
**TELEFÓNICA GENERAL SHAREHOLDERS'
MEETING**

REPORT

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A. INTRODUCTION

Good morning everyone:

I would like to start by **welcoming you and sincerely thanking you for attending** this General Shareholders' Meeting, where your participation and involvement is highly valued.

For yet another year, it is a **pleasure for me to have this opportunity to review with all of you our performance** during the past year and share the ideas that will guide our lines of action during the coming years.

On this occasion, we **have more than enough reasons to celebrate**, as **2006 has clearly marked a before and after in the history of Telefónica**.

This is due to four fundamental reasons.

First, because **in 2006 our results exceeded record highs**, not only in terms of our own company but also in terms of the telecommunications sector as a whole.

Second, because our results reflect the success of the process of **transformation which has been underway for the past few years.**

Third, because that transformation process has enabled us to develop a **new management model** aimed at attracting future growth, and **placing the customer first.**

And finally, these 2006 results place us in a **privileged position** that will enable us to **leverage the enormous potential of the business** and its very favourable outlook.

Over the next few minutes, I would like to expand on these areas in greater detail..

B. RESULTS IN 2006, BEST IN THE SECTOR

B.1. RESULTS IN 2006

Let us begin by reviewing our performance in 2006. Over this past year, Telefónica has consolidated its position as the European operator offering **the best combination of growth and profitability in the sector.**

Our **results, which greatly surpass those of our peers**, can be summarised with four key concepts: MORE GROWTH, MORE PROFITABILITY, GREATER SCALE AND GREATER DIVERSITY.

MORE GROWTH

In terms of growth, the results show a **distinctive increase in all lines of the income statement**. Revenues rose 41.5% compared to the previous year - much higher than our own estimate, which ranged from 34% to 37% - while net profit grew 40.2% to €6.233 billion, thus constituting **the largest net profit in absolute terms in the European telecommunications sector**.

Operating revenues totalled €2.901 billion, posting an organic growth rate, in constant currency and excluding the impact of changes to the Group's consolidation perimeter, **of 7.8%, the highest percentage in the sector**. Being the **benchmark in organic growth** has always been one of our top objectives, since this would show that we are capable of expanding our markets and businesses by taking advantage of the cycles in technology and demand to our benefit. **We are and will continue to be a growth company**.

This exceptional growth in revenue is underpinned by a **sound increase in our customer base of 32.4%**, to over 203 million customers, **50 million more than in 2005**. In just one year, our growth has equalled the overall size of Telefónica in 1998, only eight years ago. This is the result, on the one hand, of the **major sales efforts** undertaken, primarily in the growth businesses, such mobile telephones and broadband services, and in product and service innovation, and, on the other hand, of the **rapid and successful integration of O2 in 2006**.

We are equally pleased with the transformation undergone by **Telefónica O2 Czech Republic**, under our management, which has enabled it to resume growth, as well as with the incorporation of Colombia Telecom.

MORE PROFITABILITY

At the same time, 2006 is characterised by a **steady increase in efficiency on the back of an integrated management of operations, cost optimisation and synergies** leveraged in excess of €1 billion. This has led to a year-over-year OIBDA increase of 27%, bringing the figure to €19.126 billion. The **OIBDA** shows **organic growth of 6.4%**.

Again this year, I want to underscore the growing **capacity of Telefónica to turn revenues into operating income and ultimately, cash flow**. In 2006, our operating cash flow **rose 12.3% year-over-year to €11.122 billion**.

This cash flow generation has been **consistent with a major investment effort, the sum of which totalled €8.003 billion, up 55.3% from 2005**. In **organic terms**, that percentage **falls to 7.7%**. Virtually all of the investment was earmarked for growth projects relating to fixed and mobile broadband services and increasing the capacity of our mobile networks throughout the world, as with the rollout of GSM in Latin America and third generation networks in Europe.

In short, we rolled out our networks ahead of schedule in 2006 because we were achieving higher-than-expected growth in terms of customers, traffic and services, which has already manifested itself in a larger increase in our revenues.

This has enabled us, among other things, to significantly grow areas that are very important to us, such as fixed broadband access and the penetration of our new services that go beyond connectivity. In fact, in 2006, the **bundling of related services** in double and triple packs surpassed three million units and **33% of the Company's total revenues came from the new businesses**, such as broadband connectivity, value-added services and digital content.

