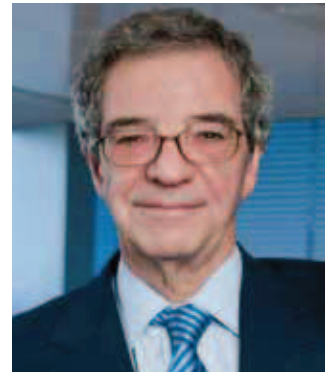


Letter to shareholders_



César Alierta Izuel Chairman & CEO

Dear shareholder,

It is my pleasure to offer you a brief summary of Telefónica's business results for 2012 and share my vision of our industry's and especially our company's future.

2012 was characterised by an uneven world economic growth and an intensification of the differences between developed and emerging countries. The markets where Telefónica operates exhibited divergent behaviour, with 3-per cent growth in Latin America compared to just 0.2 % in Europe.

The euro zone, in particular, made substantial institutional progress, denoting a firm commitment not only to the continuity of European integration, but also to a reformist agenda able to lay the grounds for sound growth in the near future. In Spain specifically, significant headway was made in 2012, in which the commitments undertaken pursued two objectives: the sustainability of the national debt and the implementation of an ambitious programme of reforms to elasticise the economy and thereby contribute to a medium-term rise in growth potential.

In this context, 2012 was a key year in Telefónica's transformation, a year in which the decisions adopted and implemented already began to bear fruit: decisions regarding the transformation of our commercial model, simplification across the board, optimisation of our investment management model and recovery of financial flexibility.

2012, key year for the transformation of Telefónica's business model

In 2012 we reached very significant milestones in Telefónica's transformation, in our commitment to become a Digital Telco and return to a pathway of growth and commercial leadership.

In this year we have implemented a number of initiatives designed to attain sustainable and differential top-line growth, based primarily on fixed and mobile broadband connectivity as well as new digital services.

We have also placed our stakes on capturing growth in high potential markets such as Latin America, which was the Company's major source of revenues for the first time in 2012.

By focusing sharply on high value customers in Latin America, we are growing profitably in the region, where Brazil is the benchmark market. In Europe, we have regained strong commercial momentum in the major markets and laid the foundations for future growth.

Despite unfavourable economic, competitive and regulatory conditions in some markets, in 2012 our yearly revenues climbed to 62.4 billion euros, only 0.8% less than in 2011.

In parallel, in 2012 we undertook a profound transformation of our commercial model,

“2012 was a key year in Telefónica’s transformation, a year in which the decisions adopted and implemented already began to bear fruit”

changing our offering from a subsidy-focused model to a more sustainable approach based on distinctive quality and offerings that enhance customer loyalty.

More specifically, in Spain we adopted bold decisions such as the elimination of subsidies for handsets and the launch of “Movistar Fusión”, an integrated communications offering that shatters industry paradigms and constitutes an inflection point in the course of Telefónica’s business in Spain. Similar offerings are being successfully launched in other countries, such as the “On&On” smartphone rates in the United Kingdom and “O2 Blue” integrated mobile data rates in Germany.

As a result of the significant impetus given to contract and fixed and mobile broadband accesses, our customer database grew by 3 % year-on-year to nearly 316 million.

At the same time, we made significant efforts to streamline processes and simplify our product base, a measure that is already generating sizeable savings and raising efficiency levels. Suffice to say that in Latin America alone we reduced our product and service catalogue by over 7,000 items during the year. Telefónica Global Resources has been instrumental in this process, with the consolidation of its operating model during this period and its consistent

contribution to Telefónica’s progress toward maximising the benefits of its scale.

As a result of the foregoing, the Company’s operating income before depreciation and amortisation (OIBDA) came to 21.2 billion euros in 2012, for a year-on-year rise of 5.1%. Of particular note is the recovery of the OIBDA margin, an indication of the success of the efficiency enhancement measures implemented throughout the year.

Lastly, we optimised our investment management model, reallocating resources to the highest growth activities. From that perspective, in 2012 we decided to share networks and co-invest in some countries. Such decisions enabled us to offer our customers an optimal network experience, raise service quality and customer satisfaction, and strengthen our networks by acquiring spectrum. Furthermore, over 80% of the year’s total investment was allocated for growth and transformation projects, one of the priorities being the expansion of our high speed, fixed and mobile broadband services.

The Company also made a substantial investment effort which, including spectrum acquisition, amounted to 9.5 billion euros, bringing the CapEx to sales ratio to 14.2 %, a value comparable to the 2011 figure.

316 million customers
reflect Company
growth in 2012

**Revenues up to
62.4 billion euros**
0.8% less than in 2011

**OIBDA reached
21.2 billion euros**
a year-on-year increase of 5.1%