9 billion euros to technological innovation activities, an 20.9% increase compared to 2004.

#### Financial Results

Telefónica Group's income increased by 25.1% with respect to 2004, reaching 37.8821 billion euros.

Telefónica Group's OIBDA amounted to 15.2764 billion euros, with an increase of 25.0% compared to 2004.

Telefónica Group's net income rose to 4.4458 billion 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.

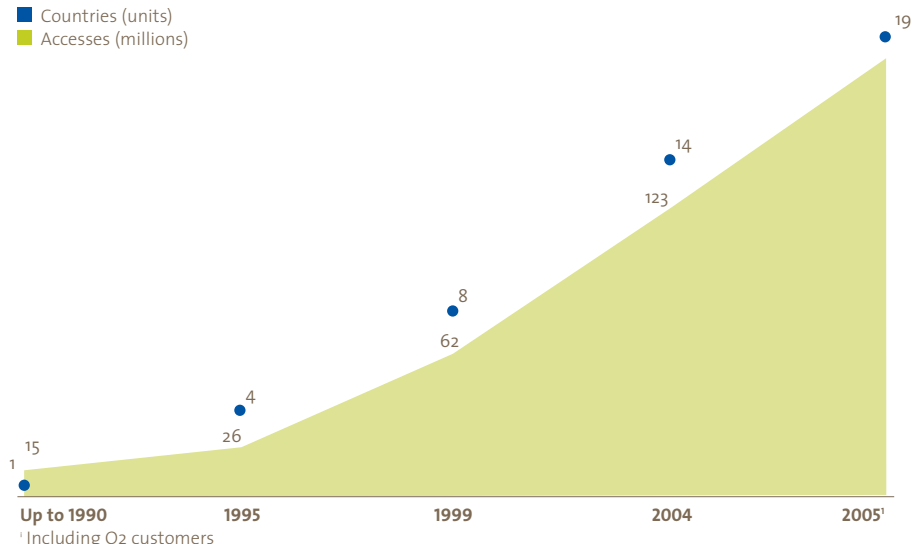
Telefónica is part of the Dow Jones Global 50 Titans index, which includes the 50 most important companies in the world.

Further information:  
[www.telefonica.es/acercadetelefonica](http://www.telefonica.es/acercadetelefonica)

\*Including o2

## Transformation of the Telefónica Group

■ Countries (units)  
■ Accesses (millions)



## International presence

### 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 3,3 billion euros.

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.

## Growth of Telefónica 2003-2005:

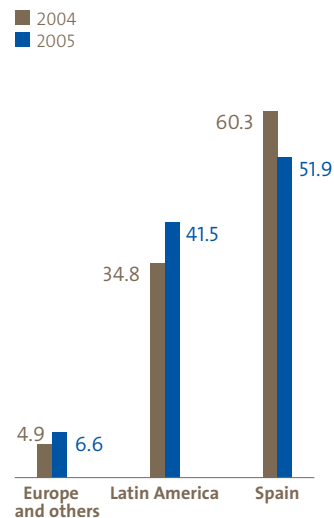
Accesses X2

Countries +10

Employees x1.5

### Geographic distribution of revenues<sup>1</sup>

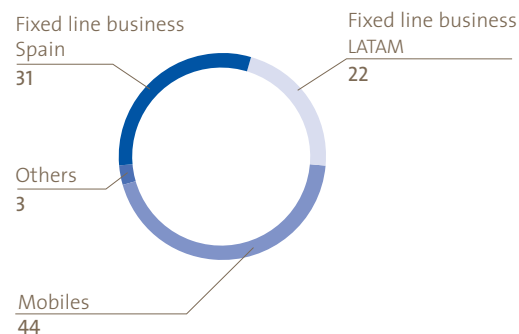
Figures in %



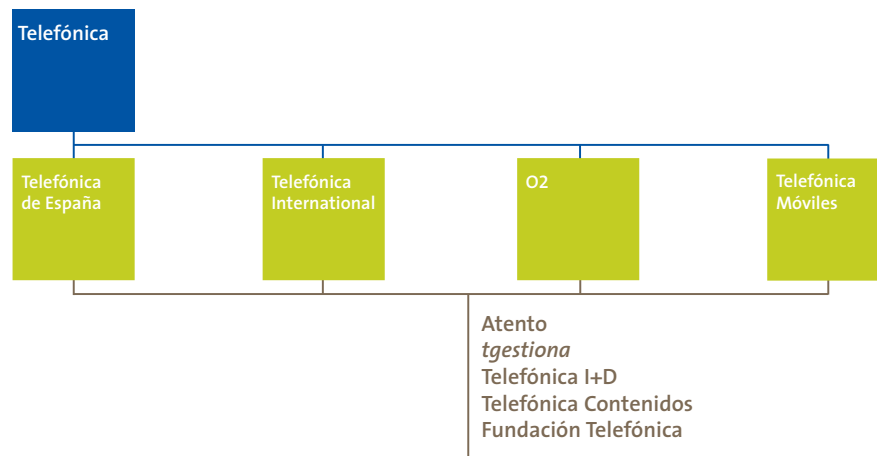
<sup>1</sup>Revenue contributed by each region to Telefónica Group's consolidated results

### Business Lines Distribution of revenues

Figures in %



Others includes: Cesky Telecom, Directories business, Atento Group, Content and media business, other companies y eliminations



## 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.

## Lines of activity

### 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 International

Telefónica's investments in the fixed telephony sector in Latin America are managed through Telefónica International (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.

## Others

### 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.

### tgestiona

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.

### Corporate Centre

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 billion euros among its stakeholder groups, of which over 4 billion euros were used for employee remuneration; almost 5 billion euros were distributed among shareholders and over 19 billion 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 8.5 billion 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 2.9 billion euros for technological innovation activities.

Telefónica further increased its investment in R&D activities in 2005, reaching a total of 533 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 stakeholder groups.

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.

**51.581 billion euros** redistributed among stakeholder

**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





“Telefónica’s growth-oriented business strategy is represented by the motto “Forging ahead to gain leadership”, and is built on 5 cornerstones: Customers, Innovation, Excellence, People Leadership and Identity and Communication”

# Business strategy



## A new scale

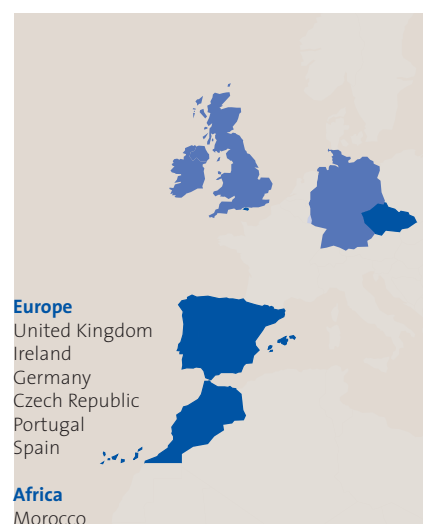
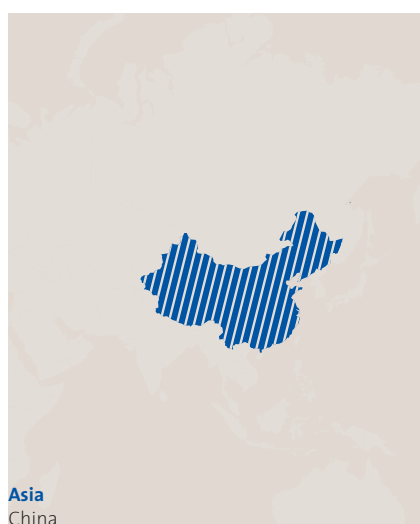
Telefónica in 2005 has taken on a new dimension. In fact it has become a new and better company, with a new size on a regional scale and greater diversification in its businesses. The reasons for this transformation are supported by the establishing of suitable growth platforms and thanks to geographical and business equilibrium. The rapid integration of the assets acquired from BellSouth, the clear operating and financial improvement of Cesky Telecom and the incorporation of O2 into Telefónica's assets are the main milestones of the past financial year.

This unique and distinctive profile of Telefónica within the industry as a whole locates the company in an incomparable position to gain the maximum benefit from the growth opportunities available in the sector. This distinguishes Telefónica from the rest, exceeding market expectations and winning credibility through sticking to its commitments.

In the past 20 years, Telefónica has in fact increased the value of its assets seven times, has multiplied the revenue generated twenty-one times and has increased its stock market capitalisation thirty-nine times. The number of employees has tripled and the number of customers multiplied twenty times.

As from April 2006, Telefónica also became strategic partner of the state operator Colombia Telecom. At the same time, Telefónica has 5% of the equity of the Chinese telecommunications company China Netcom, which has enabled it to start a strategic cooperation framework in areas such as the joint acquisition of technology and infrastructure, technology transfers and other areas related with management.





## An integrated, diversified and global operator

Telefónica has met all the financial targets set for financial year 2005. These economic and financial results have been strengthened by the diversification involved in being an integrated operator. In this context, the mobile business is clearly the main contributor to Group revenues (+38.1% per year) while the fixed telephony business is the main source of profitability, growing 19.9% in Spain and 14.6% in Latin America compared to 2004.

By geographic zones, Spain represents 51.9% of the consolidated revenue of the Group while Latin America represents 41.5% due to the incorporation of the BellSouth operators. The incorporation of Cesky Telecom since July 2005 has provided greater geographic diversification, providing some 2.7% of consolidated revenues from the Czech Republic.

Telefónica operates in numerous countries, each with its own very different challenges and opportunities. The value of our business is not centred only on a dynamic of entering new markets, but on the day-to-day running of our companies, thinking globally but keeping the local focus of our operations. Telefónica will only become a truly global company if it acts and manages itself as a local company. For this, the common focus of the Telefónica Group is on the customer and the importance that the customer has for Telefónica is what differentiates it from other operators.

Telefónica has been one of the few incumbents to revise its growth expectations upwards thanks to European industry obtaining greater organic growth, to confidence in its revenue generating capacity, above the market average, aspects in which it also offers greater growth profiles compared with its European peers. The predictions are suggesting revenue increases of between 34% and 37%, and an investment of around 7.2 billion euros.

2006, then, will be marked by the integration and consolidation of O2, which not only brings with it significant benefits of scale and synergies, but also, together with the activity in the Czech Republic, enables a rebalancing and diversifying of Group exposure.

### Orientated to growth

All these operations help to point up that obtaining synergies is one of the strategic targets of Telefónica. In fact, as a result of the integration of the BellSouth mobile operators in Latin America, Telefónica has already obtained more than 50% of its own predictions of synergies. As for the integration of O2, predictions suggest that the synergies produced should reach some 3.3 billion euros in the first year.

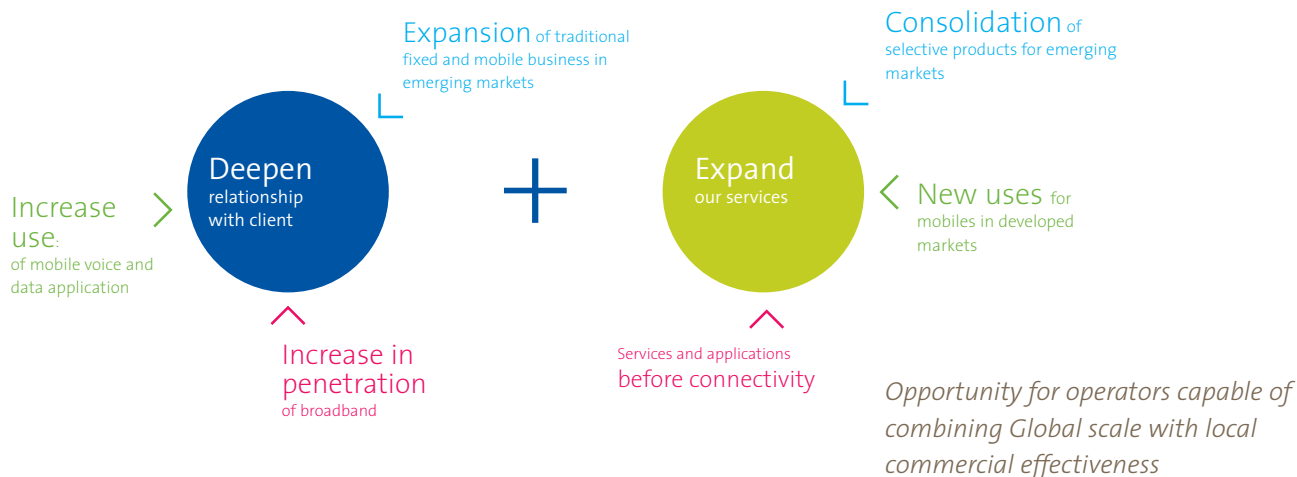
Telefónica continues to maintain its objective of offering the best combination of growth and returns to the sector shareholder. This is why the company's vision involves placing the customer in the foreground, being the most competitive operator in every market, offering innovative services simply and running Telefónica as an integrated IP company.

