

# Annual Report

2005

*Telefonica*









|    |   |     |
|----|---|-----|
|    | 2005 Highlights                                   | 4   |
|    | Letter from the Chairman                          | 6   |
|    | Governing bodies                                  | 10  |
| 01 | The Telefónica Group in 2005                      | 12  |
|    | 01 01 About Telefónica                            | 14  |
|    | 01 02 Business Strategy                           | 20  |
|    | 01 03 Group Structure                             | 52  |
|    | 01 04 Timeline                                    | 56  |
| 02 | Information for Shareholders                      | 62  |
|    | 02 01 Information for Shareholders                | 64  |
|    | 02 02 Risk Management                             | 70  |
|    | 02 03 Corporate Governance                        | 82  |
| 03 | Corporate Responsibility                          | 90  |
|    | 03 01 Corporate Responsibility in Telefónica      | 94  |
|    | 03 02 Driving progress                            | 100 |
|    | 03 03 For everyone                                | 108 |
| 04 | Quarterly results: January to December 2005       | 130 |
|    | 04 01 Quarterly results: January to December 2005 | 132 |

In the past two years Telefónica  
has increased its growth by:

**x2** the number of accesses

**+10** more countries

**x1.5** the number of employees

increasing profitability:

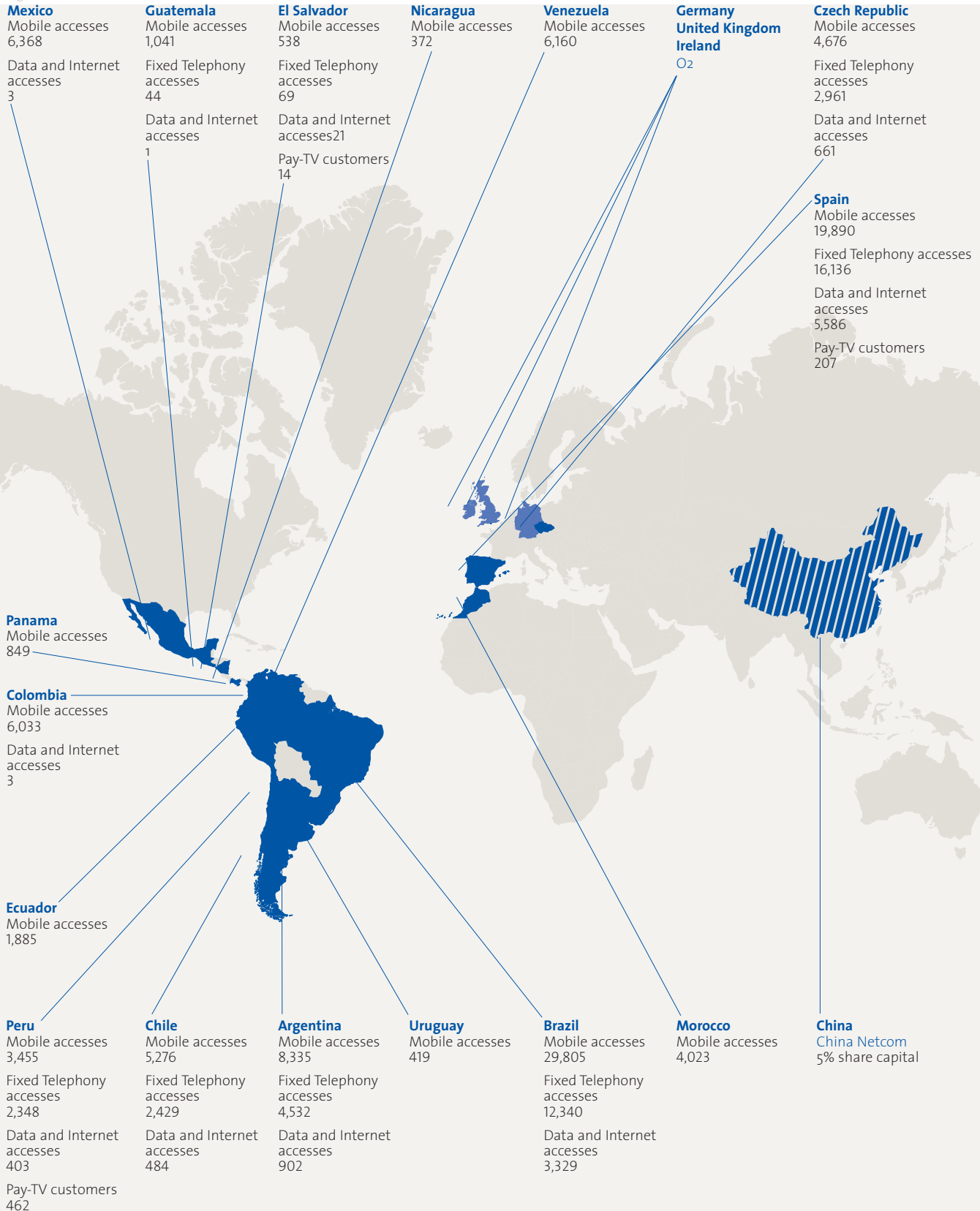
**x1.7** in revenue<sup>(\*)</sup>

**x2.37** in net earnings per share<sup>(\*)</sup>

# 2005 Highlights

## Telefónica: Market size (2005)

Figures in thousands



# Profitable Growth\*

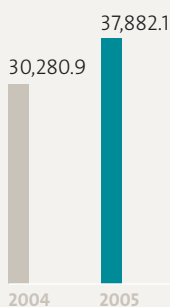
+40%

## Results

4,445.8 million euros

### Revenue

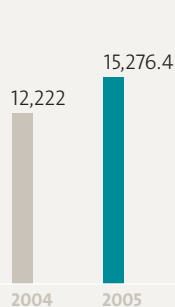
Millions of euros



+25.1%

### OIBDA

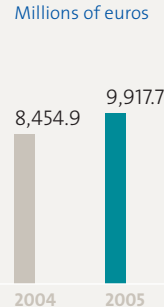
Millions of euros



+25.0%

### Cashflow generation

(OIBDA - CAPEX)  
Millions of euros



+17.3%

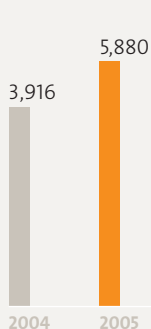
+24%

## Customers

154 million accesses (not including O2)

### Broadband Internet accesses

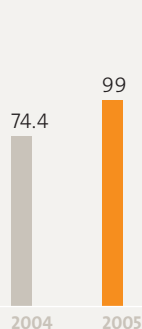
Thousands of Customers



+50.2%

### Mobiles

Thousands of Customers

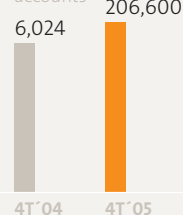


+33.2%

### Imagenio

Customers

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



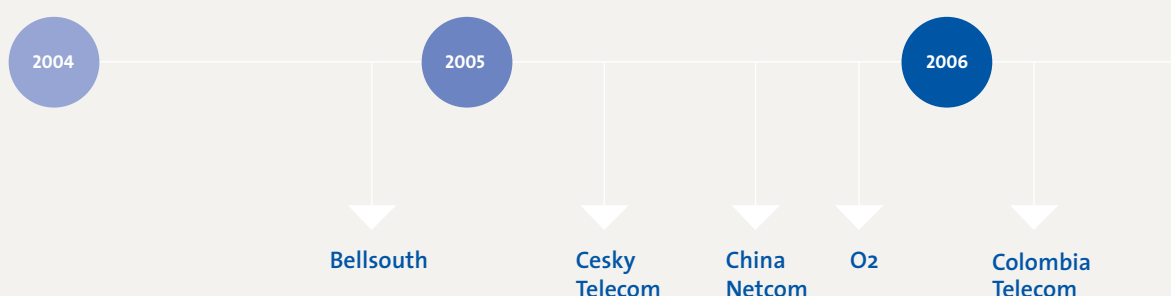
+200.6%

x2

## Size

5 corporate acquisitions in the past 2 years

Growth due to acquisition 2004-2005





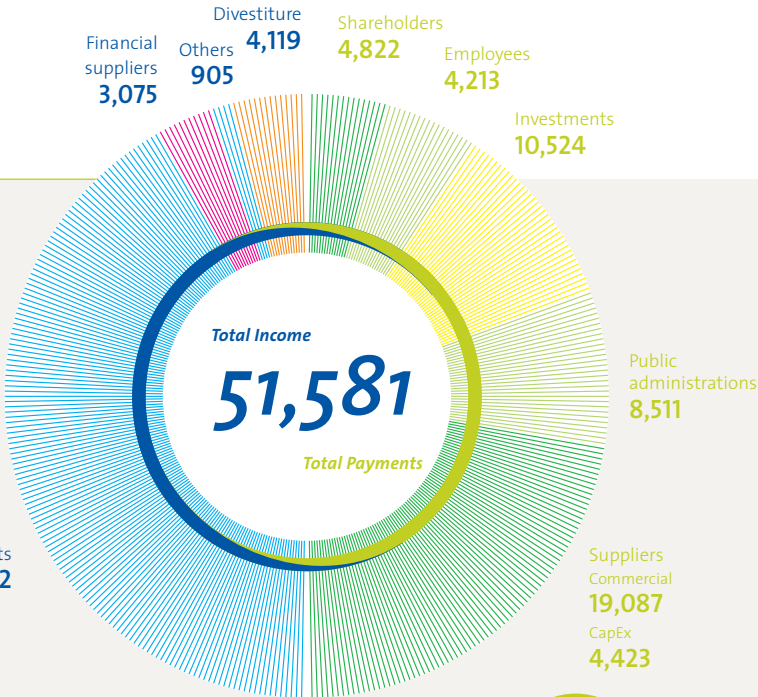
# Driving Progress

## Economic

- 18,000 Suppliers
- 1.7% Contribution of income of National GDP
- 154 Million accesses (not including O2)
- 1.5 million shareholders
- 207,000 Employees

51,581 million euros

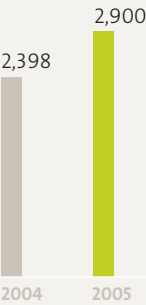
Clients  
43,482



+21%

## Technological

**Innovation**  
Millions of euros



+20.9%

**R&D**  
Millions of euros



+16.6%

**Who innovates?**  
Percentages



+16%

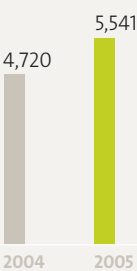
## Social

**Social action**  
Millions of euros



+16.6%

**Digital inclusion**  
Millions of lines in low income homes LATAM



+17.4%

**Employee training**  
Thousands of hours



+5%





Dear Shareholder,

It gives me great satisfaction to share with you the results of Telefónica's management for 2005, and our vision of the future of the telecommunications business.

This year has been especially positive, and I believe we have reason to be satisfied, given both the exceptional results achieved, and the impact of the operations carried out.

Undoubtedly, 2005 was a milestone financial year, not only due to the consolidation of our leadership and the strengthening of our Company's competitive advantages, but also due to our short- and long-term outlook.

The current state of the telecommunications sector is at once promising and challenging. The challenges and opportunities are bigger than in the past. Today the market is more global; and our competitors, more dynamic and varied. Technology is doing away with frontiers between sectors, opening up new opportunities for us and for companies in sectors adjacent to ours, in the face of which our main strength will be, once again, to remain one step ahead.

### **A new Telefónica**

Two years ago, we embarked on an important process of change, which is translating into an excellent combination of scale and diversification, with a view to one aim: maximising value for the shareholder. Every year, Telefónica sets itself further apart from the rest of operators in the sector, because it grows more than the rest, and because, at the same time, it has the best balance in terms of geography and business.

In addition, Telefónica is generating new business opportunities and reaching higher levels of efficiency, derived from its integrated management model. Its local sales strength, the integration of solutions for each customer segment, the advantages of being an international brand, together with the adoption of best practices and the coordination of networks and services, define the features of a Telefónica that is increasingly strong and flexible, based on three pillars:

- Customer-orientation.
- Innovation.
- Operational Efficiency.

Not only our profile is different; our results are too. Telefónica's unique profile is due both to its singular features as a telecommunications operator and to the solidity of its results, which is reflected in the constancy of its growth, profitability, cash flow generation and shareholder remuneration.

In 2005, Telefónica's results have shown, once again, that the company is capable of growing within an increasingly competitive environment. Net profit rose by 40%, reaching the record mark of 4.45 billion euros and net profit per share of 0.913 euros, 43.4% above that achieved in 2004. These figures are proof of the robust organic growth of our businesses and of the efficiency of our operations.

Revenues for operations exceeded the substantial growth registered in the previous year, with a year-on-year growth of 25.1%, comparing favourably with any of the main European operators, which, together, registered a weighted average growth of 5.8%. At constant exchange rates and excluding changes in the consolidation boundary, our revenues would have increased at a rate of 9.3%.

In addition, this financial year has allowed Telefónica to achieve operating earnings before and after amortizations of 15.28 billion euros and 8.56 billion euros respectively, with increases of 25% and 30.5% with regard to 2004.

These figures have been compatible with a 42.3% increase in investment, which reached 5.36 billion euros, whereas free cash flow generation reached 7.11 billion euros, which implies a conversion ratio of 18.7% of our revenue.

Telefónica and each of its lines of activity fulfilled all the financial aims established for financial year 2005.

These results are only the foretaste of the potential provided by combining scale, balanced diversification and integration in our sector.

### **The integrated operator with the most international profile.**

Together with the improvement registered in results, it has also been important to position Telefónica as the company with the most international profile of all the large integrated operators. 59% of our revenues are now generated outside our original home market, as well as 77% of our accesses.

FY 2005 has contributed decisively to this process of internationalisation, with transactions such as the acquisition of 69.4% of the operator Cesky Telecom, the fixed and mobile telephone services leader in the Czech Republic, or the completion in January of the process of integration of all the operators acquired from BellSouth in Latin America. Telefónica closed the financial year with mobile operations in a position of leadership in 15 countries, with a total combined population of almost 500 million.

Also worthy of note is the strategic investment of 5% in China Netcom, which gives Telefónica access to a region with great potential and opens a fruitful path for the collaboration between both companies.

And, lastly, I would like to draw your attention to the purchase of the British mobile operator O2, announced in October 2005, which, with over 27 million customers at the close of last financial year, and relevant operations in Great Britain, Ireland and Germany, brings to Telefónica a quality asset, a new source of growth, as well as profitability from day one.

Whereas the purchase of O2 brought Telefónica European scale, the announcement in 2006 of the purchase of a controlling stake in Colombia Telecom, with 50% of shares plus one, strengthens our commitment as a long-term investor with Latin America.

At year-end 2005, Telefónica had a total of 153.5 million accesses, of which 99.1 million corresponded to mobile accesses, 40.9 million to fixed telephone services accesses and the rest, to data, Internet and pay-TV accesses. With the addition of O2, the total base of accesses of Telefónica reaches 180.9 million, exceeded worldwide only by two Chinese companies. This growth in the number of accesses is also reflected in the presence of Telefónica in new markets, with relevant operations in 19 countries at the end of year 2005, of which 10 have been incorporated in the last two years, and which amount to a total combined population of 670 million.

### **Investment in growth.**

One of the distinctive features of Telefónica's approach is anticipation in all aspects of its operations.

This factor, together with technological evolution, leads Telefónica to permanently increase investment in new businesses and growth initiatives: the deployment of broadband and the improvement of fixed telephone lines, the pioneering development of TV over IP, the increased capacity of mobile networks and the adoption of 3G in Spain, or the regionalisation of infrastructures and systems to favour efficiency of our operations in Latin America.

In 2005, Telefónica devoted over 2.9 billion euros to items associated with technological innovation, a figure 21% above that of 2004. Of this amount, 533 million corresponded to research and development activities, amounting to 1.4% of our turnover, positioning Telefónica among the first companies in the Telecommunications sector worldwide in terms of investment in innovation. During 2005, the European Commission recognised Telefónica as the first Spanish company in terms of R&D efforts, and in terms of participation in European projects.

This investment in growth and profitability is validated by the growth in broadband accesses and services, both in Spain and in Latin America, by the increase in penetration of mobile services and by the positive advances in our offer of solutions.

We are creating the broadband market in Spain, the Czech Republic and Latin America. We chose to believe in DSL technology and worldwide trends confirm that we were right to do so: 66% of consumers worldwide have also chosen this option.

At the end of 2005, Telefónica had almost 5.9 million DSL lines (3.5 million in Spain). Especially worthy of note is the 52.1% growth of broadband in Latin America, reaching 2.2 million lines, as well as the performance of Imagenio, the pay-TV service over DSL that in Spain, reached a coverage of 33% and over 200,000 users.

### **We know what we want to be.**

We want to be among the best in anticipating wants and needs of consumers and in making technological advances essential elements of day to day life.

To this aim we have carried out an in-depth transformation of our structures with a clearly defined goal: to reorientate our entire organisation towards interaction, collaboration and synergies between all the people and business areas that make up Telefónica. With one priority -the consumer, as the main focus-, and one goal -the offer of integral solutions-.

Through different transformation programmes covering all our service and management areas, with a clear vision of the company: we aim to be the integral operator that is the most competitive, the most capable of providing solutions to the customer, and at the same time, of offering the best combination of growth and profitability for our shareholders.

Within this framework, Telefónica is ideally positioned to obtain value from added-value products, emerging markets or new possibilities of an extended sector, and in fact, it is already doing so.

### **The best combination of growth and shareholder remuneration.**

Our performance and our evolution have allowed us to offer, one more year, the best combination of growth and shareholder remuneration in the sector. A growth that, as I mentioned above, reached 25.1% in revenues this year. As regards shareholder remuneration, in 2005, a dividend corresponding to FY 2004 of 0.5 euros per share was paid out, own shares in the proportion of 1x25 corresponding to 4% of share capital were distributed, and progress has continued in the share buyback programme.

It is in this direction that the changes in the company are geared to, increasing our focus on core activities and lightening the structure of assets and costs. In May 2005, the absorption of Terra Networks by Telefónica S.A. was approved, thus enabling access to the advantages of operational integration of the fixed telephone network and Internet, increasingly necessary with the development of broadband. In 2006, the merger of Telefónica Móviles and Telefónica S.A. has been proposed, strengthening a strategic model that benefits from the economies of scale and scope, as well as from an integrated offer, and is coherent with a technological development that softens barriers between fixed and mobile networks and services.

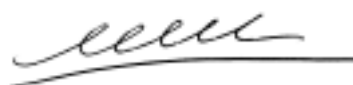
The results and decisions of 2005 improve Telefónica's positioning in the face of coming years. The outlook is still favourable, both for Europe and Latin America, on the macroeconomic front, as well as for the ICTs sector. Information and Communication Technologies are proving to be essential to increase competitiveness and productivity of economies, as well as citizens' quality of life. Telecommunications are a key tool to bring to life the Information Society, whose development they are already driving, and that is why our sector has a very positive growth outlook, associated with increases in use, penetration and new services and markets.

### **Telefónica's Commitment.**

I believe we have more than enough reasons to be optimistic.

We are prepared for a new phase, where strategy will be measured by success in execution. That is why, to this aim, we will continue our work. With a threefold commitment: towards our team of professionals, towards society in general and, of course, towards each and every one of our shareholders.

On behalf of the Board of Directors of Telefónica and in my own name, I wish to thank you, once again, for the trust you have placed in us, and assure you that we will make every effort to continue deserving it.



**César Alierta**  
Executive Chairman, Telefónica, S.A.

---

# Governing bodies

## Composition of the board of directors of Telefónica, S.A.<sup>1</sup>

---

### Executive Chairman

Mr. César Alierta Izuel

### Vice Chairmen

Mr. Isidro Fainé Casas

Mr. Gregorio Villalabeitia Galarraga

### Directors

Mr. Fernando de Almansa Moreno-Barreda

Sir David Arculus

Mr. Maximino Carpio García

Mr. Carlos Colomer Casellas

Mr. Peter Erskine

Mr. Alfonso Ferrari Herrero

Mr. Gonzalo Hinojosa Fernández de Angulo

Mr. Pablo Isla Álvarez de Tejera

Mr. Luis Lada Díaz

Mr. Julio Linares López

Mr. Antonio Massanell Lavilla

Mr. Vitalino Manuel Nafria Aznar

Mr. Enrique Used Aznar

Mr. Mario E. Vázquez

Mr. Antonio Viana-Baptista

### Secretary (Non- Member)

Mr. Ramiro Sánchez de Lerín García-Ovies

<sup>1</sup> May 2006

## Executive committee

---

### Executive Chairman

Mr. César Alierta Izuel

### Vice Chairmen

Mr. Isidro Fainé Casas

Mr. Gregorio Villalabeitia Galarraga

### Vocals

Mr. Maximino Carpio García

Mr. Carlos Colomer Casellas

Mr. Peter Erskine

Mr. Julio Linares López

Mr. Antonio Viana-Baptista

### Secretary

Mr. Ramiro Sánchez de Lerín García-Ovies

## Composition of the committees of the board directors of Telefónica, S.A.

### Audit and Control Committee:

Mr. Antonio Massanell Lavilla (Chairman)  
Mr. Maximino Carpio García  
Mr. Gonzalo Hinojosa Fernández de Angulo  
Mr. Gregorio Villalabeitia Galarraga

### Nominating, Compensation and Corporate Governance Committee:

Mr. Alfonso Ferrari Herrero (Chairman)  
Mr. Maximino Carpio García  
Mr. Pablo Isla Alvarez de Tejera  
Mr. Gonzalo Hinojosa Fernández de Angulo

### Human Resources and Corporate Reputation Committee:

Mr. Pablo Isla Alvarez de Tejera (Chairman)  
Mr. Alfonso Ferrari Herrero  
Mr. Antonio Massanell Lavilla  
Mr. Enrique Used Aznar

### Regulation Committee:

Mr. Enrique Used Aznar (Chairman)  
Mr. Fernando de Almansa Moreno Barreda  
Mr. Julio Linares López  
Mr. Gregorio Villalabeitia Galarraga

### Service Quality and Customer Service Committee:

Mr. Gonzalo Hinojosa Fernández de Angulo (Chairman)  
Mr. Carlos Colomer Casellas  
Mr. Luis Lada Díaz  
Mr. Antonio Massanell Lavilla

### International Affairs Committee:

Mr. Fernando de Almansa Moreno-Barreda (Chairman)  
Mr. Alfonso Ferrari Herrero  
Mr. Gonzalo Hinojosa Fernández de Angulo  
Mr. Enrique Used Aznar  
Mr. Gregorio Villalabeitia Galarraga

<sup>1</sup> May 2006

## Organisational Structure of Telefónica\*

### Executive Chairman

Mr. César Alierta Izuel\*\*

#### Secretary

Mr. Ramiro Sánchez de Lerin

#### General Director of Legal Services

Mr. Juan C. Ros

#### General Director of Corporate Communications

Mr. Luis Abril

#### General Director of Internal Auditing

Mr. Calixto Riós

#### General Director of Institutional Relations and Foundation<sup>7</sup>

Mr. Javier Nadal

#### General Director of Coordination, Business Development and Synergies<sup>1</sup>

Mr. Julio Linares\*\*

#### General Director of Strategy, Budgeting and Control

Mr. Alfonso Alonso

#### General Director of Sales<sup>2</sup>

Mr. Adrián García Nevado

#### General Director of Infrastructures and Information Systems

Mr. Vicente San Miguel

#### General Director of Purchasing<sup>3</sup>

Mr. Alberto Horcajo

#### General Director of Human Resources

Mr. Oscar Maraver

### Executive Chairman of Oz<sup>4</sup>

Mr. Peter Erskine\*\*

### Executive Chairman Telefónica Móviles

Mr. Antonio Viana\*\*

### Executive Chairman Telefónica de España<sup>5</sup>

Mr. Luis Lada\*\*

### Executive Chairman Telefónica LATAM

Mr. José M<sup>a</sup> Álvarez Pallette\*\*

### General Director of Finance and Corporate Development

Mr. Santiago Fernández Valbuena\*\*

#### Finance

Mr. Santiago Fernández Valbuena

#### Corporate Development

Mr. Ángel Vilá

#### Subsidiaries and Owned Companies<sup>6</sup>

Mr. Luis Blasco

\*December 2005

\*\*Member of the Executive Committee

<sup>1</sup> Also responsible for the Secretariats of the Executive and Directors' Committees. Includes Telefónica I+D

<sup>2</sup> Includes associated Terra Networks

<sup>3</sup> Includes Inmobiliario, Logística and *tgestión*

<sup>4</sup> Cesky Telecom and Telefónica Deutschland are dependent on this Unit

<sup>5</sup> Includes the General Management of Catalonia

<sup>6</sup> Includes Endemol, Atento, TSA, Telefé and the Owned Companies

<sup>7</sup> Includes the Regulation and Department of External Relations

# 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.

|         |                   |    |
|---------|-------------------|----|
| 01   01 | About Telefónica  | 14 |
| 01   02 | Business Strategy | 20 |
| 01   03 | Group Structure   | 52 |
| 01   04 | Timeline          | 56 |



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

## About Telefónica 2006

### 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.

Over 181\* million accesses

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

Almost 2.9 billion euros invested in technological innovation

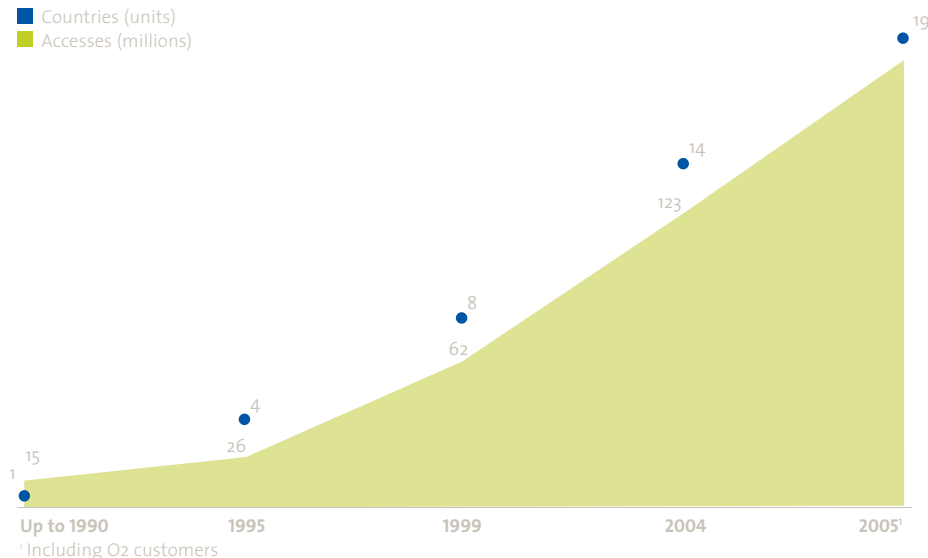
More than 207,000 employees

Listed in the Dow Jones Global 50 Titans

\*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**

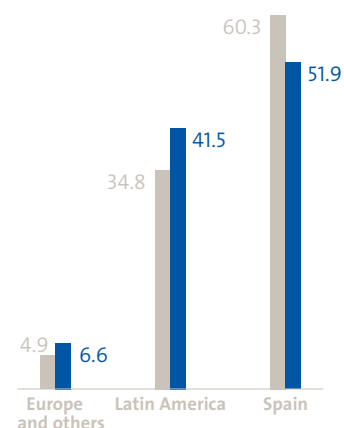
Countries **+10**

Employees **x1.5**

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

Figures in %

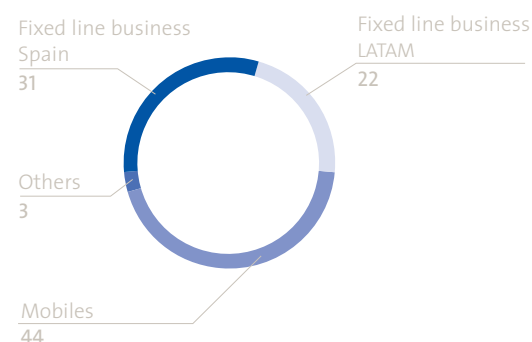
■ 2004  
■ 2005



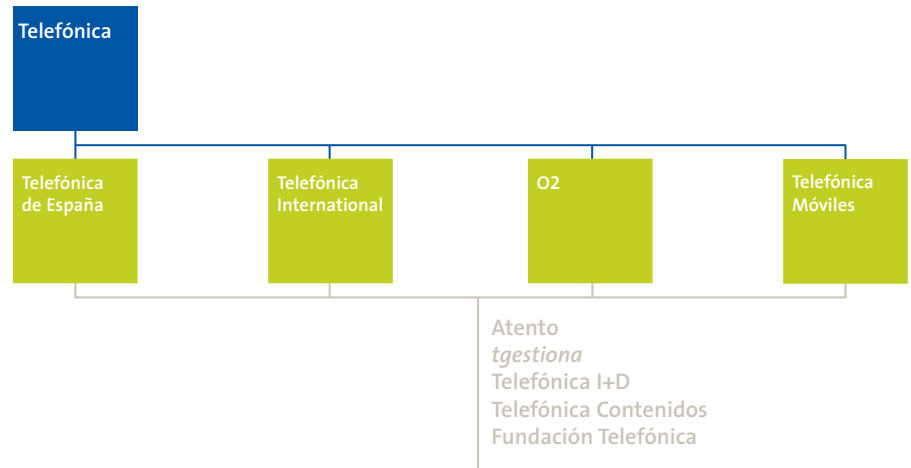
<sup>1</sup> Revenue contributed by each region to Telefónica Group's consolidated results

### 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

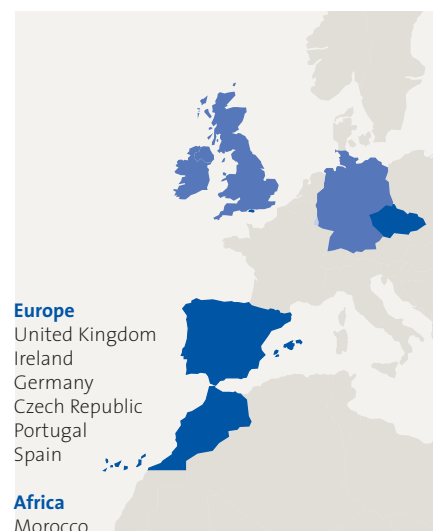
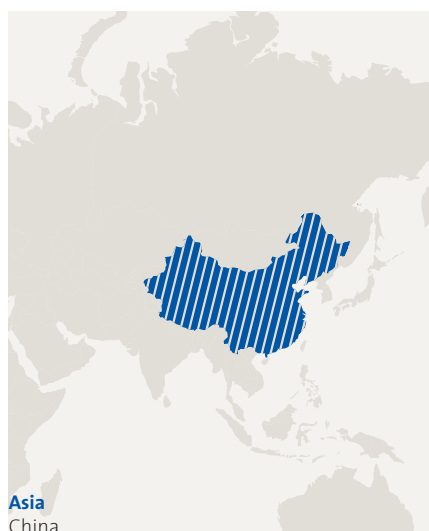
Telefónica in 2005 has taken on a new dimension. In fact it has become a new and better company, with a new size on a regional scale and greater diversification in its businesses. The reasons for this transformation are supported by the establishing of suitable growth platforms and thanks to geographical 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.

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.

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.





## 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.

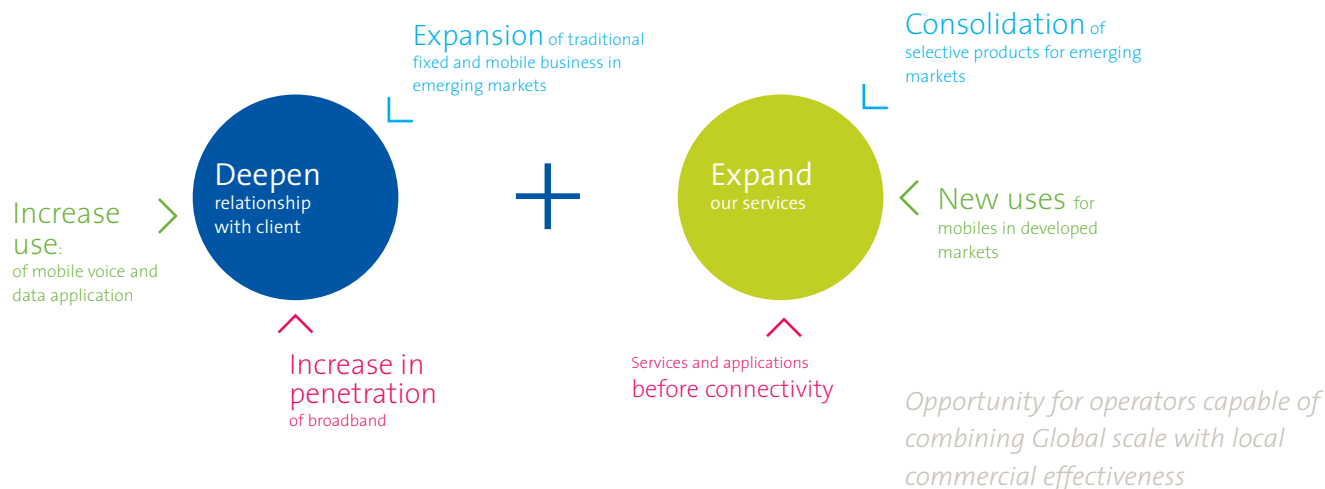
Telefónica continues to maintain its objective of offering the best combination of growth and returns to the sector shareholder. This is why the company's vision involves placing the customer in the foreground, being the most competitive operator in every market, offering innovative services simply and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

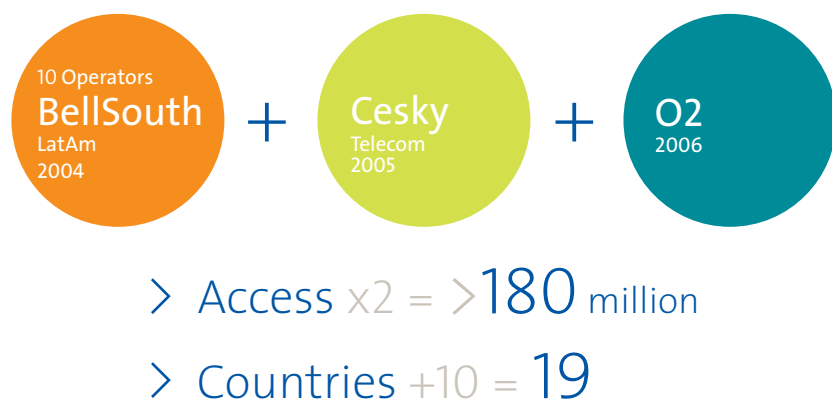
together (wholesale plus retail including connections that offer only the Imagenio service) 3,479,824 connections at the end of 2005. As well as in Spain, the broadband market in 2005 also shows great dynamism and growth in Latin America and the Czech Republic, with Group retail broadband Internet connections 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



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 disinvestment 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**



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

to a **customer-centred 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 *tgestiona*, 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



<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



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.



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.

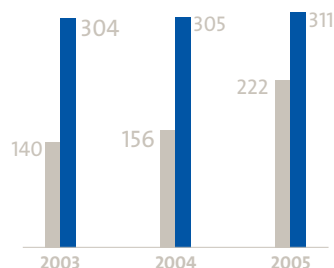
However, innovation cannot be based on technology acquisition alone. It is essential that the research and development activities be made the axis and focus for the rest of innovation activities in order to guarantee competitive advantages.

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&amp;D by country

Millions of euros

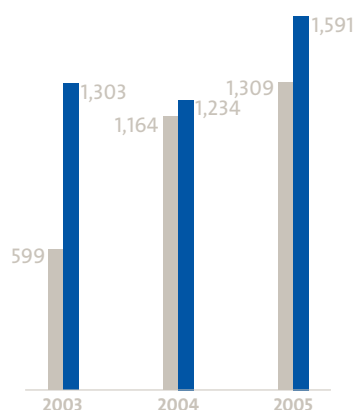
■ Spain  
■ Others



## 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.

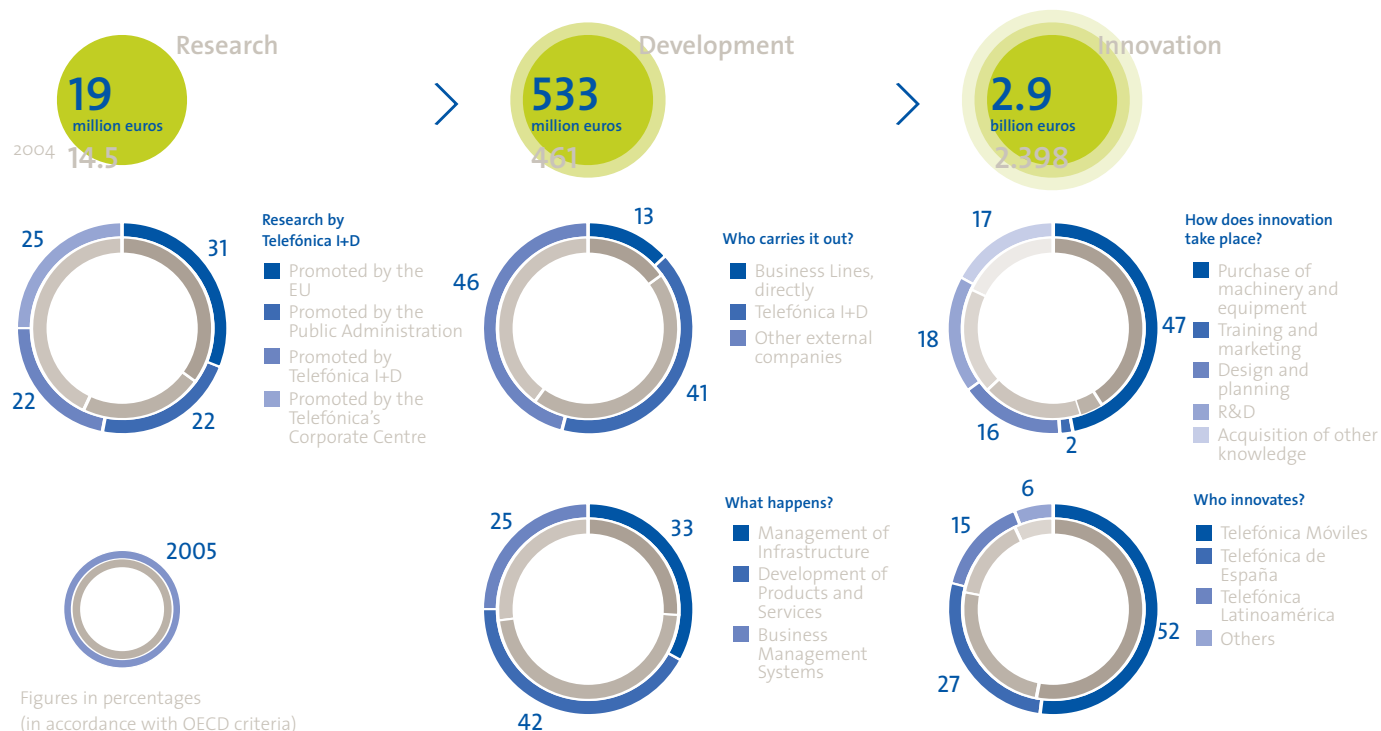
Telefónica I+D  
(Research & Development)

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.

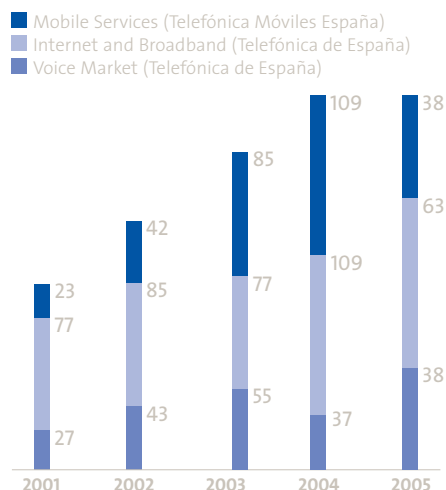
Significant progress has also been made with regard to leveraging multioperator synergies, through the platforms developed to host pay-as-you-go, corporate (VPN), messaging and other network services. In this context, they have completed the deployment of pay-as-you-go services for seven new operators, 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<br>ADSL<br>Residential | Companies<br>PNP | Commercial reasons    | Óptima Project<br>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, *tgestion* made progress in making general efficiency improvements and, in particular, reducing the weight of the structure throughout all country *tgestion* 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

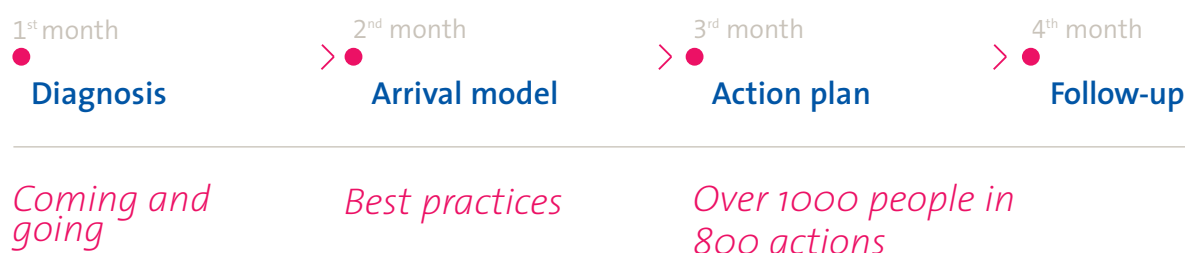
and commercial monitoring and the launch of new products and services.