As such, by year-end 2006, Telefónica had **almost 8 million broadband accesses**, up almost 41% from 2005, with a similar percentage in both Spain and Latin America. Moreover, at the close of 2006, **we had already exceeded 1 million pay TV customers**, a year-over-year growth of 56%.

In summary, **the management results achieved easily surpass** the commitments undertaken with the market, **and also** those of comparable companies in the sector, both of which support and strengthen **our recognized credibility**.

Furthermore, the financial results described reflect the **advancements achieved in terms of management**, the most salient of which I would like to share with you:

- **In Latin America**, we have **consolidated our position as the leading broadband operator**, through the widely successful launch of the double and triple packs, which has enabled us at the same time to move forward in the **pay TV market**. Moreover, there has been new activity in the **mobile telephone segment** with an 18% increase in the customer base, bringing the total to 83 million by year-end 2006; and we have **launched our satellite TV offer in Brazil, Chile and Peru**.

- **In Europe**, I have the pleasure of informing you that we have become the **largest mobile telephone operator in the United Kingdom**, with over 17 million customers; and we have launched **ADSL in Germany** and **IPTV in the Czech Republic**.
- **And, in Spain**, we have yet again successfully **driven and led the broadband market, consolidating the position of the Double and Triple Pack offers**, within one year since their launch, as star converging products driving such growth. Moreover, despite intense competitive pressure, we have maintained **our mobile market share above 45%, with profitable revenue growth**.

Telefónica's positive performance in 2006 shows the **renewed strength of our leadership**.

GREATER SCALE AND DIVERSITY

As I mentioned previously, in 2006 we have given an unprecedented boost to our efforts in order to achieve the critical mass necessary for future growth, surpassing 200 million customers, which would make us the **third largest telecommunications operator in the world based on the number of accesses**, behind only two Chinese operators: "China Mobile" and "China Telecom". I would like to note here how pleased we are with our dealings and **involvement in China Netcom**, operator, which as you know, registered 130 million accesses by year-end 2006.

In such a competitive sector such as ours, although growing is **the main challenge**, it is even more important **to ensure such growth is achieved in**

a diversified manner. Against this backdrop, and following the rapid integration of the most recent acquisitions undertaken, **Telefónica boasts a very favourably diversified portfolio both in terms of geographical location and area of business,** which translates into a **unique set-up within the sector,** one that is balanced and growth-oriented.

Telefónica has, today, the most international profile of all the large integrated operators, and has a presence in 23 countries. Of our total revenues, 64% originates in Europe – 38% in Spain and 26% in the rest of Europe - and 35% in Latin America.

As regards **business diversification,** 145 million of our customers have mobile access, 42 million are fixed-line subscribers and over 8 million broadband access subscribers. Moreover, there are more than 1 million pay TV customers.

B.2. CONSOLIDATION OF THE POSITION OF THE NEW TELEFÓNICA

These results are a testament to the fact that **we have been able to transform ourselves without neglecting day-to-day operations.** While processes related to large changes sometimes lead temporarily to a **loss of focus,** in our case, the transformation towards a new, enhanced Telefónica dovetailed with the achievement of very positive financial results. As such, we can affirm that **we have prepared ourselves in advance and done so better than the rest.**

Furthermore, knowing that customers demand comprehensive responses for all services, **we implemented a new organisational model** that ensures a full-spectrum view of the market by dedicating individuals solely to the fixed- and mobile businesses who will define strategies to suit the reality of each region and attain appropriate revenue and profitability growth levels for each geographical area. As such, **the new organisation is structured based on three lines of action:** Telefónica España, Telefónica Latinoamérica and Telefónica O2 Europe.

This model is based on an integrated vision of the business, processes and technology that foster a more flexible, dynamic and closer relationship with the customer and that will ensure the distribution network, brand name and the levels of customer service will be strengthened.

So, as of today, **we have consolidated the position of the New Telefónica** that we were announced just a year ago, characterized not only as a telecommunications service provider but also as a **driving force behind the economic, technological and social development of the countries in which we operate.** Our operations constitute the source of significant social enrichment, employment, digital inclusion, education, product and service innovation, as well as business opportunities for providers by helping overall economic development. Without sound telecommunications, economies turn stagnant.

Against this backdrop, our **2006 Corporate Responsibility Report**, available to you, dedicates a large section to the impact Telefónica's activities has on the progress of each country where we are present.