Its business strategy is therefore designed with a clear orientation towards growth, to designing an integrated offering that will meet the global communications needs of its customers, extend innovation from the technological area to the different processes of the value chain, have the highest levels of customer satisfaction in the sector, and stand out for its social activity and for its employees' pride of belonging.

This business strategy is based on four principles: financial excellence, a better spending structure, integrated, clearly customer-orientated management through a totally IP company, and a significant growth in revenue, the latter, driven mainly by the increase in the customer base and in the ratio obtained per customer, with innovative products and integrated communication, information and entertainment solutions. In this context already in 2005, the evolution from the traditional voice-centred business model towards a greater weighting of income from data, broadband and others, can be clearly seen. Proof of this is that, in the whole year, the income from traditional voice was expected to be 55%. The expectations for 2009 aim at voice revenue around 15%, giving way to income from data and broadband.

In this context, and with the aim of becoming the best combination of growth and profitability for the shareholder, in 2005 Telefónica continued developing its transformation programme which, with the motto Forging ahead to gain leadership, focuses itself on five cornerstones: customer orientation, innovation, excellence in operations, leadership of people and a common identity and communication.

## With a clear, growth orientated strategy



### Target 2009

Nowadays Telefónica has a series of companies that run the businesses, others that work across these, a series of support areas, and a Corporate Centre, responsible for global strategy and corporate policies, the running of common activities, and the coordination of the activities of the business units. Thus in 2005, as a consequence of its strategy for a greater internationalisation of the business and an integrated, global operator model, the Company adapted its organisation, also creating a Telefónica General Director of Coordination, Business Development and Synergies, responsible for deepening the development of the Group as a single, integrated company.

Telefónica is thus preparing to reach 255 million connections in all the world by 2009, which would be an increase of 41% over the 181 million users it currently enjoys. The greatest growth will take place in the mobile telephony business, in which it will almost double its portfolio of customers in four years to 186 million connections, and in that of rapid Internet connections (ADSL), also expected to double from 7 to 16 million.

For this future challenge, Telefónica has the regional scale to respond to globalisation, the capability to confront the competition and a great capacity for adaptation to convergence.

Today Telefónica is in a privileged position to capture the promising growth opportunities offered by the sector. Thus, out of the total market of Information and Communications Technologies (ICT), 59% corresponds to telecommunications, occupying a central role in its development and truly a huge opportunity for Telefónica. Telecommunications will thus lead this growth driven by its four great levers: mobile telecommunications, fixed broadband, the emerging markets and other related businesses. Only those companies capable of adapting themselves to market trends will be able to exploit all their possibilities.



## Customer

Customer

Innovation

Operative excellence

Identity and corporate communication

Leadership people

The “customer axis” may be the strategic line on which the other strategic axes have depended throughout the financial year. Telefónica this year has thus strengthened its trade profile with a business model designed to confront a context of important changes that have been taking place in the Telecommunications sector. During 2005, this has created a new business scenario for us of constant technological changes, greater competition and customers with new requirements. Telefónica’s response has been based, on the one hand, on profitable growth, and on the other, on deepening its commercial transformation strategy established in 2004.

### A year of growth

Financial year 2005 has seen a great expansion in the customer base (more than 24.3%), the product of organic growth as much as of entering new markets. This growth has been compatible with an increase in average income per customer, which, together with other management factors, has helped us to achieve the record net income of 4.4458 billion euros, 40% higher than the previous year.

In the fixed telephony business, Telefónica de España fully met the expectations set at the start of the year. In 2005, the estimated market share reached in fixed telephone connections was 85%, in voice traffic 66%, in fixed broadband Internet connections 89% and in retail broadband Internet connections was 55%, with a growth in the fourth quarter of half a million connections, which is the greatest absolute quarterly growth recorded up to that time in Spain. The success of Telefónica’s ADSL offerings in Spain has made a decisive contribution to this growth, reaching all

together (wholesale plus retail including connections that offer only the Imagenio service) 3,479,824 connections at the end of 2005. As well as in Spain, the broadband market in 2005 also shows great dynamism and growth in Latin America and the Czech Republic, with Group retail broadband Internet connections reaching 5 million at the end of December, 55.7% higher than the previous year’s figure.

It should be stressed that all this has been achieved in a very aggressive commercial environment, both from our cable competitors and from the loop renters.

But at the same time, this commercial effort has also meant that we have met 12 of the 16 quality targets set by the regulator. According to a study made by the Secretariat of State, Telefónica de España offers higher average quality than the alternative operators in the thirteen parameters measured. The Consumers’ Union in Spain has also situated it as the Spanish fixed telephony operator with the best quality/price ratio. The study is based on price information from the Telecommunications Market Committee, CMT, and quality information provided by the Secretariat of State for Telecommunications and the Information Society, SETSI.

Telefónica Móviles consolidated its position in 2005 as one of the main sector operators on a worldwide scale, with more than 94.4 million customers at the end of the financial year (+26.9% compared to 2004) and having captured almost 5.4 million customers in the fourth quarter, mainly because of the strong growth recorded in Latin American markets. All this, in a year marked by the process of integrating the 10 operators acquired from BellSouth,



The last two years have seen the strongest period of growth and transformation ever experienced by the Company



> Access x2 = >180 million

> Countries +10 = 19



technological migrations in 8 countries and strong pressure from the competition in the main operational markets, and in which Telefónica Móviles also earned the largest net profit in its history.

Telefónica Publicidad e Información (TPI) in 2005, set out on an intense process of adapting its business model to the new requirements of its customers and users. In December 2005 TPI had more than 455,000 customers, with 67% in Spain and the other 33% in its subsidiaries in Latin America. Visits to the network of sites in Spain increased 70.6% compared to 2004 and the new commercial strategy resulted in client growth in Spain of over 4 per cent.

The purchase of Telinver, the marketing company for Argentina's telephone directories, is the culmination of the process of integrating all the directory assets of the Telefónica Group in Latin America under the management of TPI.

In February 2006, the Telefónica Board of Directors agreed to start the divestment process (sale) of Telefónica's share in the capital of TPI. The operation was completed in May with the acceptance of a Public Offer for the Acquisition of 59.905% of the equity of TPI – currently owned by Telefónica – by the British telephone directory company, Yell Group plc. Under this agreement, Yell commits itself to present a request to the National Securities Market Commission (CNMV) for the authorisation of a Public Offer of Acquisition for all the shares of TPI, while Telefónica commits itself to accept the Offer in relation to all the TPI shares of which it is the owner, in accordance with the terms and conditions of the agreement. Only if a competitive public bid authorised by the CNMV should make a

counter-offer more than 10% higher than the initial price of Yell's offer, and the latter should opt not to improve its offer, could Telefónica be freed from its commitment to accept it.

## Renewing services

Within the process of changing towards a company with a strong commercial orientation and a cost-efficient business model, 2005 brought with it the natural development of this process towards a new concept in transformation: convergence. This means, on the one hand, that the technology supporting the services and products the Company offers has become more and more "transparent" for the customer, and this has enabled Telefónica, in turn, to give greater value added to its services and establish closer relationships with its customers.

The effort in 2005 has thus been aimed at obtaining a global view of our customers, to include comprehensively all their needs, connectivity, mobility, band-width, etc.

One example of this integrated service availability is the Duos and Trios with a broad range of modalities, flat metropolitan and national rates, 24 hour ADSL, ADSL mini, Imagenio TV ... The Imagenio met its 2005 target by reaching 206,572 customers, with a net increase in the fourth quarter of 114,466 customers, which gives an idea of its operating capacity in handling such a large number of new connections. With such growth, Imagenio has now reached a 6% share of the pre-paid television market in Spain, compared with its 0.3% in the year 2004.

Other commercial launches should also be noted, among them the inclusion of fixed-mobile traffic in the plans Tarifa Plana de Voz Mini [Voice Mini Flat-Rate] and Tarifa Plana Nacional [National Flat-Rate], fixed-mobile calls with a single price per minute and without call connection charge, or the Mini-International rate, with attractive prices to various international destinations, whether fixed or mobile.

The agreement on Wi-Fi service signed with Telecom Italia and Portugal Telecom has opened up the Roaming Wi-Fi service in both countries, thus broadening coverage to 790 new Wi-Fi zones in Portugal and to 800 in Italy. These zones are in addition to the "Zona ADSL Wi-Fi" which has the greatest operating coverage in Spain with 1,555 hotspots in December 2005.

Other examples of the renewed commercial services available from Telefónica de España are the overall management of information and communication technologies (ICT), new catalogues of sector solutions for companies, a new positioning in relation to terminals (a new concept of leading terminal, cobranded), and the development and commercialisation of multimedia IP terminals.

In the course of 2005, Telefónica has launched important initiatives, adapting the services it offers as well as the commercialisation channels, always looking for a new way of relating to Customers.

This is the case, for example, of the Telefónica de España "Impulso Comercial" module, part of its "Meta Cliente" programme of commercial transformation, organised in four blocks related with commercial projects: commercial organisation, attitudes and behaviours, capabilities and commercial talents.





## To transform technological advances into **simple communications solutions to the benefit of our customers**

from a **product-centred company**

to a **customer-centred company**



Mass services and plans  
Generic requirements  
Product focus  
Purchase from each Company

Personalised services  
Specific needs  
Benefit focus  
Relationship with Telefónica

The Atento Group is also noteworthy for facing numerous challenges in 2005 in order to improve the services it offers, thus responding to the confidence placed in the organisation by its more than 400 customers, each a leader in its own sector: banking and insurance, telecommunications, energy, large consumers, freight, services and public administration, among others.

The Telefónica company *tgestionaria*, specialising in providing comprehensive management support services, also during 2005, initiated a new period of progressively winning customers from outside Telefónica, at the same time as maintaining its commitment to quality and efficiency in its services for the Group companies, which are still the main focus of its activities.

### Synergies of scale

Telefónica is currently in various markets which are themselves in different stages of development, which makes it possible to modulate service provision and take advantage of Group synergies, always to the benefit of customers.

In this context, the ability to share knowledge between the different companies making up the Group becomes particularly important. The best practices in "customer satisfaction" and in handling the "customer experience" are thus being transferred between the different operators, among them O2.

In Spain, the "commercial intelligence" initiative was held in 2005, to strengthen the use of the tools in the organisation, providing precise information to the sales network to offer each customer the value proposal most suited to their needs. Different "Practice Communities" were also organised among the commercial professionals with the aim of sharing ideas and knowledge, to bring out even more the tacit knowledge and complement the explicit knowledge of the customers.

### Customer Satisfaction

The satisfaction of its customers is the priority objective of the Telefónica Group and the core of its strategy. In order to know how this is progressing and to monitor the effects of the different measures taken by Telefónica, the Group companies periodically follow up levels of satisfaction by polling. The methodology for measuring General Satisfaction used by Telefónica International, by Telefónica Móviles España and by Telefónica de España is homogeneous, and its use is expected to be extended to Telefónica Móviles Latam as from 2006.

Telefónica de España took more than 500,000 samples in its satisfaction polling in 2005. In Latin America in the last measurement of the year, the results of which were published in December, 4,789 customers were interviewed in the residential segment, 3,624 SMEs, 1,079 firms and also 3,499 customers of Speedy, the broadband service. In the Telefónica Móviles España studies, the number of interviewees was 27,000, 14.5% more than in the previous year, and the global satisfaction level reached in 2005 was 85.6%.

Likewise in 2005, Telefónica focused on the analysis of different areas of work that interact under the umbrella of consultation, planning, action and solution: Surveys, Indicators, Proyecto Bandera, Seis Sigma and Certifications.