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 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

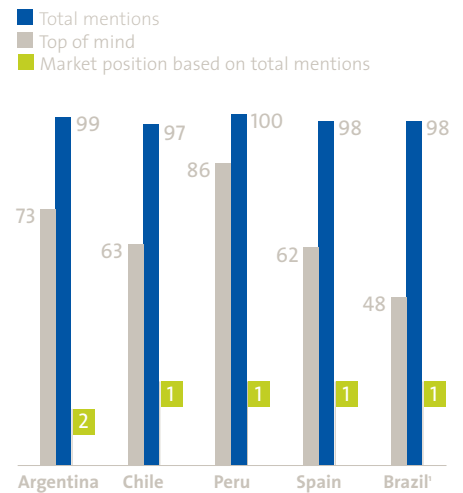


Telefónica is making progress in its integration as a single company, with values and an identity shared by all the subsidiaries of the Telefónica Group. To achieve this objective it is developing transformation initiatives within the identity and communication axis.

- 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.

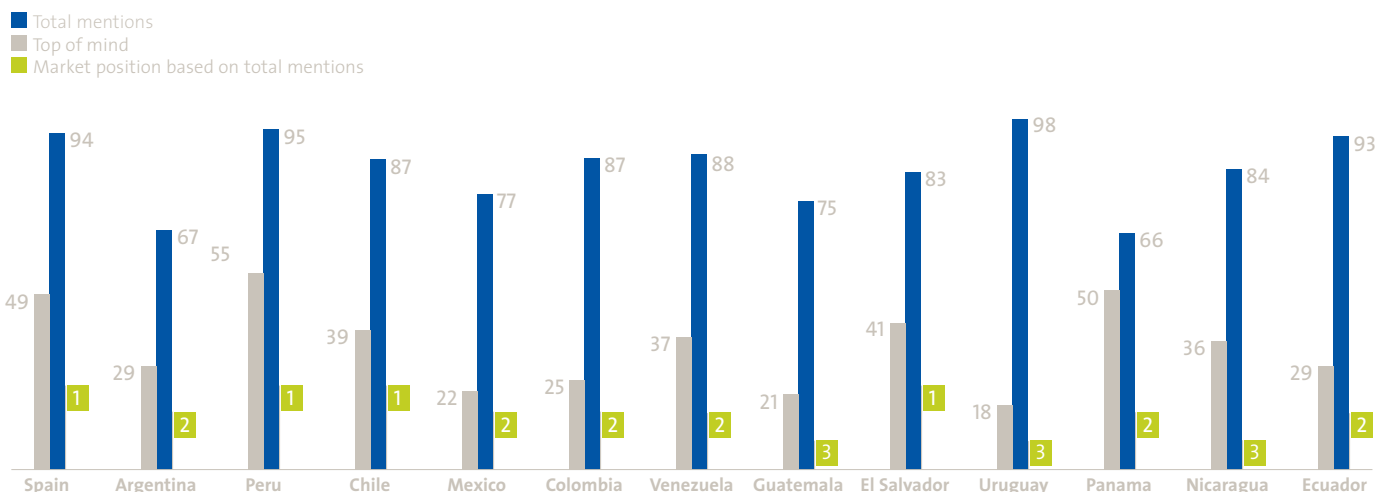
Thus, Telefónica has built its brand on two functional attributes - leadership and innovation - which are supported by the capacities of the Group, and two emotional - Proximity and Commitment - which seek to give the brand a personality and tighten relationships with those linked to it.

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



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 *gestion* 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.





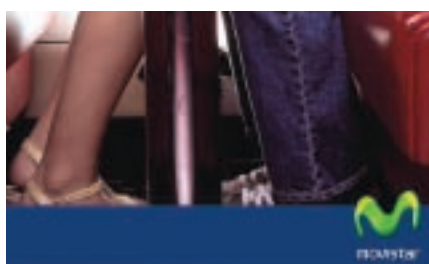


### Global launch of "movistar"

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 Paulo, 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 lead 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<br>% 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>tgestiona</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          | –              | –              |
| <b>Morocco</b>       | <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> |

| By business         | 2005           | 2004           | 2003           |
|---------------------|----------------|----------------|----------------|
| 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                |
| <i>tgestiona</i> 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%.

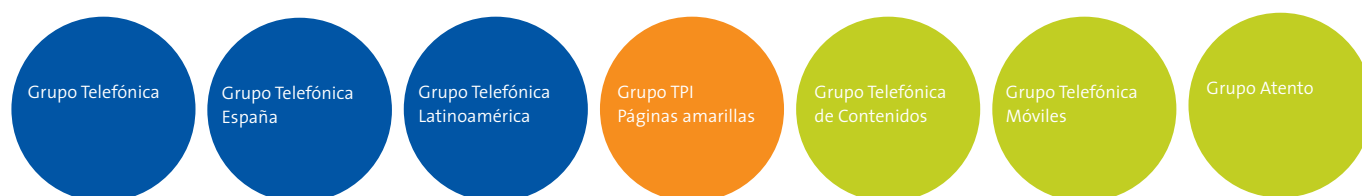
### Other Participations

|                                 | % 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.



## 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

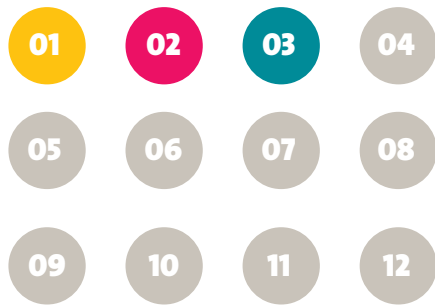
|                                    | % Part  |
|------------------------------------|---------|
| Telefé                             | 100.00% |
| Endemol <sup>1</sup>               | 99.70%  |
| Telefónica Servicios de Música     | 100.00% |
| Telefónica Servicios Audiovisuales | 100.00% |
| Hispasat                           | 13.23%  |

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





“BellSouth, Cesky Telecom and O2 were the main protagonists of the most important milestones achieved in the year”



## Timeline

### January

Telefónica de España exceeds 2,600,000 DSL lines in operation. In addition, it starts the year with 345 Wi-Fi service points.

Telefónica presents its fifth "The Information Society in Spain" report, corresponding to 2004.

Telefónica de España's Text Messaging Service registers a spectacular increase in volume of handled messages, exceeding 50 million, a 217% increase compared to the previous year.

Fundación Telefónica presents the Collection "El Cubismo y sus entornos" (Cubism and its Environment), with over 40 masterpieces.

The President of the Regional Government of Madrid opens the works for the Metronorte project, at the future headquarters of Telefónica, in the Distrito C.

Telesp Celular Participações achieves significant success in its capital increase.

The Board of Directors of Telefónica decides to increase the shareholder remuneration policy. To this aim, it agrees to propose to the General Shareholders' Meeting the payment of a dividend of 0.5 euro per share.

César Alierta, Chairman of the Telefónica Group, closes the Annual Convention of Telefónica de España Managers, within the process of transformation to turn Telefónica into the best and largest integrated telecommunications group in the world.

### February

Telefónica de España signs an agreement with the Representatives of the Employees to launch a telecommuting pilot programme for employees.

"La Caixa" and Telefónica de España reach an agreement to offer the new Zona ADSL Wi-Fi pre-paid cards through the bank's 6,988 automatic teller machines.

The latest worldwide Investor Relations Websites and Online Annual Reports Awards gives the first and second prize in Spain, respectively, to the Internet pages for Shareholders and Investors of Telefónica S.A. and Telefónica Móviles S.A., and the award to the Best Online Annual Report, to Telefónica's online report.

Telefónica agrees to propose to Terra Networks the start of negotiations for a possible merger. The Board of Directors of Telefónica, S.A. decides to accept Terra Networks, S.A.'s proposal and approved the merger.

César Alierta closes the internal convention of Telefónica Móviles, highlighting the company's significant synergy opportunities arising after the acquisition of Bellsouth's assets in Latin America.

The Customer Relations Centre of Telefónica Móviles España wins the first Excellence Prize, awarded every year by Izo System.

Telefónica Móviles España presents the first catalogue of "Mobile Services for Social Integration" in the telecommunications sector.

### March

Telefónica de España announces the sale of DSL access and wireless terminals in major retail outlets. Imagenio, the new digital television service of Telefónica de España, is awarded the prize to the best innovative idea by the magazine Actualidad Económica.

The Spanish Association of Telecommunications and Information Society Users (AUTELSI) awards Telefónica Móviles España the prize in the Digital City category for its Ciudad Móvil (Mobile City) project.

Telefónica Latinoamérica exceeds one and a half million DSL lines in operation.

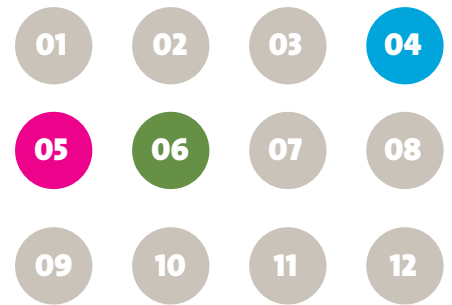
Telefónica's Spanish website ([www.telefonica.es](http://www.telefonica.es)) registers a 22 per cent increase in number of sessions and a 21 per cent increase in number of unique visitors.

Telefónica International holds its II Convention of Managers of the Programme "Compromiso Cliente" (Customer Commitment).

The Telefónica Group, through the platform Adquiria España, reaches electronic purchases for the value of 4 billion euros in over 12,000 transactions.

Telefónica de España, through Telefónica International Wholesale Services (TIWS), joins the international association Wireless Broadband Alliance (WBA).





## April

Telefónica Móviles unifies the image of its operations in 13 Spanish-speaking countries under the brand movistar, an operation without precedent in the telecommunications market.

César Alierta chairs the first meeting of the "Alianza Brazil-España" (Brazil-Spain Alliance) programme.

The Government of the Czech Republic approves the sale to Telefónica of 51.1% of its stake in the operator Cesky Telecom.

Paginasamarillas.es' street map receives the annual Award to the Best Website from the Spanish Association of Internet Users (AUI).

Telefónica creates the Telefónica Board of the Region of Valencia.

César Alierta announces at the opening of the IV Investors Conference held in Barcelona, that in 2008 the company will reach 8 million DSL customers (Spain and Latin America) and will enable 40% of the total number of mobile customers in Spain to operate with UMTS handsets.

80th anniversary of Telefónica's presence on the Madrid Stock Exchange. On the occasion, the chairman of Telefónica Group, César Alierta takes part on April 27 in the symbolic act of opening the Madrid trading floor.

## May

The Annual General Meeting of Telefónica Móviles approves a gross fixed dividend for 0.193 euros.

Spain exceeds three million DSL lines in operation, following the increase in over 95,000 lines in April.

Telefónica Empresas completes the migration of its interconnection network with the Switched Telephone Network to a new generation network.

Telefónica takes part in the III Social Action in Businesses Fair, whose aim is to promote Social Action and Social Responsibility in companies.

Iberia and Telefónica Empresas reaches an agreement by which the latter will be responsible for the management and operation of the communications of the airline in Spain for a period of five years.

Fernando Xavier Ferreira replaces Félix Ivorra as Chairman of the Board of Directors of Brasilcel and Roberto de Oliveira Lima takes over from Francisco Padinha at the head of the Management of Vivo.

The television advertising spot "Oficina", of Telefónica Móviles España, receives a Silver Ampe Award from the Spanish Association of Advertising Media.

The General Shareholders' Meeting of Telefónica approves the merger with Terra Networks.

## June

Terra Networks holds its General Shareholders' Meeting in Barcelona, where it approves the merger between Telefónica, S.A. and Terra Networks, S.A.

Telefónica Wholesale extends its coverage in Europe through Dutch operator KPN's network.

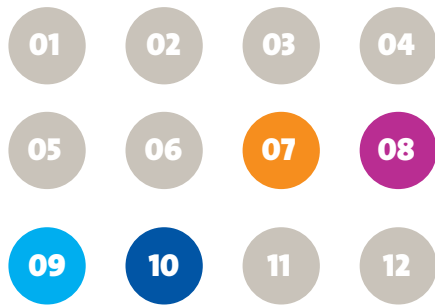
Telefónica Móviles España becomes the first Spanish operator and one of the first operators in the world, to carry out a real-time demonstration of the latest developments in HSDPA technology, the new version of the UMTS standard.

César Alierta expresses to Álvaro Uribe, the President of the Republic of Colombia, the strategic importance that Colombia has for the Telefónica Group.

The European Commission authorises the concentration operation whereby Telefónica S.A. takes control of the Czech telecommunications operator Cesky Telecom. Telefónica joins the initiative. Connect the World, launched by the International Telecommunications Union (ITU).

Telefónica presents, for the third consecutive year, its Annual Corporate Responsibility Report. The new headquarters of Telefónica being built in Madrid is chosen as the best Town-planning Project in Spain, and receives the special award to the best architectural concept at the Real Estate Awards organised by the financial newspaper La Gaceta de los Negocios.

Telefónica acquires 2.99% of the share capital of the Chinese telecommunications company China Netcom (CNC), and announces its intention to acquire up to 5 % of the share capital of CNC.



## July - August

Telefónica requests approval from the Czech Securities Commission, of a mandatory tender offer for 48.9% of Cesky Telecom's share capital.

The Ministry of Industry, Tourism and Commerce publishes its "General Report on Service Quality with Regard to Fixed Telephone Services in Spain", where it is recognised that Telefónica de España offers high levels of service quality.

The General Directorate of State Assets awards the Temporary Business Association formed by Telefónica, Indra and Software AG the contract for the design and development of the Spanish Electronic National Identity Document.

Telefónica Móviles, through its subsidiary Vivo, launches the first services on the Brazilian market for mobile handsets based on Third Generation technology.

Médi Telecom, the subsidiary operator of Telefónica Móviles in Morocco, wins a fixed telephone service licence.

Telefónica de España completes the first phase of the deployment of Imagenio across the Spanish territory.

Telefónica launches a plan for the reinforcement of its activities and structure in Catalonia.

Telefónica announces the inclusion in its new headquarters being built in Madrid (Distrito C), of the largest solar power site in Europe and one of the largest roof-mounted solar cell panel installations in the world.

## September

A report prepared by the Spanish Consumer Union (UCE) points to the advantages of Imagenio for consumers and users, with regard to cable television.

The chairman of Telefónica, César Alierta, states at the courses held at the UIMP of Santander that the telecommunications sector is key in the globalisation and convergence of technologies.

The Spanish-US Chamber of Commerce awards the Chairman of Telefónica, "The Global Spanish Entrepreneur" prize in recognition of the Telefónica Group's recent entry in the Dow Jones Global Titans 50 index of New York.

Telefónica Móviles is listed in the prestigious FTSEurofirst 300 index, which includes the 300 European companies with the largest capitalisation of the FTSE Developed Europe index.

Telefónica creates an advisory body that reinforces the Group's new Technological Innovation Model and establishes a new framework in the development of its R&D&I activities.

Telefónica is listed in the European and World Dow Jones Sustainability Indices (DJSI).

Telefónica announces that its participation in Cesky Telecom rises from 51.1% to 69.4 per cent after concluding its PTO on the Czech operator.

TPI-Páginas Amarillas announces it will start to operate in Italy through its subsidiary 1288 Servizio di Consultazione Telefonica.

## October

Telefónica takes part in the Broadband World Forum Europe 2005, the international meeting that brings together the main agents of the broadband business, held in Spain for the first time.

The Spanish Ministry of Industry publishes a study on the quality of service in the sector of mobile telephony, where movistar stands out in four of the six sections regarding voice and SMS services.

Telefónica de España reaches 100,000 Imagenio connections.

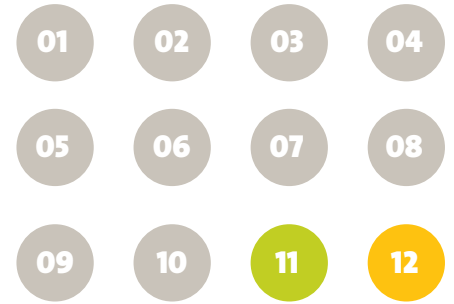
Telefónica Móviles España, Abertis Telecom, Nokia and the main TV channels join forces to carry out the first tests of digital television on mobiles carried out in Spain.

At the European Parliament, César Alierta calls for the need of a regulatory framework that aids investment by the sector's companies.

Telefónica's website achieves the most points with regard to social action, according to the report by Empresa y Sociedad.

Telefónica de España concludes the second process of free speed duplication for its DSL lines, which now exceed the figure of 3.48 million.

Telefónica announces the launch of a binding Tender Offer for the UK company O2 plc. The Board of Directors of O2 plc announces its unanimous recommendation for its shareholders to accept the offer of Telefónica.



## November

Over 2,000 education professionals come together at the III EducaRed International Conference organised by Fundación Telefónica.

Telefónica International increases by 57% the number of DSL lines (Speedy in Latin America), reaching 2 million.

All twenty-two Spanish Language Academies present the Diccionario Panhispánico de Dudas (Pan-Hispanic Dictionary of Usage), sponsored by Telefónica.

Telefónica de Argentina is prized for its Good Corporate Governance by the country's Centre for Financial Stability. In addition, the chairman of the Telefónica Group in Chile, Bruno Philippi, presents the first Corporate Responsibility report for the country.

The president of the Republic of China, Hu Jintao, visits the facilities of the National Centre of Supervision and Operation (CNSO) at Aravaca, Madrid, coinciding with the start of his official visit to Spain.

Telefónica de España launches its Wi-Fi roaming service with Telecom Italia and PT Wi-Fi (Portugal Telecom Group).

Telefónica participates in Tunisia in the second phase of the World Information Society Summit promoted by the United Nations.

Telefónica and NTT DoCoMo analyse different ways of reinforcing the strategic alliance between both groups.

Telefónica Móviles reaches an agreement with Research in Motion (RIM) to launch BlackBerry in the 13 Latin American countries.

## December

TPI test-launches Noxtrum, an Internet search engine, with proprietary technology.

Telefónica Móviles España announces that the Spanish data service market will generate annual revenues exceeding 350 million euros.

Telefónica, MRW and Caja Madrid stand out as the entities which are best perceived for their social action, according to a survey carried out by the Empresa y Sociedad Foundation to 275 experts.

Telefónica is awarded four prizes by AUTELSI (Asociación Española de Usuarios de Telecomunicaciones y de la Sociedad de la Información).

Telefónica presents its sixth edition of the Information Society in Spain report, corresponding to 2005. 85% of Spanish homes are connected to the Internet.

Telefónica de España presents the project "One bill, one tree", an initiative that aims to plant a tree for each client that subscribes to the online billing service, e-factura.

Telefónica International announces a new organisational structure that aims to make progress in its functioning as a single company in Latin America.

The Ministry of Public Administrations renews the image of the State Lotteries and Bets on the Internet, aided by Telefónica Empresas.

Telefónica Móviles reaches an agreement with its partner Alejandro Burillo, for the purchase of 8% of the capital of Telefónica Móviles Mexico.

Telefónica launches Peru Mágico, a new international cable television channel, which will air in the US, Canada, Latin America and Spain.

The users of the service Imagenio reaches 200,000.

Telefónica adapts its new managerial structure to the new projection of the Group's aims. The new General Directorate of Coordination, Business Development and Synergies is created, headed by Julio Linares, and Luis Lada is named chairman of Telefónica de España.

# Information for Shareholders

02

In 2005, Telefónica reinforced its aim of positioning itself as the best combination in the sector in terms of growth and profitability for the Shareholder.

|         |                              |    |
|---------|------------------------------|----|
| 02   01 | Information for Shareholders | 64 |
| 02   02 | Risk Management              | 70 |
| 02   03 | Corporate Governance         | 82 |





“Telefónica, the best combination in the sector in terms of growth and profitability for shareholders”



# Information for shareholders

## Shareholder remuneration in 2005

In Financial Year 2005, the Telefónica Group reinforced its strategic aim of positioning itself as the best combination in the telecommunications sector in terms of growth and profitability for its shareholders. In this sense, the shareholder remuneration policy has continued making progress during 2005 and the Company has positioned itself as one of the most attractive in the sector, further strengthened by the acquisition of O2, announced in October 2005. In 2005, a dividend of 0.57/share was paid corresponding to financial year 2004, own shares of Telefónica S.A. representing 4% of share capital were distributed, and the share buyback programme continued. At March 30, 2006, the company's treasury stock represented 4.868% of the share capital.

The measures taken and approved by the last General Shareholders' Meeting held on May 31, 2005, were:

- The payment of a dividend charged against the results of the financial year closed on December 31, 2004, for the set gross sum of 0.23 euros per share. This dividend was paid on May 13, 2005.
- The distribution of own shares of Telefónica, S.A., in the proportion of one treasury stock share for every 25 shares held by shareholders, charged against paid-in surplus. The distribution consisted of a maximum of 190,611,206 shares.

- The payment of a dividend charged against paid-in surplus, for a set sum of 0.27 euros per share. This dividend was paid on November 11, 2005.

Telefónica has announced at its Fifth Investor Conference being held in Valencia that it has set as a strategic target for the year 2009 to double both earnings per share and dividend per share from the 0.91 euros and 0.50 euros reported for 2005.

Moreover, the Chairman of Telefónica will submit to the Board of Directors a proposal to pay an interim dividend of 0.30 euros per share from 2006 profits, to be paid in November 2006. This payment will be followed by an additional 0.30 euros per share to be paid in the first semester of 2007.

Finally, and until the end of 2007, the Company has decided to set a limit of 1.5 billion euros and a commitment not to issue new shares to execute net new acquisitions over those already announced. Shares to be acquired to complete the current buyback program will be cancelled.

## Evolution of Share Performance in 2005

In 2005, the performance of the European Telecommunications sector was in contrast with that of the international stock exchanges, ending the financial year with a negative profitability of 1.8%. This worse relative performance was also different to that of the rest of sectors in Europe, all of them ending the year with positive returns, in a macroeconomic context that was more favourable for other sectors, and untouched by the perception of higher uncertainty in the telecommunications sector. Among the main risks associated with the telecommunications operators in 2005, it is important to point to the risk of mergers and acquisitions, both in cash and in shares, with the subsequent uncertainty with regard to future shareholder remuneration, as well as uncertainties associated with increased competition, technology and regulations.

In this context, the evolution of stock performance for telecommunications companies was generally negative, except for the companies considered to be acquisition targets (TDC +62.9%, OTE and Telecom Austria +36.2%, KPN +21.2%). However, Telefónica was the operator with best performance relative to other comparable operators, with a negative return of 8.3% compared to the drops registered by Telecom Italia (-18.3%), Deutsche Telecom (-15.4%), France Telecom (-13.5%) and Vodafone (-11.2%).

Telefónica's average daily trading volume on the Spanish stock market in 2005 was 44.5 million shares, up from the 41.4 million shares traded in 2004. The Company's market capitalisation at close of 2005 was 62.548 billion euros (74.113 billion dollars).

## Stock exchanges where Telefónica shares are traded

- Spanish computerised trading system (within the "Ibex 35" Index) and the four Spanish stock exchanges (Madrid, Barcelona, Bilbao and Valencia)
- London Stock Exchange
- Paris Stock Exchange
- Frankfurt Stock Exchange
- Tokyo Stock Exchange
- New York Stock Exchange
- Buenos Aires Stock Exchange
- Lima Stock Exchange
- Sao Paulo Stock Exchange

## Returns for Shareholders

A shareholder who purchased 100 shares at January 1, 2005, would have obtained a return of -0.94% for financial year 2005, mainly due to the downward stock market trend in 2005 that affected the entire telecommunications sector, and would have obtained for his or her investment 4 additional shares due to the distribution of own shares of Telefónica S.A. in the proportion of 1x25, as well as 51.08 euros in dividends.

## Company Share Capital

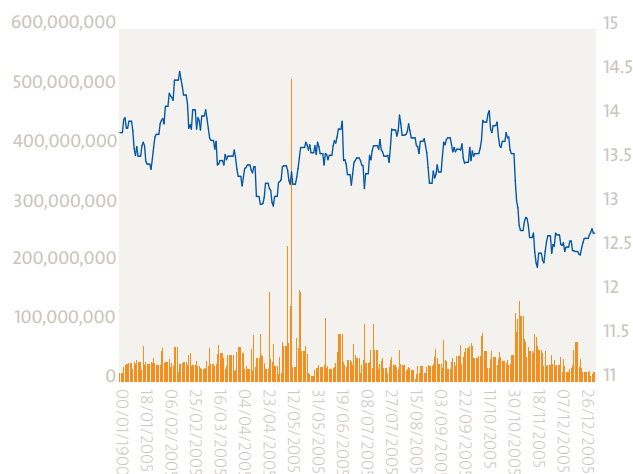
The latest share capital modification took place in June 2005 as a result of the reduction of the capital with the amortisation of treasury stock shares (for an amount of 34,760,964 euros), placing corporate share capital at 4,921,130,397 euros, which was maintained throughout financial year 2005.

## Number of Shareholders

According to the information obtained from the "Sociedad de Gestión de los Sistemas de Registro, Compensación y Liquidación de Valores" (Securities, Recording, Clearing and Settlement Systems Management Company) (Iberclear), dated April 3, 2006, the number of shareholders in Telefónica, according to separate records in favour of legal and natural persons, amounted to 1,570,039 shareholders.

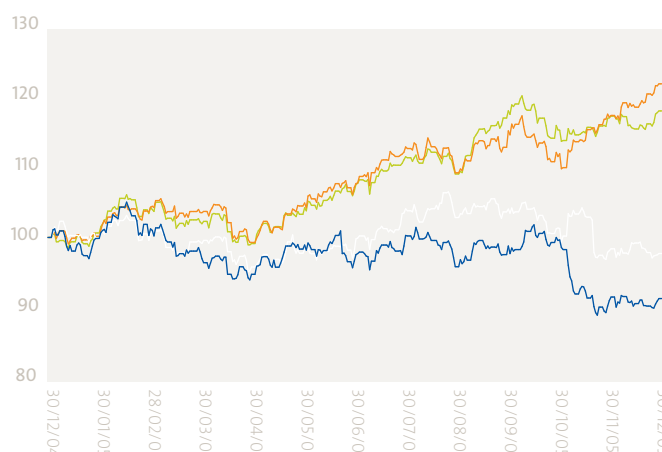
### Price / Volume

■ N° shares  
■ Price



### Stock performance in 2005

■ Telefónica  
□ DJ euro stoxx telecommunications  
■ DJ euro stoxx 50  
■ IBEX 35



## Purchase of 100 Telefónica shares on January 1, 2005

Earnings per share 2005

|   | Nº shares | Net amount      |
|---|-----------|-----------------|
| Value of 100 shares at January 1, 2005            | 100       | 1,386€          |
| Cash Dividend May 13, 2005                        | 100       | 0.23€/share     |
| Dividend in kind in June distribution 1x25 shares | 104       | –               |
| Cash Dividend November 11, 2005                   | 104       | 0.27€/share     |
| Value of 104 shares at January 1, 2006            |           | 1,321.8 €       |
| Total value of portfolio of 104 shares            |           | 1,372.9€        |
| <b>Earnings 2005</b>                              |           | <b>(0.94) %</b> |

### Significant Shareholdings<sup>1</sup>

Telefónica shares are recorded by the book entry system and therefore the company does not keep a shareholders' registry. It is therefore difficult to know the exact ownership structure.

In any case, according to the information available in the Company, there is currently no natural or legal person that exercises, or may exercise control, directly or indirectly, individually or jointly, over Telefónica,

according to the terms established in article 4 of the Spanish Securities Exchange Act (Ley del Mercado de Valores).

There are, however, certain shareholders with shareholdings that can be considered significant, in accordance with the Ministerial Order 3722/2003, of December 26. These shareholders are listed below:

|          | Percentage | Total shares | Percentage | Direct shareholding shares | Percentage | Indirect shareholding shares |
|----------|------------|--------------|------------|----------------------------|------------|------------------------------|
| BBVA     | 6.63%      | 326,349,743  | 6.63%      | 326,256,235                | 0.00%      | 93,508                       |
| La Caixa | 5.09%      | 250,466,066  | 1.41%      | 69,406,501                 | 3.68%      | 181,059,565                  |

### Shares held by members of the Board of Directors<sup>1</sup>

| Name                                     | Direct Shareholding | Indirect Shareholding | Number of shares held |
|--|---------------------|-----------------------|-----------------------|
| Mr. César Alierta Izuel                  | 923,200             | 78,000                | 1,001,200             |
| Mr. Isidro Fainé Casas                   | 144,978             | 0                     | 144,978               |
| Mr. Gregorio Villalabeitia Galarraga     | 55                  | 0                     | 55                    |
| Mr. Fernando de Almansa Moreno-Barreda   | 3,849               | 0                     | 3,849                 |
| Mr. Maximino Carpio García               | 8,069               | 0                     | 8,069                 |
| Mr. Carlos Colomer Casellas              | 564                 | 22,450                | 23,014                |
| Mr. Alfonso Ferrari Herrero              | 1,883               | 103,480               | 105,363               |
| Mr. Gonzalo Hinojosa Fernández de Angulo | 39,476              | 150,000               | 189,476               |
| Mr. Miguel Horta e Costa                 | 368                 | 0                     | 368                   |
| Mr. Pablo Isla Álvarez de Tejera         | 401                 | 0                     | 401                   |
| Mr. Luis Lada Díaz                       | 31,200              | 0                     | 31,200                |
| Mr. Julio Linares López                  | 24,420              | 2,067                 | 26,487                |
| Mr. Antonio Massanell Lavilla            | 2,190               | 667                   | 2,857                 |
| Mr. Vitalino Manuel Nafría Aznar         | 300                 | 0                     | 300                   |
| Mr. Enrique Used Aznar                   | 20,228              | 34,000                | 54,228                |
| Mr. Mario Eduardo Vázquez                | 10                  | 0                     | 10                    |
| Mr. Antonio Viana-Baptista               | 22,873              | 0                     | 22,873                |
| <b>Total</b>                             | <b>1,224,064</b>    | <b>390,664</b>        | <b>1,614,728</b>      |

<sup>1</sup> 31/12/2005







# Risk Management

The Telefónica Group is exposed to several financial market risks, as a result of (i) its ordinary business, (ii) the debt undertaken to finance its operations, (iii) stakes in companies, and (iv) other financial instruments related to the previous points.

The main market risks that affect the Group's companies are:

- **Exchange Rate Risk.**

This risk arises mainly due to the international presence of Telefónica, with investments and operations in countries with currencies other than the euro (mainly in Latin America, but also in the Czech Republic and, as from 2006, in the United Kingdom), and due to debt in currencies other than those of the countries where business is carried out or where the companies that have undertaken the debt are based.

- **Interest Rate Risk.**

This risk is related to the variation of (i) the financial costs of debt with a variable interest rate (or with short term maturity, and foreseeable renewal), as a consequence of the variation in interest rates, and of (ii) the value of long term liabilities with fixed interest rates (whose market value increases when interest rates drop).

- **Share Price Risk.**

This is the risk related to the variation of the value of the share stakes that can be subject to operations, of the derivatives of those stakes, of the company's own treasury stock, and of share derivatives.

In addition, the Group faces liquidity risk, which arises due to the possibility of imbalance between the need for funds (for operating and financial expenses, investment, debt maturity and committed dividends) and the sources of these

(income, divestitures, financing commitments to financial bodies, and capital market operations). The cost of obtaining funds can also be affected by variations in credit margins (of interest rates) required by the lenders.

Lastly, it is important to note what is known as "country risk" (in combination with the market and liquidity risks) that is related to the possibility of asset value loss or to the reduction of flows generated or sent to the parent company, as a consequence of political, economic and social instability in the countries where the Telefónica Group operates, especially in Latin America.

The Telefónica Group actively manages these risks, with a view to stabilising:

- Cash flows, in order to aid the financial planning and to take advantage of the investment opportunities that arise,
- Financial Results, in order to aid investors in their understanding and predictions,
- The value of the company's equity, protecting the value of investments made.

In cases where these aims are mutually exclusive, the financial management of the group decides which aim should prevail.

In its risk management, Telefónica uses derivative financial instruments, mainly on exchange rates, interest rates and shares.

## Exchange Rate Risk

The main aim of the exchange rate risk management policy is to compensate (at least partially) possible loss in the value of assets related to Telefónica's business caused by depreciation of currencies with regard to the euro, with the savings generated by the lower value in euros of the debt in foreign currency (due to the depreciation of the currency). The degree of coverage (percentage of foreign currency debt with regard to asset value) implemented tends to be higher:

- the higher the estimated correlation between the asset value and the foreign currency exchange rate, and
- the lower the estimated cost of the coverage (calculated as the spread between the additional financial costs for financing in the local currency and the expected depreciation of the currency with regard to the euro).
- the higher the liquidity of the currency and derivatives market.

In general, the estimated correlation between the asset value and the currency exchange rate is higher the higher the weight of cash flows generated in the first years as a percentage of the estimated value for the asset is.

The protection against future depreciations of Latin American currencies with regard to the euro is based, firstly, on the debt in Latin American currencies. As at December 31, the debt in Latin American currencies amounted to almost 5.4 billion euros. However, this debt is not uniformly distributed as the proportion of the flows generated in each country, so its future effectiveness as protection against exchange rate risks will depend on where depreciations may take place.

In addition, the protection against losses in the value of Latin American assets due to changes in exchange rates, is complemented with debt in dollars, both in Spain (associated to the investment while the coverage is deemed effective) and in the countries in question in the absence of a financing market in local currency or a deep enough coverage market. As at December 31, the Group's debt in dollars amounted to the equivalent of 2.999 billion euros.

Likewise, the exchange rate risk management is carried out by seeking to minimise the negative impact on the Financial Results, without prejudice to remaining flexible if required. The need for this flexibility may arise for three reasons: (i) due to the narrowness of some derivatives markets or due to the difficulty of obtaining financing in local currency, which does not allow for low cost coverage (as is the case in Argentina); (ii) due to financing by means of intra-group loans, with an accounting treatment of the foreign currency risk different from that applied to financing through capital contributions; (iii) due to company decisions.

In 2005 exchange rate management achieved positive results amounting to a total of 162.0 million euros, mostly because it was decided not to entirely cover the loans in dollars to Latin American subsidiaries, which led to profit as a result of the appreciation with regard to the dollar and of the dollar with regard to the euro.

Additionally, in 2005 the group acquired a 69.4% stake in Cesky Telecom for 3.658 billion equivalent euros. This acquisition was financed with debt, a substantial part of which (1.839 billion equivalent euros) was transformed by means of exchange rate derivatives into synthetic debt in Czech crowns. This implies that a substantial part of value of the acquisition has been left exposed to the risk of the Czech crown – Euro exchange rate. This decision was made on the basis of a positive opinion on the evolution of the Czech economy, an opinion which underlies the acquisition decision. From the moment of the acquisition until December 31, 2005 the crown increased in value by 3.5% with regard to the euro.

The recent acquisition of the British company O2 has been financed with a multicurrency loan signed in 2005. The final composition by currency of the liability resulting from the acquisition will take into account that part of the value of the company is due to its business in the Eurozone (Germany and Ireland), and that the lack of a perfect correlation between the value of the business in the United Kingdom and the Pound Sterling-Euro exchange rate does not make it advisable to finance it entirely in Pounds Sterling.

## Interest Rate Risk

The financial costs to Telefónica are exposed to variations in interest rates. In 2005, short-term interest rates with the highest volume of exposed debt were mainly the Euribor, the Brazilian SELIC rate, the dollar Libor and the Chilean UF. At December 31, 2005, 55% of the total debt (or 66% of the long-term debt), had its rate fixed for a period of more than a year. Of the remaining 45% (floating debt or debt at a fixed interest rate with a maturity of under a year) 14 percentage points (or 16% of long-term debt) had a fixed interest rate for a period exceeding a year, whereas at December 31, 2004, 83% of the long-term debt had a fixed interest rate. The new debt undertaken in the course of the year also implied exposure to the long-term interest rates applicable at the time of contracting or coverage. In this sense, a syndicated loan of 6 billion euros was taken out, to which interest rate swaps were associated to fix the financial costs.

Lastly, the financial updating of the early retirement liabilities was carried out in the course of the year with the interest rate curve of the swap market. The drop in interest rates implied an increase in the value of these liabilities.

Financial costs in 2005 came to 1.6343 billion euros, 0.3% lower than those in 2004. However, excluding results due to exchange rate variations, the figures would be 1.7964 in 2005 and 1.4621 in 2004, which would entail a 22.9% increase in adjusted financial costs in 2005 with regard to 2004. To a great extent this rise is explained by the 18.6% increase in the total net average debt (29,5339 billion euros, at December 31, 2005, including early retirement commitments); the rest of the increase is due to the rise in interest rates in Brazil

(average SELIC rate of 19.14% in 2005 compared to 16.38% in 2004) and to the increase of the debt in Latin American currencies, following the acquisitions of mobile telephony companies made in 2004 and beginning of 2005. Financial expenses in 2005 show an average cost of 5.5% for the total average net debt in the year, and of 6.1%, excluding the effect of variations in exchange rates.

The acquisition of O2 for almost 17.9 billion Pounds Sterling through a syndicated loan and its subsequent refinancing increases the exposure of the Group to changes in rates, including Pound Sterling exchange rates. In January 2006, Telefónica issued long-term bonds for amounts of 4 billion euros and 1.25 billion pounds sterling in order to prolong the maturity terms of its debt, with fixed interest rates similar to those used in the valuation of the acquired company.

## Share Price Risk

One of the equity risks to which Telefónica is exposed is that related to the price of its own shares, as a result of the share buyback programme announced in October 2003 and renewed in April 2005, for an estimated amount of 6 billion euros until 2007 (inclusive), subject to cash flow generation and the evolution of the share price.

At December 2005, Telefónica S.A. held over 136 million own shares, and purchase options for 56 million own shares, with maturity in the first four months of 2006. This option strategy offers a certain degree of protection against the scenario where share prices rise, purchases become more expensive and fewer shares can be purchased with the previously established amount. The maximum financial losses

that could be faced with this strategy is the premium paid for the option, if at maturity the share price were to be lower than the exercise price; however, in such case Telefónica would be able to purchase its shares on the market at a lower price.

Telefónica is also exposed to fluctuations in the prices of shares of its investee companies, especially to the extent that these are not integrated in its core business and may be subject to divestiture. In 2005 the most significant divestiture was the sale of 25.0% of Endemol, for an estimated amount of 264.4 Mio. Eur, which generated a profit of 55.2 Mio. Eur before tax.

## Liquidity Risk

Telefónica aims to adapt the maturity profile of its debt to its capacity to generate cash flows to pay it, maintaining a certain margin. In practice, that has led to the monitoring of two criteria:

1. The average maturity of the Group's debt must be longer than the time required to pay the debt (assuming fulfilment of the internal projections, and all the flows generated being allocated to payment of the debt, and not to dividends or acquisitions).
2. The group must be able to pay off all its commitments in the coming 12 months, without having to resort to further loans or to the capital markets (but maintaining the credit lines already firmly committed by financing institutions), assuming budgetary fulfilment.

At December 31, the average maturity of the net financial debt – 30.0669 billion euros – was 5.0 years. As was announced at the Investor Conference held in April 2005, the Telefónica Group expects to generate more than 36 billion euros in the four-year period

from 2005-2008, assuming exchange rates stay at 2004 levels. This shows that the first of the criteria is fulfilled: in a period of less than four years the Group will be able to repay all its debt, which has a longer average maturity.