B.3. SHAREHOLDER REMUNERATION POLICY

In 2006, and just as I had announced at the General Meeting last year, **Telefónica implemented a new long-term shareholder remuneration policy that is more attractive and competitive, whose goal is to double** earnings and dividends per share by 2009, based on the €0.91 and €0.5 per share figures from 2005; **this constitutes a unique, differentiating commitment in the industry and in the markets.**

And we have already begun to meet this commitment. In **2006, the Company's earnings per share rose 43%, to €1.3 per share, and the dividend per share increased by 20% to €0.6.** On 10 November 2006, a dividend of €0.3 per share was paid out against 2006 earnings, which will be complemented with an additional payout of €0.3 per payable share on 17 May 2007, according to our proposal to the Shareholders.

Consequently, in 2006 the Company earmarked **over €3.5 billion in shareholder remuneration**, of which €2.627 billion was paid out as a dividend and the rest in treasury stock, which at 31 December 2006 totalled 75.6 million shares: 1.5% of capital stock.

The share buyback programme, totalling €2.7 billion, will finalise before year-end 2007 and the shares will be paid in accordance with the terms agreed. Specifically, we will today propose to this General Shareholders' Meeting the recovery of 148 million shares, which will have a very positive impact on the EPS.

B.4. STOCK MARKET PERFORMANCE

The distinctive results seen this year have boosted our company's share price on the exchanges.

As such, between 31 December 2005 and 9 May 2007, **Telefónica's share price increased by 31.5%** to €16.71 per share. This **drastically differs** from the share price performance of the other major European operators.

Moreover, **we have greatly outperformed the international benchmark indexes for the telecommunications sector**, such as Dow Jones Telco, which posted 17.8% for the period, **and general stock market indexes**, such as Standard & Poor's 500 or the Dow Jones Euro Stoxx 50, the gains of which for said period stood at 21.2% and 23.6%, respectively.

The backing of the capital markets of Telefónica's strategy has enabled us to rank **third worldwide as a value-added operators**, that is, in terms of market capitalisation and net debt, up from sixth place at year-end 2005.

Furthermore, Telefónica is today ranked fifth in terms of market capitalisation.

We strive, and will strive, to offer the best combination of growth and profitability in the sector to our shareholders. **In 2006, Telefónica offered a Total Shareholder Profitability at 31.2%**, which widely outperformed the benchmark index for the sector, Dow Jones Telco, the profitability of which posted at 22%.

Moreover, in 2006, Telefónica was **the second most liquid security** listed on the Euro Stoxx 50, and our **shareholder base** is the most international in the sector, with over 1,700,000 shareholders.

C. OUR VISION OF THE FUTURE –

Distinguished shareholders, at this point in my address, allow me to address what are, in my opinion, **the reasons behind our confidence in a future of successes awaiting Telefónica.**

Telecommunications are at the heart of all sectors in which the new economic and social model of the XXI century is being implemented. **We as operators are working together** with companies that provide technology, content or information services to build a new digital environment, **which in fact relies on our capacity to offer mobility and broadband** to the masses. As such, unlike other agents, **our success as operators will above all depend on ourselves.**

In the past few years, skeptical views have been heard often regarding the achievement of our objectives, and yet, year after year, we have successfully increased our customer base and revenue per customer, and we are confident that the future will continue the same path.

The forecasts confirm the unstoppable trend in the penetration of our services and the change in consumption patterns. In 2010, the total number of mobile accesses and Internet users will exceed 3.8 billion and 1.5 billion, respectively. Between 2006 and 2010, broadband penetration in **Latin America** is expected to double, reaching 16% of all households and mobile penetration to grow over 20 percentage points to 77%. In turn, it is estimated that over 80% of the population **in Europe** will have access to the Internet in 2010.

In short, **we are working in a sector whose revenues in the next few years will increase 7% annually** worldwide.

In an effort to unlock the full potential of the current situation afforded at the moment, we have defined **our vision as a company**, which focuses on three great aspirations:

- To improve the lives of people.
- To facilitate the development of the businesses.
- To contribute to the progress of the communities where we operate.
- And provide all innovative services that use information technologies and communication.