The efforts in customer loyalty activities should also be mentioned. Telefónica Móviles stands out for launching campaigns in Spain that rewarded the permanence of customers and offered favourable conditions for renewing the terminal, encouraging greater commitment

### Map of Telefónica Group channels



#### Spain

Own Stores: 112  
 Exclusive distributor PoS: 5,000  
 Call Centre: 5,600 operators  
 Consumer Channel PoS: 3,500

<sup>1</sup>Including own and third party

<sup>2</sup>Excluding O2 UK

<sup>3</sup>Including GG.SS. and LBM

from our customers. This explains why, in the fourth quarter of 2005 almost 1.1 million changes were registered, with an increase of nearly 4.5 million in all the year 2005 (+23.2% compared to the year 2004). These activities and commercial initiatives such as the “Ya te llamo yo” [Now I'll call you] or the “100x1” promotion have proved an important tool for customer loyalty, and have enabled us to contain “churn” at a level of 1.8% for the whole of 2005, despite the commercial aggressiveness of the competition.

Telefónica de España also worked on a series of initiatives seeking to encourage an attitude and individual mentality about the commercial transformation process, strengthening particular critical aspects internally with a greater customer orientation and taking of initiatives. This is the case of “Acércate a Ventas” [Approaching Sales], “Foro de Mejores Prácticas” [Best Practices Forum], “Role modelling”, or “Acércate a Marketing” [Approaching Marketing], the latter with the aim of establishing a new way of working in marketing (common language and methodology), and consolidating a level of marketing knowledge in the organisation, resulting in more than 45 business ideas, some of which have been partly or wholly put into practice.

Also during 2005 the TPI group went further in setting up the comprehensive customer management project in Spain. This initiative aims to improve the level of knowledge about the customer to be able to more precisely identify their publicity needs and offer them tailored commercial advice.

Telefónica maintains a fluid dialogue with many consumer and user associations, some of which are specialised in the area



#### Rest of Europe (UK, Germany and Czech Republic)

Own Stores: 790 (including 194 franchises)  
 Exclusive distributor PoS: n.d.  
 Call Centre: n.d.  
 Consumer Chain PoS<sup>2</sup>: 12,000

of ICT. The company has set up a single communication channel for this in order to transfer to the different companies and business lines of the Group the concerns raised by these associations with Telefónica.

## A multi-channel offering

Seeking closeness and convenience for customers, the Company designed a new multi-channel commercialisation strategy during 2005, with the entire portfolio of Telefónica products and services through its Online, telephone, face-to-face, and Large Consumer channels...This new multi-channel model of multi-contact with the customer, aiming to offer them a single point of contact able to respond to any wish or request, has involved the development of an optimum channel map in coordination with the whole Telefónica Group.

The year 2005 also brought the start of developing the Customer Protection Service (SDC), an important initiative that is being finally launched in Spain at the start of 2006, with the objective of watching over the customer's rights and guaranteeing the Group's quality commitments. The SDC is open to customers of those companies that have joined the Service: Telefónica de España S.A.U and Telefónica Móviles España S.A.U.



#### Central and South America

Own Stores: 770  
 Exclusive distributor PoS: 28,000  
 Call Centre: 10,700 operators  
 Consumer Chain PoS<sup>2</sup>: 12,000

The SDC is a new instrument for customer relations that is accepted voluntarily by the customer and the company, and offers the customers of companies joining the Service an additional guarantee of fair treatment and conditions of equity. Its main function is to provide a review system for customers who have previously gone through the normal complaints procedure made available by Telefónica, and thus works as a mechanism of last resort. The work of the Customer Protection Service will always be guided by principles of objectivity and independence, in order to act in the defence and protection of the customers' rights.

# Innovation

## Innovation at the Telefónica Group

The innovation projects carried out by Telefónica in 2005 have not been limited to the creation of new products, services and management processes, but have also included all actions geared towards creating and capturing value and developing new opportunities for growth. Proof of this is the 2.9 billion euros invested in technological innovation (21% more than the previous year).

For Telefónica, innovation is the key to profitable and sustained growth, and is based on the transformation of ideas into more efficient business processes that offer competitive advantages, or into profitable products and services that provide value to customers. For this reason, innovation should have a specific impact on revenues, customer satisfaction or cost reduction, as a consequence of the changes in organisational processes, the business model and/or the portfolio of products and services.

In order to achieve good results it is necessary to develop an innovation culture and a set of structured and coordinated processes to strategically address the social, regulatory and technological challenges faced by Telefónica.

### Technological innovation in 2005

In 2005, Telefónica earmarked almost 2.9 billion euros, following the OECD criteria, for technological innovation. This is a 21% increase with regard to the previous financial year, mainly due to the incorporation of the new businesses in Latin America, with a 29%

increase compared to the previous year, and the Czech Republic, already contributing 2% to the total of the Group's technological innovation activities. 45% of this investment refers to technological innovation carried out in Spain, 23% to that carried out in Brazil and 6% to the activities carried out in Argentina.

Telefónica Móviles is, once again, with its investment accounting for 52% of the total, the company of the Group with the highest proportional investment in innovation, due to its efforts in Latin America. Broken down by item, technological innovation for the deployment of new networks is especially significant.

However, innovation cannot be based on technology acquisition alone. It is essential that the research and development activities be made the axis and focus for the rest of innovation activities in order to guarantee competitive advantages.

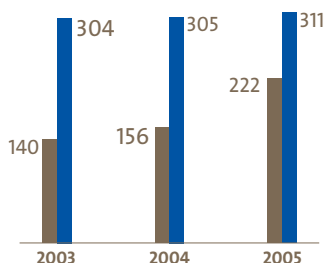
During 2005, R&D investment rose 16% with regard to the previous year, reaching 311 million euros in Spain and more than 533 million worldwide. The latter figure is equivalent to 1.42 % of Telefónica's total revenues. According to data from the European Commission, in 2004, Telefónica was the Spanish company, including all sectors, which devoted the most resources to research and development, with an investment three times that of the second company in the classification. Telefónica's investment represented 8% of private investment in R&D in Spain. With regard to the companies in the ICTs sector, according to the Spanish Association of ICT Companies, the sector devoted 1.334 billion euros to R&D, and 5,249 billion euros to technological innovation in general. According to these figures, Telefónica accounts for 23% of the ICT sector's investment in R&D, and for 22% of its technological innovation investment.



### Distribution of R&D by country

Millions of euros

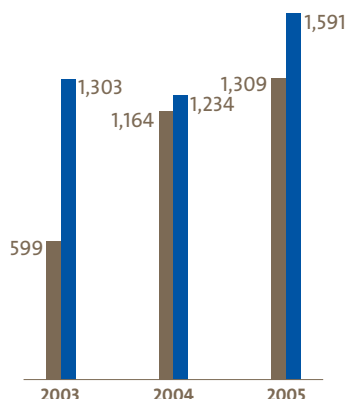
- Spain
- Others



### Distribution of innovation by country

Millions of euros

- Spain
- Others



Proof of these efforts is the fact that in Telefónica I+D alone, technological innovation activities in 2005 involved all 1,265 employees of their staff (93% of whom are university graduates) and approximately 40 companies and 30 universities, contributing an activity equivalent to that of more than 1,500 people, of which approximately 600 work at the Telefónica I+D centres. Generally speaking, Telefónica's R&D activities generate employment equivalent to 4,200 people in Spain and 6,800 people worldwide.

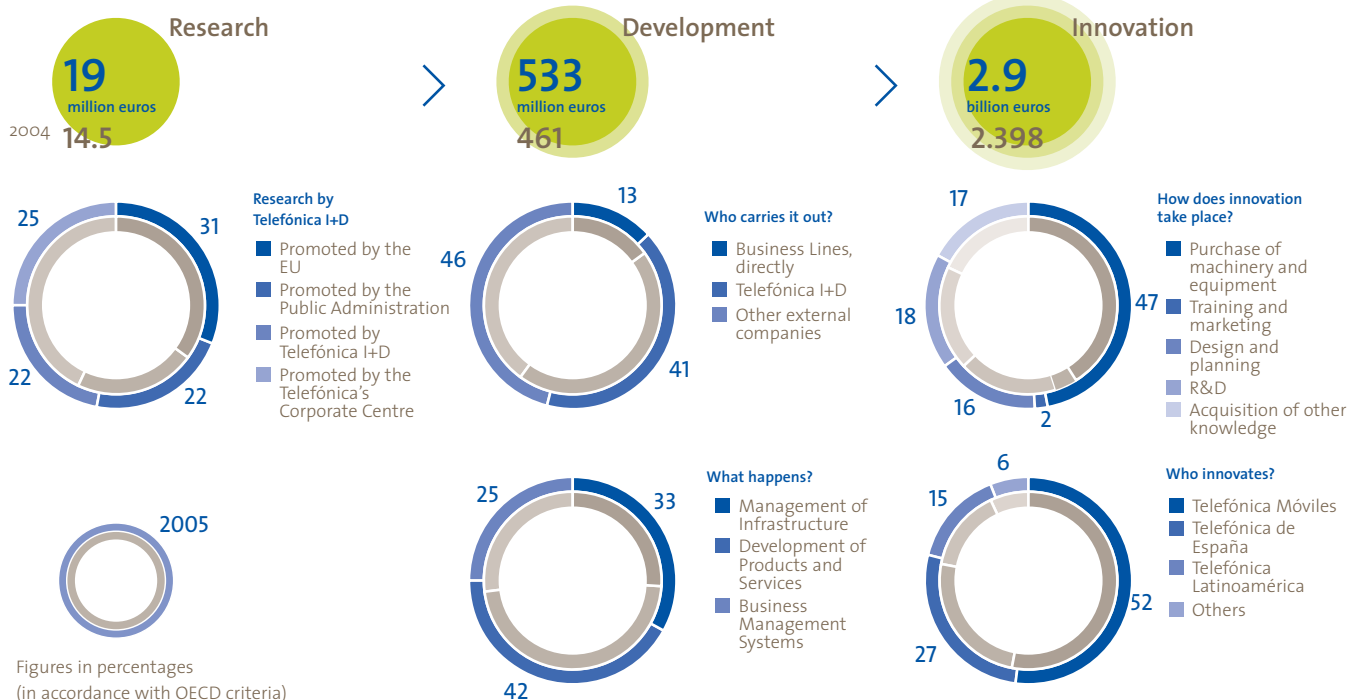
### Telefónica I+D (Research & Development)

Most of the Group's R&D activities are carried out at Telefónica Investigación y Desarrollo, a subsidiary fully owned by Telefónica, which works mainly for the Group's businesses, as well as participating in other research projects, both nationally and internationally. Its mission is to contribute to increasing the Group's competitiveness through technological innovation, always bearing in mind that the R&D activities must represent a competitive value for the operators, transferable to the customers.

During 2005, Telefónica initiated a gradual transformation process, seeking to strengthen innovation activities as part of a global strategy, which it defines as one of the four essential areas of focus to position itself as the leading integrated operator of the world.

Telefónica has significantly increased its efforts of participation in calls for proposals made by national and European organisations throughout 2005 and has taken part in the most important innovation projects launched by these organisations. Specifically, during 2005, it worked on over 1,800 projects, devoted to

### Technological innovation in Telefónica 2005



developing products, services and processes for Telefónica's businesses, and applied research financed by the Corporation. Generally speaking, this activity puts into practice Telefónica's strategy, followed for many years now, of strengthening its own research and development activities, as a guarantee to ensure competitive advantages, and to drive the rest of the Group's innovation activities. Thus, Telefónica is a driving force for technological innovation, with a double role: on the one hand it develops the ICT solutions and platforms and networks it requires, and on the other hand, it identifies and anticipates technological alternatives which could have an impact on the Businesses.

Another result of Telefónica's innovating effort is the Company's portfolio of proprietary products, which, at December 31, 2005, comprised 3,055 patents, models and industrial designs. The portfolio has generated 26.4 million euros in royalties, of which 77% is from products and technologies developed by Telefónica I+D.

The new Innovation Model has also led to the creation of Telefónica I+D's Scientific Advisory Council, formed by academic experts of national and international renown, with the mission of providing guidance to Telefónica from the scientific and academic spheres.

### Main products

The development of advanced products, services and processes has allowed the different Businesses of the Group to have quick access to applied results and solutions, either to increase their offer with a better positioning in the market or to incorporate to their systems and processes improved efficiency and better quality. Thus, the technological innovation activities carried out in 2005 have been geared mainly towards creating value for the Lines of Business, especially for broadband services and mobile services.