On the other hand, the gross maturity of debt in 2006 (8.824 billion euros or 9.066 billion euros taking into account the market value of derivatives with a maturity term of under a year and debt to employees), is less than the liquid assets, calculated as the sum of (i) liquid assets as at December 31 of 3.561 billion euros (temporary financial investments of 1.348 billion euros and treasury of 2.213 billion euros) (ii) the annual cash generation estimated for 2006 (projected to exceed the figure of 2005, which amounted to 6.975 billion euros), (iii) the unused lines of credit committed by banks with an initial maturity term of more than a year or extendible at the discretion of the Telefónica Group (3.029 billion euros at December 31, including Cesky Telecom and Endemol BV) and (iv) 1.264 billion euros in lines of credit with an initial maturity term of more than a year or extendible at the discretion of Telefónica used for the purchase of O2 shares, and which could be transferred to the syndicated loan of 18.5 billion pounds sterling structured for the acquisition of that company. The existing margin allows the Group to face the payment of a minimum dividend of 50 cents per share (approximately 2.4 billion euros), and the continuation of the own shares buyback programme.

Following the acquisition of O2 it is advisable to perform a liquidity analysis beyond 2006, estimating possible additional sums maturing in 2007. After exercising the extension option, these could amount to 2.175 billion pounds sterling (approximately 3.175 billion euros). This is due to the fact that after, (i) adjusting the cost of the acquisition to almost 17.9 billion pounds sterling, (ii) receiving requests for exchange of O2 shares for "Loan Notes", and (iii) the January 2006 long-term bond issue for 4 billion euros and 1.25 billion pounds sterling, it has been possible to pay off part of the syndicated loan taken out for the acquisition. The amount of the loan was thus reduced to 14.175 billion pounds sterling, of which only 2.175 billion cannot be extended beyond October 2007.

To this amount, the long-term debt maturities for 2007 (almost 2.4 billion euros) must be added, which would result in a figure of approximately 5.5 billion euros, similar to net maturities in 2006 (gross maturity less cash). This figure will be affected by the results of the refinancing processes scheduled for 2006, which will have two contradictory impacts:

- An increase in maturities in 2007 due to short-term renewal of part of the debts with maturity in 2006 (especially commercial paper), and
- A reduction in 2007 maturities due to the raising of long-term financing (bonds and loans) largely to pay off the syndicated loan for the acquisition of O2.

The raising of long-term financing is exposed to the financial market risks, both with regard to volume and to cost. The possible variation in cost is due not only to changes benchmark rates (on sovereign bonds or swap rates) but also to changes on the credit spread to be paid on these benchmarks.

Having said this, given the scale of 2007 maturities, the Group should be able to meet its second criterion –to cover its 12 month commitments with available financing- at the end of 2006, assuming the operations generate the expected flows.

In any case, following the acquisition of O2, there is an increased need to have access to swift credit, at a good price and under good terms and conditions. To this aim, Telefónica has established two objectives as axes of its financial policy:

1. To maintain a BBB+/Baa1 credit rating as the minimum desirable rating, and
2. To maintain a net debt – assumable financial commitments ratio equal or less than 2.5 times the OIBDA (Operating Income Before Depreciation and Amortisation) in the medium term.

With regard to these points, the Group's current ratings are BBB+ by Standard & Poor's, Baa1 by Moody's and A- by Fitch, and a pro-forma analysis with unaudited data at September 2005 (as if the O2 acquisition had taken place at that date) shows a net financial debt equal to 3.0 times the OIBDA.

## Main credit ratios as at year-end 2005<sup>1</sup>

### Operating highlights 2005

|             |                                   |          |
|-------------|-----------------------------------|----------|
| I           | OIBDA                             | 15,276.4 |
| II          | Free Cash Flow                    | 7,108.1  |
| III         | Capex                             | 4,409.9  |
| IV          | Telefónica, S.A. dividends        | 2,379.5  |
| V=II+III-IV | Cash Flow Withheld (before capex) | 9,138.5  |
| VII         | Pro-forma OIBDA                   | 15,733.1 |

### Liabilities at Dec 31, 2005

|         |   |          |
|---------|---|----------|
| A       | Financial debt                          | 30,067.0 |
| B       | Guarantees                              | 449.0    |
| C       | Net commitments for workforce reduction | 3,057.7  |
| D=A+B+C | Total debt + Commitments                | 33,554.3 |

### Financial ratios

|  |        |
|--|--------|
| Financial Debt / Pro-forma OIBDA                           | 1.91   |
| Total debt + Commitments / Pro-forma OIBDA                 | 2.13   |
| Cash Flow Withheld (before capex) Total Debt + Commitments | 27.23% |

<sup>1</sup> Credit checking agencies also adjust their ratios for operational leasing and other commitments

## Country Risk

The perception of sovereign risk in Latin America ended 2005 under 280 bps, an all-time low, due to a number of macroeconomic milestones, some of them historic. Thus, with a growth of over 4% in 2005, a path of high and solid growth is established, which has allowed an 11% growth of the income per capita in the region since 2003, the highest growth rate since the 1970s. In addition, this growth has occurred with no rise in inflation (6%) and, even more importantly, with the current account showing a record surplus of \$30 billion.

Undoubtedly, the favourable international climate of growth and the prices of raw materials generated clear improvements in the region's terms of trade (31% above the average in the 1990s), driving export growth to almost 10%. This influx was accompanied by a strong increase in the remittances from expatriate workers, to \$47.4 billion.

The current account surplus, equal to 1.3% of the GDP, was further strengthened by the \$47 billion in direct foreign investment. This has made it possible to pay off \$42 billion of foreign debt and to accumulate \$35 billion in international reserves, reaching the highest level since 1990. That is, the region has taken advantage of the favourable climate to address its weakest points in terms of external vulnerability: high foreign debt and low reserves.

In addition, some governments in the region have taken advantage of the existing surplus liquidity and the emerging appetite for risk, to swap external debt for domestic debt on favourable terms

(Argentina, Colombia and Peru) or to redeem debt issued on foreign markets (Argentina, Brazil, Mexico, Panama and Peru) so as to increase maturities for long-term debt and increase the percentage of foreign debt in local currency (especially in Mexico and Brazil).

All these measures –aimed at raising the credit rating of the region to ‘investment grade’– have been reflected not only in the lowest country risk rate in history, as was mentioned at the beginning of this section, but also in the appreciation by 4% in the real trade-weighted exchange rate of the region with regard to the rest of the world and more moderate public debt ratios (42.9% of GDP), thereby boosting investor confidence and regaining investment ratios similar to those of 1998 (almost 23% of GDP), before the severe economic recession that lasted until 2002.

Although the macroeconomic scenario promises stability and the economic policies are still appropriate, it is necessary to bear in mind some risks that are still present on the microeconomic front, that affect the countries in the region when compared to other more economically developed countries. Among these risks are regulatory decisions, the highly bureaucratic procedures in business and the rigidity of some of the market of production factors, which prevent the region from achieving a higher growth through investment and productivity. Likewise, additional efforts are required in terms of reforms of the tax, educational and health systems that build on the achievements gained in human development in recent years for the region to meet the World Bank's Millennium Development Goals.

The previously mentioned improvement in the economic context and the positive outlook does not prevent Telefónica from continuing with its strict monitoring of the risk of unforeseen loss in value of Latin American assets due to possible social, economic or political instability. To this aim, it has continued by pursuing two broad lines of action (in addition to the normal management of its businesses):

1. To partially compensate the assets with liabilities in the Latin American companies, not guaranteed by the parent company, to ensure that any loss in asset value would go hand in hand with a reduction of liabilities, and
2. To repatriate funds generated in Latin America which are not expected to be made satisfactorily profitable in future, through opportunities for the development of the business in the region.

With regard to the first point, the Latin American companies have a net external debt volume unguaranteed by the Spanish companies amounting to 2.716 billion euros, 9% of the net financial debt of the Group, with Brazil (1.583 billion euros) and Argentina (760 million euros) as especially salient cases. In some mobile companies previously belonging to Bell South there was another debt guaranteed by Telefónica S.A. as a result of the acquisition process, part of which has already been refinanced without guarantee. In fact, in December 2005 the mobile subsidiary in Chile signed a loan for almost 180 million dollars (without guarantees from the parent company) in order to replace another loan for the same amount guaranteed by Telefónica S.A., for which reason this amount has been considered part of the total external debt without recourse in

<sup>1</sup> In accordance with the EMBI indicator drawn up by JP Morgan

Latin America (even though the replacement took effect at the beginning of January). In addition, the mobile subsidiary in Peru refinanced, without guarantees from the parent company, throughout 2005 and the beginning of this year, a loan for 200 million dollars guaranteed by Telefónica, S.A., whose outstanding balance at December 31 amounted to 163 million dollars (not included in the external debt without recourse in Latin America at December 31).

Also as an exceptional measure, Telefónica, S.A. guaranteed a programme for the issuance of certificados bursátiles (peso bond) for the amount of up to 12 billion Mexican pesos by its indirect subsidiary Telefónica Finanzas de Mexico, S.A. de C.V. The amount issued under this programme at December 31 amounted to 5 billion pesos. Subsequent issues have raised the amount to a total of up to 11.5 billion pesos, an amount that has not been included in the previous calculation of Latin American debt without recourse (nor has the calculation for the total unused cash at December 31 been included). The special factors that led to extending the guarantee in this specific case are:

- Difficulties to make contributions from the Telefónica Group, either in capital (due to the existence of a minority shareholder) or debt (due to fiscal inefficiencies).
- Impossibility of raising external financial resources for the necessary amount at a reasonable cost, given the long phase of expansion the company has embarked on, and that correspond to negative operating results due to the strong commercial activity and high investment in infrastructure.

- Possibility of legally implementing the guarantee without causing a structural subordination for the rest of Telefónica's creditors (from the point of view of the credit rating agencies).

With regard to the second point –repatriation of funds – in the year 2005 Latin America received a net sum of 1.684 billion euros –excluding Mexico– mostly in dividends (884 million euros) and the rest in loan interests and principal to the Latin American subsidiaries and management fees. In the opposite direction, the influx of funds into Mexico continued mainly to finance the needs of Telefónica Móviles both for capex -261 million euros–, and OIBDA losses -159 million euros–.

Lastly, the exposure of Telefónica SA's OIBDA to the different countries has altered slightly after the final completion of the acquisition of the subsidiary mobile companies of Bell South at the beginning of 2005 and the acquisition of Cesky Telecom. Thus, looking at the most important countries in terms of OIBDA generation, the Eurozone still dominates, with 61.8% of the total, followed by Brazil (generating 18.5% of the Group's OIBDA), Argentina (4.7%), Chile (4.2%), Venezuela (3.9%) and Peru (3.8%), with the exposure to the Czech Republic being 3% of the Group's OIBDA for 2005.

## Derivatives Policy

At December 31, 2005 the nominal value of outstanding derivatives with external counterparties came to 58.1345 billion euros. This volume is so high because derivatives may be applied several times to the same debt for an amount equal to its nominal value; for instance, a debt in foreign currency may be hedged into euros, at a floating rate, and then for each interest rate period, the rate may be fixed by using an FRA. Even adjusting the position downwards, it is necessary to exercise extreme caution when using derivatives so as to avoid problems due to errors or lack of knowledge of the real position and its risks.

The policy followed in the use of derivatives emphasised the following points:

- I. Existence of a clearly identified underlying, on which the derivative is based.

Acceptable underlying include profits, income and cash flows both in the Company's operating currency and in currencies other than the operating currency. These flows may be contractual (debt and interest payments, payment of accounts payable in foreign currency) which are reasonably certain or foreseeable (capex programme, future debt issues, commercial paper programmes, etc.). Whether the previously mentioned cases are counted as underlying, will not depend on whether or not they adapt to the criteria required by accounting regulations for underlying as hedged items, as occurs, for instance, with some intragroup transactions. In addition, in the case of the parent company, the investment in subsidiaries with an operating currency



other than the euro also qualify as acceptable underlying assets.

Economic hedges, i.e. hedges with an assigned underlying asset and which in some circumstances may offset variations in the value of the underlying asset, do not always fulfil the requirements and effectiveness tests established by the various accounting regulations to be treated as hedges. The decision to maintain them after they fail to pass the effectiveness test or certain requirements are not fulfilled, will depend on the marginal impact on the financial statements and therefore on how far this might compromise the aim of stabilising the Financial Statements. In any event the results are recorded in the Profit and Loss Account.

In this sense, in 2004, hedging relationships were adjusted to take into account changes in the treatment that the IFRS gives to certain transactions with respect to previous regulations, so as to maintain the full economic hedge while limiting the combined impact of the hedge and its underlying in the financial statements.

## II. Adjustment of the underlying to one side of the derivative.

This adjustment is applied mostly to debt in foreign currency and derivatives hedging payments in foreign currency in the Group's subsidiaries, as a way of cancelling the risk derived from variations in foreign currency interest rates. However, even when a perfect hedging of the flows is sought, the lack of depth to certain markets, especially those associated to LATAM currencies, has led to historical imbalances between

the characteristics of the hedges and the debts covered. Telefónica Group's intention is to reduce these imbalances, so long as this does not involve disproportionate transaction costs. In this sense, if the adjustment is not possible for the reasons mentioned, the Group will seek to modify the financial duration of the foreign currency underlying in order to minimise foreign currency interest rate risk.

On some occasions, the definition of the underlying the derivative is assigned to does not coincide with the timing of the contractual underlying.

## III. Identity of the country contracting the derivative and the company that owns the underlying.

In general, it is sought that the hedging derivative and the underlying asset or risk that it covers are held by the same company. However, on other occasions, hedges have been taken out by the holding of the companies which own the underlying asset, (Telefónica S.A., Telefónica Móviles S.A. and TISA). These transactions fail to meet the hedging criteria required by accounting standards and resulting gains or losses are therefore recognised on the Profit and Losses Account. The main reasons for the mentioned separation of the hedge and the underlying asset were possible differences in the legal validity of local hedges with regard to international hedged (as a result of unforeseen legal changes) and the different credit ratings of the counterparties (whether the companies of the Group involved or the banks).

## IV. Capacity to measure the derivatives' market value, using the valuation systems available to the Group.

Telefónica uses a number of tools to measure and manage risks in derivatives and debt. The include, notably, Kondor+ system, licensed by Reuters and widely used by financial entities, as well MBRM specialist financial calculator libraries.

## V. Sale of options only when there is an underlying exposure.

The sale of options is only allowed when: i) there is an underlying exposure (recorded on the balance or associated with a highly probable external flow) that would offset the potential loss from the exercise of the option by the counterparty, or ii) this option is part of a structure where there exists another derivative that can offset this loss. Likewise, the sale of options included in the option structures where at the time of contracting, the net premium is higher or equal to zero, is allowed.

For instance, short term options on interest rate swaps can be sold, which entitle the counterparty to enter a swap receiving a specific fixed interest rate, below the level prevailing at the time of selling the option; thus, if rates dropped, Telefónica would swap part of its debt from floating rate to a fixed rate, at lower levels to the initial ones, having collected a premium.

## VI. Hedge Accounting:

The main risks that may qualify for hedge accounting (that is, with symmetry between the underlying asset and the hedge) are:

- Variations in market interest rates (either money market rates, or credit spreads, or both) that affect the value of the underlying asset or the measurement of the cash flows.
- Variations in exchange rates that affect the value of the underlying asset in the company's operating currency and that influence the measurement of the cash flow in the operating currency.
- Variations in the volatility associated with any financial variable, asset or liability, which modifies either the valuation or the measurement of flows in debts or investments with embedded options, whether or not these options are separable.
- Variations in the valuation of any financial asset, especially shares of companies held in the available-for-sale portfolio.

### Regarding the Underlying Asset,

- Hedges can cover the total value or part of the value of the underlying asset.
- The risk to be hedged may be for the entire period of the transaction, or for a time fraction of said transaction.
- The underlying asset may be a highly probable future transaction, or a contractual underlying asset (loan, payment in foreign currency, investment, financial asset...) or a combination of both that defines an underlying asset with a longer term. Thus, there are cases in which the contracted hedges have

longer terms than the contractual underlying assets to which they are associated. This occurs when Telefónica enters into long-term swaps, caps, or collars to protect itself against interest rates rises that may raise the financial costs generated by its promissory notes, commercial paper and certain floating rate loans which mature earlier than their hedges. The likelihood of renewing these financing operations with a floating interest rate is very high and the company commits to this by defining the underlying asset in more general terms as a financing programme with floating interest rates whose maturity coincides with the maturity of the hedge.

Hedges can be of three types:

- Fair value hedges.
- Cash flow hedges, for any value of the risk to be hedged (interest rates, exchange rates, etc.) or for a given range within said value (interest rates of between 2% and 4%, interest rates above 4%, etc.). In the latter case, options are used as the hedging instruments, and only the intrinsic value of the option is recognised as an effective hedge. Changes in the time value of the option are recorded as profits and losses.
- Hedges on net investment associated with subsidiaries that are integrated in the consolidation of the Group. In general these will be put in place by Telefónica S.A and other Group holding companies. Wherever possible, these hedges are implemented through real

debt in foreign currency. However, this is often not possible for many Latin American currencies, as non-resident companies cannot issue debt in these currencies as they are not convertible. It may also be that the depth of the debt market in that currency is not sufficient to accommodate the required hedge (Czech Crown, Pound Sterling), or that an acquisition is made in cash, with no need for market finance. In these cases, the Group resorts to derivative instruments, either forwards or cross-currency swaps, to hedge the net investment. "Pay fixed-rate foreign currency" cross-currency swaps are valued using the forward calculation method (the interest spread and changes in value of the derivative due to changes in the interest rates are taken to equity). For "pay floating-rate foreign currency" swaps, the spot method is used (the interest spread and changes in value of the derivative due to movements in interest rates are taken to earnings). As an exception to this general rule, for those currencies in which the interest spreads with regard to the euro is high (e.g. Brazil), short-term structures are chosen (about 1 year) and the spot method is used even for fixed-rate foreign currency swaps, in order to make the Financial Statements easier to understand. For hedges with forwards the case is analysed currency by currency. For reasons related to technical market issues, or to a possible change in the fx risk perception, it may be decided to cancel the designation of a position as a hedge early, regardless of its maturity term. Likewise, for those hedging

positions approaching maturity (under 3 months), for technical market reasons, such as liquidity, depth, etc. maturity may be brought forward (by taking an offsetting position or selling the derivative on the market) should it have been decided not to renew, in which case the designation would be cancelled, and the operation can then be treated as effectively the same as the hedge reaching maturity. Otherwise, the hedge can be renewed early, in which case the designation of the first hedge is cancelled and the new hedge is designated in its stead. Sometimes, a derivative-based hedged may be renewed using foreign currency debt instruments.

Hedges can comprise a combination of different derivatives.

Management of accounting hedges need not be static, with an unchanging hedging relationship lasting through to maturity. In fact, hedging relationships may change to allow appropriate management that serves the Group's stated principles of stabilising cash flows, financial results and protecting the Group's share capital. Thus, the designation of the hedged may be cancelled, before their maturity, either by a change in the underlying asset or by a change in the perceived risk on the underlying asset. Derivatives included in

these hedges may be reassigned to other possible new hedges that must pass the effectiveness tests and be properly documented.

The guiding principles for risk management are laid down by the General Management of Corporate Finance of the Telefónica Group and implemented by the financial managers of the companies (ensuring they are in keeping with both the individual interests of the companies and those of the Group). The General Management of Corporate Finance may authorise deviations from this policy for justifiable reasons, normally when the market is too thin for the volume of transactions or for clearly limited, reduced risks. Likewise, companies joining the Group as a result of acquisitions or mergers may require time to adapt.

## Risk Control Systems

Telefónica carries out constant monitoring of the most significant risks that could affect the main companies that form part of its Group. To this aim it has a Corporate Model that is applied periodically and homogeneously in the Companies of the Group, allowing the evaluation of both the importance of each of the risks that could affect the companies, and the degree of control over each of the risks.

Thus, the Group has a risk map that allows it to identify those risks that require specific control and monitoring, prioritised in accordance with their importance. In addition, the model has a matrix that includes all the operational processes where each of the risks considered are managed, in order to allow the evaluation of the established controls and be able to have reasonable certainty that they will not materialise.

The identification of these risks and processes is carried out by the Internal Auditing Office, which is responsible for the internal control of the Group. Its results are informed periodically to Telefónica's Audit and Control Committee.

The 50 risks considered in the model are classified in the following categories:

- Business process risks: (operational risks, integrity risks, management and human resources risks, technological risks and financial risks).
- Information risks: (operational, financial and strategic)
- Contextual risks: (competition; shareholder relations; availability of resources; political and economic environment; legal and fiscal; regulations and changes in the sector).







# Corporate Governance

## Shareholders with significant stakes

| Name or corporate name | % total share capital |
|------------------------|-----------------------|
| "La Caixa"             | 5.09%                 |
| BBVA                   | 6.63%                 |

Information as at December, 31, 2005

## Ownership

Telefónica's fully subscribed and paid-up share capital amounts to 4,921,130,397 euros, and is divided into 4,921,130,397 ordinary shares, of a single class and series, with a nominal value of (1) one euro each, represented by book entries.

In accordance with the information available in the Company, there is currently no natural or legal person that exercises, or may exercise control, directly or indirectly, individually or jointly, over Telefónica. There are, however, two shareholders with significant shareholdings, directly and indirectly, as is shown in the following table: Caja de Ahorros y Pensiones de Barcelona (La Caixa), and Banco Bilbao Vizcaya Argentaria, S.A. (BBVA), with 5.09% and 6.632% of the share capital, respectively.

## Corporate Governance in Telefónica

### Principles of Corporate Governance

The basic corporate governance regulations of Telefónica are set out in the Company By-laws, in the Regulations of the General Shareholders Meeting and in the Regulations of the Board of Directors.

The Regulations of the General Shareholders' Meeting establishes the principles of organisation and its operation, offering shareholders a framework that guarantees and enables the exercise of their rights with regard to the General Shareholder's Meeting, as the governing body of the Company.

Likewise, the Regulations of the Board of Directors, as the founding rules of corporate governance for the Company, determine the principles guiding the actions of the Board of Directors, regulate its organisation and operation and establish the rules of conduct for its members.

In accordance with the foregoing, and as the basis of the governance structure of Telefónica, the Regulations of the Board of Directors of the Company determine the fundamental principles that guide the actions of the Board of Directors:

With respect to corporate interest. The Board of Directors executes its functions in accordance with corporate interest, understood as the Company's interest, and,

This chapter presents a summarised version of the Annual Report on Corporate Governance of Telefónica S.A. for FY 2005. This report, which addresses the requirements established in the Circular 1/2004, of March 17, of the Comisión Nacional del Mercado de Valores (Spanish Stock Exchange Commission), is published on an annual basis, and can be accessed through the Company's website for shareholders and investors. ([www.telefonica.es/investors](http://www.telefonica.es/investors)).

in this respect, acts to guarantee the long term viability of the Company and maximise its value, whilst taking into account the plurality of legitimate public or private interests that converge in the execution of all business activities.

With respect to its shareholders. The Board of Directors, as the liaison between the shareholders and management, is responsible for setting up the necessary channels to be aware of the suggestions put forward by shareholders with respect to the corporate management. The Board of Directors also undertakes to guarantee equal treatment in its relations with shareholders.

With respect to the market. The Board undertakes to execute the acts and take the necessary measures to ensure the Company's transparency in financial markets, and to promote correct formation of the Company's share prices, particularly avoiding manipulation and abuse of privileged information.

## The Board of Directors

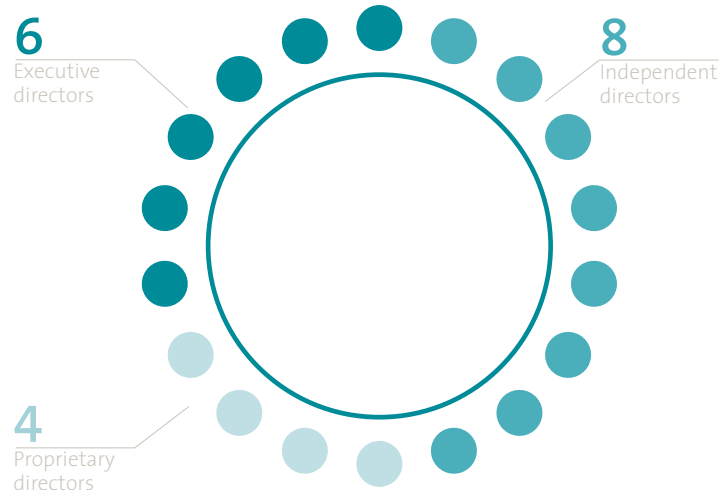
The Regulations of the Board of Directors establish it as a basically supervisory body controlling the Company's activity, while entrusting the day-to-day management of the business to the executive bodies and the management team. Moreover, and in keeping with the provisions of these Regulations, those powers that are legally or statutorily reserved for the Board of Directors may not be delegated, nor may any others necessary for the responsible performance of its basic supervisory and control duties.

Accordingly, and within the scope of its duties of supervision and control, the Board of Directors (i) determines the strategies and guidelines for the Company management, (ii) establishes the basis for corporate organisation to ensure its maximum efficiency, (iii) implements and oversees the suitable information procedures to report Company information to shareholders and the markets in general, (iv) makes decisions regarding business and financial transactions of particular importance to the Company and (v) approves the bases of its own organisation and operation to ensure the optimal fulfilment of these duties.

The Company By-Laws of Telefónica establish that the Board of Directors must comprise a minimum of five and a maximum of twenty Board Members. In April 2006, the Board of Directors of Telefónica was comprised of 18 Directors, of which 6 are Executive Directors, 4 are Proprietary Directors and 8 are Independent Directors.

## Composition of the Board of Directors

May 2006



### The Board of Directors Executive Committee

Subject to the legislation in force, the Board of Directors has expressly delegated all of its powers and attributes, save those that may not be legally or statutorily delegated, to an Executive Committee with general decision-making powers.

The relationship between the Board of Directors and its Executive Committee is based on the principle of transparency, such that the Board is always fully aware of the decisions adopted by the Committee. Thus, the Board of Directors is informed at each of its sessions of all the resolutions adopted by the Executive Committee, distributing a summary of the minutes of the Committee sessions for this purpose to all the Board members. The Board then proceeds to ratify these resolutions. Moreover, the election of the members of the Board of Directors to the Executive Committee must have the backing of, at least, two thirds of the Board of Directors.

### The Board of Directors' Consultative or Control Committees

The Board of Directors of Telefónica has constituted several consultative or control Committees –precisely six- which it entrusts with the continual study and monitoring of areas of particular relevance for the Company's good governance, or for the monographic analysis of certain significant aspects or issues where such study is appropriate. These Committees are not corporate bodies, but rather are structured as instruments to serve the Board of Directors, which receives the conclusions reached in the matters and issues the Committees are instructed to study.

Among the consultative or control Committees constituted by the Board of Directors of Telefónica, are those that have been specifically recommended:

Audit and Control Committee, established in 1997, is regulated by the Company By-Laws and the Board Regulations. It verifies both the financial information and the annual accounts of the Company, ensuring that all the financial information is prepared in accordance with the same professional principles and practices. Its responsibilities are mainly (i) to know the financial information process and evaluate the accounting verification system, (ii) to safeguard the independence of the external auditor, supervising their work and serving as a liaison between the Board of Directors and the external auditor; (iii) to supervise the internal auditing services and (iv) to supervise compliance and integrity of the internal control systems for financial information.

The Nominating, Compensation and Corporate Governance Committee, regulated by the Board Regulations, has the following competencies: (i) to inform with regard to proposals for the appointment of Directors and other high-ranking officers of the Company and its subsidiaries, (ii), to approve the remuneration bands for the high-ranking officers of the Company, (iii) to approve the standard contracts for the high-ranking officers, (iv) to determine the remuneration scheme for the Chairman, (v) to inform and propose to the Board of Directors the retribution schemes for Directors and to revise them periodically, (vi) to inform of the incentive plans, (vii) to perform an annual analysis of the remuneration policy for Directors and high-ranking officers, (viii) to inform with regard to proposals for the appointment of

members to the Board Committees, (ix), to prepare and keep a register of the status of the Directors and high-ranking officers of the Company, (x) to prepare the Annual Report on Corporate Governance and (xi) to exercise those competencies assigned to this Committee by the Board of Directors.

In addition, the Board of Directors deemed it convenient to constitute four additional consultative Committees: the Human Resources and Corporate Reputation Committee, the Regulation Committee, the Service Quality and Customer Service Committee and the International Affairs Committee.

## Directors

### Appointment

In accordance with the provisions of the Ley de Sociedades Anónimas (Spanish Corporations Act), the appointment of Directors is submitted for decision and approval by the General Shareholders' Meeting. In addition, and in accordance with the Regulations of the Board of Directors of the Company, the proposals for appointment are preceded by the relevant favourable report from the Nominating, Compensation and Corporate Governance Committee.

### Rights and Obligations

The Regulations of the Board of Directors specifically devote title V, comprised of nine articles, to the detailed description of the rights and obligations of Directors. This title sets out the duties arising from the obligations of diligence, fidelity and loyalty of Directors and, in particular, envisages situations of conflict of interest, the duty of confidentiality, the exploitation of business opportunities and the use of corporate assets.

## Telefónica's Board of Directors' Committee<sup>1</sup>

| Board of Directors' Committee                     | Non-executive board members | Executive board members | Nº. of sessions 2005 |
|---|-----------------------------|-------------------------|----------------------|
| Executive Committee                               | 4                           | 4                       | 19                   |
| Audit and Control                                 | 4                           | 0                       | 12                   |
| Nominating, Compensation and Corporate Governance | 4                           | 0                       | 10                   |
| Regulation  | 3                           | 1                       | 9                    |
| Human Resources and Corporate Reputation          | 4                           | 0                       | 5                    |
| Service Quality and Customer Service              | 3                           | 1                       | 4                    |
| International Affairs                             | 5                           | 0                       | 6                    |

<sup>1</sup>May 2006

Furthermore, the Regulations of the Board of Directors also includes the right of Directors to obtain the information and counsel necessary to perform their duties, as well as the establishment of the suitable channels for the exercise of such rights. In this respect, the Company has adopted the measures required to ensure that Directors are furnished in a timely manner with sufficient information specially drawn up to this effect, geared to preparing for the sessions of the Board and its Committees.

In accordance with the Regulations of the Board of Directors, the latter performs an annual evaluation of its performance and quality of its work on the occasion of the approval of the Annual Report on Corporate Governance.

### Remuneration Policy

As regards the remuneration policy for Directors, this policy is proposed, evaluated and reviewed by the Nominating, Compensation and Corporate Governance Committee, always in keeping with criteria of moderation. Currently there is no remuneration system linked to the market price of the company shares or that involves handing over shares or stock options to Board Directors.

On an annual basis, the Company provides information regarding the remuneration received by the Members of the Board of Directors, both in its Annual Report and in the Report on Corporate Governance, in accordance with the criteria established for each of these documents.

## Transparency of the Information for Shareholders

### Regulations for Reporting to Markets

In 2003, The Board of Directors of Telefónica approved the "Regulations on Communication of Information to the Markets", which includes the legal requirements that affect Telefónica derived both from the Spanish law and from international laws applicable to the Company due to its shares being listed on other stock markets. In accordance with these Regulations, the Company disseminates immediately and simultaneously to the markets where it is present all the information that could be considered relevant, and therefore must be communicated to the market.

Likewise, these communications are published on the Company's website.

## Independence of the External Auditor

Among the main competencies of the Audit and Control Committee is to propose to the Board of Directors, for submittal to the General Shareholders' Meeting, the appointment of the Accounts Auditor, as well as the terms and conditions of contract, the scope of the auditor's professional mandate and the renewal or not of their appointment.

The External Auditor has direct access to the Audit and Control Committee, and regularly takes part in its meetings, without the presence of the administrator when necessary.

In line with the legal requirements established by American regulations, the contracting of any service from the External Auditor of the Company must always be previously approved by the Audit and Control Committee. In addition, contracting services other than account auditing must be done in strict compliance with the Spanish Auditing Act and the Sarbanes-Oxley Act published in the United States, and its regulations. In this sense, the amount corresponding to work other than auditing with regard to the total amount invoiced by the auditing firm was 11% in FY 2005.

## Composition of the Board of Directors of Telefónica S.A. and its Committees<sup>1</sup>

|  | Type of Director | Executive Committee | Audit and Control | Nominating Compensation, and Corporate Governance | Human Resources and Corporate Reputation | Regulation | Services Quality and Customer Services | International Affairs |
|--|------------------|---------------------|-------------------|---|--|------------|--|-----------------------|
| César Alierta Izuel (Chairman)                   | ●                | ●                   |                   |   |  |            |  |                       |
| Isidro Fainé Casas (Vice Chairman)               | ●                | ●                   |                   |   |  |            |  |                       |
| Gregorio Villalabeitia Galarraga (Vice Chairman) | ●                | ●                   | ●                 |   |  | ●          |  | ●                     |
| Fernando de Almansa Moreno-Barreda               | ●                |                     |                   |   |  | ●          |  | ●                     |
| David Arculus                                    | ●                |                     |                   |   |  |            |  |                       |
| Maximino Carpio García                           | ●                | ●                   | ●                 | ●   |  |            |  |                       |
| Carlos Colomer Casellas                          | ●                | ●                   |                   |   |  |            | ●                                      |                       |
| Peter Erskine                                    | ●                | ●                   |                   |   |  |            |  |                       |
| Alfonso Ferrari Herrero                          | ●                |                     |                   | ●   | ●  |            |  | ●                     |
| Gonzalo Hinojosa Fernández de Angulo             | ●                |                     | ●                 | ●   |  |            | ●                                      | ●                     |
| Pablo Isla Álvarez de Tejera                     | ●                |                     |                   | ●   | ●  |            |  |                       |
| Luis Lada Díaz                                   | ●                |                     |                   |   |  |            | ●                                      |                       |
| Julio Linares López                              | ●                | ●                   |                   |   |  | ●          |  |                       |
| Antonio Massanell Lavilla                        | ●                |                     | ●                 |   | ●  |            | ●                                      |                       |
| Vitalino Manuel Nafria Aznar                     | ●                |                     |                   |   |  |            |  |                       |
| Enrique Used Aznar                               | ●                |                     |                   |   | ●  | ●          |  | ●                     |
| Mario Eduardo Vázquez                            | ●                |                     |                   |   |  |            |  |                       |
| Antonio Viana-Baptista                           | ●                | ●                   |                   |   |  |            |  |                       |

### Non- member Secretary

|                                      |  |   |   |   |  |   |  |  |
|--------------------------------------|--|---|---|---|--|---|--|--|
| Ramiro Sánchez de Lerín García-Ovies |  | ● | ● | ● |  | ● |  |  |
|--------------------------------------|--|---|---|---|--|---|--|--|

<sup>1</sup> May 2006

- Executive
- Proprietary
- Independent
- Chairman
- Director

## Handbook of Internal Control for Financial Information Reporting

The Sarbanes-Oxley Act affects companies listed on US financial markets and establishes, among their obligations, the need for senior managers of companies to evaluate the internal control systems regarding financial information reporting as a necessary condition for ensuring reliability.

Telefónica has considered this legal requirement as an opportunity for improvement and, far from merely complying with the law, it has fully developed its internal control structures, control mechanisms and applied evaluation procedures.

As a result of this experience, the “Manual de Control Interno para el Reporte de la Información Financiera” (Handbook of Internal Control for Financial Information Reporting) has been published, with three main goals:

- To share the knowledge acquired
- To transmit to the markets Telefónica’s commitment to the development of good corporate governance practices
- To provide an easier understanding of the model developed, with a practical handbook for all its users or users of information reported by Telefónica with reference to its Internal Control Model for Financial Reporting (SEC, rating agencies...)



# Corporate Responsibility

03

“Telefónica sees corporate responsibility as a way of managing its business in relation to all its stakeholder groups.

For Telefónica, It is as important to achieve its goals and financial results as is the way in which those results are achieved”.

|         |   |     |
|---------|---|-----|
| 03   01 | Corporate Responsibility<br>in Telefónica | 94  |
| 03   02 | Driving progress                          | 100 |
| 03   03 | For everyone                              | 108 |

# Telefónica, the power behind progress for all

## Customers

Quality and fulfilment

## Shareholders

Profitability and transparency

## Employees

Clarity and professional development

## Economic Progress

### Customer satisfaction

84% fixed Spain  
73% fixed Argentina  
55% fixed Brazil  
66% fixed Chile  
63% fixed Peru  
>70% mobile LATAM

### Price evolution

Fall of 12% in mobile telephony in Spain in 2005  
5.1% a year fall in fixed telephony in Spain (since 1998)

### Productivity increases

### Investment

>1.5 million shareholders

### Profitability

+76% accumulated profitability 2003-2005  
0.5 € dividend per share

### Results 2005

+40% results  
+24% income  
+17 free cash flow generation

### Employment

207,000 employees  
60,405 Spain  
14,326 Europe  
131,968 LATAM

### Compensation

5.045 billion euros  
147,000 employee with variable salaries

### Pension Plans

94 million € contributed by Telefónica to private plans  
>12% profitability (fonditel)

## Technological Progress

### Innovation

2.9 billion € on innovation in 2005  
533 million € on R&D  
>130 new products

### Operation

2.18% faults in Spain  
4.17% faults in Latam  
95% minimum network efficiency GSM CDMA

### Digital household

150 cities with digital television cover in Spain in December 2005  
(3 in Dec. 2004)

### Shareholder and investor website

1,182,000 visits  
963,000 downloads

### Shareholder helpline

>88,000 queries

### Training

9.3 million hours  
48 training hours per employee  
20% online training  
>43,000 training plans

### Telework

>1,000 teleworkers

### Professional career

350 published vacancies

### Competencies

>78,000 jobs evaluated

## social Progress

### Digital inclusion

5.5 million low income lines in Latin America  
>300,000 social subscribers in Spain

### Telefónica Accessible

>30 services for the disabled

### Service responsibility

### Responsible investment

48.1 million euros invested by Fonditel in responsible funds (1.01% of total)



### Working practices

142,000 employees in collective agreements

### Work auditing

26 companies audited in 2004  
4 companies audited in 2005

### Integration

1,079 disabled employees  
49.3% women  
21.8% female managers

### Contracting

85.4% payroll with permanent or indefinite contract

## Society

Contribution and proximity

### Economic impact

(% TEF income on GDP)

2.2% Spain  
1.3% Argentina  
1.1% Brazil  
1.8% Chile  
2.1% Peru  
1.6% Venezuela

### Public Administrations

8,511 billion € paid in 2005

### Digital inclusion ADSL coverage

97.3% Spain,  
89.5% Argentina, 96.8% Brazil,  
96.5% Chile, 97.0% Peru

### Mobile coverage

99% Spain,  
92% Argentina, 95% Chile  
76% Ecuador, 69% Mexico  
62% Peru, 93% Venezuela

### Public services

≈700,000 boxes

### Social action

>54 million € invested

### Fundación Telefónica

763 projects  
31,000 participating entities  
41 million participants

### Internet training

>5,000 schools  
connected in Chile

### Telefónica Accessible

Manual of accessible  
communication in  
collaboration with CERMI

## Suppliers

Equal opportunities  
and mutual benefit

### Purchases

>13 billion €  
>18,000 awarded suppliers  
>42,000 suppliers in catalogue

### Local suppliers

90% awarded suppliers  
85% volume adjudicated

### Supplier satisfaction

67.5% overall satisfaction

### Online purchasing

>8 billion € adjudicated  
>20,000 online purchasing  
processes

### Online auctions

685 million € adjudicated  
948 purchasing processes

### Joint innovation

5,000 people collaborate  
with Telefónica

### Ethical standards in the supply chain

90% of suppliers support  
them (survey)

### Compliance with payment times

98% invoices  
96% amount  
(data for Spain)

## Environment

Respect and protection

### Investments

District C: largest rooftop  
solar power producing park  
in Europe (21.5 million €)  
(16,600 solar panels)

### Support to environmental organisations

10 NGOs receive support  
from Telefónica

### Environmental impact of ICT

12 studies in 2005

### Internal training

3,348 employees trained  
in 2005

### Infrastructure development

Agreement with the  
Federation of Municipalities  
for the development of the  
Information Society

### Global environmental management

13 countries share the  
regulation of minimum  
environmental  
requirements

### Training in society

Social training on  
electromagnetic emissions

## Media

Information and  
transparency

### Advertising investment

47% television  
19% press  
18% exterior  
10% radio

### Online press room

176,000 sessions in 2005  
(82,000 in 2004)

### Product information

42% press notes  
on products

### Transparency

Telefónica, the company  
with the best information  
in social action\*

1º Telefónica: 746 points  
2º Classified: 496 points  
3º Classified: 465 points

\*Fundación Empresa  
y Sociedad

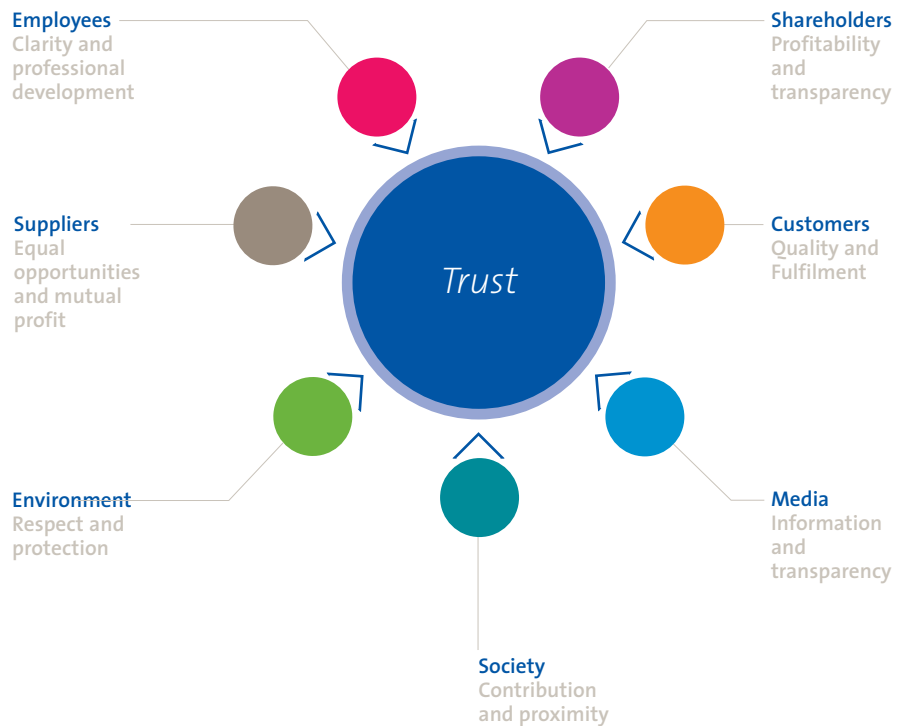






# Values & Code of Ethics

## Telefónica's Values



## Values

Telefónica's goal is, for its customers, employees, suppliers, shareholders and companies in the countries where it operates, to place their trust in its ability to fulfil the commitments it makes.