As such, **we can aspire to leading the evolution of the new digital environment**. Now is the time to **make an even better Telefónica** and successfully carry out our vision. And do so, as always, **before anyone else does and with greater ambition**. This will entail engaging ourselves again in anticipation and transformation efforts, as set out in the following **key lines** of action:

- **The first focuses on achieving a superior customer experience**, driven by a complete understanding of the customer that will enable us to tailor our offer to their current and future needs. An offer that combines access and value-added, with new digital content and services.
- **The second** addresses the importance of **innovation** in building our foothold in the new digital environment and in facing new growth opportunities. We continue to be a premier operator due to investments in R+D and its international network of research centres, the most recent of which, opened in Barcelona, has focused on

the Internet, multimedia technologies and multilingualism. Likewise, we co-manage an R+D centre in China. **In 2006, Telefónica invested €4.3 billion in technological innovation, up 48% from the previous year.**

- Another basic line of action is **to continue to renew our operating model**, as we always have. **In this commitment to operating excellence, we stand apart in the sector** due to projects such as those relating to regionalisation, process quality and the creation of centres of excellence, **which are a step ahead in leveraging** our scope, diversity, capabilities and technological development. We know that by leveraging our distinctive profile, we can go even further, and continue taking qualitative leaps towards innovation, flexibility and efficiency **to leverage a significant potential to increase our competitiveness.**
- The fourth line of work focuses on **convergence**, with which we will leverage our entire force as an integrated operator, and which is a driving force behind synergies, innovation and facilitator of a single vision of the customer who will expect comprehensive responses from us. A clear example of this method of work is our new workspace in Madrid, District C, where over 12,000 employees will work. It is the best showcase of everything that Telefónica and the ITCs can do to enhance the productivity of the companies.
- And last, we understand that with the development of the *ITC Hypersector* in terms of broadband and mobility, **collaborations with third parties** will become even more important as they will lead us down new paths to growth and operating excellence. In this sense, I would like to provide **as an example, our relationship with Telecom Italia**, one of the main telecommunications operators worldwide. Both of us as operators at year-end 2006 together accounted for nearly 300 million accesses, which represents 7% of accesses worldwide. This collaboration represents a singular opportunity to jointly explore all potential synergies in a

growing sector that will translate into higher revenues, lower costs and enhanced efficiency in engaging in investments for both companies.

In short, we are continuing to transform our culture and organisation in order to anticipate the new dynamics of the business with an ultimate goal of leading the new digital environment and **ensuring that we continue to offer you, our shareholders, the best combination of growth and profitability in the sector.**

D. TELEFÓNICA, THE BEST COMBINATION OF GROWTH AND PROFITABILITY

Distinguished shareholders, in closing, allow me to tell you that **I am confident that Telefónica is in an excellent place as a company**, with a distinctive, unique profile with more diversity and reach than any other operator, and with the highest credibility in the sector.

This credibility is based on the fact that Telefónica can affirm that it is a company that does what it says. We have always met and even surpassed our economic-financial commitments and thus **we have achieved and continue to achieve a superior Total Shareholder Profitability** in the telecommunications sector. Any of the last four years can serve as **proof of such**; you can see on the projection screen where we have always fulfilled the commitments we have undertaken.

This distinctive feature about Telefónica will continue in the future so long as it is compatible with increased ambition. **We have committed ourselves to many economic-financial targets for the next few years**, but of all of them, none is more important than **doubling the earnings and dividend per**

share by 2009, compared to 2005 levels, that is, to reach €1.826 and €1.0 per share, respectively.

There is no **better metric**, in my opinion, **than the latter to measure the growth and profitability of Telefónica** for its shareholders. Very few companies in the world, and certainly **none in our sector, dare to accept such a demanding commitment**. That is because, let me remind you, **Telefónica is a company by and for its shareholders**.

In order to **continue to satisfy** the trust you have placed in us, you can be sure that **we will not fall short in terms of our work or efforts**.

And this positioning will enable us to continue to post distinctive results in the future and **continue to grow significantly after 2009**.

We are sure that **the results of the past few years**, which have made us the benchmark in the sector, **have only begun to be reflected in the share price**. It suffices to combine our commitment to growth in the EPS for 2009 with the current average P/E multiple in the sector to be convinced that **our upward forecasts could not be more optimistic**.

I would like to take advantage of today to **undertake a renewed commitment**:

- **To the customer** as the centre of our organisation.

- **To our team** and its recognition, translated into incentive, motivation and opportunities. I would like to advantage of this moment to thank all of the employees of Telefónica for their efforts and dedication in 2006.
- **To society as a whole**, as a driving force behind development.
- And, of course, with a final, high-priority purpose: Continue to offer increasing profitability to **our shareholders**.

On behalf of the Board of Directors, of our entire team and myself, I would like to extend to you, for yet another year, our thanks.