### Fixed telephone services

In the fixed telephone sector, Telefónica participates in research projects of new NGN (Next Generation Networks) opportunities and new protocols that are being implemented over these networks. Within the wide range of fields that have been studied, special attention has been paid to areas such as service quality for personal communications and the use of network types based on GRID technologies to provide these new services.

Telefónica de España (TdE) has developed the Centro de Servicios (Service Centre), a voice portal that simplifies and facilitates the management of the wide range of its services. It has also worked on achieving full convergence between NGNs and traditional networks, in order to offer all the possible combinations of messaging between terminals of both networks. This network capacity is leading to the development of new concepts of Ambient Intelligence, where customers do not need to worry about what type of network they are using, or pay attention to the phone-set they are connected to, but may rather use the services in a transparent manner, leaving the network to make all the necessary adaptations.

### Mobile services

Telefónica Móviles has carried out consultancy activities for the development of new network technologies and the deployment of solutions. In addition, the commercial efforts related to UMTS technology, within a context of operation of heterogeneous networks, and to GSM/GPRS technology, has meant the implication of Telefónica in innovating solutions to optimise networks and processes (in order to increase operational efficiency) and increase service quality.

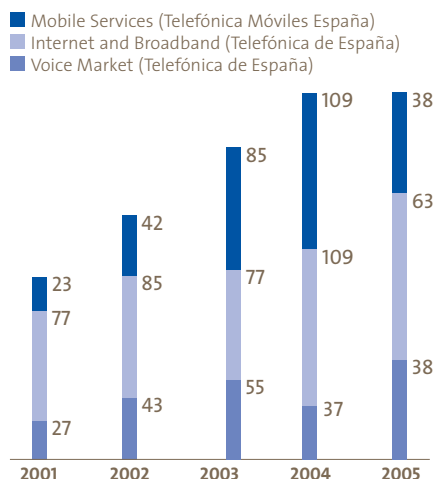
Significant progress has also been made with regard to leveraging multioperator synergies, through the platforms developed to host pay-as-you-go, corporate (VPN), messaging and other network services. In this context, they have completed the deployment of pay-as-you-go services for seven new operators, in addition to those already in place (Spain, Mexico and Peru): Colombia, Ecuador, Guatemala, El Salvador, Panama and Nicaragua, as well as in Peru. In addition, its contribution to third generation voice call and videotelephone services for mobile networks has been consolidated, with the launch of new applications.

2005 has also seen the commercial consolidation of data over UMTS services in Spain, which the 'Oficin@ movistar UMTS/GPRS' has improved with capacities, for business customers. This service has allowed the connection of high-speed data and innovative services over UMTS, using Escritorio movistar (movistar Desktop).

### Data services

Telefónica has carried out important activities aligned with its Broadband strategy, collaborating for the implementation of new connectivity services, and setting up

### Number of new Telefónica products Móviles de España and Telefónica de España



platforms capable of providing new communications and contents services, to customers with DSL access. Thus, it has promoted new services in xDS environment and collaborated in the Alejandra network, which replaces the ATM network with an Ethernet, to offer the xDSL services.

The development of the Portal de Selección de Servicios de Banda Ancha (Portal for Selection of Broadband Services), a unified project aimed at broadening the offer of broadband services in Latin America, especially in Brazil, Chile, Argentina and Peru, has been especially relevant from a strategic point of view in the offer of variable DSL services (traffic quotas, time, plans, discounts, etc.). In 2005, Telefónica reached two million DSL retail accesses in Latin America.

In addition, 2005 has also seen the launch of several innovation projects in content management and advanced services for the home focused on the interoperability of devices, ambient intelligence and creation of new contents.

#### Television and multimedia services

The activities developed within the framework of TV over DSL, the Imagenio Service, have allowed Telefónica to launch offers on the market, such as the “triple play” products: products that combine telephone, data and television services. At year end 2005, Imagenio had 200,000 customers in Spain and was being launched in the Czech Republic.

With regard to video services, among other activities, it is collaborating with the European Space Agency (ESA), to study the plausibility of deploying bidirectional services via satellite in Latin America and Africa, based on the DVB-RCS standard.

### Innovation in commercial and business processes

#### Business and operations management

Efforts in the field of innovation are not only focused on the launch of new services, but also on innovation in commercial and business processes and new working models. Thus, Telefónica has developed new management systems and substantially improved those already in place, within the framework of commercial and operational management, aimed at designing innovative solutions for business processes. The aim is to provide them with further intelligence and increase profitability and efficacy of Provisioning, Billing, Customer Service and Infrastructure Management processes.

Telefónica also leads the development of the workforce and activity management systems, key to improving the performance of basic businesses, as they reduce operating costs and improve the quality of service received by the customers.

In Latin America, it has gradually deployed the GAUDI system and has contributed significantly in the mobility of field technicians. Another relevant activity has been to strengthen all the systems that reinforce customer knowledge. In this sense, it has developed a solution for the analysis of rates of mobile operators in the region, which makes it possible to design attractive rate schemes for the market. In addition, Telefónica I+D has extensive experience in business intelligence applications, which support decision-making and allow real-time interactive access, analysis and handling of critical information for the company.



#### Network and service management

There has also been significant activity in network and service management systems, aimed at improving infrastructures and their quality, through innovative solutions. Thus, 2005 has seen the consolidation of the Sistema de Explotación de la Red de Acceso (SERA) (Access Network System Management), as the central tool of Telefónica for the diagnosis of broadband access breakdowns.

Through the Integrated DSL Management System, Telefónica has contributed to consolidating the Imagenio service, with the incorporation of new network architectures. For the provision of differentiated mobile services, it has developed a broadband manager: the CAC (Connection Admission Control) System, which allows the provider of the transport network to guarantee quality of service for the traffic requested.

In the field of open code software, significant activities were carried out within the framework of the free software community MORFEO, whose aim is to promote the development of a community for collaboration on R&D&I projects.

#### Applied Research Activities

The new Innovation Model has strengthened applied research activities, more geared to the medium and long terms, in many cases transversal, with technologies that will influence the evolution of the Lines of Business. These activities have focused on Network Technologies, Service and Content Platforms, Business and Residential Solutions and Information Systems.

The Applied Research activities within Telefónica's corporate framework are complemented with a strong participation in European R&D projects, promoted and partially financed by the EU, that have contributed decisively to Telefónica being the leading Spanish company in terms of participation in this type of project. Thus, during the period 2004-08, Telefónica is participating in 71 projects promoted by the EU, focused mainly in the areas of new multimedia services, mobile and integrated communications, and software solutions for the provision of new services.

In addition, it plays a very active role in EU initiatives and programmes aimed at promoting R&D, through three European technological platforms: eMobility (on mobility), NEM (Networked Electronic Media) and NESSI (Networked European Software and Services Initiative).

There was also been work towards providing advanced "Ambient Intelligence" services, which will improve users' relationship with technology, through applying concepts such as ubiquitous computing and communication, user recognition and natural interfaces.

In addition, the growing importance of content management has led Telefónica to develop an integrating vision of telecommunications, moving towards what is called "Networked and Electronic Media": new electronic communications and information. This scenario sets two challenges: to search for the most innovative solutions and to promote the integration both between networks and between networks and their contents.

## A new innovation culture

An essential factor for Telefónica's transformation into an even more innovative company is the development and promotion of a new innovation culture that reaches all employees. To this aim, Telefónica is creating specific organisations to manage and promote innovation.

During 2005, Telefónica de España set out to make innovation part of the day-to-day work of all employees. To this aim, different activities and measures have been carried out, such as training sessions, contact with other companies, creativity technique sessions, internal communication actions and projects for the dissemination of innovation, work sessions with people recognised for their innovative character, recognition to employees, identification of innovative projects, etc. Specifically, the Innovation Module, one of the four axes of the strategic programme Meta:Cliente, offers a framework from which to promote and cultivate innovation.

Within the innovation tools of Telefónica Móviles, it is interesting to point to the establishment of the MovilForum, an initiative launched in Spain five years ago to promote the collaboration with the business world with a view to strengthening and encouraging development and commercialisation of mobility services and applications. Movilforum -which offers companies its platforms and networks to carry out tests, free terminals and training courses-, currently has over 6,000 partner members and 150 registered companies, who already have a catalogue of products and services with over 200 different applications based on mobile technology to improve business management in various sectors such as Transport, Health, Insurance, Banking,

Public Administration or Leisure, among others. In addition, during 2005, Telefónica Móviles España has launched the second Patenta, Fábrica de Ideas, (Patenta, Factory of Ideas) competition, organised to recognise the best initiatives of employees related to the Improvement of Efficiency. The winning ideas were selected by the Evaluation Committee of the Competition from a total of 95 proposals that entered the competition.

In 2005, Telefónica International has also carried out a series of initiatives geared to promoting innovation. To this aim, it has promoted internal initiatives to define its vision of the Innovation Model, analysing the most relevant aspects of the innovating process: definition of innovation strategies, generation of ideas, development, assessment of ideas, pilot trials, commercialisation of results and management of agreements and alliances associated with the innovating process. Specifically, it created an Innovation Committee, local units for Innovation in each country, as well as starting the development of an Annual Innovation Plan.

# Operative excellence



Operative excellence is, for Telefónica, one of the main axes around on which its transformation process, which commenced in 2004, is based. Since then the company has been working on a range of initiatives to improve efficiency and performance, the so called 'Telefónica Excelente'. The transformation sought in this axis is aimed at improving our way of doing things and not just results - becoming more efficient and consistently achieving a better perception from our customers.

## Effectiveness and Efficiency

In 2005, we believe notable progress was made in two areas. In each initiative projects have been implemented aimed at improving effectiveness and achieving a significant improvement in the operative parameters of objective quality. Also, measures were implemented to improve efficiency levels, in other words the amount of resources and means used by Telefónica to carry out each activity.

The final result of these projects is, in each initiative. The improvement of our operations to improve things day by day - effectiveness - and doing this at a lower cost base - efficiency. Some notable projects of this type have included initiatives such as:

- New Working Spaces
- Global mobile terminal management
- Telefónica customer attention
- Regionalisation of operators in America
- Broadband quality
- E-purchasing
- Reduction of logistics costs
- Functional reference model (information systems)

## New working spaces: district C

The aim of the initiative is to achieve a greater number of mobile workers to further improve collaboration between divisions and businesses. This initiative is one of the levers for improving the performance of Telefónica employees, in which district C is not just a new property efficiency project (although it is that as well). It is, above all, an example of Telefónica's new working culture which will be at the heart of the transformation we are undergoing and which is based on two concepts: mobility and collaboration.

Thus, workspaces will be at the service of people, encouraging a new way of interconnecting, and the architecture and technology has been designed jointly to facilitate a new way of working which will be characterised by more horizontal relationships, greater mobility, flexibility, team work and management by objectives. Spaces, technologies and new ways of working are three main levers for innovation and transformation.

In district C the different types of workstations and spaces are designed to better meet different requirements, key to this being the "advanced workstation" aimed at people with high levels of mobility or collaboration which enables more effective use of the company's property assets, employee time and resulting in a better work-life balance.

Executives and managers will not only work alongside their teams, as is common, but many will work in open plan and airy spaces designed to facilitate communication and collaboration. All this will mean notable progress to a new form





of leadership more linked to target and performance based management; towards greater autonomy in time and activity management, beginning a clear trend towards accounting for time at the workstation and beyond it. In summary, spaces and technologies to encourage talent, creativity and innovation, favouring development, motivation and greater balance and generating efficiency and productivity.

However, district C was also designed as a space which is open to the city and our neighbours, an area to share with our customers and our partners, integrated into its surroundings and a shop window to project an innovative Telefónica committed to the environment, open, transparent and close.

Without forgetting the initiatives focussing on effectiveness and efficiency, in other administrative spaces owned by Telefónica throughout the world, other objectives have also been sought: improving the productivity of building occupancy (measured in m<sup>2</sup> for example) and implementing a 'paperless office'.

In relation to the first objective it is worth indicating that in Spain, efficiency rates have increased by 30% since the beginning of the plan, a figure which will logically be increased with the occupation of the new Telefónica offices in District C. Property efficiency improvements were also achieved in other areas, but not as significant. This has allowed savings in building occupancy.