Telefónica knows that trust cannot simply be expected, but is rather earned on a daily basis, by making the right commitments and fulfilling them, demonstrating that it is capable of delivering the goals it sets itself. Telefónica seeks to achieve this through an attitude of understanding towards the needs of its stakeholders; through constantly improving everything it does; accepting the responsibilities that come with leadership, and through being committed to respecting transparency, integrity and ethics.

## Code of Ethics

In July 2005, the Board of Directors of Telefónica approved a Code of Ethics that must be observed by the employees of the Telefónica Group in their daily activities. Grupo Telefónica Móviles already had a Code of Ethics, on the same terms as that of the Code approved.

In 2005 Telefónica Móviles celebrated the first anniversary of the creation of its Ethics Committees. Including both the activities of the operators' Corporate Committee and Ethics Committees, the total number of cases dealt with during 2005 was 306. Even if -the classification of the cases can sometimes be subjective, the cases related to behaviour, regarding the attitude of bosses or relationships between colleagues, favouritism and working harassment were the most common issues dealt with by the Committees, representing 44.9% of the total.

During 2006 one of the key aims of the Group is to consolidate the implementation of this code across the entire Telefónica Group, as well as to align O2's "Business Principles" and Telefónica's Code of Ethics.

## Anti-corruption and Bribe

Telefónica has expressed institutionally, in its Code of Ethics approved by the Board of Directors, communicated to its employees and published for the knowledge of its different stakeholder groups, its firm commitment to act in accordance with applicable national and international laws and regulations and, under no circumstance, resort to or tolerate bribes of third parties to the Company or its employees, or vice versa. Likewise,

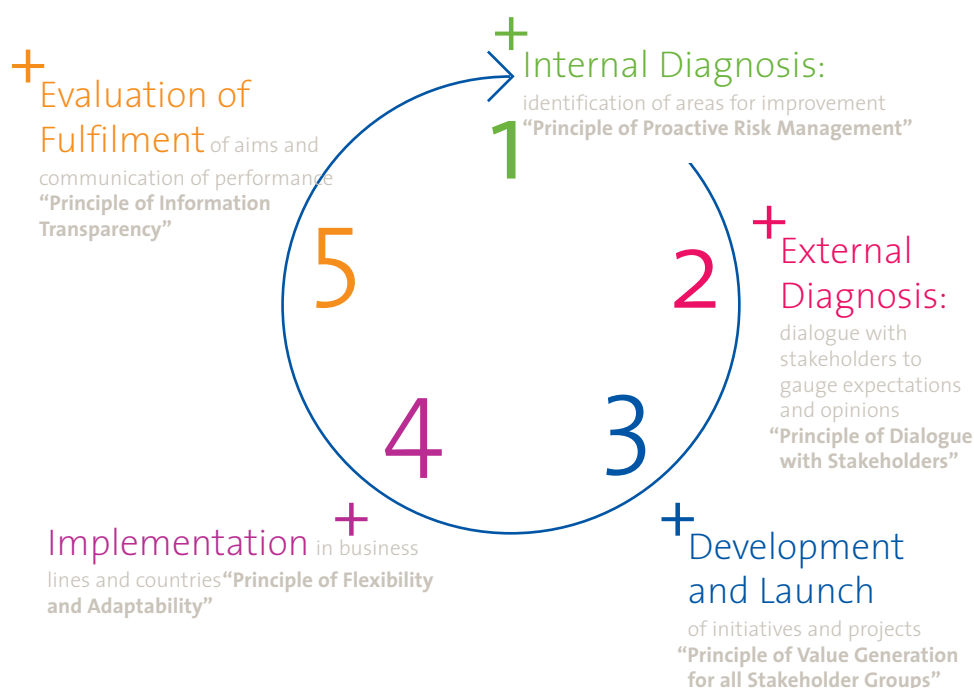
the Code includes the obligation of its employees to reject and not offer bribes, including gifts which, due to their value, could result in subsequent obligations.

The Group also has reporting channels that guarantee the confidentiality of the reporter and has established rules for his/her protection. In addition, the Group's internal regulations establish controls for the processes that link decision-making and fund releasing that provide reasonable certainty that no manager or employee may, unilaterally, make undue payments or, should payments of this sort be made, that they will be detected in time.

It should be noted that there are no conclusions in the Inspection reports prepared by the Group that suggest the existence of payments to political parties, bribes or payments to people or companies that could act as intermediaries to provide funds to political parties or candidates.

# Corporate Responsibility

## Corporate responsibility management model in Telefónica



## Strategic Goal

Telefónica has included in its Strategic Map the goal of being perceived as a committed and responsible leader by society in general and its stakeholders in particular. The associated monitoring indicators are:

- Evaluations carried out by analysts and observers of corporate responsibility.
- Public surveys with regard to society's perception of Telefónica, using the corporate reputation model RepTrack, developed by the Reputation Institute in collaboration with the Corporate Reputation Forum.

## Organisation of Corporate Responsibility in Telefónica

Corporate Responsibility management at Telefónica is the competency of the Subdirector General of Corporate Reputation, Brand and Social Responsibility, part of the Directorate General of Corporate Communication.

This unit works with the collaboration of the different corporate management areas in charge of stakeholder relations, the Business Units of the Group and the countries where the Company operates.

For the supervision of corporate social responsibility issues, Telefónica S.A.'s Board of Directors has a Committee made up by four non-executive board members: the Human Resources and Corporate Reputation Committee, a supervisory and control body that is informed every two months of the most relevant aspects related to corporate reputation and its evolution, corporate responsibility and the behaviour of Telefónica with regard to the demands of its stakeholders.

## Management Model

The management of Corporate Responsibility at Telefónica is based on five principles structured in phases that, together, make up a management cycle geared to continuous improvement. This management model (described in the Full Report) seeks a balance between the economic growth of the business and meeting the expectations of all its stakeholders.

Corporate Responsibility management should answer to a process of continuous improvement, by virtue of which a prior diagnosis is made both of the risks related to corporate responsibility and the expectations of the stakeholders. On this basis, the company establishes policies and actions for improvement that adapt to the

specifics of each business lines and country. When evaluating the degree of fulfilment of aims and communicating it to the stakeholders, a new cycle is initiated in such a way that the entire process is repeated periodically over time.

## Dialogue

During 2005, Telefónica has made significant progress in its dialogue with stakeholders, through their participation in the methodology debate and the application of four case studies. Through these dialogue processes, the Company seeks to achieve a double aim:

- That the stakeholders can influence the development of the business aims and projects undertaken by Telefónica, expressing their needs to the Company, as well as their perception.
- That the actions and projects put into practice by Telefónica are in line with the expectations of their stakeholders, are well focused, and create value.

# Milestones and Challenges

## in Corporate Responsibility

### 1 Corporate Responsibility

#### 2 Code of Ethics

#### 3 Corporate Reputation

#### 4 Brand

|   |  |  |
|---|--|--|
| 1 | Inclusion of the goal to be a "committed and responsible leader" in Telefónica's Strategic Map | Coordinate the CR strategy with O2   |
|   | Publication of Reports on Country Corporate Responsibility (Argentina, Brazil, Chile, Peru)    | Auditing of CR Report in accordance with norm AA1000/AS in the countries                     |
|   | Pilot projects for dialogue with stakeholders in Spain   | Pilot projects for dialogue with stakeholders LATAM 2006                                     |
|   | Studies regarding the impact of telecommunications on sustainable development                  |  |
| 2 | Approval of Code of Ethics for the Telefónica Group  | Implementation of the Code of Ethics in the Telefónica Group                                 |
|   | Implementation of the Code of Ethics in Telefónica Móviles                                     | Alignment with O2's Business Principles  |
| 3 | Start up of RepTrack as a measurement tool   | Improve perception of Telefónica in the weakest dimensions by 5% in Latin American countries |
|   | Identification of reputational risk factors  | Implementation of Corporate Model of reputation risk management                              |
| 4 | Establishment of the Telefónica Brand Model  | Alignment of Telefónica and O2 Brand Models  |
|   | Global launch of movistar, commercial brand of Mobile Telephony                                | Launch of a commercial brand for the digital home  |
|   | Milestone  | Challenge 2006   |

#### 5 Customers

|   |   |  |
|---|---|--|
| 5 | Consistent customer satisfaction measurement systems for TdE, TISA and Telefónica Móviles España  | Establishment of consistent customer satisfaction measurement systems for Telefónica Móviles LATAM |
|   | Projects for the improvement of assistance by solving the customer's problem in the first contact | Customer Defence Service in Spain  |
|   | Advances in ISO 9001 certification  | Advances in ISO 9001 certification   |
|   | Policy of Acceptable Use of Internet Service  | Implement Policy of Acceptable Use of Internet Service   |
|   | Adult Content Management Regulations  | Implement Adult Content Management Regulations   |
|   | Customer guide explaining the basics of mobile telephony  | Customer guide explaining the basics of mobile telephony for LATAM 2006 customers                  |
|   |   | Games Management Regulations as contents   |

## Main Awards and Recognition to Telefónica's Corporate Responsibility

### 1. Recognition for Corporate Responsibility projects in Spain

- Empresa y Sociedad Award to the Best International Social Action.
- Best social action, according to a survey by the Empresa y Sociedad Foundation to 275 experts.

### 2. Recognition for Corporate Responsibility projects in Latin America

- Most significant social work 2005 award (Spanish Chamber of Commerce of the Republic of Argentina).
- Fundación Codespa Award to Corporate Solidarity.

### 3. Corporate Responsibility Communication

- European Environment Award in the category of Communication for Sustainable Development: Awarded by the Entorno Foundation.
- Telefónica leads the social responsibility study of the annual reports of the Ibex 35 companies (CSR Observatory).

### 4. Responsible Investment



## 6 Employees

|  |  |
|--|--|
| 6 Increase employee satisfaction by over 5%  | Increase employee satisfaction by over 5%  |
| Worldwide publication of vacancies in Intranet in order to encourage professional development and internal rotation                      | Personalised development plan for all employees  |
| Regulation for control of occupational risks in the contracting of works and services (as a preventive measure following the 2004 audit) | 3rd and last phase of the social audit of the Telefónica Group   |
|  | Homogenisation of management procedures for Health and Safety in the Group   |
| Over 75% of employees evaluated by competencies  | Development of model of Corporate University   |
|  | Homogenisation of the social benefits for the Group's Management   |
|  | New ways of working: dynamic office, mobile work; Policy for the Reconciliation between private and professional life.                       |
|  | Corporate Policy for the Integration of People with Disabilities in accordance with the LISMI Law (Law for the Social Integration of People) |
| Over 75% of employees evaluated by competencies  | Launch of Internal Communication Plan LATAM 2006   |

## 7 Society

## 8 Environment

## 9 Suppliers

|  |   |
|--|---|
| 7 Strategic review of the working areas of Fundación Telefónica (educared, proniño, forum, volunteers) | Promotion of the Corporate Volunteer Projects   |
| "Telefónica Accesible" Project (Spain 2005)  | "Telefónica Accesible" Project (2 countries in LATAM in 2006)                           |
|  | Promotion of "Digital Inclusion" Project in LATAM                                       |
| 8 Implementation of Norm "Minimum Environmental Requirements"  | Implementation of the Norm "Minimum Environmental Requirements". A step in each company |
|  | Improvement of waste management systems in LATAM  |
| Programmes of paper consumption efficiency   | Internal Regulations for environmental management and control                           |
|  | Creation of Environment Committees per country  |
|  | Publication of an Environmental Policy for the Telefónica Group                         |
| 9 Supplier satisfaction survey   | Responsible purchasing policy of the Telefónica Group                                   |
| Increase of online contracting   | Purchasing policy for social suppliers  |
| Participation in the Supply Chain Group of the GeSI  | Participation in the Supply Chain Group of the GeSI                                     |











## Driving Progress

Economic  
Technological  
Social

## Driving economic development

**Impact of the Activity on the Economy**  
Telefónica, as one of the leading national companies in each of the countries where it operates, assumes its role as a driving force behind the national economy. In 2005, Telefónica has become a more regional company, as a result of its commitment to investment and to adapting to the needs of each of the markets where it operates. This regional character is reflected in the distribution of its revenue; 48% of its revenue in 2005 is from countries other than Spain (40% in 2004).

### Distribution of Income

Telefónica Group plays an important role in redistributing wealth among all its stakeholders: approximately 45% is redistributed among its suppliers; 16% goes to the various Public Administrations and 8% is devoted to the financial remuneration of its over 207,000 employees worldwide.

### Evolution of Rates

One of the issues Telefónica's customers are most concerned about is the evolution of the rates associated with the services they buy. Rate reduction provides consumers with higher purchasing power and has an anti-inflation impact on society.

In Spain, communications are the only component of the CPI consumption basket where there has been a constant reduction of rates since the year 2000. In addition, in Latin America, fixed telephony rates in recent years have evolved at a considerably slower pace than the CPI.

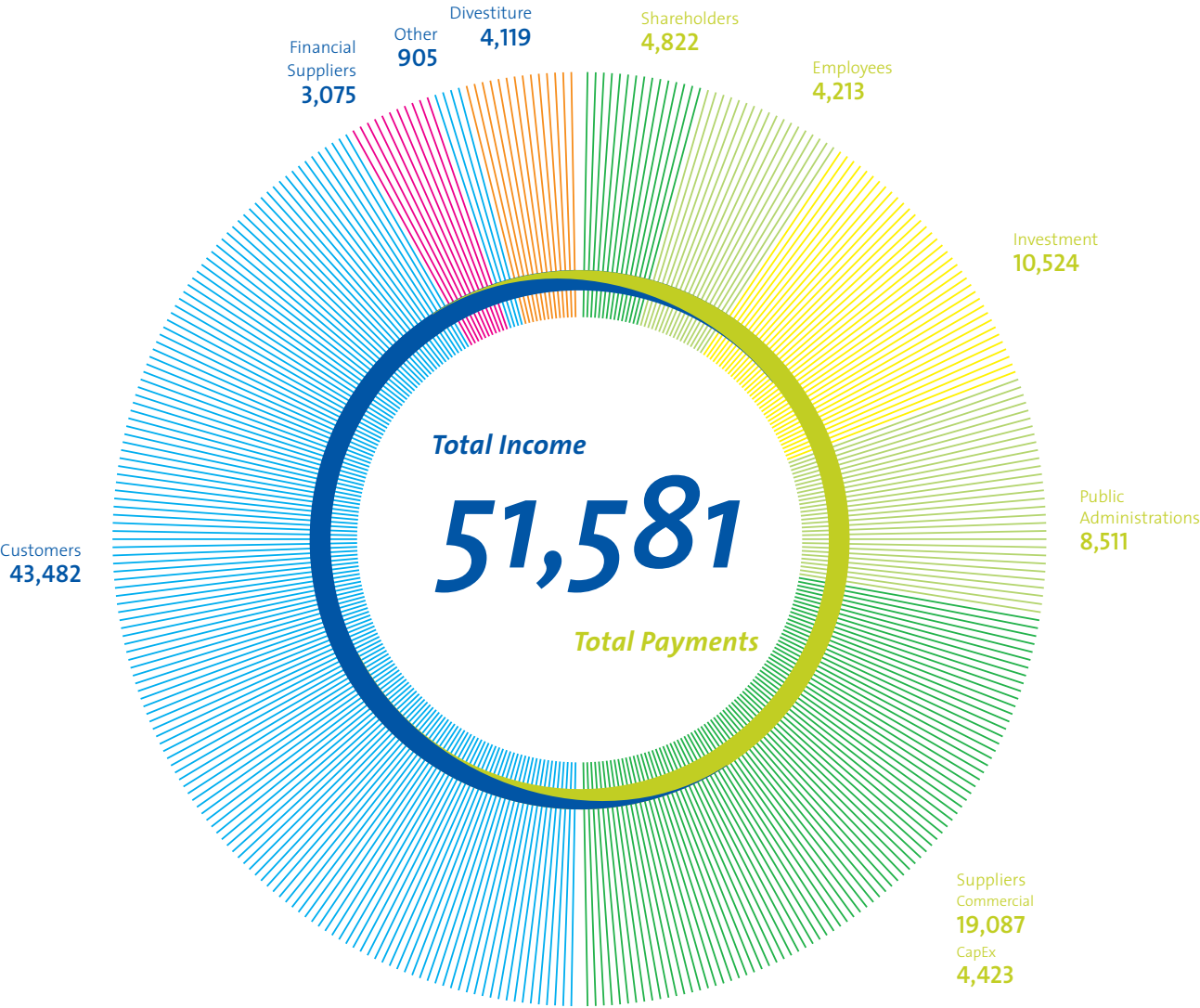
### Impact on productivity

The adoption and use of Information and Communication Technologies (ICTs) on behalf of companies seems to have a positive impact on productivity and economic growth in general. This is due to the fact that these technologies have brought opportunities for the development of new business, and the improvement of existing business processes. The possibility of reducing costs, the efficient use of resources and the possibility of increasing markets have contributed to citizens benefiting from products of increasing quality at lower prices.

# Redistribution of income

These pages are intended to provide a summary of the contribution of Telefónica’s economic activity to society. By studying the distribution of the economic flows in which the Telefónica Group intervenes, the effect of redistribution among its suppliers, employees, the public administration, credit institutions, shareholders and clients.

## Redistribution of income



Present in 19 countries

Income of 37.8821  
billion euros

&gt;1.5 million shareholders

54 million € in social and cultural action

154 million accesses

18,000 suppliers

207,000 employees

2.9 billion euros  
in innovation

## Driving economic development

**Colombia**

|                                  |       |
|----------------------------------|-------|
| % TEF revenue:                   | 2.1   |
| % TEF revenue/GDP:               | 0.8   |
| CAPEX 2005 <sup>1</sup> :        | 275.4 |
| Taxes paid <sup>1</sup> :        | 111   |
| Thousand accesses <sup>2</sup> : | 6,036 |
| Employees:                       | 4,487 |
| Suppliers:                       | 1,272 |
| % awarded to local suppliers:    | 36.9  |

**Venezuela**

|                                  |       |
|----------------------------------|-------|
| % TEF revenue:                   | 3.8   |
| % TEF revenue/GDP:               | 1.6   |
| CAPEX 2005 <sup>1</sup> :        | 1478  |
| Taxes paid <sup>1</sup> :        | 358   |
| Thousand accesses <sup>2</sup> : | 6,160 |
| Employees:                       | 5,983 |
| Suppliers:                       | 1,102 |
| % awarded to local suppliers:    | 51.4  |

**Mexico**

|                                  |       |
|----------------------------------|-------|
| % TEF revenue:                   | 2.3   |
| % TEF revenue/GDP:               | 0.1   |
| CAPEX 2005 <sup>1</sup> :        | 266.7 |
| Taxes paid <sup>1</sup> :        |       |
| Thousand accesses <sup>2</sup> : | 6,371 |
| Employees:                       | 8,506 |
| Suppliers:                       | 590   |
| % awarded to local suppliers:    | 95.8  |

\*During 2005 Telefónica received a tax rebate

**Peru**

|                                  |        |
|----------------------------------|--------|
| % TEF revenue:                   | 3.4    |
| % TEF revenue/GDP:               | 2.1    |
| CAPEX 2005 <sup>1</sup> :        | 175.3  |
| Taxes paid <sup>1</sup> :        | 399    |
| Thousand accesses <sup>2</sup> : | 6,668  |
| Employees:                       | 11,548 |
| Suppliers:                       | 2,338  |
| % awarded to local suppliers:    | 83.4   |

**Chile**

|                                  |        |
|----------------------------------|--------|
| % TEF revenue:                   | 4.2    |
| % TEF revenue/GDP:               | 1.8    |
| CAPEX 2005 <sup>1</sup> :        | 310.7  |
| Taxes paid <sup>1</sup> :        | 265    |
| Thousand accesses <sup>2</sup> : | 8,189  |
| Employees:                       | 12,375 |
| Suppliers:                       | 1,693  |
| % awarded to local suppliers:    | 74.3   |

**Brazil**

|                                  |         |
|----------------------------------|---------|
| % TEF revenue:                   | 18.2    |
| % TEF revenue/GDP:               | 1.1     |
| CAPEX 2005 <sup>1</sup> :        | 1,068.4 |
| Taxes paid <sup>1</sup> :        | 2,894   |
| Thousand accesses <sup>2</sup> : | 46,406  |
| Employees:                       | 63,743  |
| Suppliers:                       | 2,161   |
| % awarded to local suppliers:    | 98.8    |

**Argentina**

|                                  |        |
|----------------------------------|--------|
| % TEF revenue:                   | 5.2    |
| % TEF revenue/GDP:               | 1.3    |
| CAPEX 2005 <sup>1</sup> :        | 260.4  |
| Taxes paid <sup>1</sup> :        | 450    |
| Thousand accesses <sup>2</sup> : | 13,769 |
| Employees:                       | 18,856 |
| Suppliers:                       | 1,514  |
| % awarded to local suppliers:    | 83.4   |

(1) Million euros

(2) Fixed + mobile + DSL + TV

The information published on this page has been obtained from internal cash flow evolution sources of Telefónica Group, and verified by the auditor of this report. The mentioned data could be subject to variations as a result of subsequent events and evolutionary effects that could cause changes in their content.

This information has been consolidated on an accrual basis, whereas the redistribution of income has been calculated on a cash basis.

For a detailed analysis of the consolidated financial statements of Telefónica Group, the audited information is included in the annual accounts report.

Countries representing over 2% of Telefónica's revenues are included. Telefónica revenues in each country are taken as the country's contribution to Telefónica Group's consolidated revenue.

**Country**

**% TEF revenues:** Percentage contributed by the country to Telefónica's revenues, calculated on the basis of the contribution to Group's consolidated revenue. (%).

**% TEF revenues/GDP:** Ratio of Telefónica's revenues (contribution of the country to the consolidated revenues of Telefónica Group) and the estimated GDP for the country. (%).

**CAPEX 2005:** Consolidated investment in country by Telefónica in the Financial Year (millions of euros).

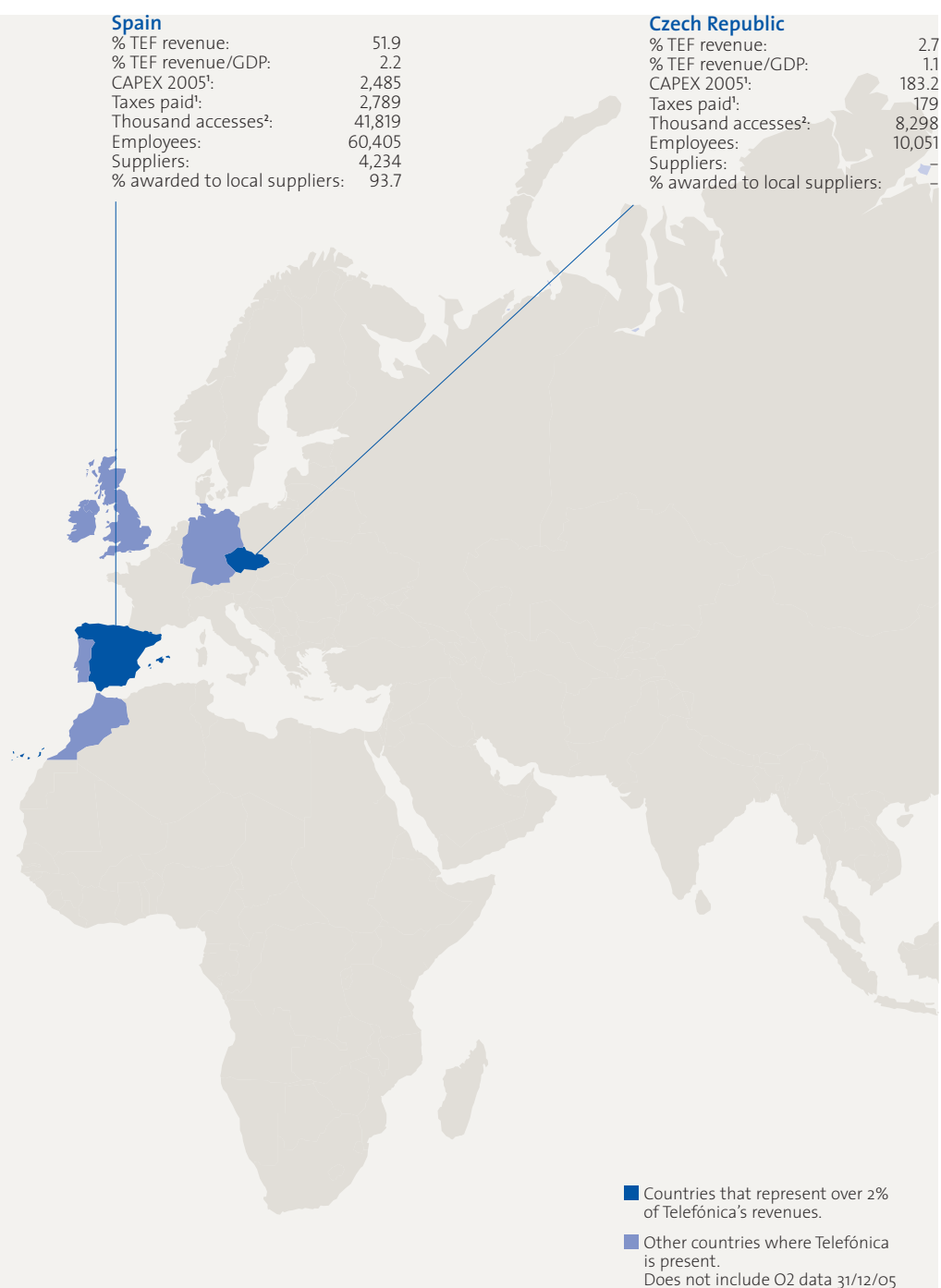
**Taxes Paid:** Taxed paid in the country during the financial year (millions of euros).

**Thousand accesses:** Number of fixed + mobile + DSL + Pay TV accesses (thousands).

**Employees:** Direct employees of Telefónica Group in the country (as at December, 31, 2005)

**Suppliers:** Suppliers awarded contracts in the country in 2005.

**% of contracts awarded to local suppliers:** percentage of contracts awarded to suppliers with registered address in the country with regard to total number of contract awards, based on awarding volume.



# Driving Technological Development

## Information Society

The key to the promotion of the Information Society lies in managing to transform its potential benefits into actual benefits for its users. To achieve this, together with the development of basic infrastructure and significant efforts in terms of studies, meetings and publications, Telefónica develops, in collaboration with other companies, services geared to improving productivity of the different business sectors and Public Administrations. These actions are classified in the following categories:

- Home and citizen inclusion
- Competitiveness and innovations
- Education in the digital era
- Digital public services
- Digital context

## Innovation

For Telefónica, innovation constitutes the key to the development of the information society. To innovate is to transform ideas into profitable products and services that provide value for the customer.

In 2005, Telefónica earmarked 2.9 billion, following OECD criteria, for technological innovation. This is a 20.9% increase with regard to the previous financial year, mainly due to the incorporation of the new businesses in Latin America and the Czech Republic. 45% of this investment went 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.

Telefónica believes that in order to achieve better positioning in an increasingly complex

market, innovation cannot only be based on technology acquisition. It is essential that the research and development activities become the axis and focus for the rest of innovation activities in order to guarantee competitive advantages. During 2005, R&D investment rose 15.6% with regard to the previous year, reaching 311 million euros in Spain and over 533 million euros worldwide. The latter figure is equivalent to 1.41 % of Telefónica's total revenues.

Telefónica generates employment for over 6,800 people in the field of technological innovation, with over 1,800 professionals in companies belonging to Telefónica Group and 5,000 employees at partner companies. The Portfolio of Proprietary Products of Telefónica includes 3,055 patents, models and industrial designs.

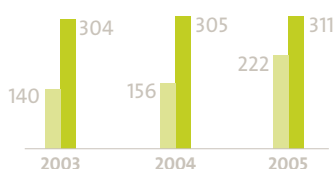
## Telefónica I+D

Its mission is to contribute to increasing Telefónica's competitiveness by means of technological innovation, keeping in mind that the R&D results must always be transferable to customers. In 2005, Telefónica I+D worked on 1,800 projects (1,660 in 2004), devoting its work to developing products, services and processes for Telefónica's businesses, as well as to applied research.

### R&D distribution by country

Millions of euros

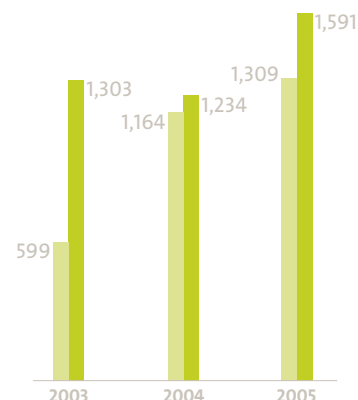
- R&D Spain
- R&D other countries



### Distribution of Innovation by country

Millions of euros

- Innovation Spain
- Innovation other countries



## Collaboration with the University Sector

Telefónica is aware of the importance of the need to be in contact with all the players that take part in the process. That is why the promotion of the relationship between Universities and Businesses is a priority goal for Telefónica. The initiatives launched by Telefónica in this field support both basic research and applied research, encourage the training of future professionals, and generally aid the expansion of new technologies throughout the country's economy.

In Spain, Telefónica Group carried out over 100 initiatives in 2005 with Universities and Business Schools and awarded 1,100 grants to students from different Universities across the country. The financial investment of the Telefónica Group aimed at supporting University training programmes exceeded eight million euros in the last financial year.

The Telefónica Chair programme has been up and running since 2001, and in its fifth year, the activity has continued its consolidation process. In 2005, the financial year was closed with 12 Telefónica Chairs and 2 master courses at different Spanish universities.

## Institutional Collaboration

Telefónica collaborates with prestigious and recognised associations and bodies worldwide, contributing to the development of technology standards and the professionalisation of the businesses. The main associations and forums with which Telefónica participates actively are those related to telecommunications, mainly in the regions where the company operates (Spain, Latin America and Europe).

# Driving Social Development:

## Telecommunications and Sustainable Development

Telecommunications have always had a leading role in the development of new models of relations between people and within companies. In addition, and increasingly, they are gaining protagonism in the reduction of the consumption of environmental resources in business activities, and in the social inclusion of people through digital inclusion initiatives. For all this to become a reality it is necessary to increase awareness in society that these positive impacts are larger than the cost of overcoming the barriers for their implementation or than the sum of their negative collateral impacts.

For more information, the complete studies can be found at [www.telefonica.es/corporate-responsibility](http://www.telefonica.es/corporate-responsibility)

|  | Positive Aspects   | Implementation Barriers   |
|--|--|---|
| Use of energy in the digital society                         | <ul style="list-style-type: none"> <li>Energetic efficiency of the networks</li> <li>Effect of replacing transport with telecommunications</li> <li>Use of ICTs as a means of creating awareness with regard to energy savings</li> </ul>  | <ul style="list-style-type: none"> <li>Production and use of electronic equipment</li> <li>Consumption of equipment in stand-by mode</li> <li>Energy consumption of network operators</li> </ul>  |
| Digital Home   | <ul style="list-style-type: none"> <li>Improvement in quality of life</li> <li>Improvement of home health assistance</li> <li>Improved home security</li> <li>Increased leisure opportunities</li> </ul>   | <ul style="list-style-type: none"> <li>Power consumption</li> <li>Investments by citizens</li> </ul>  |
| Electronic Administration                                    | <ul style="list-style-type: none"> <li>Speed, comfort and flexibility</li> <li>Simplification of bureaucracy</li> <li>Closer approach to the citizens and higher citizen participation</li> <li>Higher efficiency in bureaucracy procedures</li> <li>Reduction of errors and increased efficiency</li> </ul>               | <ul style="list-style-type: none"> <li>Need for connectivity</li> <li>Usability and accessibility</li> <li>Lack of experience and training</li> <li>Security and lack of trust</li> <li>Investments by the administration</li> </ul>  |
| Telecommunications at the service of emergencies             | <ul style="list-style-type: none"> <li>Prevention and early warning</li> <li>Warning systems for citizens and speed of response</li> <li>Help for coordination tasks</li> <li>Mobilisation and channelling of humanitarian aid</li> </ul>  | <ul style="list-style-type: none"> <li>Vulnerability of telecommunication systems</li> <li>Dependence on geographic and social-economic setting</li> </ul>  |
| Telecommunications and inclusion of people with disabilities | <ul style="list-style-type: none"> <li>Universal access to information</li> <li>Improved opportunities (study, work...)</li> <li>Solutions for integration of hearing, speech, sight, physical, intellectual, aging disabilities</li> </ul>  | <ul style="list-style-type: none"> <li>Design "for everyone" by manufacturers and service developers</li> <li>Implementation difficulties</li> <li>Cost of adaptation of services</li> </ul>  |
| Distance Learning  | <ul style="list-style-type: none"> <li>More educational resources for existing students</li> <li>Taking education to excluded groups (rural areas people with disabilities, areas in conflict...)</li> <li>Improve education in developing countries</li> <li>More flexibility and wider reach for universities</li> </ul> | <ul style="list-style-type: none"> <li>Need for equipment and infrastructure (investment required)</li> <li>Lack of motivation among students</li> <li>Lack of training of teachers</li> <li>"Life-long" training</li> </ul>  |
| Use of paper in the digital society                          | <ul style="list-style-type: none"> <li>Efficiency in work place</li> <li>Mobility and collaboration</li> <li>Administrative procedures without paper</li> <li>Dematerialisation (commercial transactions, online publications, email, learning...)</li> </ul>  | <ul style="list-style-type: none"> <li>Bad printing habits</li> <li>Implementation difficulties for the electronic signature</li> <li>Tired eyes due to reading on screen</li> <li>Need for new equipment and technologies</li> </ul>   |
| Electronic Commerce Applied to Tourism                       | <ul style="list-style-type: none"> <li>Lower travel prices for tourists</li> <li>Increased information regarding tourist destinations</li> <li>Opportunities for regional development</li> </ul>   | <ul style="list-style-type: none"> <li>Lack of trust in the security of electronic purchase processes</li> <li>Increase of greenhouse gas emissions (due to increase in travel)</li> <li>Improved adaptation to traveller's needs</li> </ul>                                      |
| New technologies at the service of health                    | <ul style="list-style-type: none"> <li>Improved emergency management (early diagnosis and preparation)</li> <li>Improved diagnosis and training of health professionals</li> <li>Improved hospital management</li> <li>Patient attention where-ever and whenever it is needed</li> </ul>                                   | <ul style="list-style-type: none"> <li>Heavy initial investment in equipment and training</li> <li>Interoperability problems between health centres</li> <li>Adaptation of health staff to new technologies</li> <li>Lack of trust in the security of personal details</li> </ul> |









## Customers

Customers  
Shareholders  
Employees  
Society  
Environment  
Suppliers  
Media

### Markets

#### Evolution of the global market

In 2005, Telefónica has experienced a strong growth in total number of accesses (+24,3% year-on-year), led by the increase of mobile telephony customers and broadband accesses, closing FY 2005 with 153,5 million accesses. Including customers of O2, whose acquisition materialised in 2006, Telefónica Group's customer base rises to 180.9 million.

#### Fixed Telephony in Spain

In Spain, Telefónica de España has an estimated market share of 85% in fixed telephony accesses, of 65% in voice traffic and 55% in retail accesses to broadband Internet.

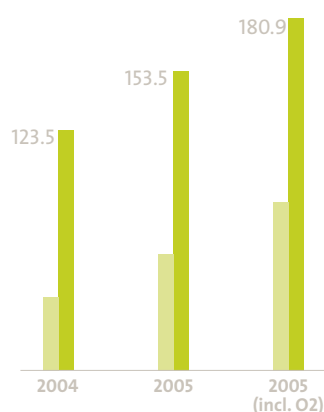
Telefónica de España fulfils 12 of the 16 quality goals established by the regulating authorities. According to a study carried out by the Department of State, Telefónica de España offers better average quality than the other alternative operators in the thirteen parameters measured.

In 2005, Telefónica de España faced different sanction proceedings, related to Telefónica de España's actions as the dominating operator, as is detailed in the Full Report.

## Total accesses of Telefónica Group

Millions

■ Mobile  
■ Fixed+ ADSL



## Fixed Telephony in Latin America

Telefónica offers fixed telephony services in Argentina, Brazil (Sao Paulo State), Chile and Peru, under the strict supervision of quality levels offered by the regulatory bodies.

- During FY 2005, TeleSP signed the renewal of its concession contract, undertaking to comply with the new terms and conditions established therein.
- Telefónica del Peru is in the process of renewing its concession contract, the regulatory body having recognised in its report that the company has a high degree of fulfilment of the aims in 18 of the 24 goals established.
- In Argentina, operations are taking place in a context of growing activity and consumption, and within the framework of frozen rates.
- In Chile there is an important claim against Telefónica before the Competition Court.

## Mobile Telephony

Mobile telephony markets are characterised by a higher degree of competitiveness in almost all markets, reflected in the fact that Telefónica's market shares are lower than in the case of fixed telephony. In Spain, Telefónica Móviles' market share is approximately at 50% of the total number of accesses.

The different operators also comply with the different conditions established by the regulatory authorities. Specifically, Telefónica Móviles España ranked first for four of the six parameters in the study on mobile telephony service quality in Spain, carried out by the Ministry of Industry, Tourism and Commerce.

Of the relevant legal claims initiated during 2005 against Telefónica Móviles SA, eleven were related to national regulations on the provision of telecommunications services.

Quality and  
fulfilment

## Critical customer relations processes



## Customer relations

Telefónica's aim is to optimise the satisfaction of its customers. Within this effort to increase customer-orientation, the motivation and persuasion of the professionals and employees of the Company is essential. This is the aim of the programmes "Compromiso Cliente" (Customer Commitment) in Telefónica Latinoamérica and "meta:cliente" (target: customer) of Telefónica de España.

In its customer relations, Telefónica pays special attention to:

## Qualitative Research

Telefónica holds an open dialogue with many consumers and users associations, some of them specialised in the field of new technologies. In the case of Spain, Telefónica actively collaborates with a total of 16 associations, 12 of them national and 4 of them regional.

In Latin America, Telefónica has consolidated permanent dialogue channels with the various consumer associations.

For Telefónica, these relationships are of great value, as they allow the company to transfer to the customers, in the form of improvements in the products and services offered, many of the suggestions received from these associations. During 2005, issues such as irregular pre-selection, rounding off practices in the telephony sector, Internet access quality and new DSL offers and packages, among others, were discussed.

## Critical customer relations processes

## Marketing

In 2005, Telefónica geared its customer strategy towards marketing products adapted to their needs. Some of the initiatives developed to this aim are:

- Free duplication of speed for DSL service, the combined offers Dúo and Trío, and the DSL solutions.
- Provide customers with terminals and applications in order that they may benefit from the better functionalities and broadband access of the new mobile networks.

With regard to the number of commercial outlets, Telefónica Group offers its services both through its own outlets (104 Telefónica de España outlets, 124 TeleSP outlets, 51 Telefónica de Argentina outlets and 815 Telefónica Móviles outlets worldwide) and through indirect sales channels (over 30,000 Telefónica Móviles sales points and 2,500 Telefónica de España sales points).

It is worth drawing attention to the efforts made by Telefónica (especially by Telefónica Móviles España) in terms of promoting customer loyalty. In 2005, the movistar points programme registered 4.5 million handset upgrades.

## Provision of service

In 2005, Telefónica de España installed more than 1,100,000 telephone lines and fulfilled its installation commitment established by the clients in 99.17% of the cases. The average time for installation of a line is under 10 days (9.68 days).

In Latin America, Telefónica strives to carry out the line installations within the shortest time possible, adapting to customer expectations, and reached an average installation time of 5.67 days in 2005 (6.84 in 2004).

In Spain in 2005, Telefónica de España installed more than one million ADSL lines, with an average installation time of 11.53 days (9.8 in 2004).

In Latin America, the average time for installation of broadband services for the residential segment, as at December, 2005, was 5.53 days (4.8 in 2004).

## Operation

All the companies of the Grupo Telefónica Móviles keep a constant control on quality by means of a series of indicators that allow them to verify the state of their networks and services periodically.

The internal value of effectiveness of the GSM and CDMA networks of Telefónica Móviles worldwide reached 95%, including the operations incorporated into the Group in 2005.

During FY 2005, the average number of breakdowns per 100 basic telephony lines was 2.18 for Telefónica de España (2.07 in 2004). As to Latin America, the percentage of breakdowns for basic telephony for 2005 was 4.17%, compared to 4.49% in the previous year.

One of the issues identified as one of the main concerns of our customers is the breakdowns ratio. That is why Telefónica International intends to measure the percentage of reoccurring breakdowns in the region. In December 2004, this percentage was 19.4% (23.11% in 2004).



## Customer satisfaction with Telefónica

Data in percentages

|                                     | Fixed telephony<br>Residential segment |      | Mobile telephony |      |
|-------------------------------------|--|------|------------------|------|
|                                     | 2005                                   | 2004 | 2005             | 2004 |
| Spain                               | 84                                     | 81   |                  |      |
| Argentina                           | 73                                     | 68   |                  |      |
| Brazil                              | 55                                     | 51   |                  |      |
| Chile                               | 66                                     | 61   |                  |      |
| Peru                                | 63                                     | 58   |                  |      |
| Global España                       |  |      | –                | 86   |
| Contract Lationamérica <sup>1</sup> |  |      | –                | 70   |
| Prepaid Lationamérica <sup>1</sup>  |  |      | –                | 78   |

<sup>1</sup> Calculated on a weighted basis with regard to number of customers per country. Data for Mexico and Uruguay has not been included, as no studies of these characteristics and methodology were available.

In June 2005, the Association of Internet Users published its third study on Internet access speed, in which Telefónica's DSL service was found the quickest and most reliable compared to the rest of DSL and cable operators, with a speed up to 32% higher than the alternative operators.

### Billing

Claims regarding Telefónica de España bills in 4Q2005 reached 3.48 per thousand, with the objective value established by the regulator being 5 per thousand.

In 2005, Telefónica Latinoamérica achieved a percentage of claims regarding basic telephony bills of 1.28% (1.59% in 2004). The percentage of these claims resulting in adjustments in favour of the customer was 65.47% for this region.

Claims regarding Telefónica Móviles España bills in 4Q 2005 reached 1.655 per thousand.

### Customer Service

Telephone is the most widely used means for Telefónica customers to communicate with the Company and formulate their queries, requests and claims, as is evident from the fact that it attended over 600 million calls in 2005.

The aim of the Telefónica Customer Service Centres is to effectively address customer demands in the shortest possible time and during the first contact. Customers gave Telefónica de España's service a mark of 6.77 (over 10), when asked to rate the service efficiency at the end of their conversation with the operator.

### Technical Support

The average time for resolving faults in a basic telephone line in Spain was 16 hours in 2005, the same average as in 2004. In Latin America, the average was 42 hours (42.75 in 2004).

The average time to solve problems with ADSL lines in Spain was 14.15 hours (10.36 in 2004). In the case of ADSL in Latin America, the average time for solving problems was 21.8 hours (19.45 in 2004).

## Customer Satisfaction

Customer satisfaction is Telefónica Group's main objective and the central axis of its whole strategy. In order to follow the evolution of this satisfaction and to verify the effectiveness of the different measures adopted by Telefónica, the companies of the Group perform periodical monitoring of the levels of satisfaction through surveys.

### Prioritisation of the critical points for improvement

The critical points for improvement are determined on the basis of the relative importance given to each process by customers and on Telefónica's qualification with regard to the competition.

The main points where Telefónica must continue working on in order to adapt to the needs of its customers are sales and customer service.

### Implementation of the projects for improving service quality

The aim is to achieve significant improvements in customer perception of the quality offered in the different processes of the Company's action towards customers. Telefónica de España has 250 improvement initiatives in course, and Telefónica Latinoamérica has over 150. One of the most widespread methodologies in the Telefónica Group is Six Sigma.

## Certification

The achievement of quality certifications enables the company to subject their internal operational systems to the evaluation by independent external bodies, who apply standardised international regulations.

- Telefónica de España has a Quality System implemented and certified since 2001, applicable in all processes across the organisation and in all territories where the Company operates.
- Telefónica Latinoamérica made significant progress in the certification of its quality processes under the ISO 9001 standard. These certification processes in the region involved more than 5,000 professionals of the Group.
- Telefónica Móviles is also moving forward in the process of certifying its processes in all countries of Latin America where it has operations.



Despite the innumerable advantages that Internet offers its users, it can also present certain threats. The global extension of the networks makes it possible for users to suffer external attacks such as spam, intrusion, attacks on intellectual property, unsuitable contents, child pornography, fraud, phishing, abuse...

## Responsibility in service provision

### Internet Abuse

Telefónica believes it must co-operate with its customers in the protection against such abuse. In March 2004, Telefónica set up a corporate initiative to co-ordinate the policies and processes used in detecting and resolving IP incidents in the networks. In 2005, the Company developed and approved the “Policy of Acceptable Use of Internet Services” and the “Obligations of the Companies of the Telefónica Group related to the Management of Abuse in Internet services”.

In addition to regulating the use of the Internet, Telefónica’s collaboration in this field includes advice to customers with regard to Internet use, claim procedures and offers of tools and services for the protection of customers’ equipment.

### Data Protection

The regulations and procedures of Telefónica’s companies to protect customers’ personal information establish that information be provided only to the owner of the line, and that requests related to the service be processed only when directly instructed by the owner of the line to do so. The request for information regarding customers made by third parties is allowed exclusively under court authorisation or under authorisation of the relevant authorities in the country.

The Full Report provides details of the claims and proceedings against Telefónica presented before the Data Protection Agencies.

### Intellectual Property Protection

Telefónica expresses its full support to promote the licit use of contents in the Information Society and its unequivocal rejection of criminal acts or infringement of third party rights through digital networks. In this sense, during 2005, it has participated in governmental and industrial initiatives in Spain, in addition to include a specific chapter on intellectual property protection in its “Policy of Acceptable Use”.

### Child Protection

During 2005, Telefónica led several initiatives for the awareness of good use of the Internet on behalf of children at schools and meetings with teachers and parents, in coordination with the “Defensor del Menor” (Child Protection Agency).

The HR and Corporate Reputation Committee of the Board of Directors of Telefónica reported favourably on the Regulations for Adult Content Management drafted by the Telefónica Group in 2005. These regulations establish several controls for the offer of content to minors, which were already being established in different service packages such as a CanguroNet (“BabysitterNet”) or PlayPack (Mobile Telephony).

In addition, in 2005 Telefónica took several measures against the exhibition of child pornography, resulting in a 99% reduction of this type of crime, according to Spanish authorities.

### Theft of Handsets

During 2005, the Telefónica Móviles operators have continued its work within the programme for the control of handset theft. The processing of handset blocking requests is carried out through an application that validates the IMEI/MSISDN identities and, if authenticated, the handset is blocked for all national operators who share these agreements. In Spain, the total number of stolen handsets reported exceeded half a million, and in 18.5% of cases, the handsets were blocked by the system.

### Promotion of responsible use by customers

Despite significant social consensus with regard to the positive impact of new technologies on society, telecommunications are having a considerable effect on people’s lifestyles, occasionally causing negative impacts. This negative impact tends to be associated with the bad use of mobile telephony, particularly in public spaces such as cinemas, theatres, churches, conferences, academic contexts, etc. In spite of growing social awareness, many drivers combine the activities of speaking on their mobile phones and driving, with the subsequent risks to their own physical integrity, and that of others.

For this reason, several Telefónica Móviles operators have made communication efforts geared towards sensitising their customers with regard to the use of technology. To this aim, in Spain, Chile, Nicaragua, Colombia and Peru, the company has developed campaigns via the Internet, publication of leaflets, advertising, and inserts with bills.



## Profitability and transparency

### Profitability per share 2003-2005

|  | Nº shares | Net amount euros |
|--|-----------|------------------|
| Value of 100 shares at January 1 2003    | 100       | 853.00           |
| Cash dividend (total) during 2003 - 2005 |           | 129.55           |
| Value of 108 shares as at 2006           | 108       | 1,372.68         |
| <b>Return</b>                            |           | <b>76.11%</b>    |

(The 100 shares of 2003 were increased by 8 shares during 2003-2005).

## Shareholders

### Profitability

Telefónica's shareholder remuneration policy has continued advancing in 2005, positioning the Company as one of the most attractive in the sector, even more so since the purchase of O2. In 2005, a dividend was paid corresponding to financial year 2004 of 0.5 ¢/share, own shares of Telefónica S.A. representing 4% of equity have been distributed in the proportion 1x25, and the share buyback programme has continued.

Despite the trend seen in the stock market in 2005 that affected the whole Telecommunications sector, the year has seen a total accumulated profit of almost 76% for a shareholder who invested in Telefónica on January 1, 2003.

### Transparency

In 1997, Telefónica set up its Shareholder Attention Service with a view to establishing transparent and fluid communication with individual shareholders. Currently a total of 194,784 shareholders are registered with this service, and receive all the Telefónica Group information, both results and any other Company news that may be relevant for their investment.

The Investor Relations Department is responsible for the communication with the financial markets and institutional investors.

### Shareholders' and investors' web page

The number of visits to the web page of Shareholders and Investors rose to 1,182,729, an estimated increase of 150% compared to the previous year's figure.

### Shareholder Information line

Telefónica has a free Shareholder information line that answered 88,251 queries in 2005. As well as the calls to the free shareholder information line, it also dealt with 3,139 email and/or postal queries.

### Annual Report

The axis of communication with analysts and investors is the Annual Report, which, in 2005 received more than 20,000 queries through the website and 300,000 file downloads, as well as its print edition of more than 18,000 copies. All the annual reports published by Telefónica, since its foundation in 1924, are available on its website.

### "Acción Telefónica" magazine

The physical means of regularly communicating with registered shareholders is the quarterly Telefónica shareholders' magazine, called Acción Telefónica. In 2005, 165,000 copies were sent quarterly to their homes.

### General Shareholders' Meeting

The 2005 General Shareholders' Meeting was held on May 31, and the quorum of attendance represented 59.163% of the share capital.

The shareholders are supported by the Shareholders' Office in all issues related to the Shareholders' General Meeting.

Telefónica has  
1,570,039 shareholders  
(April 3 2006)

## Clarity and professional development

# Employees

## Description of workforce

Telefónica closed FY 2005 with a staff of 207,641 employees, a 19% increase with regard to the previous year:

- 85.4% has a permanent contract.
- 4.3% are international executives and managers.
- 37.2% devoted to sales activities, 48.3% to production activities and 14.4% to support activities (Atento not included).
- 47% of women in the Group.
- Average of 73 years in company.
- Average age of 32.7.

Among the most relevant events is the continuation of the Workforce Adjustment Plan in Telefónica de España. The Plan is governed by the principles of freedom of decision, universality and non-discrimination. During 2005, a total of 1,945 employees requested their adhesion to the plan, which add to the 7,906 requests for severance accumulated up to 2004

## Work Climate

In 2005, 66 companies took part in the survey (19 more than in 2004), with a participation rate of 71% (ten points above the 2004 rate). For 2005, the goal was to increase the Global Satisfaction Index by 5%, and this goal has been surpassed, the index having increased by 7.11% (3.91 percentage points, from 55% to 58.91%).

## Compensation

Personnel expenses in the Telefónica Group in 2005 totalled 5.045 billion euros (4.411 billion euros in 2004). From this total, salary package expenses accounted for 78%. In addition, Telefónica has invested 611.2 million euros in staff reorganisation.

During 2005, both for fixed and variable salary, the Telefónica Group established a common remuneration framework for all its management staff. For the general Telefónica workforce, compensation conditions for employees are described in the different collective bargaining agreements in force. At the close of 2005, over 142,700 employees in the Telefónica Group had their status regulated on the basis of collective bargaining agreements (120,000 in 2004).

Over 147,000 employees (105,000 in 2004) have a variable salary scheme based on the fulfilment of individual, company and group targets.

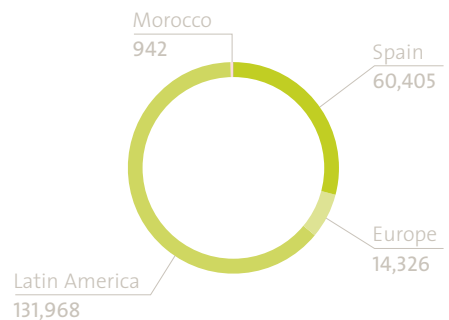
## Professional Development

### Rotation within the Group

Through the publication of all vacant positions on its intranet, Telefónica aims to inform all Group employees of the professional opportunities which exist in the different companies of the Group. The first phase of the project started in March 2005 and, since then, over 350 vacancies in the Group have been published. This tool is available for the publication of management and non management vacancies.

## Workforce by region

Data in number of employees



Rotation of managers offers opportunities for professional development to employees, as internal candidates are given priority for vacancies in management positions. During FY 2005, 171 managers rotated internally (12% of the total) and 54 have left Telefónica (4% of the total).

Professionals in Telefónica Group received over nine million hours of training in 2005, representing a 5% increase. By business lines, Atento stands out with over five and a half million hours of training for its employees. Considering the Telefónica Group without including Atento, absolute growth in training hours was around 15%.

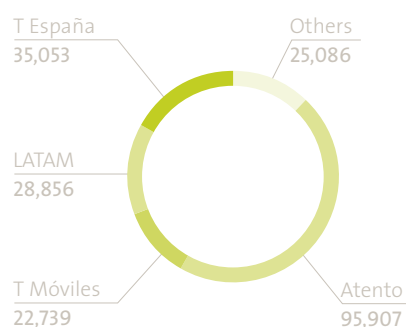
Telefónica has kept up its commitment in recent years to distance training. In 2005, professionals from the Telefónica Group (excluding Atento) carried out 20% of their training via online tools.

## Competencies

In 2005, all companies of the Telefónica Group participated in an assessment which involved, at least, self assessment and the assessment of their bosses. The results of this evaluation enabled the identification of areas for improvement for each employee and the appropriate actions to be carried out each year. During 2005, over 78,361 employees from the Telefónica Group were assessed on the basis of their skills, implying a consolidation of the model compared to the 68,677 in 2004 and the 35,758 in 2003.

## Workforce per business unit

Figures in number of employees



## Professionals and Persons

The departments of the Telefónica Group develop different initiatives aimed at guaranteeing human rights, equal opportunities, the reconciliation of private and professional life and maximum health and safety protection.

### Human Rights

Continuing the process initiated in FY 2004, during 2005, labour audits have been carried out at Telefónica companies in order to ensure compliance with applicable labour law, basic human resources policies and procedures, as well as to identify, evaluate and correct any workplace contingencies.

As a corrective measure on a corporate level, in February 2005 the Company approved a joint corporate instruction (audit and human resources), with criteria for actions geared to controlling occupational risks in the contracting of works and services. The challenge for 2006 is to complete the third and last phase of the labour audit in Telefónica.

### Freedom of Association

Freedom of association is a right of Telefónica's employees, as is shown by the more than 45,000 employees with trade union affiliation. By company, those with the largest number of affiliated personnel are Telefónica de España with 15,876, Telefónica Latinoamérica with 13,227 and Atento with 7,579. By country, the countries with the highest number of affiliated personnel are Spain, with 16,246, Argentina with 12,275 and Chile with 3,957 affiliated employees.

## Hours of training per employee and company 2005

Average no. of hours

|             | Management | Middle management | Rest |
|-------------|------------|-------------------|------|
| Fixed Spain | 46         | 187               | 44   |
| Fixed LATAM | 29         | 69                | 32   |
| Mobile      | 54         | 38                | 39   |
| Directories | 27         | 67                | 30   |
| t-Gestiona  | 21         | 57                | 31   |
| Others      | 13         | 12                | 7    |
| Atento      | –          | –                 | 64   |

In this respect, the agreement signed in July 2003 between the company and the majority trade labour unions proved efficient during the 2005 financial year.

Social dialogue and collective bargaining are irreplaceable instruments for labour relations management and governance, as well as for enabling collective bargaining to adapt to the changes occurring at the companies. Its sound functioning is clearly evidenced by the meetings held periodically between the parties.

### Equal Opportunities

On average, 49.32% of Telefónica Group's staff is comprised of women, an increase compared to the average of 48% in FY 2004. By business Line, Atento stands out for its high degree of integration of women in the Company, with 67%, whereas the fixed telephony companies have the lowest percentage of women. Without taking into account Atento, the percentage of women in the company is 33%. With regard to management, there are more than 1,700 women in management and middle management positions, representing 21.83% of the total.

Currently, 1,079 professionals with disabilities work for Telefónica Group, amounting to 0.54% of its staff worldwide. The number of employees is 9.6% higher to that of 2004, in spite of new regulations in Brazil that have raised the requirements for a person to be considered a professional with disabilities. Within its global plan of support to people with disabilities (Telefónica Accesible), the Company is developing a series of measures geared towards favouring the integration of people with disabilities into their workforce.

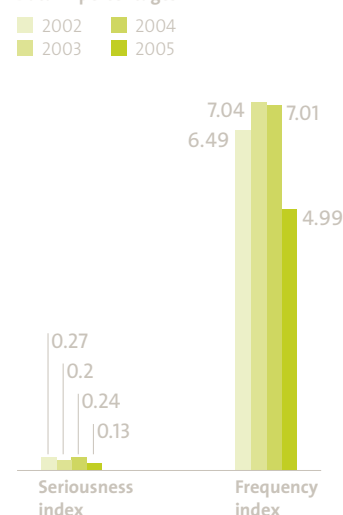
## Health and Safety

The commitment to health and safety in Spain is structured through the Joint Service for Occupational Risk Prevention, in lines of action geared towards maintaining and increasing Risk Prevention.

The rest of the countries apply different health and safety management policies, always in accordance with the legislation in force. During 2006, Telefónica Group has set itself the aim of standardising certain procedures in its health and safety management worldwide.

### Occupational accidents in Spain

Data in percentages



## Contribution and proximity

## Society

### Digital inclusion

#### Geographical divide

##### Spain

Telefónica de España's investment has led to an increase in the already substantial ADSL coverage to 96% of lines and 97% of homes, bringing Spain closer to total broadband accessibility. FY 2005 has been decisive for extending the offer of digital television from only three Spanish cities in 2004 to more than 150 cities across the country.

Telefónica de España is replacing the TRAC technology used to offer services in rural areas with other different technologies (LMDS, GSM/GPRS, satellite or, especially, copper), for which, up to December 2005, it has invested a total of 146.24 million euros. Accesses for provinces included in the European Commission "Objective 1" programme receive European subsidies to aid implementation (31 million euros in ERDF funds).

Telefónica Móviles was one of the two operators to subscribe, together with the Ministry of Industry, the Plan for the Extension of Mobile Telephony, which will place Spain at the head of European countries with regard to mobile telephony coverage, with 99% of its territory covered. The plan, linked to the concession of GSM 900 MHz frequency band (June 2005), includes a joint investment of 833 million euros.

##### Latin America

Telefónica's investment in Latin America to promote broadband is reflected in the digitalisation of the telephony network, which reaches 100% in Argentina, Brazil and Chile, and 97% in Peru. This network digitalisation has made it possible to reach high coverage of broadband services over

Digital technology itself is not the cause behind the digital divide: differing levels of telecommunications infrastructure, income and technological literacy are the main factors that lead to the divide.

In 2005, Telefónica joined the initiative Connect the World, launched by the International Telecommunications Union (ITU).

the fixed telephony network, reaching 97% in Sao Paulo (Brazil, TeleSP), Peru (TdP) and Chile (CTC), and 89.5% in Argentina (TASA).

Telefónica del Peru has launched the Llaqt@red project, to integrate the rural areas of the country and offer them access to information, satisfying the needs and expectations of its citizens. The first stage of the plan integrated 17 villages, providing permanent Internet access, for a flat rate.

In Latin America, Telefónica Móviles has reinforced its position as the main operator in the region, extending its coverage in all countries where it operates.

#### Mobile telephony coverage in Latin America

| Coverage / population (%) | 2005 |
|---------------------------|------|
| Argentina                 | 92   |
| Chile                     | 95.7 |
| Colombia                  | 68   |
| Ecuador                   | 76.1 |
| El Salvador               | 77.4 |
| Guatemala                 | 56   |
| Mexico                    | 69   |
| Nicaragua                 | 25   |
| Panama                    | -    |
| Peru                      | 61.6 |
| Uruguay                   | 80   |
| Venezuela                 | 93.3 |

Internal source

#### Economic divide

It is important that the products and services offered are adapted to the social and economic context of the different countries and address the needs of the sectors of population that, for economic reasons, do not have access to telecommunications services.

#### Rates for low income households in Latin America

In Latin America, growth of basic telephony services among low income households depends on the development and offer of products adapted to their needs and disposable income.

The over 5.5 million pre-paid and controlled consumption lines in Latin America account for over 25% of the network. When this percentage is compared with the income generated by the lines, and with the income generated from the sale of pre-paid cards, it is evident that this type of service is offering a real alternative to the lower-income sectors of society.

#### Public telephones

Public telephones are another alternative to home lines, making access to communications easier for all members of society, without the need to pay a connection or maintenance fee.

#### Public terminals, Latin America

| Thousands          | 2003 | 2004 | 2005 |
|--------------------|------|------|------|
| Argentina          | 107  | 105  | 121  |
| Sao Paulo (Brazil) | 327  | 331  | 330  |
| Peru               | 118  | 129  | 137  |
| Chile              | 33   | 28   | 24   |

Internal source

## Prepaid and controlled consumption lines in Latin America

Thousands of points of access

|                                 | 2004         | 2005         | % of total lines <sup>5</sup> |
|---------------------------------|--------------|--------------|-------------------------------|
| Brazil                          | 1,945        | 2,294        | 18.60                         |
| Argentina <sup>2</sup>          | 1,200        | 1,328        | 29.30                         |
| Chile <sup>3</sup>              | 409          | 534          | 21.90                         |
| Peru <sup>4</sup>               | 1,157        | 1,385        | 58.90                         |
| <b>Telefónica International</b> | <b>4,720</b> | <b>5,541</b> | <b>25.60</b>                  |

<sup>1</sup> Includes Economía Line.

<sup>2</sup> Includes Control, Cero and Recupero lines.

<sup>3</sup> Includes Económica, Supereconómica, Full Variable, Línea control, Plan Solución.

<sup>4</sup> Includes Fonofácil plus, Popular, Usage limit, Línea Social...

<sup>5</sup> The calculation includes public telephones.

## Contribution to the Universal Service

In Spain, Telefónica de España is assuming the net cost of the provision of a Universal Service, which in addition to including the telephone service, also comprises a series of obligations of a predominantly social character, such as the Abono Social (social plan) or certain special services for people with disabilities; a telephone information service at an affordable price (free from telephone booths); the creation of a free telephone guide for users and a sufficiently extensive offer of public phone booths in public spaces.

The net cost of the obligations of the Universal Service in 2004 amounted to 131 million euros according to Telefónica de España.

The Comisión de Mercado de Telecomunicaciones (CMT, Telecommunications Market Commission) has not yet established the final Net Cost to Telefónica in 2004. The net cost does not include the total cost which the compliance of these obligations implies for Telefónica de España. Thus, for methodology reasons established by the CMT, losses associated to the maintenance of 18,949 booths in places where their use does not cover the cost of maintenance – amounting to 62 million euros – are compensated.

In Latin America, Telefónica's companies collaborate with the different public initiatives for the universalisation of the service, with a contribution to the universalisation funds exceeding 65 million euros in 2005.

## Mobile telephony

In general terms, the prepaid system and low cost of SMS messaging have been decisive for the extension of cellular mobile telephony to all social strata, as seen in the figures relating to the use of these services.

The commercial offer that was launched together with the new unified brand included a wide range of products, making it easy for any type of client to have access to mobile telephony.

Telefónica Móviles Peru studied different alternatives to make mobile telephony more accessible to the lower income segments of population. The cost of handsets was identified as the main barrier. Through the project Rentas Bajas (Low Incomes), different plans have been analysed, as well as non-traditional distribution channels, special plans for calls originating in low income areas, as well as the creation of virtual voice-mail services to receive messages, with the possibility of purchasing the handset at a later date, and keeping the same telephone number.

## Abono Social (Social Plan)

Telefónica de España has created Abono Social (Social Plan) with the aim of providing easier access to basic telecommunications services in Spain. The number of lines benefiting from the Abono Social plan in Spain as at December 2005 was 327,243 (386,430 in 2004).

## Education-Training divide

Technological barriers are not the only cause for the digital divide. There are educational and background barriers which can be more divisive than technological barriers, especially in developing countries and among elderly or disabled communities. Telefónica, in collaboration with Fundación Telefónica, carries out programmes aimed at educating society in the use of new technologies.

Telefónica collaborates with different regulatory bodies and organisations that seek to bring new technologies to society as a whole. In this sense, Telefónica Group's advertising strategy in Peru is interesting in that it presents specific applications and services which transform people's lives, under the slogan "sin darnos cuenta, la vida se nos ha hecho más fácil" (without realising, life just got easier).

In the case of Chile, with "Internet en las Escuelas" (Internet at School), there are 3,435 schools with broadband access and 2,265 schools with dial-up connections. In 2005, Telefónica Chile's contribution in terms of non-realizable income was equivalent to US\$3.6 million.

Telefónica promotes the use of technologies in schools in every country where it operates. "EducaRed" on an international scale, "Huascarán" in Peru or "Escuelas y Ciudadanía" in Mexico are other examples of this commitment, aimed at educating primary and secondary school students of private and public schools in the use of the Internet.



## Telefónica's investment in social and cultural action

In thousands of euros

|   | 2005          | 2004          | 2003          |
|---|---------------|---------------|---------------|
| Fundación Telefónica <sup>1</sup>           | 28,999        | 25,011        | 23,447        |
| ATAM <sup>1</sup>                           | 9,069         | 8,983         | 9,111         |
| Other social and cultural action programmes | 16,045        | 12,500        | 14,271        |
| <b>Total</b>                                | <b>54,113</b> | <b>46,494</b> | <b>46,829</b> |

<sup>1</sup> Contribution of Telefónica to Fundación Telefónica and ATAM's budgets.

## Charity work

### Fundación Telefónica

Fundación Telefónica carries out different projects in collaboration with social organisations in Spain, Argentina, Brazil, Chile, Morocco, Mexico and Peru. For Fundación Telefónica, the application of new technologies is the key to improving educational processes, paying special attention to disadvantaged children.

During financial year 2005, Fundación Telefónica has completed a process of strategic review of its activity. As from 2006 it will concentrate its activities on the support of education, the social integration of children in Latin America, the promotion of the knowledge society and the management of corporate volunteer programmes.

Fundación Telefónica spent 29 million euros on 763 projects. These activities have had the backing of 489 collaborating bodies, to the benefit of more than 31,000 organisations and more than 41.5 million people. 69% of these beneficiaries are people who accessed contents, services or social information through the Internet, which reflects the role of new technologies as a driving force for social development.

The main aim of EducaRed is to contribute to improving the quality of education and to encourage equal opportunities by applying new technologies to teaching and learning processes. In Spain, Argentina, Brazil, Chile and Peru, EducaRed has made available to primary and secondary education the most advanced educational technology in terms of uses, applications, exchange of knowledge and advanced

information searching. These tools have brought pupils, teachers and researchers from the Latin American context together in virtual communities.

The Proniño programme was created in 2001 by the mobile telephony operators in Latin America, with the aim of contributing to the elimination of child labour in the region. In 2005, the programme was incorporated into the strategy of Fundación Telefónica, which runs the project in collaboration with Telefónica Móviles. In 2005, over 11,500 children have benefited from the programme.

Detailed information on the projects developed by Fundación Telefónica can be found in the Fundación Telefónica Annual Report 2005 or at [www.fundacion.telefonica.com](http://www.fundacion.telefonica.com).

### ATAM

ATAM (Asociación Telefónica de Asistencia a Personas Discapacitadas – Telefónica Association for the Assistance of the Disabled persons) is largely funded by voluntary contributions of approximately 61,000 employees from 22 companies of the Telefónica Group. The workers contribute 2 per thousand of their basic salaries and the companies double the contribution. The amounts provided to ATAM by all the companies of the Telefónica Group in 2005 reached 9,069,072 euros, directly benefiting around 4,000 people.

Details of its activity can be found on the web page [www.atam.es](http://www.atam.es).

### Other social and cultural action projects

The companies of Telefónica Group carry out different social and cultural action projects that complement the activities of Fundación Telefónica.

During 2005, a total of 16 million euros was devoted to projects of this kind.

### Social action reach Fundación Telefónica

|   |        |
|---|--------|
| Number of people (workforce)                              | 70     |
| Number of projects  | 763    |
| Number of collaborating organisations                     | 489    |
| Number of benefiting organisations                        | 31,108 |
| Number of people benefiting via Internet (thousands)      | 28,707 |
| Number of people benefiting in other contexts (thousands) | 12,891 |

In 2004, Telefónica set up the Telefónica Accesible (Accessible Telefónica) programme as a global project for people with disabilities. The aim of this programme is to make Telefónica a Group that is fully accessible in all its processes and to actively promote equal opportunities for people with disabilities.

## Telefónica Accesible®

### Collaboration

For the development of the Telefónica Accesible Global Plan, Telefónica signed an agreement of collaboration with the Spanish Committee of Representatives of People with Disabilities (CERMI), the platform that brings together the main associations for the disabled and their families, representing the needs of this population of 3.5 million Spaniards and their families. By virtue of this Agreement, people with disabilities and their representatives participate in the different initiatives, projects and actions carried out by Telefónica Group, expressing their opinion, approving the contents and advising the company.

### Awareness-raising

The Telefónica Accesible plan includes actions aimed at raising awareness in society with regard to the needs and concerns of people with disabilities. In this sense, Telefónica Group makes available to disabled people its social network and its channels of communication with the stakeholders, that reach a large part of the societies in which it is present. During 2005, various activities have been promoted and carried out, including the creation of a “Handbook of Communication for All”.

### Products and services

In setting up Telefónica Accesible, the Telefónica Group has contributed to improving everyone's quality of life, especially that of disabled people, by providing telecommunications for all. Telefónica works constantly to improve the accessibility of its processes, products and services, and with them, encourage the inclusion of disabled people in society and in the workplace.

Telefónica Móviles España has published the “Catalogue of mobile services for social integration”, including more than 30 services already in operation aimed at aiding social inclusion and improving the quality of life of people with disabilities, elderly people, victims of domestic violence, people with health problems and foreign residents in Spain.

Under the Design for All concept, Telefónica de España has developed products that enable all kinds of users to have access to fixed telephony and broadband services.

Telefónica Soluciones provides information on the accessibility of products through the Observatory of Accessibility to New Technologies, and has developed several solutions which make access to computers and communication easier for people with disabilities.

### Workplace Integration

The Telefónica Group meets the legal requirement established by the LISMI (Disabled Persons Social Integration Act) of reserving two per cent of its staff positions for people with disabilities. In addition, together with ATAM and other companies of the Telefónica Group, it is promoting policies for the integration of disabled people in the workplace such as mercadis, special employment centres in Atento, or the existence of special employment centres with ATAM.

### [www.telefonica.es/accesible](http://www.telefonica.es/accesible)

Telefónica has developed the “Telefónica Accesible” portal, [www.telefonica.es/accesible](http://www.telefonica.es/accesible), as a tool available to society showing the activities carried out by the Telefónica Group towards the integration of the disabled community, as well as anything that may be of interest to this community and their families, such as a training and legislation centre, sector-related news, or access to specialised publications.



### ATAM

ATAM is the main reference for issues regarding disability for all the Group's companies, as a specialised association within the sector. The details of its activity can be found on its web page [www.atam.es](http://www.atam.es).



## Contribution and proximity

# Environment

### Environmental commitment

Telefónica views its commitment to the environment as an essential part of corporate responsibility. In 2002, Telefónica Group signed the United Nations Global Compact, thereby undertaking as part of the principles of this pact to: adopt a preventive approach, encourage environmental responsibility and the development of environmentally friendly technologies. The Group also takes part in several international initiatives aimed at promoting Sustainable Development, such as GeSI or the ETNO sustainability group.

Likewise, various companies of the Telefónica Group have established specific environmental policies and commitments. Telefónica has established the aim of approving a corporate environmental policy in 2006.

### Environmental Management

Under the internal regulations for the "Minimum Environmental Requirements", Telefónica aims to make progress in environmental management with a common methodology throughout the Group, ensuring behaviour that is environmentally responsible. To facilitate compliance with the regulations, 5 steps have been established, based on commitment, application requirements, improvement of behaviour, implementation of systems and certification.

1

#### Environmental commitment

Communication of the environmental commitment, preliminary evaluation, environmental indicators, awareness-raising and training

2

#### Identifying legal requirements

Identification, monitoring and compliance with the environmental requirements applicable to the organisation

3

#### Follow-up and measuring

Identifying and evaluating environmental aspects, establishing objectives and establishing operational controls

4

#### Improving behaviour

Defining responsibilities, generating plans and records, documenting processes resulting from environmental management, establishing channels of communication, capacity to react to emergencies

5

#### SGMA Certification

Audits to verify the degree of implementation, management system for any deviations detected

There is a follow-up programme in place to monitor the implementation of the internal environmental regulations in each of the Group's companies, with the aim of ensuring their correct implementation. Country Environment Committees will be set up throughout 2006 to make implementation easier.

The training and sensitisation of personnel is one of the necessary conditions for ensuring correct environmental management. During the course of 2005, 3,348 professionals in the Telefónica Group received training in environmental issues.

In addition to managing the environmental impact of its own operations, Telefónica also contributes to the promotion of responsible practices throughout its supply chain. For this reason, environmental clauses obliging the fulfilment of environmental legislation and particularly of legislation related to waste management are now being included in contracts between Telefónica and its suppliers.

## Most relevant environmental aspects for telecommunications companies

|  | Fixed telephony | Mobile telephony |
|--|-----------------|------------------|
| Electromagnetic emissions  |                 | ●                |
| Visual impact  |                 | ●                |
| Energy consumption   | ●               | ●                |
| Lead batteries waste   | ●               | ●                |
| Noise from electromagnetic equipment and/or air conditioning equipment | ●               | ●                |
| Discharges from generators   | ●               | ●                |
| Consumption of poles   | ●               |                  |

### Monitoring and follow-up of environmental aspects

Throughout 2005, the majority of Telefónica's fixed and mobile telephony operators carried out a preliminary environmental diagnosis with the aim of identifying the environmental aspects that are relevant to their activity, in order to monitor and control these aspects.

#### Electromagnetic emissions

The companies of the Telefónica Group take on a double role:

- Firstly, to ensure that the levels of electromagnetic emissions comply with all international regulations and guidelines. In 2005, a total of 6,900 mobile telephony sites and 44 radio electric infrastructure sites for fixed telephony networks were measured. The number of measurements increased by 32% compared to 2004. It is important to point out that in 100% of the measurements taken, existing regulations were complied with by a broad margin.
- Secondly, Telefónica holds a regular dialogue with its different stakeholder groups, providing information on the functioning of mobile telephony, the measurements made, the degree of compliance etc.

#### Impact of the Installations

La planificación, construcción, The planning, construction, maintenance and operation of these installations affect environmental aspects such as visual impact or the occupation of land. The evaluation of these aspects prior to the installation of new equipment takes place through environmental impact studies. 1,098 studies were carried out in 2005, thus fulfilling the legal requirements set by the

different administrations or by voluntary requirements when installation is in protected areas or areas of natural interest.

The noise generated by the air conditioning equipment of the huts and buildings containing equipment is one of the aspects that Telefónica monitors most strictly. In order to check levels during 2005, measurements were taken at 1,617 sites. Preventive and, where applicable, corrective action is taken.

#### Waste Management

Waste control and management is one of the main environmental issues resulting from the activities of the Companies. Depending on the activities carried out, exclusively urban waste and office waste (paper, toner cartridges, automated office equipment, etc.) may be generated, or other specific types of waste may be generated, such as electrical or electronic waste, and to a lesser extent, hazardous waste such as batteries. During 2005, 17,626,123 kg of non-hazardous waste has been processed, as well as 2,627,520 kg of hazardous waste, and 3,839,772 kg of electric and electronic waste.

#### Energy consumption

Due to its impact on the environment, the consumption of energy is an issue that receives increasing attention in global, European and national policies.

Telefónica is carrying out important actions in the development of improvements to energy efficiency in its offices and networks, promoting the use of renewable energy, as is the case of the new Telefónica headquarters. It is also carrying out internal awareness-raising campaigns aimed at its employees in order to encourage energy saving. These actions of consumption

optimisation go hand in hand with reducing CO<sub>2</sub> emissions. The consumption increased by 8% in the network operations compared to the previous year.

#### Paper consumption

In 2005, Telefónica implemented its "Efficiency in the Use of Paper and Electronic Information in the Workplace" programme, with the aim of improving mobility and efficiency and, to contributing to a reduction in environmental impact.

To this aim, in 2005 the Group set up the Paper Efficiency Committee, which met 14 times throughout the year. Among the measures adopted were the elimination of 7,269 personal printers, the reduction in 14% in paper purchases, and increasing the percentage of recycled paper to 51%.

### Environmental Impact of Telefónica's Services

Telefónica publishes on its website, on a monthly basis, a series of articles that analyse the relationship of the use of new technologies and sustainability.

This report presents the benefits of new technologies for the environment. For instance, by 2020 it is estimated that savings from the use of new technologies in product manufacturing processes in the EU-15, will amount to 50%.

Equal  
opportunities and  
mutual profit

## Suppliers

### Purchasing volume

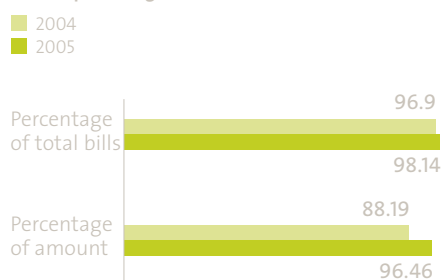
The purchasing volume awarded to suppliers by the Telefónica Group in 2005 amounted to over 13 billion euros (12 billion in 2004). This purchasing volume was awarded to over 18,000 suppliers across the world (15,500 in 2004).

Telefónica is a company committed to the economic and social progress of the countries where it is present. This commitment is reflected in the high percentage of awards to local providers, on average 86% in 2005 (92% in 2004).

Most of these are related to the category of market products (includes mobile handsets) which, together with the category of services and works, make up more than 60% of purchases. The rest correspond to network infrastructures, information systems and marketing.

### Compliance with payment terms for third party bills

Data in percentages



Data corresponding to over 700,000 bills of Telefónica de España and Telefónica Móviles España, for an amount over 9,389 billion euros.