In relation to the second objective – the paperless office, the project carried out during 2005 in Spain is achieving significant results, managing to reduce paper consumption by more than 40% since its launch.

### Global mobile terminal management

The second initiative is global mobile terminal management. The aim of this initiative is to obtain a radical improvement in processes of supply and storage of terminals among operators, differentiating us from other operators, giving us a competitive edge over our competitors.

In this respect, the acquisition of Bell South Mobile operators during 2004 and the beginning of 2005 has improved the leadership position of almost all our operators in Latin America and has significantly increased the number of markets in which they operate. This fact has made this initiative even more relevant.

Telefónica de España, for its part, has been developing the integrated management of materials, extending monitoring of Material Management to the whole life cycle, from acquisition and inventorying to customer delivery, with the aim of optimising costs and improving replacement times to guarantee agreed service levels.

### Telefónica customer attention

The third initiative focuses on Telefónica customer service. Its aim is to improve efficiency in interaction with customers from customer attention centres, maximising first contact resolution levels in any requirement related to our companies, their products and services.

In this respect, the Telefónica de España Operative Excellence module arose as a response to the need to improve the quality of attention and service as a differentiating element, always within the cost reduction strategy established for the whole group. Making this philosophy a reality has required not only the optimisation of processes but also a profound cultural transformation throughout the organisation. Each person needs to know their contribution to the value chain and act with a global view of the company.

The key to success with this module lies in the capacity to think and act as a single team, the "Telefónica team". A transversal end to end vision is necessary for this, in which all areas work in close cooperation with a common objective, the customer. Basically it means converting this cross sectoral approach into our greatest strength.

During 2005, this module's work focussed on the most critical areas requiring the most urgent action. This included Customer Attention (at home and PNP), paying attention to quality and immediate resolution of matters raised by customers.



For 2006 it is planned to expand this physical customer attention module will be expanded to include the elimination of returned service orders and continue progress in improving broadband products and services.

## Broadband Quality

In relation to the broadband quality initiative, of particular note is the effort made in the operations area of all fixed telephony operators. This effort has taken the form of projects aimed at operational improvements and has made it possible to absorb the large broadband demand generated as a result of successful commercial offers which almost all operators launched during 2005.

The importance to Telefónica of this initiative lies in the need to put broadband services in reach of a large section of the population in the markets we operate in, as a driver for the modernisation of these societies.

Specifically Telefónica de España has focussed on broadband services (Imagenio and ADSL), improving the processes of provision, maintenance and service provision and improving levels of compliance with the commitments made to the customer. In maintenance, improvements focussed on the process of customer attention and solving incidents and minimising operative costs, reducing interventions necessary in the street. Thus, the action plan focussed on provision of the ADSL Kit, ADSL solutions, PC equipment, joint subscriptions in the offices of major customers, ADSL maintenance and an end to end cross sectoral process: Imagenio and NetLan.

## Regionalisation of American operators

This is an initiative clearly aimed at efficiency, the main lever of which is the redistribution of skills between units in the same or different entities to succeed in the objective of becoming the most efficient company in the sector in Latin America.

For Telefónica to become ever more profitable, and sustainable so, with better services and solutions, it is necessary to make more of its personnel's capacity to specialise, share its technological resources and focus on activities directly related to our business.

In this direction, at the end of 2005 Telefónica International created a General Operations Department responsible for production and delivery of services to final customers and manages all network and operational processes of customers, including all systems management. This division, a regional "plant", also plays an important role in coordinating the

operations of Telefónica International, progressing towards a regional model and leading in the convergence of systems, networks and technologies as well as maximising operative synergies throughout the region in these areas.

	Customer service	Broadband service	Billing	Returned Charity Work	Operational efficiency
2005	Telefónica Service	Imagenio ADSL Residential	Companies PNP	Commercial reasons	Óptima Project Materials management
2006	Personal service	Application to other P/S			



*“Making our cross-sectoral approach our greatest strength”*

## Other initiatives

As well as those mentioned up to now, Telefónica is carrying out cross sectoral monographic projects in e-purchasing, for the reduction of logistics costs etc. Significant progress has been made in these areas and, perhaps the most important, areas of improvement for greater efficiency above and beyond the duration of the initiatives themselves.

Once of these activities carried out by Telefónica de España in 2005 is a new billing model with the aim of improving customer satisfaction with the invoice, improving clarity and quality of same. And the key was the use of a more user friendly format better understood by the customer, ensuring the accuracy of the information it contains.

For its part, and during 2005, *tgestiona* made progress in making general efficiency improvements and, in particular, reducing the weight of the structure throughout all country *tgestiona* units. Likewise, investments were strictly controlled, falling to 30% below budget.

Operative efficiency was also one of the main strategic axes of TPI. In this respect, in 2005 it made the most of its international presence, transferring and sharing synergies and practical improvements between the different subsidiaries which make up the group. As part of this continuous improvement process the company has implemented initiatives not only aimed at optimising costs, but also rationalising key functions in the management of different companies. Some examples, in this respect, were joint contracts between companies for paper and printing, unification of planning

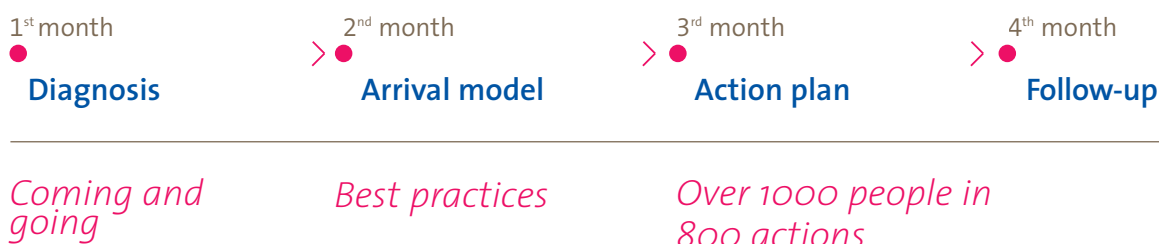
and commercial monitoring and the launch of new products and services.

For its part, in 2005 the strategy of the Atento Group continued to focus on differentiation through quality and generating value for its customers' business through proximity and operative excellence. During the year, Atento moved forwards in its strategy to seek operative excellence and improve customer attention, through the Seis Sigma strategy as the best methodology to start the COPC (Customer Operations Performance Centre) certification process in several of the countries in which it is present.

Also, during 2005, Atento Argentina, Atento Brazil, Atento Colombia and Atento Mexico y Centroamérica began progress towards COPC certification, which certifies specific and very demanding quality standards for the Contact Centre sector. It is planned that in 2006, the same process will begin with Atento Chile, Atento Puerto Rico and Atento Venezuela. In terms of Telefónica R+D, during the 2005 financial year it continued to consolidate its network of Centres of Excellence. It also notably increased the percentage of activity carried out in its centres in Mexico DF and Sao Paulo (Brazil), which share the task of supporting the technical innovation of the subsidiaries of the Group which operate in Latin America.

In the framework of the strategy which commenced a few years ago aimed at spreading the Group's technological innovation nationally, Telefónica R+D set up, in Andalusia, the new R+D centre in Granada, which complements the activities of Telefónica R+D in its other centres in Barcelona, Huesca, Madrid and Valladolid. 2005 also saw a clear boost to the centre in Barcelona, through a new organisational

structure making it possible to triple its human resources, while a new technological strategy was developed in relation to the activities to be carried out there. All this is making Telefónica R+D a Technological Innovation Network with national and international reach.



## Involvement, key to efficiency

The involvement and motivation of the Telefónica workforce is key to achieving efficiency. An example of this is can be found in Telefónica de España, whose organisation of its Operative Excellence module has an Operative Excellence Committee comprised of the Chairman of Telefónica de España and the Managing Directors of business areas, a Committee from the office of Operative Excellence formed by the module leader and directors of the participating areas.

It is supported by the module Office which is staffed by a team of full time employees who coordinate the different multi disciplinary teams participating, and Project Teams. For each initiative a multidisciplinary team has been created with the participation of all divisions participating in the process.

The working model follows the Lean-Seis Sigma methodology and is structured in four phases. The first is “Diagnosis”, critical to successfully analyse objectives. This phase analyses the reasons for customer dissatisfaction and identifies the root causes of same.

For this, a methodology of “go and see” is applied, in other words the working team is integrated in the daily operations of the activity being analysed. The second, the “End result model”, establishes the vision of what the final service provided should be. In this model, which has high yet achievable ambitions, operative indicators are established pursuant to best market practices. The third, the “action plan”

defines the actions to implement to reach the end result model. Actions are staggered into three periods, prioritised depending on their impact and complexity: short (jul-05), medium (dec-05) and long term (jul-06). Finally, the “follow up” of each action to ensure complete implementation.

In 2005, all action plans for the different projects were launched. Over 800 actions with over 1,000 people participated directly from all levels of the organisation.

## Identity and corporate communication

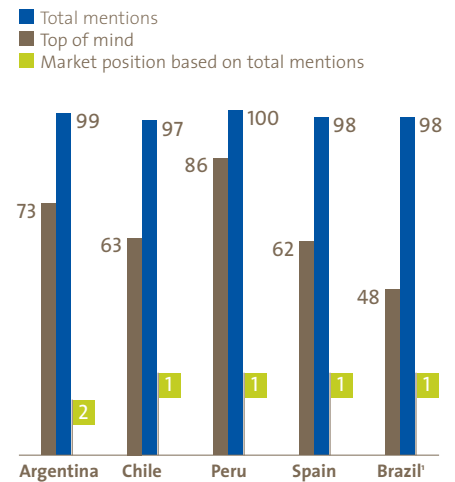
Telefónica is making progress in its integration as a single company, with values and an identity shared by all the subsidiaries of the Telefónica Group. To achieve this objective it is developing transformation initiatives within the identity and communication axis.

- Brand strategy aimed at defining the architecture strategy and model for institutional and commercial brands of the Telefónica Group.
- Communication tools which included online communication initiatives (Telefónica on the Internet) and internal communication (Internal Communication plan, Intranet etc.).
- Corporate responsibility reports, with an executive summary included in this annual report.
- Telefónica Accesible, which is Telefónica's response to the disabled (see section on Corporate Responsibility).
- Public presence of Telefónica, an initiative lead by the Communications and Institutional Relations divisions, and which seeks to position Telefónica as a strategic ally in the economic, technological and social progress of the companies in which it operates.
- Encouragement of corporate volunteering, as a means of building a group culture, bringing the company closer to the needs of society.
- Management of risk to Corporate Reputation, aimed at anticipating situations which might cause a risk to the perception of Telefónica by its interest groups.



### Brand awareness for fixed telephony

Source: Tracking of Advertising and Brand Health 2005



<sup>1</sup>Non-accumulated data corresponding to December, 2005

## Brand and Architecture strategy

In 2005, Telefónica reviewed its brand strategy and architecture model. The aim is to strengthen the commercial relationship with customers and transmit corporate values to interest groups related to the company - the starting point for fleshing out the commitments that Telefónica makes with its interest groups.

Thus, Telefónica has built its brand on two functional attributes - leadership and innovation - which are supported by the capacities of the Group, and two emotional - Proximity and Commitment - which seek to give the brand a personality and tighten relationships with those linked to it.

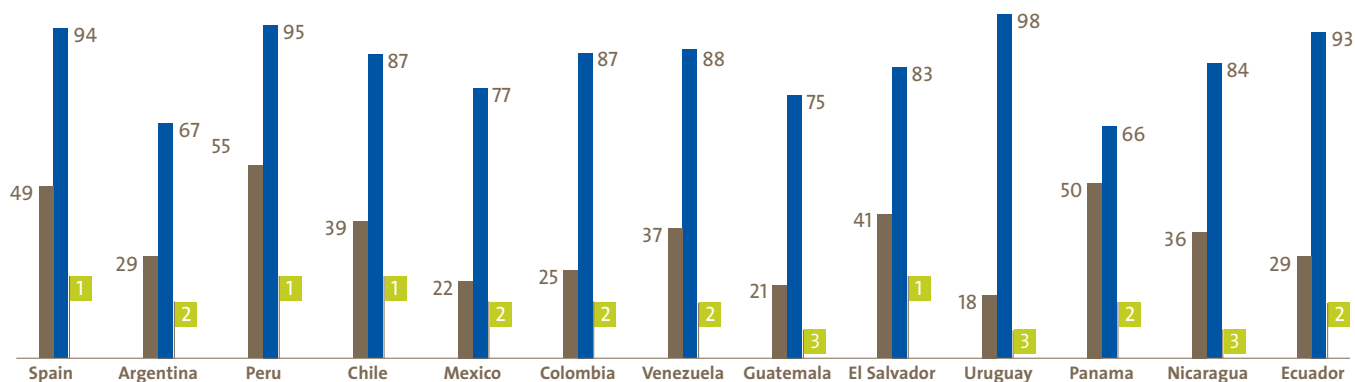
Said model defines the roles, criteria and hierarchies between Group brands, described through its principles of identity and a graphic system of brand coexistence.