### Distribution of purchases by country

|                   | Purchasing volume |       | Local Purchasing |      |
|-------------------|-------------------|-------|------------------|------|
|                   | 2004              | 2005  | 2004             | 2005 |
| Argentina         | 4.8%              | 6.7%  | 79%              | 83%  |
| Brazil            | 32.1%             | 8.8%  | 98%              | 99%  |
| Chile             | 4.1%              | 6.0%  | 76%              | 74%  |
| Colombia          | –                 | 4.6%  | –                | 38%  |
| Spain             | 45.8%             | 52.3% | 93%              | 94%  |
| Mexico            | –                 | 4.6%  | 94%              | 96%  |
| Peru              | 4.1%              | 4.4%  | 86%              | 83%  |
| Venezuela         | –                 | 5.6%  | –                | 52%  |
| Rest of countries | 9.1%              | 4.0%  | 68%              | 53%  |

% of local purchasing per volume.  
% of total purchasing.

### Supplier satisfaction

To assess supplier satisfaction with Telefónica, in 2005 the first online survey to suppliers was carried out. Over 2,700 answers were received, forming a significant base of results for Spain, Argentina, Brazil, Chile, Colombia, Mexico, and Peru.

### Supplier satisfaction

| Out of 10    | 2005        |
|--------------|-------------|
| Spain        | 6.14        |
| Argentina    | 6.98        |
| Brazil       | 6.95        |
| Chile        | 6.39        |
| Peru         | 6.56        |
| Mexico       | 7.34        |
| Colombia     | 7.92        |
| <b>Total</b> | <b>6.75</b> |

### Online purchases

The electronic management of offers for certain products and services is now available in Spain, Brazil, Argentina, Peru, Chile and Mexico. The purchasing volume negotiated in 2005 through the Adquiria electronic market amounted to 8 billion euros (3.99 in 2004), corresponding to 20,612 purchasing processes (12,675 in 2004).

In 2004, Telefónica implemented a new purchase negotiation format through electronic auctions, which offers greater transparency and objectivity in the purchase process and full equal opportunities to all bidding suppliers, as well as making the process more agile and simplifying purchase management. In 2005, 685 million euros were awarded through this system, through 948 purchasing processes.

### Responsible practices in the supply chain

Telefónica Group endeavours to contribute to the encouragement of responsible business practices throughout its entire supply chain by collaborating with other companies and in initiatives that go beyond legal requirements.

- In the case of suppliers from the telecom sector (typically “market product”, “network infrastructure” and “information systems” product lines), it is worth drawing attention to the company’s work with the GeSI supply chain work group.
- In the case of local and smaller suppliers (typically suppliers of “services and works”), Telefónica directly establishes specific conditions with its suppliers to ensure their responsible behaviour.

The results of the survey on supplier satisfaction showed that 9 out of 10 Telefónica suppliers agreed with the incorporation of corporate responsibility terms and conditions in the supply chain.

Working, Human Rights, equal opportunities and environment protection requirements are detailed in the full report.

## Information and transparency

## Media

### Information and Transparency

The Telefónica Group encourages a policy of communication based on truthfulness and transparency, with constant interaction with the media. Its relationship with the media is an important tool for the Telefónica Group as a means of open communication with all its audiences: customers, shareholders, professional team and society in general. Telefónica, aware of its corporate responsibility, thus maintains a communications policy based on closeness to the media, and on rigour and transparency in information.

The Corporate Communications area has the task of coordination in order to ensure the coherence of the strategic, financial and operations messages. It works closely with the Communications areas of all the subsidiaries, and all together maintain a policy of continuous, planned and agreed communication, that means that information flows regularly and constantly between the Company and the media. As a fruit of this close communication strategy, the Telefónica Group in Spain has held more than 300 meetings with the media, including news conferences, breakfast briefings, and social events -organised through Fundación Telefónica.

Noteworthy among the more than 3,000 press releases issued by the Telefónica Group to the media in 2005 is the dissemination of information about the products and services offered by the Company (42.2%), followed by financial information (20.1%) and strategic and related to the Company's investment capacity (10.8%). Agreements with third parties, whether suppliers or technology partners, among others, are also the subject of press releases.

Regarding the journalistic treatment of the information from the Telefónica Group in Spain by the media, a 92.7% of the press coverage of the information issued by the Telefónica Group in Spain is in the form of news. Other forms such as reports (3.1%) and opinion (3.1%) occur at similar levels, but far from that of news.

### Information and Transparency

Telefónica is a company that has intense publicity activity, making it one of the main investors in the media. All the investment activity is channelled through the corporate media area, following criteria of maximum publicity effectiveness.

For this a unified policy of negotiation and hiring of publicity media has been established in the Group, with the technical area of the Departments of Marketing and of Purchases in each country working together on this.

By media type, television is the means most used with 47% of the Group's investment in publicity, followed by the press (19%), external support (18%) and radio (10%). By country, given the highly commercial character of publicity, Spain

concentrates 56.5% of the publicity investment, followed by Brazil with 10.2%, Mexico with 8.9%, Argentina with 5.6% and Chile and Venezuela with 4.6% each. The chapter on customers contains more information about the intense publicity activity of Telefónica.

### Online Press Room

In order to foster transparency and make information more accessible, the Telefónica Group offers journalists and the media an Online Press Room:

[www.telefonica.es/saladeprensa](http://www.telefonica.es/saladeprensa)

This channel received 176,052 visits from users in 2005 (82,073 in 2004) which shows the increasing interest.



### Distribution of Press releases in Spain by Topics

|                          | 2004  | 2005  |
|--------------------------|-------|-------|
| Telefónica S.A.          | 55    | 71    |
| Telefónica de España     | 206   | 53    |
| Telefónica Móviles       | 1,313 | 1,747 |
| Telefónica Latinoamérica | 765   | 1,045 |
| Fundación                | 65    | 70    |
| TPI                      | 25    | 21    |
| Cesky Telecom*           |       | 130   |
| Eurotel*                 |       | 53    |

\* Both Cesky Telecom and Eurotel became part of the Telefónica Group in June 2005.



**INFORME DE VERIFICACIÓN DEL INFORME ANUAL  
DE RESPONSABILIDAD CORPORATIVA 2005 DE TELEFÓNICA, S.A.**

A la Comisión de Recursos Humanos y Reputación Corporativa del Consejo de Administración de Telefónica, S.A.:

De acuerdo con los términos de nuestra Carta de encargo de fecha 1 de febrero de 2006, hemos llevado a cabo la verificación, con el alcance y procedimientos acordados y que se indican en el apartado siguiente, del Informe de Responsabilidad Corporativa 2005 de Telefónica, S.A. cuya preparación es responsabilidad exclusiva de Telefónica, S.A.

Nuestra responsabilidad por la prestación de este servicio profesional es, únicamente y exclusivamente, ante la Dirección de Telefónica, S.A. y de acuerdo con los términos establecidos para la verificación de su Informe Anual de Responsabilidad Corporativa.

**Alcance**

De acuerdo con el alcance solicitado, la verificación del Informe de Responsabilidad Corporativa 2005 de Telefónica, S.A. se ha realizado con un doble perímetro:

- Perímetro global del Grupo Telefónica bajo los estándares del Global Reporting Initiative (GRI).
- Perímetro de las actividades desarrolladas en España bajo los principios establecidos en la norma AA1000 Assurance Standard emitida por AccountAbility, Institute of Social and Ethical Accountability.

Asimismo, se han seguido las directrices establecidas en la norma ISAE 3000 aplicable a la verificación de informes no financieros, así como las normas profesionales de general aceptación en España relativas a procedimientos acordados.

Las verificaciones, por tanto, han consistido en:

- **Verificación del cumplimiento de los estándares del GRI**

1. La adecuación de la estructura y contenido del Informe a los principios y directrices establecidos en la Guía de Referencia GRI versión 2002.
2. La adecuada trazabilidad de la información y los datos correspondientes a los indicadores centrales y adicionales y el Suplemento sectorial de Telecomunicaciones, así como la razonabilidad del criterio seguido para su consideración, en su caso, como no aplicables.

- **Verificación bajo la consideración de la norma AA1000AS**

Los procedimientos de verificación se han desarrollado para valorar, para el perímetro de las actividades desarrolladas en España, el Informe de Responsabilidad Corporativa bajo los siguientes principios:

1. Materialidad o Relevancia de la información proporcionada en función de las necesidades o requerimientos de los grupos de interés.
2. Integridad en la identificación, entendimiento y gestión de los impactos a través de los sistemas y procesos, incluidos los procesos de compromiso con los grupos de interés.
3. Capacidad de respuesta ante los objetivos y expectativas de los grupos de interés y de la adecuada y oportuna comunicación de los planes dirigidos a ellos.

**Procedimientos de verificación**

Los procedimientos efectuados han consistido en:

1. Realización de entrevistas con una selección de directivos y personal clave de la Corporación y de las unidades operativas significativas de cada uno de los países (en adelante Telefónica o el Grupo, salvo que se mencione expresamente alguna de las compañías) para obtener un entendimiento de los objetivos establecidos en el Grupo en materia de responsabilidad corporativa, relativos a aspectos sociales, éticos y medioambientales. Asimismo, se ha obtenido un entendimiento del seguimiento y aseguramiento interno de tales objetivos.
2. Revisión de información relevante de Telefónica, tal como transcripciones literales de actas de las reuniones del Consejo de Administración en las que se han adoptado acuerdos relacionados con la Responsabilidad Corporativa, así como de los extractos de las actas correspondientes a los aspectos tratados en esta misma materia en las reuniones celebradas por la Comisión de Recursos Humanos y Reputación Corporativa.
3. Revisión de los procesos y sistemas a través de los cuales el Grupo Telefónica establece sus compromisos con sus grupos de interés, así como la identificación y establecimiento de los aspectos claves a incluir en el Informe.
4. Revisión de una muestra de noticias publicadas en prensa durante el ejercicio 2005 en relación con cualquiera de los aspectos relativos a la responsabilidad corporativa de Telefónica o relacionados con sus grupos de interés para comprobar su adecuado tratamiento en el Informe.
5. Revisión de la elaboración del Informe de Telefónica, S.A. de acuerdo a los estándares del GRI 2002, verificando que:
  - Contiene información relativa a la visión y estrategia, el perfil y estructura de gobierno y de los sistemas de gestión.

- Incluye un índice de contenidos.
  - Contempla información concerniente a cada uno de los indicadores establecidos por el GRI o la justificación de su omisión.
  - El criterio seguido para la consideración de alguno de los indicadores como "no aplicables" es razonable.
  - La información contenida en dicho Informe es consistente con los principios del GRI.
  - Contiene una declaración firmada por Presidente del Grupo confirmando que el Informe ha sido preparado de acuerdo con los estándares del GRI.
6. Realización de entrevistas con una selección de directivos y personal clave de las entidades españolas representantes de las líneas de negocio de telefonía fija y de móviles, para obtener un conocimiento de cómo los objetivos y políticas corporativos son puestos en práctica e integrados en las estrategias de las entidades, en relación con los estándares AA1000AS.
7. La verificación de la información, tanto cuantitativa como cualitativa, contenida en el Informe se ha realizado mediante pruebas muestrales. La selección de las muestras se ha efectuado entre los datos relativos a las siguientes entidades en España (Telefónica de España, S.A.U., Telefónica Móviles España, S.A., Telefónica I+D, Telefónica Móviles, S.A.; Telefónica, S.A., Atento Teleservicios España, S.A), Argentina (Telefónica de Argentina, Telefónica Móviles Argentina, Atento Argentina), Brasil (Telesp, Atento Brasil), Chile (Telefónica CTC Chile, Telefónica Móviles Chile, Atento Chile) y Perú (Telefónica de Perú, Telefónica Móviles de Perú, Atento Perú), en función de su relevancia para cada uno de los indicadores.
- Adicionalmente, cuando se ha estimado necesario por su relevancia, se ha procedido a la verificación de información correspondiente a otros países en los que opera Telefónica.
8. Verificación de otras informaciones, no requeridas por el GRI, contenidas en el Informe con documentación soporte acreditativa, a través de fuentes externas siempre que ha sido posible o internas, en caso contrario.

### **Nivel de verificación**

Dado que en la actualidad la AA1000 Assurance Standard no establece normas sobre los niveles de verificación o aseguramiento, hemos planificado y diseñado los procedimientos aplicados para la obtención de la información y las explicaciones que hemos estimado necesarias para el establecimiento de nuestras conclusiones bajo dichos estándares, dentro de los términos acordados con la Dirección de Telefónica, S.A., teniendo en cuenta asimismo las directrices de la ISAE 3000 para la realización de verificaciones con alcance limitado.

### **Limitaciones de nuestra revisión**

- La extensión de nuestro trabajo ha consistido en la verificación de las muestras obtenidas según lo descrito en los puntos 7 y 8 anteriores para los datos correspondientes al ejercicio 2005. Los datos de ejercicios anteriores que figuran en el Informe no han formado parte del alcance de nuestros procedimientos, habiéndose comprobado únicamente su coincidencia con los recogidos en el Informe 2004 elaborado por Telefónica, S.A. y que fue verificado por otra entidad independiente.
- Ernst & Young no ha participado en las actuaciones de diálogo que Telefónica ha llevado a cabo con sus grupos de interés, por ello nuestras conclusiones sobre el principio de materialidad o relevancia y de capacidad de respuesta están basadas en la revisión de los documentos, facilitados por Telefónica, resultantes de dichas actuaciones.

### **Nuestras conclusiones**

En base a los resultados obtenidos de los procedimientos de verificación aplicados, a continuación recogemos nuestras conclusiones y aspectos de mejora más relevantes en relación con cada uno de los principios de la AA1000, así como del cumplimiento de las directrices del GRI. Dichas conclusiones deben ser tomadas en consideración, junto con las limitaciones expuestas con anterioridad.

#### **a) Materialidad o relevancia**

**Principio:** El Informe de RC presenta los aspectos relevantes concernientes al desempeño económico, social y medioambiental.

El Informe Anual de Responsabilidad Corporativa 2005 proporciona información equilibrada de las actuaciones llevadas a cabo por Telefónica en esta materia, habiéndose incorporado al mismo aspectos reclamados por los grupos de interés en las actuaciones de diálogo realizadas, tal como se pone de manifiesto en el apartado "Diálogo con grupos de interés" del capítulo 11 del Informe.

En relación con ciertos indicadores de la Tabla GRI 2002 que se adjunta a continuación, y que forma parte integrante de este Informe de Verificación, se pone de manifiesto la no disponibilidad aún de información para algunos países o algunas de las actividades llevadas a cabo por Telefónica. Como línea lógica de avance sería adecuado incorporar progresiva y sistemáticamente tal información para todo el perímetro del Grupo Telefónica.



**b) Integridad**

**Principio:** La organización dispone de mecanismos y sistemas que le permitan conocer las expectativas de los grupos de interés e identificar la información relevante a incorporar al Informe de RC.

En base a nuestra revisión:

No hemos observado declaraciones erróneas realizadas a lo largo del Informe ni aspectos materiales excluidos del mismo distintos de los mencionados en el apartado a) anterior. En el desarrollo de los procedimientos aplicados, no se ha puesto de manifiesto la exclusión de informaciones correspondientes a las actuaciones sociales y medioambientales de unidades de negocio relevantes, salvo las descritas con anterioridad.

Hemos recibido información o explicaciones que soportan y evidencian las afirmaciones reflejadas en el Informe y que han sido objeto de selección por nuestra parte para su verificación.

Como líneas de consolidación de los procesos y procedimientos puestos en marcha por Telefónica se recomiendan las siguientes actuaciones:

- Extensión progresiva del modelo de diálogo y comunicación con sus grupos de interés a todos los países y líneas de negocio que integran sus actividades.
- Continuar en la integración de los objetivos en materia de Responsabilidad Corporativa en los objetivos estratégicos de las distintas Áreas y países del Grupo, mediante sistemas de gestión e indicadores únicos.
- Reforzar los sistemas implantados para gestionar la trazabilidad de los datos comunicados.

**c) Capacidad de respuesta**

**Principio:** La organización dispone de procesos efectivos para gestionar e informar de la respuesta dada a las expectativas de sus grupos de interés

En base a nuestra verificación:

El Informe Anual de Responsabilidad Corporativa 2005 de Telefónica incluye los aspectos materiales relativos a las expectativas de sus grupos de interés puestas de manifiesto en las actividades de diálogo llevadas a cabo durante el ejercicio y cuyos resultados han sido puestos a nuestra disposición. A los efectos de esta conclusión se debe tener en cuenta lo indicado en el apartado a) anterior.

A lo largo de su Informe, Telefónica recoge las políticas, normas, programas y actividades aprobadas y desarrolladas a lo largo del ejercicio. En cada uno de los capítulos, se hace mención a la situación o grado de desarrollo e implantación en cada caso.

En línea con lo indicado en el párrafo anterior se anticipan como líneas de actuación recomendables las siguientes:

- Extender el avance que ha supuesto la implantación del Código Ético en Telefónica Móviles al resto del Grupo. Esta extensión supondrá desarrollar y aprobar nuevas políticas concretas que permitan el adecuado desarrollo e implantación de los principios recogidos en dicho Código, así como de otros requerimientos de sus grupos de interés.
- Optimizar los procedimientos de cumplimiento, seguimiento y reporte de la totalidad de las políticas y normas ya aprobadas por Telefónica, de forma estandarizada y sistemática.

**Concordancia del Informe Anual de RC con los estándares GRI**

En base a los resultados obtenidos de los procedimientos aplicados sobre la información publicada y disponible, según se indica en el apartado a) anterior, consideramos que el Informe Anual de Responsabilidad Corporativa de Telefónica, S.A. ha sido elaborado de acuerdo con el GRI Sustainability Reporting Guidelines 2002 y el Suplemento sectorial de Telecomunicaciones.

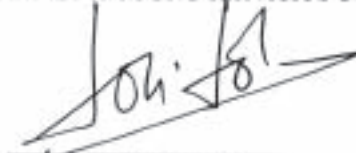
El alcance de nuestro trabajo ha consistido en la realización de los procedimientos específicos que se describen en este informe. De haberse aplicado procedimientos distintos a los indicados o haberse ampliado el tamaño de los muestreos analizados, se podrían haber puesto de manifiesto aspectos significativos adicionales a los contemplados en el presente informe.

**Nuestra Independencia**

Las políticas de independencia de Ernst & Young son de aplicación a la Firma, socios y sus profesionales. Estas políticas prohíben cualquier interés financiero en nuestros clientes que pudieran comprometer nuestra independencia. Cada año, los socios y el personal son requeridos para confirmar el cumplimiento de las políticas de la Firma.

Por otra parte, como auditores de las cuentas anuales de Telefónica, S.A. la prestación de nuestros servicios ha sido aprobada por la Comisión de Auditoría y Control para garantizar nuestra independencia, tal como establecen los procedimientos del Grupo y que se describen en el capítulo de Gobierno Corporativo del Informe Anual de Responsabilidad Corporativa.

ERNST & YOUNG SERVICIOS CORPORATIVOS, S.L.

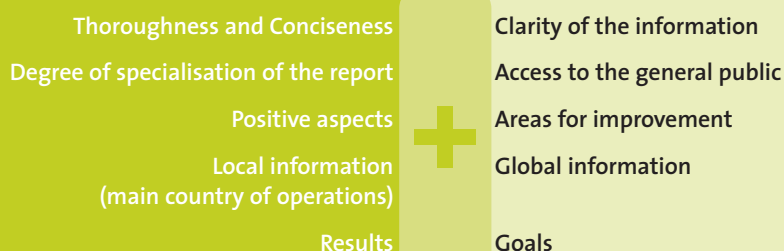


José Luis Solís Céspedes  
Socio

Madrid, 15 de mayo de 2006

# About the report

According to the stakeholders, the CR Reports should achieve a balance between



Departments that collaborated in the preparation of the report.

**01 Corporate Governance**  
Secretariat General / Internal Auditing Department

**02 Identity**  
Communication (Brand, Reputation and CSR) /  
Human Resources Office / Sponsorship /  
Internal Auditing Department

**03 Driving Force for Progress**  
Finance (Consolidation, Management Control),  
Tax, Regulatory Affairs, Innovation, Telefónica I+D,  
Institutional Relations, Information Systems,  
Investor Relations

**04 Customers**  
Corporate Marketing Development /  
Quality, marketing and customer service  
departments of the main business lines  
(Telefónica de España, Telefónica Móviles, Telefónica  
Latinoamérica) / Legal consultancy /  
Communication / Security

**05 Shareholders**  
Shareholders' Office / Investor Relations /  
Secretariat General

**06 Employees**  
Corporate Human Resources / Human Resources  
Departments of the main lines of business  
(Telefónica de España, Telefónica Móviles, Telefónica  
Latinoamérica, TPI, Terra, Atento, tgestiona) /  
Communication / Health and Safety / Fundación  
Telefónica / ATAM / Fonditel

**07 Society**  
Main lines of business (Telefónica de España,  
Telefónica Latinoamérica, Telefónica Móviles) /  
Institutional Relations / Regulatory Affairs /  
Reputation and Corporate Social Responsibility /  
Fundación Telefónica / ATAM / Sponsorship

**08 Environment**  
Internal Auditing / Reputation and Corporate Social  
Responsibility / Environmental Departments of the  
main lines of business (Telefónica de España,  
Telefónica Móviles, Telefónica Latinoamérica)

**09 Suppliers**  
Purchasing / Internal Auditing /  
Reputation and Corporate Responsibility

**10 Media**  
Communication

**About the Report**  
Reputation and Corporate Responsibility

**Independent Verification**  
Ernst & Young

**Coordination**  
Reputation, Brand and Corporate Social  
Responsibility (G.D. of Communication)

## Participants in the dialogue

In March 2006, Telefónica called meetings of two panels of corporate responsibility experts representing Telefónica's different stakeholder groups in order to find out their opinion with regard to the "Corporate Responsibility Annual Report 2004", and gather any suggestions and comments.

Over 40 experts in corporate responsibility took part in this dialogue process, from almost thirty relevant organisations and institutions within Telefónica de España's stakeholder groups. This dialogue was organised by CR experts from the Nôos Institute, an organisation that had already worked with Telefónica on the adaptation into Spanish of the "Good Practice Guide for Relations with Stakeholders". The Report on Corporate Responsibility includes details of the stakeholder groups' recommendations with regard to the report, as well as the improvements applied by Telefónica in 2005.

## Reporting principles

In the drafting of its 2005 Corporate Responsibility Report, Telefónica has

applied the principles proposed by the GRI for decisions regarding the contents and structure of the report.

## Boundary of the Report

Since the publication of its first corporate responsibility report in 2002, Telefónica has strived to present itself before its stakeholder groups as a multinational company. This is why, since this first report, it has always included data of its operations outside Spain.

The publication of the Report on Corporate Responsibility 2005 includes details on the performance of the fixed and mobile telephony operators in Spain and Latin America that are controlled by Telefónica. This criteria has been applied on the basis of the application of the relevant principles of the companies' impact and on the degree of control over them.

With a view to encouraging maximum transparency, Telefónica explains the way in which the information is consolidated in the different chapters and aspects included in the report.

## Note on the Independent Verification

Telefónica commissioned from Ernst & Young (as a private entity) the verification of the Annual Report on Corporate Responsibility 2005. This Executive Summary includes a literal transcription of the Verification Report (excluding GRI tables) that refers to the Report on CR in its full version and not to this Executive Report. Both the full Report on Corporate Responsibility and Ernst & Young's Verification Report are included in the enclosed CD.

# Quarterly results January to December 2005

04

|         |   |     |
|---------|---|-----|
| 04   01 | Quarterly results<br>January to December 2005 | 132 |
| 04   02 | Appendix                                      | 178 |









Telefónica Group

Cellular business

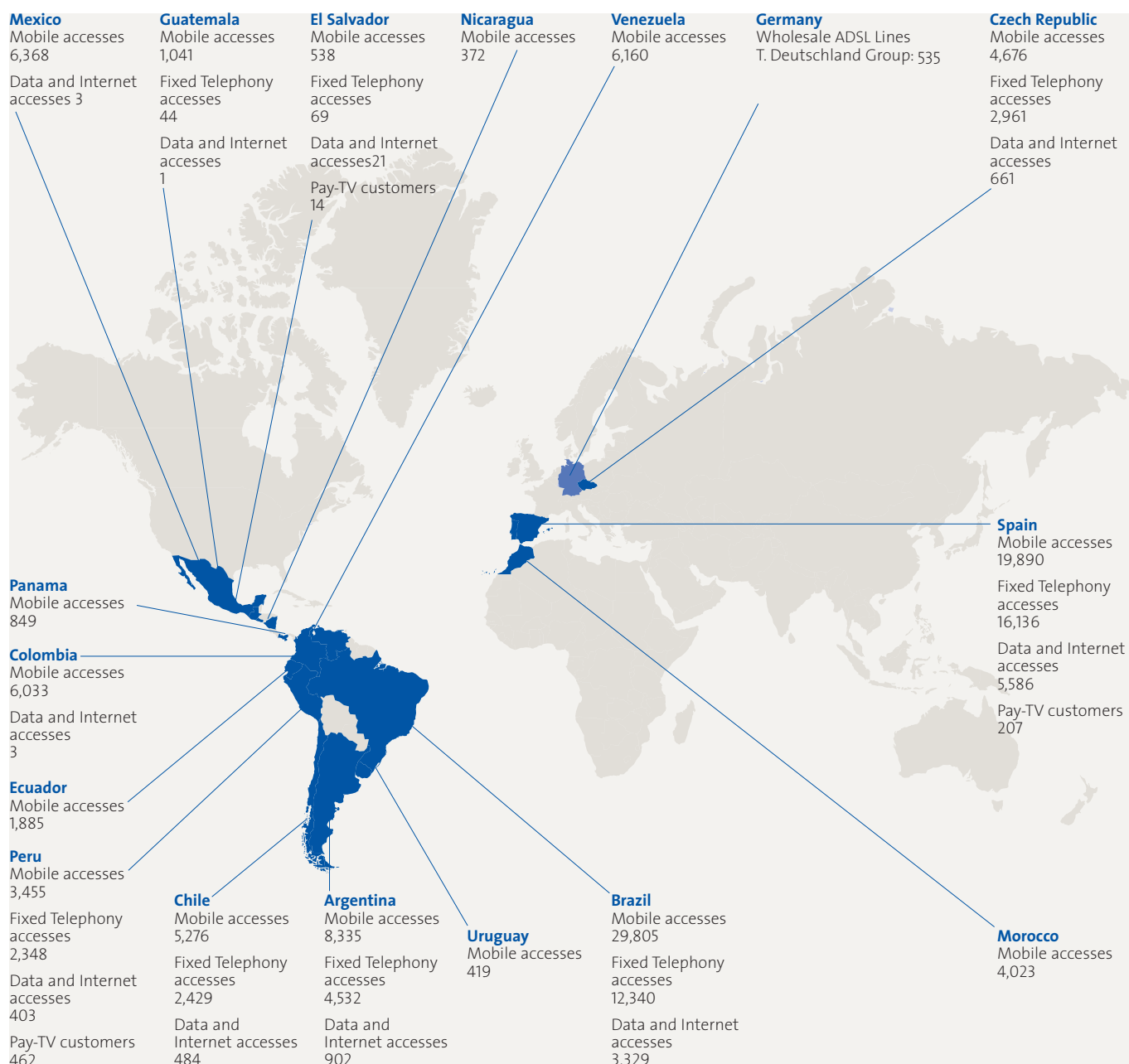
Cesky Telecom

Other business

## Quarterly results

### Telefónica: Market size (2005)

Figures in thousands



The financial information contained in this document has been prepared under International Financial Reporting Standards (IFRS). This financial information is unaudited and, therefore, is subject to potential future modifications. 2004 financial results were originally prepared under Spanish GAAP and have been translated into IFRS for comparison purposes only.

## Financial Highlights

The most relevant factors of Telefónica Group results for fiscal year 2005 are the following:

- Net income reached a record amount of 4,445.8 million euros, 40.0% higher than in 2004, thanks to the good evolution of operations and the positive contribution of the executed acquisitions:
  - Net income would have reached 4,915.8 million euros if we exclude the write-down of the remaining value of the UMTS license of IPSE and the provision for the Redundancy Program in Telefónica de España and Telefónica Data España.
  - A 43.4% rise in basic earnings per share, to 0.913 euros.
- Achievement of the financial targets set for 2005, in terms of revenues, OIBDA, OI and CapEx, both at the Telefónica Group level and within the main business lines.
- Strengthening of the Group's growth profile, after reporting a solid year-on-year revenue growth of 25.1%:
  - All business lines reported revenues above 2004 fiscal year figures.
- A sharp increase in total accesses (+24.3% over the prior year), driven by the growth in mobile customers and in broadband, which stood at 153.5 million at the end of the year. Including the O2 customers, whose acquisition was completed in 2006), the Telefónica Group's customer base would increase to 180.9 million:
  - Telefónica Móviles Group's customer base increased to 94.4 million, gaining 16.3 million new customers.
  - The Group's retail Internet broadband accesses reached 5.0 million, up from 3.2 million in December of 2004.
- Outstanding organic growth (constant exchange rates and excluding changes in the perimeter of consolidation) in the main Income Statement items:
  - Revenues grew by 9.3% year-on-year, OIBDA by 9.9% and OI by 21.7%.
- The positive contribution of the exchange rate fluctuations, particularly the appreciation of Latin American currencies against the euro, which added 47 percentage points 4.5 percentage points and 3.3 percentage points to the growth of revenues, OIBDA and OI, respectively.
- Transformation of operating efficiency into profitability and generation of free cash flow:
  - The consolidated OIBDA margin stood at 40.3%, unchanged from the previous year, in a high-growth environment and higher commercial activity.
- Operating free cash flow (OIBDA-CapEx) rose to 9,917.7 million euros, equivalent to 17.3% increase over the 2004 figure with the positive contribution of all business lines, despite a higher investment in growth.
- The 2005 shareholder remuneration policy is one of the most attractive in the industry, as demonstrated by the payment of a cash dividend of 0.5 euros/share, distribution of treasury stock representing 4% of shareholders' equity (1x25) and extension of the share buy-back program until the end of 2007, for a total of 6 billion euros. For 2006, the Board of Directors agreed to propose the payment of a dividend against 2005 fiscal year results of 0.5 euros/share in the next AGM.

<sup>1</sup> Net of their corresponding tax effect and the loss attributable to minority interest.

<sup>2</sup> Net of their corresponding tax effect

<sup>3</sup> Excludes the adjustment for 300,000 inactive lines in Mexico, no longer considered in the reported customer base in the second quarter of 2005

<sup>4</sup> Assuming constant exchange rates and including the consolidation of the Latin American assets acquired to BellSouth in Argentina, Colombia, Chile, Ecuador, Guatemala, Nicaragua, Panama, Peru, Uruguay and Venezuela in the cellular business and Atrium in the Telefónica Latinoamérica Group from January 1st 2004. Cesky Telecom has been included in the period July-December 2004.

## Telefónica Group Accesses

Unaudited figures (thousands)

|   | December         |                  |             |
|---|------------------|------------------|-------------|
|   | 2005             | 2004             | % Chg       |
| <b>Fixed telephony accesses<sup>1</sup></b> | <b>40,859.0</b>  | <b>37,768.5</b>  | <b>8.2</b>  |
| <b>Internet and data accesses</b>           | <b>12,859.9</b>  | <b>10,872.2</b>  | <b>18.3</b> |
| Narrowband                                  | 5,166.9          | 5,672.5          | –           |
| Broadband                                   | 6,902.7          | 4,736.7          | –           |
| ADSL <sup>2</sup>                           | 5,880.2          | 3,915.5          | –           |
| Retail <sup>3</sup>                         | 5,023.1          | 3,225.6          | –           |
| Other accesses <sup>4</sup>                 | 790.3            | 463.0            | –           |
| Unbundled loops <sup>5</sup>                | 434.8            | 116.1            | –           |
| <b>Pay TV</b>                               | <b>683.2</b>     | <b>408.3</b>     | <b>67.3</b> |
| <b>Cellular accesses</b>                    | <b>99,124.0</b>  | <b>74,441.4</b>  | <b>33.2</b> |
| <b>Total Accesses</b>                       | <b>153,526.0</b> | <b>123,490.3</b> | <b>24.3</b> |

<sup>1</sup>PSTN (including Public Use Telephony) x1; ISDN Basic access x1; ISDN Primary access; 2/6 Access x30. Company's accesses for internal use included.

<sup>2</sup>IT. Deutschland's connections resold on a retail basis and Cable Modem in Peru included.

<sup>3</sup>Includes Cable Modem in Peru. TdE Retail includes Terra form 3Q05, Línea ADSL and satellite. TASA Retail includes ISP in the north part of the country.

<sup>4</sup>Cable modem El Salvador, WiFi clients, satellite Latam, fibre and leased circuits included.

<sup>5</sup>Includes fully unbundled loops and shared loops.

## Consolidated Results

The results obtained by Telefónica Group and the management report included in this report are based on the actions carried out by the various business units in the Group and which constitute the units over which management of these businesses is conducted. This implies a presentation of results based on the actual management of the various businesses in which Telefónica Group is present, instead of adhering to the legal structure observed by the participating companies.

In this sense, income statements are presented by business, which basically implies that each line of activity participate in the companies that the Group holds in the corresponding business, regardless of whether said holding has already been transferred or not, even though it might be the final intent of Telefónica, S.A. to do so in the future.

It should be emphasised that this presentation by businesses in no case alters the total results obtained by Telefónica Group. These results are incorporated from the date of effective acquisition of the holding.

Starting third quarter 2005, Terra Networks results will be included in the Telefónica de España Group and Telefónica Latinoamérica Group results. Hence, Terra España, Azeler and Maptel results will be incorporated within the Telefónica de España Group, whereas Terra in Latin America will be incorporated in the Telefónica Latinoamérica Group's results. The Terra Networks Group results from the first and second quarter of 2005 and from fiscal year 2004 will be incorporated into Other Companies in the Telefónica Group accounts.

Also starting in the third quarter of 2005, the Cesky Telecom results corresponding to the July-September 2005 period will be incorporated as an independent business line, at the closing of its acquisition last June.

In 2005, the Telefónica Group obtained a new dimension after the successful integration of the mobile telephony operations acquired from BellSouth in Latin America and Cesky Telecom, combined with the acquisition of O2, strengthening the Group's competitive position through the Company scale. With these acquisitions, the Group's strategic objective offering the best combination in terms of growth and cash returns is strengthened, after successfully executing the integrated management of operations through an increasing focus on customers and efficiency.

The Telefónica Group thus achieved in 2005 a record net income of 4,445.8 million euros, 40.0% above last year's figure. The achievement of this good result stems from the strong annual growth in revenues (+25.1%) thanks to the expansion of the customer base (+24.3%) and of the average revenue per customer, as a consequence of

the increased commercial efforts, with particular emphasis on growing businesses and on product and service innovation. Operational efficiency means maintaining profitability (OIBDA margin) at a 40% ratio and operating free cash flow (OIBDA-CapEx) growing at a high annual rate (+17.3%). It is also significant the successful management of non-operational results, going from an annual growth in OIBDA of 25.0% and 30.5% of OI to a 40.0% of net income.

The economic and financial results for 2005 were also strengthened by the diversification of being an integrated operator. The cellular business is the main contributor to Group revenues (+38.1% year-on-year), while the fixed telephony business line is so in terms of profitability, with a growth in the operating income of Telefónica de España Group of 19.9% and of Telefónica Latinoamérica Group of 14.6% year-on-year. This way, the need to finance the increased number of customers in the mobile telephony business in order to capture the unique opportunity for growth of its markets, with its logical impact on margins, is compensated by the solid results from the fixed telephony business line, a reference in the sector in terms of revenues, profitability and generation of cash flow.

As a result, the Telefónica Group achieved all the financial objectives established for 2005. In terms of revenues<sup>1</sup>, growth at constant exchange rates and excluding changes in the consolidation perimeter stood at 17.2%, surpassing the growth target of “over 15%”. With respect to the

Operating Income before Depreciation and Amortisation (OIBDA), growth stood at 12.3%, within the announced range of +10%/+13%. Operating Income (OI)<sup>1</sup> grew by 16.1%<sup>2</sup>, also within the range of +12%/+18%. Lastly, CapEx<sup>1</sup> stood at 4,725.9 million euros, in line with the guidance of reaching approximately 4,600 million euros. It should also be noted that all business lines achieved the targets set for 2005.

The shareholder remuneration policy in 2005 continued to progress, being one of the most attractive in the sector and reaffirming itself after the acquisition of O2. In 2005 a dividend corresponding to the 2004 year of 0.5 euros/share was paid, Telefónica S.A. shares were distributed, representing a 4% of capital share, in a proportion of 1x25 and there has also been a progress in the share buy-back program. This program was renewed in April, and extended until the end of 2007, for a total of 6,000 million euros. On 31st December 2005, the treasury stock stood at 2.8% of the current share capital.

For 2006, the Board of Directors agreed to propose the payment of a dividend against 2005 fiscal year results of 0.5 euros/share in the next AGM.

At 2005 year end, the Telefónica Group managed 153.5 million accesses (+24.3% year-on-year), of which 99.1 million are cellular accesses, 40.9 million are fixed telephony accesses, 12.9 million are data and Internet accesses, and 0.7 million are Pay TV accesses. The acquisition of Cesky Telecom contributed with 8.3 million, while,

<sup>1</sup> All projections refer to local currency (constant exchange rates) and exclude changes in consolidation other than assets acquired to BellSouth in Argentina & Chile in 2005 (TEM), and Atrium (T.Latam).

<sup>2</sup> In terms of guidance calculation, Operating Income and Operating Income before D&A exclude other exceptional revenues/expenses not foreseeable in 2005.

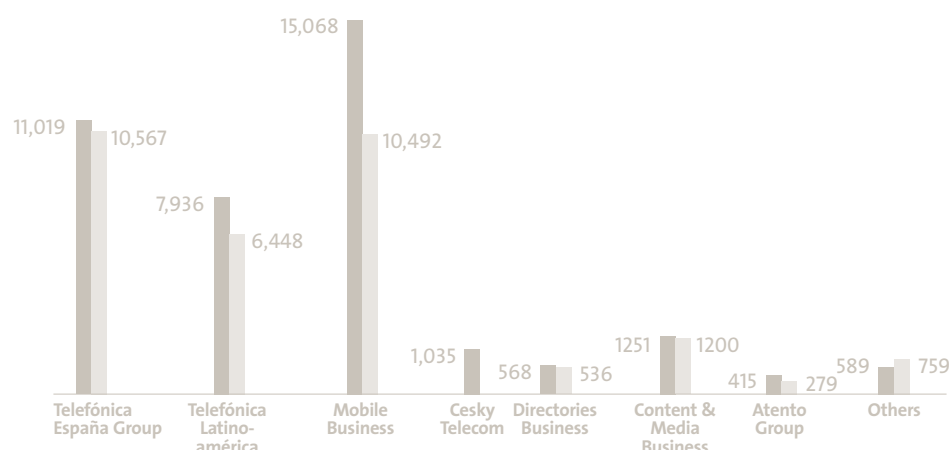
<sup>3</sup> Personnel Restructuring and Real Estate Programs are included as operating revenues/expenses.



## External sales by business lines

Data in million euros

■ December 2005  
■ December 2004



if we include O2 lines as of 31st December 2005, the Telefónica Group total accesses reached 180.9 million.

The Telefónica Móviles Group has placed itself as one of the sector's main operators, in the high-growth environment of the Latin American markets, with a managed customer base of 94.4 million, up 26.9% year-on-year. Net adds in the fourth quarter recorded 5.4 million customers, in a period characterised by Christmas campaigns, while in the year as a whole added 16.3 million new customers.

The broadband market in 2005 showed great dynamism and growth in Spain, Latin America and the Czech Republic, with a total of 5.0 million retail Internet broadband accesses for the Telefónica Group at the end of December, 55.7% higher than the previous year. The contribution of Spain (2.7 million +68.5% year-on-year) and Brazil (Telesp: 1.2 million +46.0% year-on-year) must be highlighted.

Telefónica Group revenues increased 25.1% compared with 2004, reaching an absolute figure of 37,882.1 million. This strong yearly growth was due to the increased revenues achieved by all business lines, the positive impact of exchange rates (contributing with 4.7 percentage points to the growth) and changes in the consolidation perimeter, mainly the BellSouth and Cesky Telecom assets. Excluding these final two effects, the organic growth of revenues stood at 9.3% (+9.9% to September).

By business lines, the cellular business continued to be the main contributor to

the Group's growth, recording a 38.1% year-on-year growth in revenues in 2005, to 16,513.5 million euros. The solid performance of revenues is mainly explained by changes in the consolidation perimeter on the one hand, and the contribution of Telefónica Móviles España (revenues +7.6%, making it one of the European operators with the highest growth in domestic market), Venezuela (revenues of 1,438 million euros) and Argentina (revenues of 1,010 million) on the other hand. In the fourth quarter of the year there was a slowdown in the growth rate of revenues (+29.1% year-on-year), since the first nine months (+41.7% year-on-year) were more affected by the consolidation of eight of the ten Latin American operators acquired from BellSouth since November 2004. Telefónica de España Group revenues totalled 11,739.5 million euros in the year (Terra's operations in Spain accounted 21.6 million euros), up 4.8% year-on-year (+4.6% excluding Terra). Revenues from Internet and Broadband services (+26.9% over 2004) are the growth engine, particularly those for Broadband (+40.2% compared with January-December 2004), compensating the reduction in revenues for traditional voice services (-0.7% year-on-year). In the fourth quarter of 2005 the quarterly trend for the slowdown in the year-on-year increase in revenues, excluding Terra, (+3.6% vs. +4.0% in the third quarter vs. +4.9% in the second quarter vs. +6.0% in the first quarter) mainly due to the elimination of the effect of the increase in the monthly fee in 2004, the fall in revenues from voice traffic and the slowing growth of broadband revenues.

The Telefónica Latinoamérica Group, supported by the good performance of the operators, and the appreciation of Latin American currencies against the euro, obtained revenues of 8,265.5 million euros in 2005 (Terra Latinoamérica contributed with 111.0 million euros), 22.5% above 2004 figure. In constant euros, and excluding the effect of Terra, the increase with respect to January-December of the previous year stood at 6.2% (+6.5% to September) mainly due to the contribution of Telesp (+7.9% compared with +7.7% of September) driven by the increase in tariffs in July and the solid growth of the broadband business.

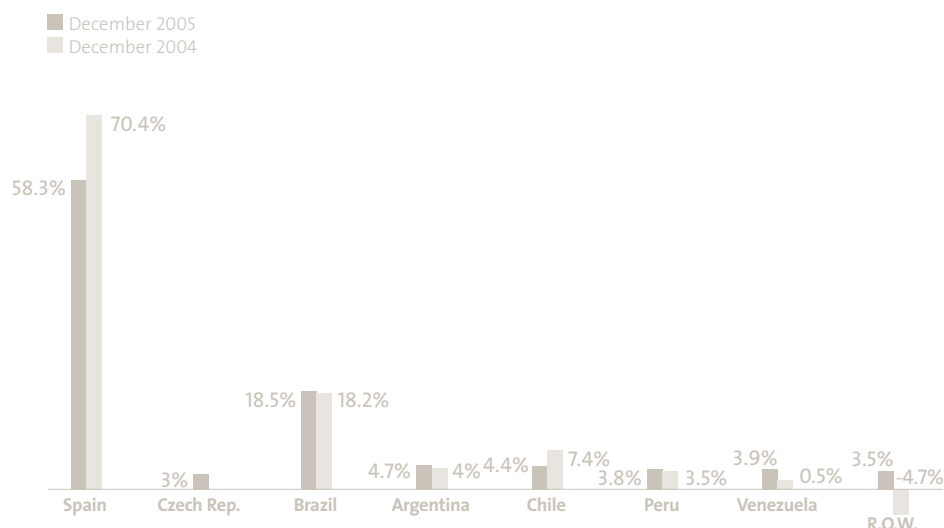
By geographic areas and as of the end of 2005, Spain represented 51.9% of consolidated revenues, reducing its contribution by 9.4 percentage points compared with December 2004, while Latin America increased its contribution to total revenues by 7.3 percentage points to 41.5%, due to the incorporation of BellSouth Latin American operators. Brazil maintained a contribution to total sales practically stable (18.2% vs. 17.3% twelve months ago). The incorporation of Cesky Telecom in July 2005 has given better geographical diversification, with 2.7% of revenues coming from the Czech Republic.

Cumulative operating expenses in 2005 stood at 23,219.3 million euros, recording a year-on-year growth of 26.7%, as a result of the intensification of commercial efforts carried out by Telefónica Group and the changes in the consolidation perimeter.

Supplies expenses (10,065.0 million euros) grew by 31.8% year-on-year (+27.2% excluding the effect of the exchange rate vs. +29.9% to September) and is explained mainly by the cellular business, with the incorporation of BellSouth Latin American

\* Excludes the adjustments of 300,000 inactive lines in Mexico, no longer considered in the reported customer base as of the second quarter of 2005.

## OIBDA by countries



operators and by the higher interconnection costs, as well as Telefónica de España Group due to the purchase of equipment for the ADSL and Imagenio services, and the boost in the local loop unbundling (ULL) by the competition.

Personnel expenses amounted to 5,656.4 million euros and grew by 11.0% in 2005 year-on-year (+7.9% in constant euros vs. +5.3% to September) related with the rise in the Group's average workforce (+21.4% to 190,385 employees) due to the cellular business, the acquisition of Cesky Telecom and the Atento Group (excluding Atento the average workforce would be 106,021 employees, a growth of 12.3%). Regarding the Telefónica de España 2003-2007 Redundancy Program, as an exceptional measure, 127 layoffs have been accepted in addition to the 1,750 applications accepted for 2005, and a new Redundancy Program in Telefónica Data España has been approved, joined by 68 persons, increasing the total provision made for 2005 to 597.3 million euros.

Cumulative external services expenses at year end (6,715.3 million euros) increased by 32.4% year on year (+26.4% in constant euros) as a result of the increased commercial and advertising activity, mainly in the bet on growth in number of customers and the changes in the consolidation perimeter. However, in the last quarter there was a control over commercial costs in Telefónica Móviles España.

At the end of the year 2005, Telefónica Group recorded a gain for the sale of fixed

assets of 249.3 million euros compared with the 21.6 million euros accrued the previous year. The main items accounted for in this accounts are the capital gains from; i) the sale of Infonet, ii) the listing of Endemol, iii) the disposal of 1.2% of TPI share capital, iv) the disposal of real state and v) the sale of Radio Continental and Radio Estéreo, both from the ATCO Group. The capital gain obtained from the listing of Endemol and from the sale of Telinver in Argentina explain the positive accrued amount of 71.7 million euros in the fourth quarter of 2005.

Consolidated OIBDA in January-December 2005 stood at 15,276.4 million euros, a 25.0% growth in relation to the same period in 2004, a significant increase in the rate of variation compared with January-September (+20.0% year-on-year), after the 39.7% year-on-year OIBDA growth during the period October-December. The fluctuations in exchange rates contributed with 4.5 percentage points to the growth rate in 2005. The organic growth in consolidated OIBDA in 2005 stood at 9.9%, 3.2 percentage points higher than in the first nine months of the year, mainly due to the control of expenses during the last quarter, specially in the cellular business. In terms of profitability, despite the high levels of commercial activity, particularly in the cellular business, (OIBDA margin) was maintained practically stable compared with the previous year (40.33% vs. 40.36%).

In 2005, there was an acceleration in the cellular business OIBDA growth rate higher than the obtained to September (+25.4% vs. +19.4%), reaching 5,817.0 million euros

<sup>5</sup> Assuming constant exchange rates and including the consolidation of the Latin American assets acquired to BellSouth in Argentina, Colombia, Chile, Ecuador, Guatemala, Nicaragua, Panama, Peru, Uruguay and Venezuela in the cellular business and Atrium in the Telefónica Latinoamérica Group from January 1st 2004. Cesky Telecom has been included in the period July-December 2004.

and representing 38.1% of the consolidated OIBDA. In yearly terms, the OIBDA margin fell by 3.5 percentage points, to 35.2%, due to the commercial efforts made and the brand launch (movistar) last April. However, it is worth highlighting the year-on-year 3.9 percentage points improvement in the OIBDA margin of the fourth quarter (35.6%). This was mainly due to the 11.9 percentage points increase in the OIBDA margin of the Latin American subsidiaries to 24.5% because of the lower unit acquisition costs (SAC).

The Telefónica de España Group (31.2% of total OIBDA) finished the year with an OIBDA of 4,766.8 million euros (Terra's operations in Spain contributed 27.3 million euros), up 4.5% on that recorded in 2004. In the fourth quarter, the trend observed in previous quarters was reversed, and there was a year-on-year fall of 3.8%, basically associated with the 127 new people joining the Telefónica de España 2003-2007 Redundancy Program in 2005, and 68 people joining the Telefónica Data España Redundancy Program. The OIBDA margin stood at 40.6%, 0.1 percentage point lower than in 2004, though if we exclude the effect of the Redundancy Program in both years, the OIBDA margin would increase to 45.7% (-0.8 percentage points vs. January-December 2004).

The Telefónica Latinoamérica Group OIBDA, contributing with 24.6% to the total OIBDA, stood at 3,758.3 million euros at year end (Terra in Latin America contributed 4.8 million euros), showing a growth in nominal terms of 14.1%, which translates to 0.4% (-7.5% to September), in constant

euros and excluding the effect of Terra Latam. It should be noted that these variations are influenced by the gain on the sale of fixed assets (mainly the sale in July 2004 of the CTC mobile telephony subsidiary and the sales of Infonet and Telinver in Argentina) as a result of which, the variation excluding this effect would be 27.4% (+11.7% excluding the exchange rates and Terra Latam effect). The OIBDA margin, excluding the result of the gain for the sale of fixed assets in both periods, stood stable compared with September at 44.2%, though increasing by 1.7 percentage points compared with 2004.

The geographical distribution of the OIBDA in 2005 reflects, in the same way as revenues, greater diversification, with 58.3% of the consolidated OIBDA coming from Spain (70.4% of the previous year), 36.4% from Latin America (32.5% two months ago) and 3.0% from the Czech Republic after the incorporation of Cesky Telecom in the second half of 2005.

The operating income for January-December 2005 amounted 8,558.8 million euros, a year-on-year growth of 30.5%, 6.0 percentage points higher than that recorded in the first nine months of the year. This acceleration was the result of the higher increase in OIBDA described above, and despite the higher increase in depreciation compared with September (+18.6% vs. +14.6%). The main business lines that contribute to this increase in depreciation are, in first place, the cellular business, due to the changes in the consolidation perimeter and the impact of 280 million euros associated with the

Amortisation of allocated intangible assets related to the acquisition of Telefónica Móvil Chile and BellSouth Latin American operators in 2004 and at the beginning of 2005, and, secondly, Cesky Telecom, which was incorporated from the second half of the year. The organic variation rate in operating income is +21.7% compared with the +16.6% registered to September.

The results of associated companies reversed the positive trend recorded in the first nine months of the year (+9.6 million euros) and closed 2005 with losses that can be attributed to these companies of 128.2 million euros (-50.5 million euros in January-December 2004). In the fourth quarter -136.8 million euros mainly related to the write-down of the remaining value of the UMTS license of IPSE were accounted (this asset write-down does not imply any cash outflow)). It should be noted, in particular, that if we exclude this effect, the results of these companies would be positive (+8.6 million euros) thanks to the lower losses that can be attributed to Sogecable, Lycos Europe and the positive contribution of Medi Telecom, which, last year, brought losses to the Group.

Financial net expenses amounted to 1,634.3 million euros in 2005, 0.3% year-on-year reduction (4.8 million euros) compared with the comparable figure of 2004 (1,639.1 million euros). The interest rates expenses deteriorated by 334.3 million euros, of which 261.3 million euros belong to the 18.6% increase in the average net debt versus 2004. The exchange rate differences improved in 339.1 million euros compared with 2004, highlighting the positive

<sup>6</sup> Assuming constant exchange rates and including the consolidation of the Latin American assets acquired to BellSouth in Argentina, Colombia, Chile, Ecuador, Guatemala, Nicaragua, Panama, Peru, Uruguay and Venezuela in the cellular business and Atrium in the Telefónica Latinoamérica Group from January 1st 2004. Cesky Telecom has been included in the period July-December 2004.

contribution of the USD/EUR position, that contributed with a 43% to the improvement in the result.

The net free cash flow after CapEx generated by the Telefónica Group amounted to 7,108.1 million euros in 2005, of which 4,476.1 million euros were dedicated to the net payments of dividends and treasury stock in Telefónica S.A., 5,839.9 million euros were deployed on financial investments (net of the sale of real state) and 692.8 million euros to the cancellation of commitments, mainly to headcount reduction. Hence, the free cash flow after dividends, that explains in a high degree the increase in the net financial debt of 3,900.7 million euros.

The Telefónica Group's net financial debt at the end of December 2005 stood at 30,067.0 million euros. The increase of 6,372.6 million euros with respect to the 2004 net financial debt figure (23,694.4 million euros) was due to the free cash flow after dividends of -3,900.7 million euros. Moreover, the net financial debt increased by 1,075.8 million euros corresponding to changes in the consolidation perimeter and others and in 1,396.1 million euros as a consequence of the effects of the exchange rates on net financial debt not denominated in euros.

The tax provision amounted to 1,969.2 million euros in 2005, and the tax rate stood at 29.0%, although the cash outflow for the Telefónica Group will be reduced even further as negative tax bases are compensated for.

The results attributed to minority interests in 2005 showed year-on-year growth of 23.0% and deducted 381.2 million euros from the Telefónica Group's net income.

This evolution is explained by the participation of minority interests in the net income of Cesky Telecom since 1st July 2005, the improved net income obtained by Telesp and the lower losses recorded by Telefónica Móviles Mexico.

As a result of this, the consolidated net income accumulated to December reached 4,445.8 million euros, up 40.0% year-on-year. In the fourth quarter, the net income grew by 51.6% compared with the fourth quarter of 2004, and reached 1,192.5 million euros.

During 2005, consolidated CapEx reached 5,358.7 million euros (4,725.9 million euros with constant exchange rates of 2004 and excluding changes in the consolidation perimeter), which represents a growth of 42.3% vs the 2004 figure (organic variation +21.0%). By business lines, there was a generalised growth, mainly associated with growth initiatives both in Spain and Latin America (broadband, increase in capacity of mobile telephony networks, and rollout of the UMTS network in Spain and GSM in Colombia). It is also worth to highlight the investment made in Distrito C, the future Telefónica Group headquarters in Madrid and the incorporation of the Cesky Telecom's investments since July 2005.

<sup>7</sup> All projections refer to local currency (constant exchange rates) and exclude changes in consolidation other than assets acquired to BellSouth in Argentina & Chile in 2005 (TEM), and Atrium (T.Latam).

<sup>8</sup> Assuming constant exchange rates and including the consolidation of the Latin American assets acquired to BellSouth in Argentina, Colombia, Chile, Ecuador, Guatemala, Nicaragua, Panama, Peru, Uruguay and Venezuela in the cellular business and Atrium in the Telefónica Latinoamérica Group from January 1st 2004. Cesky Telecom has been included in the period July-December 2004.

## Financial Data

### Telefónica Group: Selected financial data

Unaudited figures (Euros in millions)

|  | january - december |                |              |
|--|--------------------|----------------|--------------|
|  | 2005               | 2004           | % Chg        |
| Revenues   | 37,882.1           | 30,280.9       | 25.0         |
| Operating income before D&A (OIBDA)  | 15,276.4           | 12,222.0       | 25.0         |
| Operating income (OI)  | 8,558.8            | 6,556.0        | 30.5         |
| Income before taxes  | 6,796.2            | 4,866.4        | 39.7         |
| Net income   | 4,445.8            | 3,175.7        | 40.0         |
| Basic earnings per share   | 0.913              | 0.637          | 43.4         |
| <b>Weighted average number of ordinary shares outstanding during the period (millions)</b> | <b>4,870.9</b>     | <b>4,987.8</b> | <b>(2.3)</b> |

For the basic earnings per share calculation purposes, the weighted average number of ordinary shares outstanding during the period have been obtained applying IFRS rule 33 "Earnings per share". Thereby, there are not taking into account as outstanding shares the weighted average number of shares held as treasury stock during the period nor the shares assigned to the stock options plan for employees "Programa TIES". Furthermore, in line with IFRS rule 33, the weighted average number of shares outstanding during every period, has been adjusted for these operations that had implied a difference in the number of outstanding shares, without a variation associated in the equity, as if those have taken place at the beginning of the first period presented. It consists on the distribution of the paid-in capital reserve by means of delivery of shares in the proportion of 1 share to every 25 shares, approved by the AGM as of May 31, 2005.

### Telefónica Group: Results by companies

Unaudited figures (Euros in millions)

|                                | Revenues<br>january - december |                 |             | OIBDA<br>january - december |                 |             | Operating income<br>january - december |                |             |
|--------------------------------|--------------------------------|-----------------|-------------|-----------------------------|-----------------|-------------|--|----------------|-------------|
|                                | 2005                           | 2004            | % Var       | 2005                        | 2004            | % Var       | 2005                                   | 2004           | % Chg       |
| Telefónica de España Group     | 11,739.5                       | 11,202.2        | 4.8         | 4,766.8                     | 4,560.0         | 4.5         | 2,627.7                                | 2,192.4        | 19.9        |
| Telefónica Latinoamérica Group | 8,265.5                        | 6,748.4         | 22.5        | 3,758.3                     | 3,294.8         | 14.1        | 1,965.8                                | 1,716.1        | 14.6        |
| Cellular Business              | 16,513.5                       | 11,961.4        | 38.1        | 5,817.0                     | 4,637.6         | 25.4        | 3,443.0                                | 3,057.5        | 12.6        |
| Cesky Telecom                  | 1,035.2                        | -               | n.c.        | 456.7                       | -               | n.c.        | 164.8                                  | -              | n.c.        |
| Directories Business           | 660.5                          | 616.4           | 7.1         | 220.0                       | 204.8           | 7.4         | 196.0                                  | 181.0          | 8.3         |
| Atento Group                   | 856.5                          | 606.5           | 41.2        | 116.4                       | 85.1            | 36.7        | 88.5                                   | 51.4           | 72.1        |
| Content & Media Business       | 1,269.1                        | 1,219.1         | 4.1         | 269.2                       | 185.0           | 45.5        | 240.3                                  | 156.2          | 53.9        |
| Other companies*               | 868.2                          | 1,265.0         | (31.4)      | (188.0)                     | (248.9)         | (24.5)      | (258.5)                                | (410.2)        | (37.0)      |
| Eliminations                   | (3,325.7)                      | (3,338.1)       | (0.4)       | 60.1                        | (496.5)         | c.s.        | 91.1                                   | (388.4)        | c.s.        |
| <b>Total Group</b>             | <b>37,882.1</b>                | <b>30,280.9</b> | <b>25.1</b> | <b>15,276.4</b>             | <b>12,222.0</b> | <b>25.0</b> | <b>8,558.8</b>                         | <b>6,556.0</b> | <b>30.5</b> |

\* Starting third quarter 2005, Terra Networks results will be included in the Telefónica de España Group and Telefónica Latinoamérica Group results. The Terra Networks Group results from the first and second quarter of 2005 and from fiscal year 2004 will be incorporated into Other Companies in the Telefónica Group accounts. Also starting in the third quarter of 2005, the Cesky Telecom results corresponding to the July-December 2005 period will be incorporated as an independent business line, whose acquisition was last June.

\* OIBDA and Operating Income exclude the variation in investment valuation allowances accounted for by Telefónica S.A. parent company and that are eliminated in consolidation.

## Telefónica Group : Exchanges rates applied

|                                   | P&L <sup>1</sup> |                | Balance Sheet and CapEx <sup>2</sup> |               |
|-----------------------------------|------------------|----------------|--------------------------------------|---------------|
|                                   | Jan - dec 2005   | Jan - dec 2004 | december 2005                        | december 2004 |
| USA (US Dollar/Euro)              | 1.242            | 1.242          | 1.180                                | 1.362         |
| Argentina (Argentinean Peso/Euro) | 3.631            | 3.651          | 3.577                                | 4.058         |
| Brazil (Brazilian Real/Euro)      | 3.002            | 3.632          | 2.761                                | 3.616         |
| Czech Republic (Czech Crown/Euro) | 29.780           | -              | 29.005                               | -             |
| Chile (Chilean Peso/Euro)         | 694.444          | 757.576        | 606.061                              | 757.576       |
| Colombia (Colombian Peso/Euro)    | 2,881.844        | 3,257.329      | 2,695.418                            | 3,257.329     |
| El Salvador (Colon/Euro)          | 10.870           | 10.868         | 10.322                               | 11.919        |
| Guatemala (Quetzal/Euro)          | 9.496            | 9.887          | 8.974                                | 10.570        |
| Mexico (Mexican Peso/Euro)        | 13.517           | 14.017         | 12.715                               | 15.344        |
| Nicaragua (Cordoba/Euro)          | 20.799           | 19.794         | 20.222                               | 22.242        |
| Peru (Peruvian Nuevo Sol/Euro)    | 4.096            | 4.240          | 4.051                                | 4.470         |
| Uruguay (Uruguayan Peso/Euro)     | 30.331           | 35.587         | 28.490                               | 35.958        |
| Venezuela (Bolívar/Euro))         | 2,624.672        | 2,386.635      | 2,538.071                            | 2,617.801     |

<sup>1</sup> These exchange rates are used to convert the P&L accounts of the Group foreign subsidiaries from local currency to euros.

<sup>2</sup> Exchange rates as of 31/12/05 y 31/12/04.

## Telefónica Group: Consolidated income statement

Unaudited figures (Euros in millions)

|  | january - december |                 |              | january - december |                |              |
|--|--------------------|-----------------|--------------|--------------------|----------------|--------------|
|  | 2005               | 2004            | % Var        | 2005               | 2004           | % Chg        |
| Revenues   | 37,882.1           | 30,280.9        | 25.1         | 10,480.0           | 8,217.9        | 27.5         |
| Internal expenditure capitalised in fixed assets <sup>1</sup>                              | 601.3              | 470.3           | 27.9         | 263.2              | 165.2          | 59.3         |
| Operating expenses   | ((23,219.3)        | (18,329.8)      | 26.7         | (6,461.3)          | (5,116.9)      | 26.3         |
| Supplies   | (10,065.0)         | (7,637.3)       | 31.8         | (2,941.0)          | (2,276.1)      | 29.2         |
| Personnel expenses   | (5,656.4)          | (5,095.2)       | 11.0         | (1,441.0)          | (1,164.1)      | 23.8         |
| Subcontracts   | ((6,715.3)         | (5,072.0)       | 32.4         | (1,827.9)          | (1,523.1)      | 20.0         |
| Taxes  | (782.6)            | (525.3)         | 49.0         | (251.5)            | (153.6)        | 63.7         |
| Other net operating income (expense)   | (212.9)            | (43.6)          | n.s.         | (9.1)              | (4.1)          | 123.0        |
| Gain (loss) on sale of fixed assets  | 249.3              | 21.6            | n.s.         | 71.7               | 2.7            | n.s.         |
| Impairment of goodwill and other assets  | (24.2)             | (177.3)         | (86.4)       | (12.5)             | (164.7)        | (92.4)       |
| <b>Operating income before D&amp;A (OIBDA)</b>   | <b>15,276.4</b>    | <b>12,222.0</b> | <b>25.0</b>  | <b>4,331.9</b>     | <b>3,100.2</b> | <b>39.7</b>  |
| Depreciation and Amortisation  | (6,717.7)          | (5,666.0)       | 18.6         | (1,897.6)          | (1,461.6)      | 29.8         |
| <b>Operating income (OI)</b>   | <b>8,558.8</b>     | <b>6,556.0</b>  | <b>30.5</b>  | <b>2,434.3</b>     | <b>1,638.6</b> | <b>48.6</b>  |
| Profit from associated companies   | (128.2)            | (50.5)          | 153.9        | (137.8)            | 1.5            | c.s.         |
| Net financial income (expense)   | (1,634.3)          | (1,639.1)       | (0.3)        | (505.1)            | (590.7)        | (14.5)       |
| <b>Income before taxes</b>   | <b>6,796.2</b>     | <b>4,866.4</b>  | <b>39.7</b>  | <b>1,791.4</b>     | <b>1,049.4</b> | <b>70.7</b>  |
| Income taxes   | (1,969.2)          | (1,512.8)       | 30.2         | (513.8)            | (364.0)        | 41.2         |
| <b>Income from continuing operations</b>   | <b>4,827.1</b>     | <b>3,353.6</b>  | <b>43.9</b>  | <b>1,277.5</b>     | <b>685.4</b>   | <b>86.4</b>  |
| Income (Loss) from discontinued operations   | 0.0                | 132.0           | n.s.         | 0.0                | 190.8          | n.s.         |
| Minority interest  | (381.2)            | (309.9)         | 23.0         | (85.0)             | (89.7)         | (5.3)        |
| <b>Net income</b>  | <b>4,445.8</b>     | <b>3,175.7</b>  | <b>40.0</b>  | <b>1,192.5</b>     | <b>786.5</b>   | <b>51.6</b>  |
| <b>Weighted average number of ordinary shares outstanding during the period (millions)</b> | <b>4,870.9</b>     | <b>4,987.8</b>  | <b>(2.3)</b> | <b>4,813.1</b>     | <b>4,912.2</b> | <b>(2.0)</b> |
| <b>Basic earnings per share</b>  | <b>0.913</b>       | <b>0.637</b>    | <b>43.4</b>  | <b>0.248</b>       | <b>0.160</b>   | <b>54.7</b>  |

<sup>1</sup> Including work in process.

For the basic earnings per share calculation purposes, the weighted average number of ordinary shares outstanding during the period have been obtained applying IFRS rule 33 "Earnings per share". Thereby, there are not taking into account as outstanding shares the weighted average number of shares held as treasury stock during the period nor the shares assigned to the stock options plan for employees "Programa TIES". Furthermore, in line with IFRS rule 33, the weighted average number of shares outstanding during every period, has been adjusted for these operations that had implied a difference in the number of outstanding shares, without a variation associated in the equity, as if those have taken place at the beginning of the first period presented. It consists on the distribution of the paid-in capital reserve by means of delivery of shares in the proportion of 1 share to every 25 shares, approved by the AGM as of May 31, 2005.



## Telefónica Group: Consolidated Balance sheet

Unaudited figures (Euros in millions)

|  | december        |                 |             |
|--|-----------------|-----------------|-------------|
|  | 2005            | 2004            | % Chg       |
| <b>Non-current assets</b>  | <b>59,545.0</b> | <b>48,954.5</b> | <b>21.6</b> |
| Intangible assets  | 7,877.1         | 5,674.1         | 38.8        |
| Goodwill   | 8,910.2         | 5,949.4         | 49.8        |
| Property, plant and equipment and Investment property                      | 28,027.4        | 23,221.7        | 20.7        |
| Long-term financial assets and other non-current assets                    | 6,345.6         | 5,152.0         | 23.2        |
| Deferred tax assets  | 8,384.7         | 8,957.1         | (6.4)       |
| <b>Current assets</b>  | <b>13,628.8</b> | <b>11,124.4</b> | <b>22.5</b> |
| Inventories  | 919.5           | 655.5           | 40.3        |
| Trade and other receivables  | 7,515.7         | 5,919.8         | 27.0        |
| Current tax receivable   | 1,448.3         | 1,069.5         | 35.4        |
| Short-term financial investments   | 1,517.8         | 2,556.6         | (40.6)      |
| Cash and cash equivalents  | 2,213.2         | 914.3           | 142.1       |
| Non-current assets classified as held for sale                             | 14.3            | 8.7             | 64.8        |
| <b>Total Assets = Total Equity and Liabilities</b>                         | <b>73,173.8</b> | <b>60,078.9</b> | <b>21.8</b> |
| <b>Equity</b>  | <b>16,158.4</b> | <b>12,342.5</b> | <b>30.9</b> |
| Equity attributable to equity holders of the parent                        | 12,733.3        | 10,439.8        | 22.0        |
| Minority interest  | 3,425.1         | 1,902.7         | 80.0        |
| <b>Non-current liabilities</b>   | <b>35,126.5</b> | <b>27,742.6</b> | <b>26.6</b> |
| Long-term financial debt   | 25,167.6        | 17,492.2        | 43.9        |
| Deferred tax liabilities   | 2,477.4         | 1,642.6         | 50.8        |
| Long-term provisions   | 6,353.2         | 7,407.7         | (14.2)      |
| Other long-term liabilities  | 1,128.2         | 1,200.1         | (6.0)       |
| <b>Current liabilities</b>   | <b>21,888.9</b> | <b>19,993.8</b> | <b>9.5</b>  |
| Short-term financial debt  | 9,235.9         | 10,210.4        | (9.5)       |
| Trade and other payables   | 6,932.9         | 5,632.3         | 23.1        |
| Current tax payable  | 2,191.6         | 1,824.9         | 20.1        |
| Short-term provisions and other liabilities                                | 3,528.5         | 2,323.5         | 51.9        |
| Liabilities associated with non-current assets classified as held for sale | 0.0             | 2.7             | n.s.        |
| Financial Data   |                 |                 |             |
| <b>Net Financial Debt <sup>1</sup></b>                                     | <b>30,067.0</b> | <b>23,694.4</b> | <b>26.9</b> |

<sup>1</sup> Net Financial Debt = Long term financial debt + Other long term liabilities + Short term financial debt - Short term financial investments - Cash and cash equivalents - Long term financial assets and other non-current assets.

## Telefónica Group: Free cash flow and change in debt

Unaudited figures (Euros in millions)

|                   |   | January - December |                  |              |
|-------------------|---|--------------------|------------------|--------------|
|                   |   | 2005               | 2004             | % Chg        |
| <b>I</b>          | <b>Cash flows from operations</b>                                       | <b>13,854.3</b>    | <b>11,706.5</b>  | <b>18.3</b>  |
| <b>II</b>         | <b>Net interest payment <sup>1</sup></b>                                | <b>(1,449.4)</b>   | <b>(1,235.9)</b> | <b>-</b>     |
| <b>III</b>        | <b>Payment for income tax</b>   | <b>(1,233.0)</b>   | <b>(326.0)</b>   | <b>-</b>     |
| <b>A=I+II+III</b> | <b>Net cash provided by operating activities</b>                        | <b>11,171.9</b>    | <b>10,144.6</b>  | <b>10.1</b>  |
| <b>B</b>          | <b>Payment for investment in fixed and intangible</b>                   | <b>(4,409.9)</b>   | <b>(3,457.7)</b> | <b>-</b>     |
| <b>C=A+B</b>      | <b>Net free cash flow after CAPEX</b>                                   | <b>6,762.0</b>     | <b>6,686.9</b>   | <b>1.1</b>   |
| <b>D</b>          | <b>Net Cash received from sale of Real Estate</b>                       | <b>99.9</b>        | <b>210.8</b>     | <b>-</b>     |
| <b>E</b>          | <b>Net payment for financial investment</b>                             | <b>(5,939.8)</b>   | <b>(3,714.3)</b> | <b>-</b>     |
| <b>F</b>          | <b>Net payment for dividends and treasury stock<sup>2</sup></b>         | <b>(4,822.8)</b>   | <b>(4,804.4)</b> | <b>-</b>     |
| <b>G=C+D+E+F</b>  | <b>Free cash flow after dividends</b>                                   | <b>(3,900.7)</b>   | <b>(1,621.0)</b> | <b>140.6</b> |
| <b>H</b>          | <b>Effects of exchange rate changes on net financial debt</b>           | <b>1,396.1</b>     | <b>-</b>         | <b>-</b>     |
| <b>I</b>          | <b>Effects on net financial debt of changes in consolid. and others</b> | <b>1,075.8</b>     | <b>-</b>         | <b>-</b>     |
| <b>J</b>          | <b>Net financial debt at beginning of period</b>                        | <b>23,694.4</b>    | <b>-</b>         | <b>-</b>     |
| <b>K=J-G+H+I</b>  | <b>Net financial debt at end of period</b>                              | <b>30,067.0</b>    | <b>-</b>         | <b>-</b>     |

<sup>1</sup> Including cash received from dividends paid by subsidiaries that are not under full consolidation method.

<sup>2</sup> Dividends paid by Telefónica S.A. and dividend payments to minorities from subsidiaries that are under full consolidation method and treasury stock.

## Telefónica Group: Reconciliations of cash flow and OIBDA minus CAPEX

Unaudited figures (Euros in millions)

|  | january - december |                  |              |
|--|--------------------|------------------|--------------|
|  | 2005               | 2004             | % Chg        |
| <b>OIBDA</b>   | <b>15,276.4</b>    | <b>12,222.0</b>  | <b>25.0</b>  |
| - CapEx accrued during the period (EsP exchange rate)            | (5,358.7)          | (3,767.1)        | -            |
| - Payments related to commitments                                | (894.2)            | (916.5)          | -            |
| - Net interest payment   | (1,449.4)          | (1,235.9)        | -            |
| - Payment for income tax   | (1,233.0)          | (326.0)          | -            |
| - Results from the sale of fixed assets                          | (249.3)            | (21.6)           | -            |
| - Invest. in working cap. and other deferred income and expenses | 670.2              | 732.0            | -            |
| <b>= Net Free Cash Flow after CapEx</b>                          | <b>6,762.0</b>     | <b>6,686.9</b>   | <b>1.1</b>   |
| - Net Cash received from sale of Real Estate                     | 99.9               | 210.8            | -            |
| - Net payment for financial investment                           | (5,939.8)          | (3,714.3)        | -            |
| - Net payment for dividends and treasury stock                   | (4,822.8)          | (4,804.4)        | -            |
| <b>= Free Cash Flow after dividends</b>                          | <b>(3,900.7)</b>   | <b>(1,621.0)</b> | <b>140.6</b> |

At the Investor Conference held in October 2003, the concept expected "Free Cash Flow" 2003-2006 was introduced to reflect the amount of cash flow available to remunerate Telefónica S.A. Shareholders, to protect solvency levels (financial debt and commitments), and to accommodate strategic flexibility. The differences with the caption "Net Free Cash Flow after CapEx" included in the table presented above, are related to "Free Cash Flow" being calculated before payments related to commitments (workforce reductions and guarantees) and after dividend payments to minorities, due to cash recirculation within the Group.

|   | 2005    | 2004    |
|---|---------|---------|
| Net Free Cash Flow after CapEx                    | 6,762.0 | 6,686.9 |
| + Payments related to cancellation of commitments | 692.8   | 697.2   |
| - Ordinary dividends payment to minorities        | (346.7) | (176.1) |
| = Free Cash Flow                                  | 7,108.1 | 7,208.0 |

## Net financial debt and commitments

Unaudited figures (Euros in millions)

|   | december 2005   |
|---|-----------------|
| Long-term debt  | 25,647.8        |
| Short term debt including current maturities                  | 9,193.9         |
| Cash and Banks  | (2,213.2)       |
| Short and Long-term financial investments <sup>1</sup>        | (2,561.5)       |
| <b>A Net Financial Debt</b>                                   | <b>30,067.0</b> |
| Guarantees to IPSE 2000                                       | 365.5           |
| Guarantees to Newcomm   | 83.5            |
| <b>B Commitments related to guarantees</b>                    | <b>449.0</b>    |
| Gross commitments related to workforce reduction <sup>2</sup> | 5,270.1         |
| Value of associated Long-term assets <sup>3</sup>             | (754.7)         |
| Taxes receivable <sup>4</sup>                                 | (1,457.7)       |
| <b>C Net commitments related to workforce reduction</b>       | <b>3,057.7</b>  |
| <b>A + B + C Total Debt + Commitments</b>                     | <b>33,573.7</b> |
| <b>Net Financial Debt / OIBDA<sup>5</sup></b>                 | <b>1.91x</b>    |
| <b>Total Debt + Commitments/ OIBDA<sup>5</sup></b>            | <b>2.13x</b>    |

<sup>1</sup> Short term investments and certain investments in financial assets with a maturity profile longer than one year, whose amount is included in the caption "Investment" of the Balance Sheet.

<sup>2</sup> Mainly in Spain, except 91.3 million euros related to the provision of pension fund liabilities of corporations outside Spain. This amount is detailed in the caption "Provisions for Contingencies and Expenses" of the Balance Sheet, and is the result of adding the following items: "Provision for Pre-retirement, Social Security Expenses and Voluntary Severance", "Group Insurance", "Technical Reserves", and "Provisions for Pension Funds of Other Companies".

<sup>3</sup> Amount included in the caption "Investment" of the Balance Sheet, section "Other Loans". Mostly related to investments in fixed income securities and long-term deposits that cover the materialisation of technical reserves of the Group insurance companies.

<sup>4</sup> Net present value of tax benefits arising from the future payments related to workforce reduction commitments.

<sup>5</sup> Calculation based on annualized OIBDA. Including Cesky Telecom January-December 2005 OIBDA.

## CAPEX by business lines

Unaudited figures (Euros in millions)

|                                | january-december |                |             |
|--------------------------------|------------------|----------------|-------------|
|                                | 2005             | 2004           | % Chg       |
| Telefónica de España Group     | 1,406.6          | 1,207.5        | 16.5        |
| Telefónica Latinoamérica Group | 1,061.2          | 748.5          | 41.8        |
| Cellular Business              | 2,330.4          | 1,669.0        | 39.6        |
| Cesky Telecom                  | 147.0            |                | n.c.        |
| Directories Business           | 24.1             | 21.5           | 11.9        |
| Atento Group                   | 42.9             | 22.8           | 88.6        |
| Content & Media Business       | 25.5             | 24.3           | 5.2         |
| Other companies & Eliminations | 321.0            | 73.5           | n.s.        |
| <b>Total Group</b>             | <b>5,358.7</b>   | <b>3,767.1</b> | <b>42.3</b> |

Starting third quarter 2005, Terra Networks results will be included in the Telefónica de España Group and Telefónica Latinoamérica Group results.

The Terra Networks Group results from the first and second quarter of 2005 and from fiscal year 2004 will be incorporated into Other Companies in the Telefónica Group accounts.

2004 data of Telefónica Latinoamérica Group and Total Group is adapted to the new accounting criteria (IFRS) for IRKs.

## Results by business

### Fixed Line Business

#### Telefónica de España Group

The 2005 results for Telefónica de España Group comfortably met forecasts announced at the beginning of the year, which were revised upwards following the publication of the third quarter results. Operating revenues grew 4.8% to stand at 11,739.5 million euros and OIBDA increased by 4.5% to total 4,766.8 million euros. Investments amounted to 1,406.6 million euros to remain within announced levels. In terms of operations, the ambitious objective of closing 2005 with over 200,000 Imagenio customers in service was met. This service has notably reaffirmed the attractiveness of Telefónica's Broadband offer, both in terms of an individual marketed product, and sold as part of a bundle in Dúo and Trío packages. This led to a record growth in broadband accesses during the last quarter of the year.

The following broadband products are worthy of mention in terms of the latest commercial initiatives:

- ADSL Mini Class that, with download volume-based billing and a speed of up to 2Mb/s, focuses primarily on SMEs or Businesses.
- ADSL TOP and ADSL PREMIUM PLUS, services based on ADSL 2+ technology with upload/download speeds of up to 10Mb/s / 800Kb/s and 20Mb/s / 800Kb/s, respectively.

Of particular note in the traditional voice business:

- The inclusion of fixed-to-mobile traffic in the Voice Mini Flat-Rate (Tarifa Plana de Voz Mini) and in the National Flat Rate (Tarifa Plana Nacional), at monthly fees

of 4 and 16 euros, respectively. Fixed-to-mobile calls are billed at a single price of 0.19 euros a minute, with no set-up fee.

- International Mini Rate (Tarifa Mini International) at a monthly fee of 3 euros, implying attractive prices to different international destinations to both fixed and mobile lines.

In relation to Wi-Fi services, particularly relevant was the agreement signed with Telecom Italia and Portugal Telecom within the framework of the Wireless Broadband Alliance, an international association of Wi-Fi operators of which Telefónica is the sole Spanish member. Through this agreement, Wi-Fi Roaming has been set up in both countries to expand coverage to 790 new Wi-Fi zones in Portugal and 800 in Italy. These zones now form part of the ADSL Wi-Fi Zone, the operational coverage of which is the largest in Spain with 1,555 hotspots by December 2005.

Lastly, the agreement signed with Federación Valenciana de Municipios y Provincias (Valencia Federation of Municipalities and Provinces) to supply wireless technologies to its facilities should be highlighted.

Aware of the home entertainment market's great potential for development, Telefónica has signed an agreement with Intel, through its subsidiary Terra, to provide the content for the new Intel home entertainment platform.

Besides of the constant launching of new services, Telefónica de España has continued to make intense commercial efforts, especially during the Christmas campaign, with the launch of new promotions. Foremost are the Dúo and Trío promotions that, for subscriptions received

between November 15th and January 7th, were billed at a fee of 20.00 euros per month until the end of January for both Dúo and Trío with flat-rate national voice calls and 24-hour ADSL, compared with the standard fees of 39.90 and 51.90 euros per month, respectively.

As a proof of the continuous commercial efforts to offer users quality and price-competitive products and services, in a recent study the Consumers' Union of Spain placed Telefónica de España as the fixed-line operator with the best price-quality ratio in Spain, based on information regarding prices from the Spanish Telecommunications Regulator, the CMT, and regarding quality from the State Department of Telecommunications and Information Society (SETSI, Secretaría de Estado para las Telecomunicaciones y Sociedad de la Información).