In this context, and as a "masterbrand", Telefónica, the main brand because of its institutional profile and values associated with it, supports and guarantees the commercial offer associated with its commercial brands, increasing their stature. The commercial brands provide proximity and freshness, differentiation and relevance to the commercial offer, making it more relevant and credible. They also rejuvenate and refresh the "masterbrand". The brand family system is strengthened via a solid and inseparable relationship. This doesn't involve a co-branding or endorsement, but rather a system which favours the standardisation of values between Group brands.

### Brand awareness for mobile telephony

Figures for Telefónica Móviles (Accumulated year 2005) The movistar brand was launched in April 2005

■ Total mentions  
 ■ Top of mind  
 ■ Market position based on total mentions



Tracking of Advertising and Brand Health 2005. Millward Brown

The graphic system defines colours, codes, formats, styles and typesetting to transmit a balanced and coherent picture of the group.

### Brand Committee

In 2005 the "Brand Committee" was consolidated as a technical body, reporting directly to the Board of Directors and headed by the General Manager of Corporate Communication and comprising technical representatives from the different business lines and country corporate centres and possibly from other corporate areas for specific matters. Its mission is to ensure the correct implementation of the Group's new Brand Strategy and Architecture Model.

For this end, the Committee has full powers to catalyse the vision, objectives and requirements of business lines and countries, channel all Group initiatives related to the brand (communication, advertising, sponsorship, fairs, events etc.) and encourage the establishment of the brand architecture system, developing specific rules, procedures, projects and initiatives to, if necessary, strengthen same.

Throughout the year the Committee has developed new adaptations of the brand within the scope of Telefónica businesses. Among them, a new brand strategy for *tgstiona* adapted to its new internal and external business requirements.

Telefónica has developed a range of tools to manage and analyse information common to business lines and countries, with the aim of carrying out ongoing and systematic monitoring and control of the reputation, image, satisfaction and affinity of brands in their different audiences.

In the fixed telephony category, the Telefónica brand showed high levels of recognition in all countries. In mobile telephony, bearing in mind the launch of the new commercial brand in the countries where the Group's mobile operation did not have a presence, similar levels of recognition were obtained, and in some cases higher than that of previous brands.





### Global launch of "movistar"

movistar was the first commercial brand to adapt its identity to the Telefónica Group's new architecture strategy. The advertising campaign for the new image was launched simultaneously in 13 countries in March 2005 and was accompanied by attractive product promotions and services and means the substitution of the brand image in 25,000 movistar sales establishments.

One year after its launch, the publication Expansión rated the launch campaign as one of the best advertising campaigns carried out in Spain over the next 20 years, highlighting the coordination of simultaneous actions in the different Spanish and Latin American markets.

It can also be stated that the system of coexistence between both brands, Telefónica and movistar, has shown that this level of connection improves the recognition of both brands among its customers.



## External communication

Telefónica sees external communication as an act of responsibility and transparency in its relationships with communications media, and by extension with society. Thus, with its daily contact with the media, Telefónica lets its customers, shareholders, investors and even its own employees what is going on.

Telefónica pays special attention to its relationship with the media and meets the demand for information in various ways, whether over the phone or by personal meetings and press conferences with the aim of meeting all information needs.

This attention is reproduced locally in each of the countries where the company operates. The Telefónica communications team spreads from Buenos Aires to Mexico DF, from Lima to London and from Prague to Sao Paolo, and in each country its relationship with the media is adapted to the specific nature of each of them, with the shared aim of transparent, rigorous and truthful communication.

Another alternative route of communication and constant information is the Telefónica virtual press room, attractive and intuitive, complete and continuously updated. Just one more example of the way the Telefónica Group anticipates and responds to the great demand for information it generates. Specifically, in Spain at the end of 2005, the total amount of sessions on its press room was 129,398, total accesses to said page being 2,813,253.

## Internal communication

One of the priorities for the 2005 financial year was to involve all professionals in Telefónica's transformation process, carried out under the slogan "Forging ahead to gain leadership". In this respect, both internal communications channels and presentations to directors have paid special attention to the five main axes for transformation which have been worked on since 2004.

Specifically, the Internal Master Communication Plan approved in 2004 and aligned with the company's Strategic Plan, established for 2005 the aim of giving our Group a single dynamic for internal communication which took account of the requirements and particular nature of all professionals, motivating their active participation in achieving the company's objectives and strengthening internal 'cohesion. "Forging ahead to gain leadership" was the main message from the development of this Master Plan.

In this context, the action plan carried out in 2005 involved the implementation of numerous initiatives. Among them, the creation of teams and new communications dynamics in different companies, the inventorying and remodelling of internal communications tools and the creation of new channels, the implementation of personal communications dynamics and the commencement of a Training Program in communication, both for directors and professionals involved in this sphere. Also carried out, and in coordination with the different countries, were specific communication initiatives in the Master



Plan, as well as ensuring compliance with new common objectives of existing actions in different businesses and countries.

One of the main initiatives of the Internal Communication Master Plan was the establishment of an Internal Communications Consultant-Advisor per country, which has become a driver and guarantee for this joint dynamic.

### El diario de Telefónica

Specifically, in Spain and as part of the priorities of the Consultant-Advisor, 2005 saw the launch of "el diario de Telefónica", a decisive step forward in the creation of an integrated communications dynamic for all Telefónica employees. With real time information updates, the newspaper has become the online reference for internal communication of the Group in this country, developing and integrating the experience of various internal communication channels with those already available to the Group in Spain, including Infobuzón, which was included in the newspaper after 9 years of daily contact with employees. It is planned that, during 2006, this same online channel model will be progressively implemented in all the countries where Telefónica operates.

### Management portal

Another of the initiatives of the Internal Master Communication Plan developed over the year was the launch of the beta version of the "Management portal" to which the top 1400 executives throughout the world have personalised access. This is a new channel for executives in the Group which, alongside the Telefónica Intranet, has the objective of becoming a communication channel par excellence for executives involved in Telefónica's process of change as catalysts for said change process.





## Telefónica on the Internet

Germany	<a href="http://www.telefonica.de">http://www.telefonica.de</a>
Argentina	<a href="http://www.telefonica.com.ar">http://www.telefonica.com.ar</a>
Brazil	<a href="http://www.telefonica.com.br">http://www.telefonica.com.br</a>
Chile	<a href="http://www.telefonicachile.cl">http://www.telefonicachile.cl</a>
Colombia	<a href="http://www.telefonica.com.co">http://www.telefonica.com.co</a>
El Salvador	<a href="http://www.telefonica.com.sv">http://www.telefonica.com.sv</a>
Spain	<a href="http://www.telefonica.es">http://www.telefonica.es</a>
USA	<a href="http://www.us.telefonica.com">http://www.us.telefonica.com</a>
Guatemala	<a href="http://www.telefonica.com.gt">http://www.telefonica.com.gt</a>
Morocco	<a href="http://www.telefonica.ma">http://www.telefonica.ma</a>
Mexico	<a href="http://www.telefonica.com.mx">http://www.telefonica.com.mx</a>
Peru	<a href="http://www.telefonica.com.pe">http://www.telefonica.com.pe</a>
Puerto Rico	<a href="http://www.telefonica.pr/empresas">http://www.telefonica.pr/empresas</a>

The portal contains content on both current affairs and training matters, management tools, items relating to executive talent etc. Of particular interest and continuously updated is the Telefónica Strategic Plan. This activity, lead from the Presidency in collaboration with the Communications department, carried out the following activities in 2005: Presentation of the Strategic Plan to 34 Boards of Directors in Group subsidiaries in 7 countries, involving over 400 executives, executive training courses on the methodology of strategic plans, involving over 300 participants in Spain (15 sessions) and 750 in Latin America (35 sessions); cascade communication through specific communication materials, among others.

### district C

The imminent move to the new headquarters that Telefónica is building in Madrid (district C) has led to the implementation of an extensive Communication Plan aimed directly at the 14,000 people who will be transferring to the complex and, indirectly, to all professionals in the Group, because district C will become the benchmark for the new way of working that Telefónica will be implementing in all the countries it operates in, as part of the transformation process.

### Other initiatives

Notable progress has also been made during 2005 in the new Single Intranet model, already applied as part of district C as a pilot experience.

The new model benefits from the contributions of experts in all business lines, with the aim of meeting the communication and management needs of all professionals in the Group.

Of particular note are communication and involvement actions carried out during the year by the Telefónica de España Group. Thus, numerous activities were launched and implemented from the communications module in the "Meta: Cliente 2005, a project for all" program developed with over 500 people through different media Televip, el diario, e-domus, screensavers, mass mailing, meetings, motivation channel, motivation mail box etc. Also implemented was a Plan to improve communication satisfaction through the creation of the Focus Group with operational personnel from the different divisions, the identification of improvement actions to be implemented, among other initiatives.

## Online communications

Telefónica's online presence articulates around the Alquimia Project which was launched at the end of 2002 in the context of a collaboration agreement between Terra and Telefónica. This project was completed at the end of 2005, following the start-up of the new web page model "telefonica.pais" in 13 countries. During the year, a range of technical activities were also carried out relating to said portals to improve accessibility to their pages and obtain better global positioning on the Internet.

Thus, the number of visits received in 2005 to all "telefonica.pais" portals in Latin America exceeded sixty million, with over 400,000 individually registered users. The "telefonica.es" portal ended the 2005 financial year with over three million monthly visits.

Telefónica presents itself on the Internet as an integrated telecommunications service provider in each of the countries it operates in. The "telefonica.pais" model seeks to establish in each country a single point of Internet access allowing the customer to gain transparent access to all the company's commercial and institutional information. The final result is a range of products and services which meet the needs of customers; offering specific solutions aimed at private individuals, professionals and companies. Other interest groups of the company (shareholders, investors, providers, partners, employees, communications media and citizens in general) also have specific sections in each of the "telefonica.pais" portals.

Telefónica's Internet model is transparent and the organisation and technology have achieved great flexibility and speed in meeting the needs of the market. Organisational transparency means it can adapt to changing commercial models while maintaining the operative autonomy of businesses without changing the model.



## Sponsorships

Telefónica participates in numerous activities in the companies it operates in through sponsorship of sporting, technological, cultural and social activities. In total, during 2005 there were 819 sponsorships.

### Cultural

Of particular note are certain cultural sponsorships such as the 'Diccionario Panhispánico de Dudas' (a dictionary unifying use of the Spanish language) in collaboration with the 22 Spanish Language Academies from all Spanish and Latin American countries; the monographic exhibition on Juan Gris at the National Museum Reina Sofia Art Centre, with over 160,000 visits; the celebration of the IV centenary of El Quixote, with an interactive web site aimed at school children and with over 194,000 visits. In relation to music, the most notable events were concerts and tours in Latin America and Spain of artists such as Shakira or Carlinhos Brown, sponsored by Telefónica movistar.

### Sports sponsorships

The Telefónica Group has continued its support for the Spanish driver Fernando Alonso and the Renault F1 Team, in 2005 and for the first time in the history of Formula 1, seeing the World Champion won by a Spaniard, as well as his group. Telefónica also continues its support for football as sponsor and exclusive provider from the telecom sector to important Spanish clubs Real Madrid C.F. and F.C. Barcelona as well as supporting the Zaragoza Expo 2008 through the football club Zaragoza S.A.D. It has also initiated a social sponsorship action with this sport, promoting with great success initiative such as the Copa movistar de las Culturas and the Mundialito Solidario, both aimed at the significant social group of immigrants.

Also, local initiatives have been carried out with a popular, cultural or sporting nature, including the Maratón Popular de Madrid which attracted over 13,000 runners and in Latin America support for a large number of popular and cultural fiestas such as the fiestas in San Pedrito de Chimbote in Peru or the Rio carnival in Brazil, among others. Telefónica wants people to know about its presence and support for activities in society, so for this end it has a sponsorship section on the Internet [www.telefonica.es/patrocinios](http://www.telefonica.es/patrocinios) which is a window on the actions it promotes and carries out in all spheres: Sporting, cultural and social...

### Other sponsorships

Another axis of action has developed through another type of sponsorship aimed at actively involving and committing Telefónica to the encouragement and development of the information society. For this end it collaborates directly with those public and private bodies that have the same objective, through sponsorship of business forums, congresses and international meetings of the main representatives of the sector, such as for example: Internet Global Congress 2005, Broadband World Forum Europe 2005, etc. This strategic line also takes the form of Technical Institutes, Academies, professorships in universities, in other words collaboration knowledge generation sources in Information Technology matters.

In 2005, once again Telefónica has provided technical support, through the installation of telecommunication lines and services, to the main meeting of European Internet users - the Campus Party in Valencia

## Leadership people

People management is one of the key values in the new culture of Telefónica. For this reason, within the axis aimed at strengthening the leadership and commitment of Telefónica's professionals, numerous initiatives have been taken related to professional development, clarity, training or reward policies, among others.

### Description of the workforce

Telefónica closed financial year 2005 with a workforce of 207,641 professionals, which is a 19% increase over the previous year. The most significant changes affecting the workforce during the year were due, among other reasons, to the purchase or creation of new companies (TPI Direct in the Directorios Group, the purchase of Azeler Automoción and Terra Business Travel, the creation of Terra Asociadas or the purchase of Cesky), the closing of companies such as Terra, Telefónica UK, T Gestiona Mexico, Lola Films or T. Short in Contenidos, or to the Continuation of the Employment Regulation Plan at Telefónica de España. In the latter case, a total of 1,945 employees are recorded as signing up in 2005, to add to the 7,906 requests for redundancy accumulated up to the year 2004.

The Telefónica Group workforce worldwide has the following characteristics: 85.4% have a fixed or indefinite contract (86% in 2004), with the rest divided between employees with temporary contracts (13.6%) and grants (0.9%). As regards their distribution by functions, without taking into account the Atento staff, 37.2% are dedicated to commercial functions (33.2% in 2004), 48.3% to production functions and 14.4% to support functions. The increase in commercial staff for the second year running stands out. 47% of the

workforce are women (48% in 2004), with an average seniority of 7.3 years (8 years in 2004) and an average age of 32.7.

The Telefónica Group companies (not including Atento) made more than 10,000 staff appointments in financial year 2005, 10% of which are appointments from inside the Group itself.

Telefónica has launched numerous programmes to incorporate young people into the workforce or to the labour market in general. Specifically, Telefónica de España and the Fundación SEPI, as part of the 2005 grants programme, offered 52 scholarships to young graduates of tertiary professional training in the specialities of Telecommunications and Information Technology Systems, Commercial and Marketing Management, Administration and Finances and IT Systems Management. This programme of long-term grants is part of the Employment Creation processes associated with the Social Plan of the Employment Regulation Plan, since it is expected that in 2006 part of those selected can be consolidated as appointments to Telefónica. One of the aims of these incorporations is to strengthen the Customer Attention Centres of the Business and Professionals Segment.

Telefónica International, in turn, during 2005 ran a regional process to cover management vacancies which, through a committee, identified and selected for and filled 76 posts. It also designed and set up a regional mobility programme to spur the development of professionals with a regional vision and to push forward projects of high strategic value for the company. 70 professionals from all the countries took part in the rotation programme.



## Characteristics of Telefónica Group workforce

	Contract type %			Manager-staff ratio %	Function %			Experience		Diversity % women
	fixed	temporary	grants		commercial	operations	support	seniority	Average age	
Fixed España	98.5	1.0	0.6	3.3	31.4	56.5	12.1	18.7	42.3	27.4
Fixed Latinoamérica	95.9	2.0	2.0	6.5	33.9	53.5	12.6	13.5	39.7	28.3
Telefónica Móviles	96.9	1.1	2.0	10.5	56.2	25.6	18.1	5.0	30.0	40.5
Contenidos	98.3	1.6	0.1	5.4	12.0	72.8	15.2	3.5	38.7	7.7
Directorios	91.8	5.9	2.3	7.9	73.7	11.4	14.9	8.3	38.5	43.9
Atento	71.4	28.5	0.1	1.4	0.2	98.5	1.3	1.5	27.1	66.3
<i>tgestión</i>	94.2	1.1	4.7	7.4	1.0	93.6	5.4	8.3	25.8	26.2
Cesky Telecom	95.2	4.8	0.0	5.3	38.8	49.0	12.2	12.2	37.8	34.4
Otras	84.1	6.9	8.9	18.0	9.9	52.4	37.7	4.9	28.9	47.2

## Telefonica Group workforce<sup>1</sup>

By Country	2005	2004	2003
<b>Spain</b>	<b>60,405</b>	<b>59,978</b>	<b>58,189</b>
<b>Europe</b>	<b>14,326</b>	<b>4,322</b>	-
Czech Rep,	10,051	-	-
Netherlands	3,789	3,789	-
Germany	480	533	-
Luxembourg	3	3	-
Switzerland	3	3	-
<b>Latin America</b>	<b>131,968</b>	<b>94,204</b>	<b>80,041</b>
Argentina	18,856	15,177	14,100
Brazil	63,743	51,741	42,496
Chile	12,375	10,060	8,795
Peru	11,548	10,733	9,422
Mexico	8,506	6,493	5,228
Colombia	4,487	-	-
Venezuela	5,983	-	-
USA	1,166	-	-
Uruguay	536	-	-
Ecuador	747	-	-
Panama	601	-	-
Nicaragua	285	-	-
Central America	3,135	-	-
Morocco	<b>942</b>	<b>1,075</b>	-
Other countries	-	13,469	10,058
<b>Telefónica</b>	<b>207,641</b>	<b>173,554</b>	<b>148,288</b>
<b>By business</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>
Spain Fixed	35,053	36,425	38,464
Latin America Fixed	28,856	25,905	25,762
Terra	-	1,584	2,229
Telefónica Móviles	22,739	19,797	13,093
Directorios	2,942	2,876	2,787
Contenidos	5,734	5,860	4,638
Atento	95,907	74,829	54,394
Cesky Telecom	10,051	-	-
Others	6,359	6,278	6,921
<b>Telefónica</b>	<b>207,641</b>	<b>173,554</b>	<b>148,288</b>

<sup>1</sup> Physical Workforce: Number of employees working in the Company.  
Equivalent Workforce: Number of employees proportional to number of hours.



The Atento Group again stood out in 2005 for its capacity for generating employment. At close of year, the organisation had 96,000 employees, 28 per cent more than the previous year. This ability to create jobs and thus contribute to the development of society was greatly valued in the 12 countries where the Group is present.

### Professional development

To continue moving its transformation process forward, Telefónica has taken numerous initiatives in 2005 related to a series of principles: Clarity, Remuneration Policy, Professional Development, etc. These initiatives throughout the year and since the Management Summit of 2004 have had a particular concrete visibility in the organisation, led by the senior management of Telefónica, with a commitment to follow-up by its Board of Directors.

If, in general, people are Telefónica's most important resources, this statement has especial importance when we are talking of innovation, since this is only possible when it starts from the creative and pioneering spirit of the people responsible for developing new products or analysing the business impact of new technologies.

### Professional career

Among the initiatives developed around the careers of its professionals, Telefónica established a framework during 2005 for rotating managers and supervisors with the aim of encouraging the transfer of good management practices between different units of the company, offering the employees opportunities for professional development and helping to share existing talent within the organisation. This makes it easier to be able to reach management

levels, since it creates management vacancies that have to be covered internally and as a priority. Thus during financial year 2005, 171 managers have rotated internally (12% of the total), and a good proportion of JAP (high potential young people) have taken part in this initiative. In Telefónica de España, staff rotation between general departments was used in 30% of the internal selection processes, and in 44% of the cases of employees of the same general department.

Also in 2005, thanks to the participation in the Fundación Carolina Grants Programme, 26 professionals of the Telefónica Group in Latin America worked professionally in Telefónica Group companies in Spain while doing postgraduate studies for a year.

The global publication of vacancies in the Intranet of Telefónica has also helped to make known to all the Group's employees the professional opportunities available in the different companies and to encourage clarity and transparency in the processes of filling posts, and foster the transmission of internal talent. The first phase of the project was put into effect in March 2005, and since then more than 350 vacancies have been published. This tool is available for publishing both management and non-management vacancies.

A programme with similar aims is the interchange of projects between Telefónica de España and Telefónica Latinoamérica, with the dual purpose of transferring good project management practices and developing professionals with an overall telecommunications group vision. 25 professionals took part in this initiative during 2005.

At the start of the year, Telefónica de España also approved the evolution of the expert career model towards a new professional career in project management with the aim of understanding and adapting the expert function to the needs of the company, identifying the most suitable experts for each post, offering more attractive professional perspectives and greater job satisfaction, and, in brief, positioning this group within the overall strategic lines of the company. The Project Management career, together with the Commercial career and that of Customer Technical Adviser (ATC) brings together around 4000 company professionals into a single model of professional development and career. A plan was also drawn up for revitalising the commercial career, according to the business units.

The selection of High Potential Young People (JAP) was completed in 2004 with a total of 138 employees. Periodic rotations (from 3 to 6 months) were made in 2005 in which they carried out their work in other functional areas within the same company, other Group companies, and in some cases, in other countries. This has helped to increase their overall view and knowledge of the Group. Additional development activities are expected to be held in 2006, which will mark the end of the 2004-2006 invitations to the JAP Programme.



### Variable Reward and Remuneration Policies

Staff costs in the Telefónica Group in 2005 totalled 5.045 billion euros (4.346 billion euros in 2004), representing some 13.3% of Group revenues in 2005 (14.4% in 2004). Of this total, the salaries package (fixed remuneration + variable remuneration + benefits + pensions plans + commissions) covers 78%, with 69.2% corresponding to the sum of the fixed and variable remuneration and 4.3% to benefits. In addition, Telefónica has run up workforce restructuring costs for a total of 611.20 million euros.

The Telefónica Group's Remuneration System is in line with the Group's global strategy and with the best market practices. The objective is to motivate the employee in a competitive, equitable and consistent way, setting a remuneration package based on the following points: adaptation to the reality of each market and each business line, consistency with the values of the Telefónica Group, focussing on key persons according to their performance, and the contribution and relevance of non-cash rewards: social benefits and in kind.

For defining this remuneration system, salary benchmarks were set that would enable comparison with companies in the market of similar size and importance to those of the Telefónica Group. These analyses have been made for the senior and middle managers in Spain, Europe and Latin America, and the remuneration conditions for the workforce in general are described in the various current collective agreements. At the end of 2005, there were more than 142,700 Telefónica Group employees with their conditions regulated by collective agreements, as against 120,000 in 2004.

For some years the Telefónica Group has been working on the design and establishment of variable remuneration policies to reward its employees' efforts and achievement of objectives. These policies seek, on the one hand, greater commitment and involvement by the employees with the objectives of their company, and on the other, greater equity in remuneration systems. Variable remuneration is thus aimed to foster the achievement of global Group aims and to reward in function of the contribution to results through its Company, Area and individual objectives. It is also based on a model which, linked to the overall results of the Group, combines the perspective of goal achievement (what has been obtained), with perception of performance (how it was obtained). More than 147,000 employees (105,000 in 2004) are subject to variable remuneration based on the achievement of individual, company and group goals.

For its managers, both in terms of fixed and of variable remuneration, the Telefónica Group set an overall common remuneration framework aimed at achieving the results and defined strategies, with the necessary flexibility and transparency for maintaining the greatest possible internal equity and external competitiveness, and with the aim of encouraging mobility, attractiveness, motivation and the retention of management talent.

### Management by competencies

All the Telefónica Group lines share a generic competencies system for the employees which reinforces Group values and serves as a basis for the implantation of the strategy. Competencies are the guidelines for performance that enable

each of the employees to know what the company expects from them, and also serve as a personalised guide for professional development.

In 2005, the Telefónica Group companies took part in an assessment process that consisted in, at least, self-evaluation and in the assessment of their supervisors. The result of this assessment helped to identify areas of improvement for each employee and the appropriate activities to be carried out each year.

During 2005, excluding Atento, more than 78,361 employees of the Telefónica Group were assessed on the basis of their competencies. This was a strengthening of the model compared with the 68,677 in 2004 and the 35,758 in 2003.

Telefónica continues moving ahead with management by competencies, integrating them within the different human resources management systems (selection, training, development ...), thanks to a corporate competencies model that aids horizontal and vertical mobility between areas, units and countries, driving the development of the organisation and improving the integration of personal skills.

The development of competencies is intended to advance a process of moving the culture towards a professional model of greater employability, facilitating efficiency, the vision of the internal customer and transfunctional empathy. All Group employees thus have access to a training portal where there is a section for self-development of corporate competencies in which many activities can be found to raise one's skill level in the competencies.

## Hours of training by employee and business line

	2005			2004		
	Seniors Managers	Middle Managers	Rest of workforce	Seniors Managers	Middle managers	Rest of workforce
Spain fixed business	46	187	44	48	187	40
Latin America fixed business	29	69	32	50	48	31
Mobiles business	54	38	39	123	58	71
Directories business	27	67	30	145	132	35
gestiona Group	21	57	31	-	-	-
Other companies	13	12	7	38	95	25
Atento Group	-	-	64	-	-	84

The Human Resources area of Telefónica is also moving ahead on a project of implanting a 360° assessment model for the Group managers, which up to now has completed the assessment of management talent in 2005 and the 180° minimum feedback process. 360° assessment implies the evaluation of professionals by their superiors, the people depending on them and the people who work at the same level, as a complement to the self-assessment process. A series of corporate policies around this initiative are expected to be developed during the next financial year.

### Training

The Telefónica Group invested more than 70 million euros in 2005 in the training of its employees, an average of 380 euros per employee. Telefónica Group professionals spent more than nine million hours in training in the year 2005, which is an absolute growth of 5%. By business lines, the effort of Atento again stands out this year with more than five and half million hours of training for its employees. Considering the Telefónica Group without counting the customer relations company, the absolute growth in hours of training is 15%.

Annual hours of training per employee equivalent are over 48, which breaks down into 33 hours for managers, 58 for middle managers and 48 for the rest of the workforce. The decrease compared to the 60 hours per employee of 2004 is basically due to the lower intensity of training in the mobile telephone and directory businesses, joined to the effect of the specific training activities for middle level managers held by Telefónica de España in 2004.

The number of individual students was over 650,000 (600,000 in 2004) which is an average of over three training activities per employee. Counting the rest of the workforce (without including Atento), the distribution of hours by functions shows 37 hours of training for employees who perform commercial functions, 38 for those with operational functions and 30 for the support professionals.

During 2005 Telefónica has advanced the commercial orientation of its workforce through various training programmes. The Managers' programme: "Transforming the organisation towards the customer", already started in 2004 and held for more than 1,000 managers of all the Group businesses and given in Spain, Argentina, Brazil, Chile, Peru and Mexico, went more deeply into the importance of converting Telefónica into an operator creating value solutions for its customers. The training Itinerary: "Commitment to our customers" was completed by more than 5,000 middle managers of the Group in the main countries where it is present (Argentina, Brazil, Chile and Peru). This programme has helped to improve the participants' skills and the knowledge which they need in order to respond successfully to the commitment of the whole organisation to a greater customer orientation. Among the activities targeted at all the Group's employees should be stressed the access to specific courses for improving the commercial orientation through the training Portal.

This commercial orientation in formation has led to the different Group businesses reinforcing this commercial training with specific activities. Among these are the recuperation of the teacher-collaborator and the Telefónica de España Sales Schools,

and the programmes associated with the "Customer Commitment" initiative of Telefónica International. The formation of Atento's employees is particularly intensive due to the size of its workforce, its greater turnover of professionals compared with other Telefónica Group companies and to the special characteristics of the activities involved in its operations. The employees in Atento acquire formation in the handling of computer applications for recording their contacts with customers, as well as that directly related to customer attention.

### Number of employees with personalised training plans<sup>1</sup>

<b>Spain</b>	<b>35,242</b>
<b>Latin America</b>	<b>7,441</b>
Argentina	1,858
Brazil	1,576
Chile	N.D.
Peru	1,060
Mexico	153
Colombia	430
Venezuela	2,364
<b>Rest of America</b>	<b>367</b>
<b>Total</b>	<b>43,050</b>

<sup>1</sup> Including Atento  
Footnote to graph: Aspiring to be the biggest and best integrated telecommunications group in the world, Telefónica has set itself the challenge of becoming the best option for the future for all its professionals. Telefónica has set the objective of launching the individualised formation plan in financial year 2006.

## Evolution working environment survey

Figures in percentages	2004	2005
Management	73	78
Mid management	63	64
Collaborators	48	57
Telefónica	55	59

Figures obtained from the 29 homogeneous questions for 2004



### Workplace environment

The second application of the common environment survey began in Telefónica in November 2005. As well as the seven corporate indicators measured in 2004 (Clarity of Communication, Leadership of the Immediate Supervisor, Confidence in Management, Professional Development, Customer Orientation, Internal Collaboration, and Perception of the Group), four extra questions have been included (passing from 29 to 33) to obtain a new indicator to measure Innovation in the Group companies.

66 companies took part in the survey (19 more than in 2004) and 71% participation has been obtained (10 points more than in 2004). The objective was set for 2005 of increasing the Global Satisfaction Index by 5% and this has been passed, increasing it by 7.11% (3.91 percentage points, passing from 55% to 58.91%). Taking into account the 4 values introduced in 2005 (reaching 33 questions) the resulting satisfaction value is at 58%. The greatest improvement (average increase of 9 percentage points) has been in the perception of the collaborators, especially in aspects related to Clarity of Communication and Confidence in Management. This advance reduces the gap between the perceptions of Management and of the Collaborators. The improvement in the Managers group has been seen fundamentally in subjects related with internal Collaboration and in professional Development.

After communicating the results to all the employees, 2006 will begin with the design of the action plans for improving the environment. The priority lines of action on which the action plans for improving the environment will concentrate are: Professional Development, Leadership, Innovation and Customer Orientation.

### Workplace environment observatory

During 2004 the workplace environment observatory was established, comprising workplace environment representatives from the main Telefónica companies. Its mission is to share and encourage workplace environment improvement initiatives in the Group and, definitively, provide a space for debate and innovation to help improve employee satisfaction and their motivation in terms of the project for the future of Telefónica. The workplace environment observatory started off in Spain and has been repeated in Argentina, Brazil, Chile and Peru.





“Telefónica has gradually adapted its organisational structure to its commercial orientation and the development of the synergies of the Group”

## Group Structure\*

### Telefónica Group

	% Part
Telefónica de España	100.00%
Telefónica Móviles <sup>1</sup>	92.46%
Telefónica Latinoamérica	100.00%
TPI Group	59.90%
Telefónica de Contenidos	100.00%
Atento Group	91.35%
Cesky Telecom	69.41%

<sup>1</sup> Effective participation: 92.91%. Includes Telefónica Móviles S.A.' Stock Options Program ("Programa MOS").

### Telefónica España Group

	% Part
Telyco	100.00%
Telefónica Telecomunic. Públicas	100.00%
Telefónica Soluciones Sectoriales	100.00%
Telefónica Empresas España	100.00%
Terra Networks España <sup>1</sup>	100.00%
T. Soluciones de Informática y Comunicaciones de España	100.00%

<sup>1</sup> Telefónica, S.A. owns 100%

### Telefónica Latino América Group

	% Part
Telesp	87.49%
Telefónica del Peru	98.19%
Telefónica de Argentina	98.03%
TLD Puerto Rico	98.00%
CTC Chile	44.89%
Terra Networks Peru	99.99%
Terra Networks Mexico	99.99%
Terra Networks USA	100.00%
Terra Networks Guatemala	100.00%
Terra Networks Venezuela	100.00%
Terra Networks Brazil	100.00%
Terra Networks Argentina	99.99%
Terra Networks Chile	100.00%
Terra Networks Colombia	99.99%
Telefónica Data Colombia	100.00%
Telefónica Empresas Brazil	93.98%
Telefónica Empresas Peru	97.07%
Telefónica Data Argentina	97.92%
Telefónica Data USA	100.00%
T. Intern. Wholesale Serv. (TIWS) <sup>1</sup>	100.00%

<sup>1</sup> Telefónica, S.A. owns 92.51% and Telefónica DataCorp owns 7.49%.

### Other Participations

	% Part
Lycos Europe	32,10%
Sogecable <sup>1</sup>	23.83%
Portugal Telecom <sup>2</sup>	9.84%
China Netcom Group <sup>3</sup>	5.00%
BBVA	1.07%
Amper	6.10%
Telepizza	4.13%

<sup>1</sup> Telefónica de Contenidos, S.A. holds 22.23% and Telefónica, S.A. holds 1.60%.

<sup>2</sup> Telefónica Group's effective participation. Telefónica Group participation would be 9.96% if we exclude the minority interests.

<sup>3</sup> Ownership held by Telefónica Latinoamérica.

\* Excluding 2nd December 2005



## Telefónica Móviles Group

	% Part
Telefónica Móviles España	100,00%
Brasilcel <sup>1</sup>	50,00%
TCP Argentina	100,00%
TEM Peru	98,03%
T. Móviles Mexico	100,00%
TM Chile	100,00%
TEM El Salvador	99,02%
TEM Guatemala	100,00%
Telcel (Venezuela)	100,00%
TEM Colombia	100,00%
TEM Guatemala y Cía	100,00%
Otecel (Ecuador)	100,00%
TEM Panama	99,98%
Abiatar (Uruguay)	100,00%
Telefonía Celular Nicaragua	100,00%
Radiocomunicac. Móviles SA (Arg)	100,00%
Telefónica Móviles Chile	100,00%
Group 3G (Germany)	57,20%
IPSE 2000 (Italia) <sup>2</sup>	45,59%
3G Mobile AG (Switzerland)	100,00%
Medi Telecom	32,18%
Telefónica Móviles Interacciona	-
100,00%	-
Mobipay España	13,36%
Mobipay International	50,00%
T. Móviles Soluciones y Aplicac. (Chile)	100,00%
Tempos 21 <sup>3</sup>	38,50%

<sup>1</sup> Joint Venture which fully consolidates TeleSudeste Celular Participações, Celular CRT Participações, TeleLeste Celular Participações and Telesp Celular Participações. Telesp Celular Participações fully consolidates Global Telecom Participações and TeleCentro Oeste Participações.

The states that Brasilcel consolidated in its subsidiaries are the following: TeleSudeste Celular Participações 91.0%; Telesp Celular Participações 66.1%; Global Telecom Participações 66.1%; Celular CRT Participações 66.4%; TeleLeste Celular Participações 50.7% and TeleCentro Oeste Participações 34.7%.

<sup>2</sup> Additionally, Telefónica Group holds a 4.08% of IPSE 2000 through Telefónica DataCorp.

<sup>3</sup> In June 2005, Tempos 21 is consolidated by the equity method with a retroactive effect as from January 1st 2005.

## TPI - Páginas Amarillas Group

	% Part
TPI Edita	100,00%
Publiguias (Chile)	100,00%
TPI Brazil	100,00%
TPI Peru	100,00%
Teleinver (Argentina)	100,00%
11888 Servicios de Consulta Telefónica	100,00%
Services de Renseig. T. (Francia)	100,00%
Servizio di Consultazione Telefonica, S.R.L. (Italia)	100,00%

## Atento Group

	% Part
Atento Teleservicios España, S.A.	100,00%
Atento Brazil, S.A.	100,00%
Atento Argentina, S.A.	100,00%
Atento de Guatemala, S.A.	100,00%
Atento Mexicana, S.A. de C.V.	100,00%
Atento Peru, S.A.C.	99,46%
Atento Chile, S.A.	77,60%
Atento Maroc, S.A.	100,00%
Atento El Salvador, S.A. de C.V.	100,00%

## Telefónica de Contenidos Group

	% Part
Telefé	100,00%
Endemol <sup>1</sup>	99,70%
Telefónica Servicios de Música	100,00%
Telefónica Servicios Audiovisuales	100,00%
Hispasat	13,23%

<sup>1</sup> Ownership held bay Telefónica, S.A.