From a regulatory viewpoint, the measures published over recent months regarding the RIO and the 2006 price-cap must be underlined:

- Last November, the CMT published the new RIO, Reference Interconnection Offer, in which the prices of basic services were modified, leading to an average decrease of 1.8% in real terms. Hence, Capacity-based Interconnection prices were maintained and the effective average price of Time-based Interconnection fell by an average of 5.6%. Given the high percentage of traffic processed through the Capacity-based Interconnection model, representing almost 70% of Fixed to Fixed interconnection traffic in 2005, the measure has low financial impact. Other aspects considered in the modification of the RIO concern are the inclusion of new services in the Capacity-based Interconnection model, such as

call interconnection at special rates (intelligent network and subscriber number enquiry services) and calls to short numbers, except for 112, placing effective average interconnection prices among the cheapest in Europe.

- As a result of the measure adopted by the CMT in September to reduce interconnection prices of mobile phone operators, Telefónica de España readjusted fixed-to-mobile prices for each of the three operators in November, to comply with the regulatory requirement forcing Telefónica to have the same net remuneration per traffic, independent of the target mobile phone operator. These adjustments had no impact on average prices.
- Subsequently, on February 4th 2006, Telefónica de España modified its rates for local and fixed-to-mobile traffic under the provisions of the Comisión Delegada de Asuntos Económicos (Delegated Commission for Economic Affairs). The new prices meant that monthly subscription fees for PSTN lines remained unchanged, and voice traffic billing per second from the start of the call was introduced, without the inclusion of franchise time. The new rates, which modify prices per minute, increase fixed-to-mobile set-up fee to 0.12 euros and reduce metropolitan set-up fee to 0.065 euros, while removing the existing 160-second franchised time. These modifications have been defined under the principle of neutrality and, therefore, will have no impact on the average price per minute.
- However, on February 9th 2006, the CMT approved a resolution to suppress the ex-ante control of domestic and international retail prices for the telephone service.

Revenues of Telefónica de España Group amounted to 11,739.5 million euros over 2005, a year-on-year growth of 4.8%. Considering the fourth quarter independently, revenues grew by 4.0% to total 3,010.9 million euros.

Excluding revenues from Terra business in Spain over the last half of the year, Telefónica de España Group revenues for 2005 would stand at 11,717.9 million euros (2,998.3 million euros in the last quarter of 2005), a 4.6% year-on-year growth (+3.6% in the fourth quarter) in line with the guidance revised upward during the publication of the results from the third quarter 2005, which set the growth rate for 2005 revenues over 4%.

Telefónica de España parent company's revenues amounted to 11,250.5 million euros, up 4.8% year on year. Revenues for the fourth quarter of the year stood at 2,889.7 million euros, a 4.3% increase on the same period of the previous year despite the drop in revenues from voice traffic and the slowing down in the growth of broadband revenues.

With regard to revenue contribution by the most relevant subsidiaries in 2005, Telyco Group reached 478.1 million euros revenues equivalent to a 10.2% year-on-year increase, Telefónica Telecomunicaciones Públicas revenues reached 226.6 million euros falling 6.0% year on year and, finally, Terra added 21.6 million euros to the Group revenues over the last half of the year.

- Revenues from Traditional Access grew by 0.1% over the year to reach 2,826.2 million euros. The growth in revenues from subscriptions was able to offset the drop in revenues from connection fees, affected by the free connection fee campaigns. However, revenues from

access experienced a 0.9% decline over the last quarter of the year, essentially due to the reduction in revenues from surcharges on calls from public payphones.

- The fixed telephony accesses in Spain are estimated to have grown 0.9% over 2005, while those of Telefónica de España decreased 1.2% to 16.135.563, to end the year with an estimated market share around 85% of those accesses, after aligning historical data with latest data available from the CMT.
- But this decreasing trend has been more than compensated by the 2.8% growth of the total number of accesses of Telefónica de España, that by year end stood at 21.9 millions. This growth is a result of successful broadband marketing, and was achieved despite the loss of 199,243 fixed telephony accesses over the year.
- Revenues from Traditional Voice services amounted to 5,161.8 million euros during 2005, with a year-on-year reduction of 0.7%. These revenues fell by 1.9% over the fourth quarter.
- Regarding analogue voice traffic originated in fixed lines, the estimated total volume of the market in Spain, expressed in minutes, was down 3.1% year on year, a 1.9 percentage points slowdown in relation to the decline recorded the previous year. After aligning historical data with latest data available from CMT, Telefónica de España's estimated share of the voice market stood at 66% in December.
- The estimated total volume of minutes processed by Telefónica de España during 2005 amounted to 110,207 million, a 10.4% year-on-year drop. Total outgoing traffic (including Internet)

amounted to 59,418 million minutes and fell by 13.6% with regard to the previous year. Traditional outgoing traffic totalled 43,932 million minutes, down by 7.2% year-on-year and slowing down the decline in comparison with the beginning of the year as a result of the lower significant drop in the market.

- In closer detail, metropolitan traffic in the January-December period dropped by 10.9%, provincial by 10.5%, DLD by 5.5% and fixed-to-mobile by 1.6%. International traffic made very good progress over the year, 13.5% up at the end of December, although its growth in the last quarter (+7.6%) was slightly below than that recorded during the first three of 2005. The number of outgoing minutes to the Internet amounted to 15,486 million and continued to show a negative year-on-year variation (-27.8% over the year), mainly as a result of cannibalization of switched Internet traffic by broadband ADSL services. Finally, incoming traffic amounted to 50,789 million minutes, a 6.4% drop compared with the previous year.
- With regard to service packages, it is worth noting that the total number of plans, Combinados and flat rates amounted to 2,905,941, 34.3% more than that reached in September 2005 primarily due to the launch of the Dúo and Trío packages that same month.
- Moreover, the number of pre-selected lines stood at 2,284,590 by the end of 2005, a reduction of 78,121 lines over the quarter, as a result of migrations to unbundled loops, the customer win-back campaigns and the positive effect of new commercial products - particularly the Dúos and Tríos.

- Internet and Broadband services, which contributed almost 79% of the growth in Telefónica de España revenues, totalled 1,904.7 million euros over 2005, a 26.9% increase year on year.

- Within this section, broadband revenues including both, Internet broadband access revenues and Pay TV revenues, grew 40.2% over the year to reach 1,703.5 million euros, of which 1,297.8 million euros are from the retail business.

- Strong growth of the customer base was boosted by the new bundles of products and by promotions, which despite its implication on ARPU reduction, resulted in a final strong top line revenue growth.

- According to our estimates, total fixed broadband Internet accesses in the Spanish market at year end exceeded 5 million lines, with an estimated net gain of around half a million accesses in fourth quarter of the year, being up to date the highest quarterly net gain figure ever in Spain. The success of Telefónica's ADSL offering has been a determining factor in this growth, reaching 3,479,824 accesses (wholesale and retail including those accesses providing only Imagenio service) by the end of 2005. On the other hand, the growth of unbundling has resulted in a decline of Telefonica de España's market share on ADSL down to 89%.

- The offer by Telefonica de España of retail Internet broadband accesses (ADSL, optical fibre, and other technologies, excluding the accesses providing only Imagenio service) registered a net gain of 303,346 accesses in the fourth quarter, almost

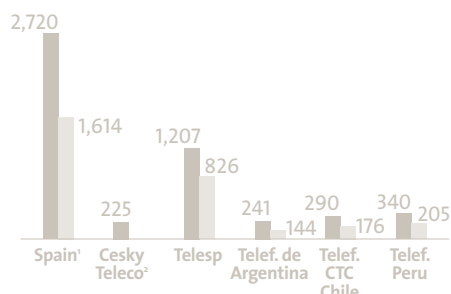
doubling the net gain of same quarter 2004 and representing more than 60% of the estimated net gain of the Spanish market. This led to a total number of retail Internet broadband accesses by Telefónica de España of 2,719,669, representing, according to Company's estimates, a 55% share of the Spanish market. It must be noted that this growth has been achieved in an environment of strong commercial aggressiveness by both our cable-modem and unbundled loop competitors.

- The net gain of unbundled loops for the fourth quarter was 73,475. By year end, the total number of unbundled loops stood at 434,759, 116,112 unbundled lines at 2004 year end, and amounting, according to our estimates, to 8.8% of the total number of fixed broadband Internet accesses and 11.1% of total ADSL connections. Of these unbundled loops, 279,027, 64.2%, were shared access loops.
- The wholesale ADSL service is being affected by the migration to unbundled loops. However, a net growth of 13,332 lines was recorded over the fourth quarter to place the total number at 721,940.
- Broadband value added services (VAS) provided by Telefónica de España remained a distinguishing factor with regard to the competition's commercial offer. 65.1% of our retail broadband customers have contracted at least one VAS and the number of operative services now amounts to over 2.6 million units. ADSL Solutions is noteworthy among these services, a total of 393,295 solutions being operational by the end of 2005 to give a 17.1% increase in relation to September 2005.

## Retail internet broadband accesses

Data in thousands

■ December 2005  
■ December 2004



<sup>1</sup> Telefónica de España includes Terra from the third quarter of 2005, Línea ADSL and satellite.

<sup>2</sup> Cesky Telecom is incorporated as of July 2005

- As indicated, the Imagenio service met its target for 2005 with 206,572 clients, after achieving a fourth quarter net gain of 114,466 customers. This figure is above the total net gain accumulated to September, which shows the commercial efforts made and the operational capacity to manage such a large number of subscriptions. With this growth, Imagenio has reached a significant share of the Spanish Pay TV market, which we estimate at a 6% level, compared to the 0.3% estimated market share at the end of 2004.
- Revenues from Data services grew by 5.4% over the year to reach 1,031.0 million euros. Retail data services fell by 1.1% over this period, despite the 12.7% growth in VPN connections and as a result of the migration of traditional network solutions towards cheaper IP products and the replacement of circuit rental for other, cheaper products.
- Fibre connections to retail customers stood at 13,810, 40.2% above the figure reported at 2004 year end.
- Lastly, revenues from Information Technology services continued to progress with regard to contribution to Group revenues, ending the last quarter of the year with a contribution of 108.4 million euros, a year-on-year growth of 69.0%. Revenues of this type over the year represented 326.8 million euros and a 38.9% growth. This good behaviour was due to the growth in *(-fX)-£286* services of desktop positions and systems integration.
- There are currently 184 client management centres operated by Telefónica staff, and 123 contracts with customers who are outsourcing their

communications service/information systems.

- These figures have grown by 52.1% and 36.7% respectively year on year.
- The number servers dedicated to clients' amounted to 2,931, a 38.6% increase on the previous year. The number of desktop positions managed stood at 87,249.

Telefónica de España Group's operating expenses increased by 5.0% compared with last year to stand at 7,213.7 million euros, as a consequence of the commercial efforts made and the development of new products that allow Telefónica de España to offer the most complete and innovative portfolio of services in our market. Expenses in the fourth quarter amounted to 1,777.7 million euros, having increased 9.5% due to the contribution of additional expenses from the workforce restructuring program during this period.

- Personnel expenses fell 0.8% over the year to stand at 2,695.8 million euros. A new Redundancy Program (E.R.E.) was applied to the Telefónica Data España S.A. workforce during the last quarter of the year. 68 people joined this program, along with the 127 additional employees accepted under the Telefónica de España Redundancy Program during the fourth quarter of 2005, leading to a total figure of 1,945 redundancies by year end.
- This led to an additional provision of 71.0 million euros in the fourth quarter for workforce restructuring, increasing personnel expenses over the quarter by 18.6% year on year to stand at 597.5 million euros.
- Excluding the effect of Redundancy Program provisions in 2004 (643.5 million euros including actuarial

revision) and in 2005 (595.4 million euros), personnel expenses would have grown by 1.3% over the year and 4.4% over the last quarter. This latter figure was affected by the extraordinary provision arising as a result of the salary review in line with the increase in the 2005 CPI, from the 3.3% foreseen at the end of the third quarter to the 3.7% actually recorded at year end.

- The Telefónica de España Parent Company workforce at the end of December was placed at 33,279 employees, a net reduction of 1,766 employees since the start of the year. The average Telefónica de España Parent Company workforce in 2005 stood at 34,280 employees, a 4.5% reduction in comparison with the average workforce in 2004.
- Supplies expenses grew by 8.7% over the year to reach 3,032.0 million euros. This growth was slightly lower during the fourth quarter, standing at 7.5%, due to the lower handset sales at Telyco, the reduction in fixed-to-mobile interconnection tariffs (mobile termination rates) and lower fixed-to-mobile traffic processed during the last quarter of the year. The greater expenses related to the purchase of equipment for Imagenio and new broadband connections, and those allocated to unbundling loops by competitors of Telefónica de España are the main factors following the growth in supplies expenses over 2005. These effects were partially offset by the slight 0.6% fall in interconnection expenses.



## Telefónica de España Group: Selected operating data

Unaudited figures (Thousands)

|   | december        |                 |              |
|---|-----------------|-----------------|--------------|
|   | 2005            | 2004            | % Chg        |
| <b>Fixed telephony accesses<sup>1</sup></b> | <b>16,135.6</b> | <b>16,334.8</b> | <b>(1.2)</b> |
| <b>Internet and data accesses</b>           | <b>5,585.9</b>  | <b>4,989.7</b>  | <b>11.9</b>  |
| Narrowband                                  | 1,614.9         | 2,263.5         | (28.7)       |
| Broadband                                   | 3,441.6         | 2,492.7         | 38.1         |
| Retail <sup>2</sup>                         | 2,719.7         | 1,614.5         | 68.5         |
| Unbundled loops <sup>3</sup>                | 434.8           | 116.1           | n.s.         |
| <b>Pay TV</b>                               | <b>206.6</b>    | <b>6.0</b>      | <b>n.s.</b>  |
| <b>Total Accesses</b>                       | <b>21,928.0</b> | <b>21,330.5</b> | <b>2.8</b>   |

<sup>1</sup> PSTN (including Public Use Telephony) x1; ISDN Basic access x1; ISDN Primary access; 2/6 Access x30. Company's accesses for internal use included.<sup>2</sup> Includes Terra from the third quarter of 2005, Línea ADSL and satellite.<sup>3</sup> Includes fully unbundled loops and shared loops.

- External services expenses grew by 9.3% over the year to total 1,289.9 million euros, as a result of the intense commercial campaign developed by Telefónica de España to face the demanding competitive environment. In fact, Telefónica de España's commercial expenses increased by 12.3% over this period in relation to the same period of the previous year.

The combined effort made by the Company with regard to the growth in revenues and efficiency has led to an operating income before depreciation and Amortisation (OIBDA) of 4,766.8 million euros, a 4.5% year-on-year growth. However, the OIBDA in the fourth quarter of 2005 stood at 1,280.6 million euros, a 3.8% fall year on year following the acceptance of an additional 195 employees to join the Redundancy Plan over the last three months of the year.

In order to compare this with the announced financial guidance, the effect of including Terra assets in Spain and other exceptional revenues/expenses not foreseen in 2005 and 2004 must be excluded from the OIBDA. Excluding the effect of the integration of Terra, the OIBDA recorded a year-on-year growth of 3.9% in 2005 to stand at 4,739.5 million euros. Also excluding other exceptional revenues/expenses not foreseen in 2005 and 2004, the growth of OIBDA would stand at 5.1% to exceed the guidance announced by the company, which set the OIBDA growth forecast at between 2% and 5% for 2005.

The OIBDA margin stood at 40.6% in 2005, remaining almost the same (-0.1 percentage points) as that recorded the previous year. Excluding the effect of Redundancy Plan provision in 2005, the margin would have increased by 5.1 percentage points to reach 45.7%. Comparing this margin with the comparable margin of the same period in 2004 (excluding the Redundancy Program provision and the actuarial review for 2004), a 0.8 percentage point drop was recorded as a result of the greater commercial and supply efforts during 2005.

The OIBDA for the Telefónica de España parent company amounted to 4,716.4 million euros, up 4.1% year on year.

CapEx totalled 1,406.6 million euros, a 16.5% increase in comparison with the previous year but staying within the announced range.

## Telefónica de España Parent company: Operating revenues

Unaudited figures (Euros in millions)

|  | january - december |                 |              | october - december |                |              |
|--|--------------------|-----------------|--------------|--------------------|----------------|--------------|
|  | 2005               | 2004            | % Var        | 2005               | 2004           | % Chg        |
| <b>Traditional access<sup>1</sup></b>                | <b>2,826.2</b>     | <b>2,823.2</b>  | <b>0.1</b>   | <b>704.3</b>       | <b>710.7</b>   | <b>(0.9)</b> |
| <b>Traditional Voice Services</b>                    | <b>5,161.8</b>     | <b>5,199.4</b>  | <b>(0.7)</b> | <b>1,298.3</b>     | <b>1,323.4</b> | <b>(1.9)</b> |
| Domestic Traffic <sup>2</sup>                        | 1,330.8            | 1,467.6         | (9.3)        | 334.7              | 378.3          | (11.5)       |
| Fixed to Mobile Traffic                              | 1,151.8            | 1,207.4         | (4.6)        | 281.8              | 303.7          | (7.2)        |
| International Traffic                                | 474.4              | 410.1           | 15.7         | 120.0              | 115.8          | 3.6          |
| Intel. Network. other cons. and bonuses <sup>3</sup> | 309.9              | 237.1           | 30.7         | 87.4               | 65.7           | 33.1         |
| Interconnection <sup>4</sup>                         | 944.0              | 868.9           | 8.6          | 227.1              | 222.9          | 1.9          |
| Handsets sales and others <sup>5</sup>               | 951.0              | 1,008.3         | (5.7)        | 247.3              | 237.0          | 4.3          |
| <b>Internet Broadband Services</b>                   | <b>1,904.7</b>     | <b>1,501.1</b>  | <b>26.9</b>  | <b>516.7</b>       | <b>425.6</b>   | <b>21.4</b>  |
| Narrowband   | 201.2              | 285.9           | (29.6)       | 47.8               | 61.9           | (22.8)       |
| Broadband  | 1,703.5            | 1,215.2         | 40.2         | 468.9              | 363.7          | 28.9         |
| Retail <sup>6</sup>                                  | 1,297.8            | 950.8           | 36.5         | 358.9              | 283.6          | 26.5         |
| Wholesale <sup>7</sup>                               | 405.7              | 264.4           | 53.4         | 110.1              | 80.1           | 37.4         |
| <b>Data Services</b>                                 | <b>1,031.0</b>     | <b>978.6</b>    | <b>5.4</b>   | <b>262.1</b>       | <b>247.2</b>   | <b>6.0</b>   |
| VPN. Leased Circuits and Broadcasting                | 666.9              | 674.1           | (1.1)        | 169.0              | 176.6          | (4.3)        |
| Wholesale  | 364.1              | 304.4           | 19.6         | 93.1               | 70.6           | 31.9         |
| <b>IT Services</b>                                   | <b>326.8</b>       | <b>235.3</b>    | <b>38.9</b>  | <b>108.4</b>       | <b>64.1</b>    | <b>69.0</b>  |
| <b>Total operating revenues</b>                      | <b>11,250.5</b>    | <b>10,737.6</b> | <b>4.8</b>   | <b>2,889.7</b>     | <b>2,771.0</b> | <b>4.3</b>   |

<sup>1</sup> Monthly and connection fees (PSTN, Public Use Telephony, ISDN and Corporate Services) and Telephone booths surcharges.

<sup>2</sup> Local and domestic long distance (provincial and interprovincial) traffic.

<sup>3</sup> Intelligent Network Services, Special Valued Services, Information Services (i18xy), bonuses and others.

<sup>4</sup> Includes revenues from fixed to fixed incoming traffic, fixed to mobile incoming traffic, and transit and carrier traffic.

<sup>5</sup> Managed Voice Services and other businesses revenues.

<sup>6</sup> Retail ADSL services and other Internet Services.

<sup>7</sup> Includes Megabase, Megavía, GigADSL, and local loop unbundling.

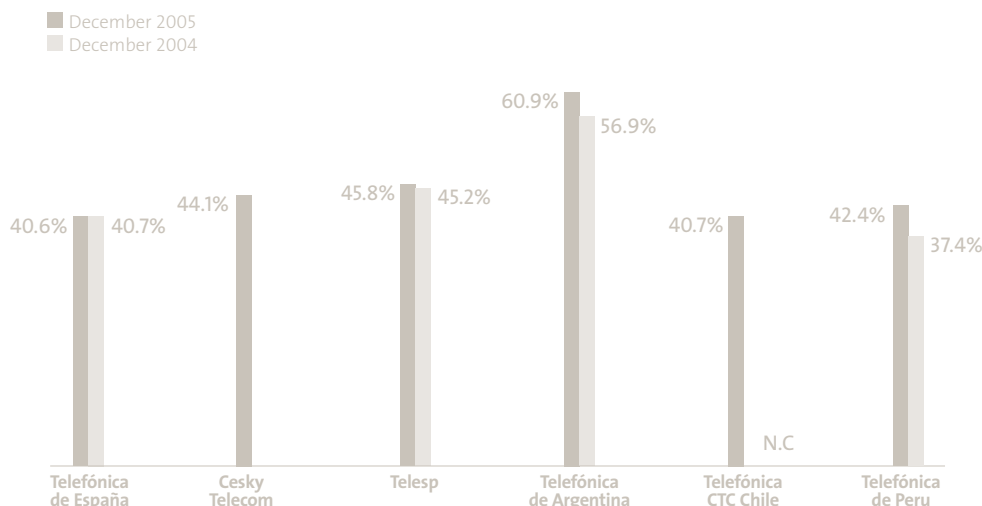
## Telefónica de España Group. : Consolidated Income statement

Unaudited figures (Euros in millions)

|   | january - december |                |             | october - december |                |              |
|---|--------------------|----------------|-------------|--------------------|----------------|--------------|
|   | 2005               | 2004           | % Var       | 2005               | 2004           | % Chg        |
| Revenues  | 11,739.5           | 11,202.2       | 4.8         | 3,010.9            | 2,894.1        | 4.0          |
| Internal expenditure capitalised in fixed assets <sup>1</sup> | 160.8              | 144.3          | 11.5        | 53.3               | 47.0           | 13.3         |
| Operating expenses  | (7,213.7)          | (6,871.0)      | 5.0         | (1,777.7)          | (1,623.5)      | 9.5          |
| Other net operating income (expense)                          | 19.6               | 64.1           | (69.5)      | (12.2)             | 14.6           | c.s.         |
| Gain (loss) on sale of fixed assets                           | 70.7               | 43.0           | 64.4        | 10.7               | 9.9            | 8.3          |
| Impairment of goodwill and other assets                       | (10.0)             | (22.6)         | (55.8)      | (4.4)              | (11.1)         | (60.6)       |
| <b>Operating income before D&amp;A (OIBDA)</b>                | <b>4,766.8</b>     | <b>4,560.0</b> | <b>4.5</b>  | <b>1,280.6</b>     | <b>1,331.1</b> | <b>(3.8)</b> |
| Depreciation and Amortisation                                 | (2,139.1)          | (2,367.7)      | (9.7)       | (510.9)            | (568.7)        | (10.2)       |
| <b>Operating income (OI)</b>                                  | <b>2,627.7</b>     | <b>2,192.4</b> | <b>19.9</b> | <b>769.8</b>       | <b>762.4</b>   | <b>1.0</b>   |
| Profit from associated companies                              | (2.1)              | (0.5)          | n.s.        | 0.1                | (0.1)          | c.s.         |
| Net financial income (expense)                                | (393.5)            | (523.7)        | (24.9)      | (51.9)             | (147.4)        | (64.8)       |
| <b>Income before taxes</b>                                    | <b>2,232.1</b>     | <b>1,668.1</b> | <b>33.8</b> | <b>718.1</b>       | <b>614.9</b>   | <b>16.8</b>  |
| Income taxes  | (737.3)            | (554.8)        | 32.9        | (243.8)            | (203.4)        | 19.8         |
| <b>Income from continuing operations</b>                      | <b>1,494.7</b>     | <b>1,113.4</b> | <b>34.3</b> | <b>474.3</b>       | <b>411.5</b>   | <b>15.3</b>  |
| Income (Loss) from discontinued operations                    | 0.0                | 0.0            | n.s.        | 0.0                | 0.0            | n.s.         |
| Minority interest   | (0.5)              | (0.2)          | 157.5       | (0.1)              | (0.0)          | n.s.         |
| <b>Net income</b>   | <b>1,494.3</b>     | <b>1,113.2</b> | <b>34.2</b> | <b>474.2</b>       | <b>411.5</b>   | <b>15.2</b>  |

<sup>1</sup>Including work in process.

## OIBDA margin fixed telephony



## Telefónica Latinoamérica Group

The good progress made by the fixed telephone line operators Telefónica Empresas América (TEA) and TIWS, and the general appreciation of all Latin American currencies against the Euro, in particular the Brazilian real (+21.0%) have allowed Telefónica Latinoamérica Group to record outstanding results in 2005, in line with all the financial targets announced at the beginning of the year. Furthermore, since July the results of Terra's Latin American operations (Terra Latam) have been consolidated in the Telefónica Latinoamérica Group, contributing 1.6 percentage points to the increase in revenues.

Over the year, Telefónica Latinoamérica Group generated revenues of 8,265.5 million euros, a 22.5% increase in current euros (+6.2% in constant euros and excluding the effect of the inclusion of Terra Latam). This year-on-year growth was achieved mainly through the growth in Telesp revenues (+7.9% in local currency), driven by tariff increases, the good progress made by Broadband and TUP, and, to a lesser extent, the growth of value-added services. It is also worth noting the increase in TASA revenues (+9.3% in local currency) thanks to the good performance of the traditional business (+7.3%), the increase in fixed telephony accesses (+4.8%) and the good performance in the wholesale business, as well as the positive growth of the broadband business. CTC recorded a lower level of growth (+1.1% in local currency), thanks to the positive progress made by the Internet business (narrowband + broadband), whose 32.5% growth in local currency compensated for the decreased revenues from the traditional business, which dropped by

0.9%. TdP is a similar case, with a slight growth in revenues (+1.6% in local currency), thanks to growth in the Internet business (+38.7%), that counteracts the 1.3% fall in traditional business, affected by the application of the new productivity factor to its tariffs (10.07%). Telefónica Empresas América and TIWS showed significantly increased revenues, up 8.3% and 18.9% in constant euros, respectively.

At year end, Telefónica Latinoamérica Group's operating expenses stood at 4,462.4 million euros, +22.3% in current euros compared to 2004. This growth was reduced to 5.0% in constant euros and excluding the inclusion of Terra Latam, 1.2 percentage points below the growth in revenues. The main cost growth factor for the operators was the increased commercial efforts, mainly sales commissions and customer assistance expenses.

Bad debts made good progress, with a 12.3% decrease in bad debt provision in constant euros (excluding Terra Latam), thanks to good recovery management and the larger volume of prepaid and consumption control lines in the operators.

In 2005, Telefónica Latinoamérica Group recorded a net gain on sale of fixed assets of 107.1 million euros, primarily corresponding to the capital gains generated by the sale of Infonet, which took place during the first quarter of the year, and of Telinver, in Argentina, in the last quarter.

As a result of the above, Telefónica Latinoamérica Group recorded an operating income before depreciation and Amortisation (OIBDA) of 3,758.3 million euros, 14.1% higher year-on-year in current euros (+0.4% in constant euros and excluding the contribution of Terra Latam).

This progress was influenced by gain on sale of fixed assets, that include the sale of the mobile telephony division of CTC to Telefónica Móviles in 2004, and the sales in 2005 of Infonet and Telinver in Argentina. Excluding the gain on sale of fixed assets, there was a 27.4% growth in OIBDA in current euros (+11.7% in constant euros and excluding Terra Latam). The OIBDA margin as a percentage of revenues (excluding the gain on sale of fixed assets) stands at 44.2% (compared with 42.5% in the previous year).

The greater investment in broadband, which was necessary for the expansion of this business in the region, placed Telefónica Latinoamérica Group's CapEx at 1,061.2 million euros, a year-on-year growth of 13.2% in constant terms and excluding Terra Latam. Despite this growth, the significant OIBDA volume that was achieved allowed to reach an operating free cash flow (OIBDA-CapEx) of 2,697.1 million euros.

At year end, Telefónica Latinoamérica Group managed 28.2 million accesses, up 7.0% year on year, mainly due to the 53.8% growth in retail Internet broadband accesses, which have reached 2.1 million. The fixed telephone accesses reached 2.1 million, an increase of 1.5% compared to 2004, as a result of the significant growth recorded by TASA (+4.8%) and TdP (+9.8%). The Group's final workforce stood at 28,856 employees, an 11.4% increase compared with 2004 year end, due essentially to the inclusion of Terra Latam (around 1,000 employees), the takeover of Atrium in Brazil and the insourcing of employees, mainly in Telesp and TASA.

## Telesp

On December 22nd, Telesp signed the renewal of its concession contract, which expired on 31st December 2005, for a period of 20 years. The conditions of the new contracts were approved by Anatel in December. The main ones are the obligation to bill local traffic in minutes instead of pulses, the new tariff revision reference index (IST), the new productivity factor applicable to tariff revisions, the new interconnection tariff regulation, and the provision of a new type of service to favour access for customers with low income (AICE). On February 23rd, Anatel announced a delay of 12 months in the implementation of the pulses to minutes conversion.

At 2005 year end, Telesp had 15.7 million accesses, a growth of 1.7%, thanks to the strong growth of its retail Internet broadband plant, which stands at 1.2 million accesses (+46.0% year on year), having recorded the highest net gain in one quarter (more than 122,000 accesses in the last quarter of 2005). This progress compensates for the slight fall in fixed telephone accesses (-0.9%, to 12.3 million accesses), although the positive change in family lines, in place since the end of March, should be noted, meaning that lines with consumption control represent 19% of the fixed-line telephony plant at the end of the year.

Voice traffic (57,577 million minutes) fell by 2.3% year on year, slightly improving on the performance recorded until September (-3.6%). This decrease is due to the greater use of mobile phones, which affects mainly long distance and public telephony traffic, to the decline in traffic in the Intrastate Long Distance market, and to the change in the mix of the plant, which affects fixed-to-mobile and long distance traffic. Note,

however, the improved progress of local fixed-to-fixed traffic, which grew by 2.6%. Internet traffic fell by 12.3%, due to the migration of customers to broadband.

Revenues stood at 4,852.7 million euros, an increase of 7.9% in local currency, thanks to 6.6% growth in revenues from traditional business, helped by the increase in fixed-to-fixed and fixed-to-mobile tariffs, increased sales of value-added services and sales of equipment, and also the good performance of Internet revenues (narrowband and broadband), which increased by 27.1% in local currency, and now represent 7.5% of the company's revenues (6.4% in 2004), due to the good progress in numbers of Internet broadband accesses.

Throughout the year, Telesp kept control of operating costs, which grew by 6.8% in local currency, lower than the increase in revenues. This increase is associated with higher personnel costs (+4.3% in local currency) due to the growth of the workforce caused by the takeover of Atrium and the insourcing of Security and Systems employees, and also to increased interconnection costs resulting from the rise in fixed-to-mobile tariffs, counteracted by the increased revenues, and to higher costs for increased commercial activity, improvement of customer care, and higher prices in some contracts. Despite this, the good management regarding renegotiation with service providers should be noted, managing to limit contractual readjustments.

The positive evolution of bad debt provision is also noteworthy, with an 8.4% decrease compared with last year, thanks to good recovery management and to new products aimed at customers' needs. The bad debt to revenues ratio thus stands at 2.4%.

Telesp operating income before depreciation and Amortisation (OIBDA) in September stood at 2,221.8 million euros, up 9.5% year on year in local currency, in line with the growth recorded in September, mainly as a result of the increase in revenues. The OIBDA margin stands at 45.8%, an improvement of 0.3 percentage points compared to September and 0.6 percentage points year on year.

CapEx accumulated to December was 607.1 million euros, a growth of 25.2% with regard to 2004 in local currency, amounting to 11.5% of revenues in local currency. This increase is due to the sales of new products, and, mainly, to the expansion of broadband. The operating free cash flow (OIBDA-CapEx) stood at 1,614.7 million euros (+5.0% in local currency with regard to last year).

## Telefónica Argentina

Management of TASA, adapted to a context of growing activity and consumption, and of frozen tariffs, has allowed growth in fixed telephone lines and voice traffic (+4.8% and +6.9% respectively), factors that, together with the expansion of broadband, have contributed to the 9.3% increase in revenues.

At 2005 year end, TASA managed 5.4 million accesses (+4.7% compared to December 2004), thanks to the year-on-year increase in fixed telephone accesses (+4.8% to stand at 4.5 million) and the extraordinary growth in retail Internet broadband accesses (+68.1%). With 241,500 retail Internet broadband accesses, TASA remains the leader in the broadband market in the Southern zone of the country.

Voice traffic per line grew by 3.1% year on year, driven by the strong growth in total incoming traffic (+18.7% year-on-year) and of total fixed-to-mobile traffic (+28.0%) in line with the strong expansion of the mobile telephony business in the country. Narrowband Internet traffic fell by 29.4%, affected by the migration to broadband.

The good performance of line and traffic operating variables compared with 2004 has resulted in a volume of revenues that grew to 890.9 million euros, equivalent to a 9.3% year-on-year increase in local currency. Broken down by business, revenues from the traditional business grew by 7.3% year on year, due to the good performance of lines in service and voice traffic, and by the wholesale business, while revenues from the internet business (Narrowband + Broadband), which now contribute 9.0% of TASA revenues (+1.7 percentage points year on year), rose 34.5% in local currency, thanks to the expansion of Internet

broadband accesses, increasing revenues for these services by 82.5% year on year, and offsetting the decrease in the narrowband business.

The growth in TASA operating expenses is slowing down, to 7.4% year on year in local currency, mainly due to the decrease in personnel costs (-2.4%), as a result of the lower labour-related contingencies recorded in 2005, and also due to the lower growth in subcontracting (+18.1%, vs. +21.9% in September), the increase of which is associated with revenue generation (greater commercial activity, customer assistance, increase in quality plans and infrastructure maintenance). Supply expenses increased by 7.9%, mostly due to the expansion of broadband.

The bad debt to revenues ratio was reduced, thanks to the good performance of recoveries and the sales of prepaid lines and lines with consumption limits, which now represent more than 29% of fixed telephone accesses.

The significant growth in revenues, together with the policy of rationalising and containing costs that is maintained, and the capital gains recorded with the sale of Telinver in the last quarter (48.4 million euros), allowed TASA to obtain an operating income before depreciation and Amortisation (OIBDA) of 542.9 million euros, a figure that is 17.0% higher, in local currency, than that for 2004. Excluding the sale of Telinver, the OIBDA shows a year-on-year growth of 6.6% in local currency (+4.7% to September), achieving a margin of 55.5% of revenues.

In 2005, CapEx grew by 7.2% year on year in local currency, to stand at 117.3 million euros, of which approximately a third was dedicated to the development of broadband. The increase in OIBDA, along with control over investments, led to a growth in the operating free cash flow (OIBDA-CapEx) -excluding the capital gain from the sale of Telinver- of 6.4% in local currency year on year, to stand at 377.2 million euros.

## Telefónica CTC Chile

On January 1st 2005, the distribution of the product and customer portfolio for the business segment between CTC and T-Empresas Chile was reviewed. As a consequence of this, Telefónica CTC Chile's 2004 results are shown on comparable terms with the new segmentation.

In January, CTC announced its plans to offer its employees a voluntary retirement plan, to be carried out in 2006. As a result of this, CTC recorded an extraordinary provision of around 2.6 million euros.

In December 2005, CTC managed 2.9 million accesses, up 0.9% on 2004, thanks to the development of new flexible plans, and to the solid progress made by broadband in Chile. Within traditional access, of particular note is CTC's new commercial offer, based on the development of unregulated tariff plans (plans of minutes and product bundling). On December 31st 2005, more than 700,000 customers had flexible plans (plans of minutes, prepaid and consumption control solutions for those with low incomes, and bundled offers of voice and broadband services).

Thanks to the good progress made by Internet broadband accesses sales, a 56.5% growth in accesses was achieved in 2005. CTC thus had a total of 314,200 accesses at the end of the year (of which 289,600 are retail accesses), reaching a 43% market share. This growth reflects the strong commercial efforts made in the year for the expansion of broadband in the country. New variable broadband services (Speedy Recargado) have been developed, and new broadband + voice packages have been launched, in addition to a combined offer with satellite TV and new distribution channels.

Total traffic carried by CTC's network continued to fall, essentially due to significant replacement by mobile telephony and Internet. Local fixed-to-fixed traffic dropped 10.5% in 2005, while fixed-to-mobile traffic grew 8.4%. The total market for domestic and international long distance continues to fall (-13.8% for DLD and -6% for ILD in the last quarter). Despite this decline, CTC achieved better performance than the market as a whole (in the same period -11.5% and +1.3%, respectively).

Revenues amounted to 890.0 million euros, up 1.1% over 2004 figure in local currency, due to the good performance of broadband, whose revenues grew 46.1% in local currency. Thus Internet revenues (narrowband + broadband) grew by 32.5% in local currency to contribute 8.1% of CTC revenues (up 1.9 percentage points year on year). This progress compensates for the slight fall in revenues from the traditional business (-0.9% year on year in local currency), given that the increased revenues from local traffic, which include plans of minutes, interconnection and business and operator services do not offset the decreased revenues from monthly fees, sales of equipment, public telephony and long distance.

Accumulated operating expenses grew by 1.9% to December, in local currency. Personnel expenses fell 6.5% year on year, as a result of the lower workforce restructuring costs in 2005. Subcontracting expenses increased by 4.3%, mainly due to the significant network installation and maintenance work carried out, and commercial and customer care activity. During the fourth quarter a significant effort was made to contain these costs (+9.5% to September).

Bad debts were contained, thanks to specific new prepaid and consumption control products, and to the readjustment of debt recovery policies. The bad debt provision fell by 22.2% in local currency, to stand at 3.2% of revenues.

At 2005 year end, the operating income before depreciation and Amortisation (OIBDA) stood at 362.4 million euros. This result, which is around 57.2% lower than the one recorded in the previous year in local currency, cannot be compared with the 2004 result, since the latter includes the results of the sale of the CTC mobile telephony subsidiary to Telefónica Móviles, which generated capital gains of around 425 million euros for CTC. Excluding this, the fall in OIBDA in local currency is around 4.1%. 2005 OIBDA margin as a percentage of revenues stands at 40.7% (affected by the adjustments in the long distance business announced in the previous quarter and the voluntary retirement programme announced in January; excluding the effects of both, the margin would stand at 43.6%).

The aggregate CapEx to December 2005 stood at 108.5 million euros, of which around 30% was dedicated to the expansion of broadband. This figure represents a year-on-year growth of 11.3% in local currency. The aggregate operating free cash flow (OIBDA-CapEx) in 2005 thus amounted to 253.9 million euros.



## Telefónica del Peru

In 2005, Telefónica del Peru (TdP) recorded significant growth in the number of accesses (+13.7%) to 3.2 million, due to intense commercial activity throughout the entire year, which resulted in a net gain of 208,735 fixed telephone accesses in 2005. The total fixed telephony plant hence stands at 2.3 million accesses, and in broadband the company managed to pass 340,000 retail Internet broadband accesses (+65.7% year on year) recording a net gain of 135,011 customers in the year. Noteworthy, also, is the good performance of the Cable Television plant (Cable Mágico), which has seen year-on-year growth of 18.8%, with 462,211 customers at the end of the year.

TdP's revenues stood at 1,031.4 million euros at 2005 end, meaning year-on-year growth of 1.6% in local currency. Internet revenues (broadband + narrowband) grew by 38.7%, essentially due to the good performance of the broadband plant (+55.6% in revenues). Internet revenues continue to increase their weight in the total revenues, to 9.7% (7.1% in 2004). Revenues from the traditional business fell 1.3%, due to lower revenues from the basic telephone service, despite the growth in lines, as a result of the impact of the productivity factor applied since September 2004 (CPI-10.07%). These are compensated in part by increased public telephony revenues, due to better management of the plant and the good performance of cable TV revenues, which grew by 11.3% year on year thanks to the growth of the accesses.

Total traffic carried by TdP decreased by 2.8% year on year: while voice traffic grew 2.2%, promoted by the good performance of incoming interconnection traffic (+14.4%), local fixed-to-fixed traffic (+1.7%)

and International Long Distance (+32.1%). Internet traffic showed a 39.9% year on year fall, due to the market demand for faster Broadband products.

The year's operating expenses fell by 3.5% in local currency, because of savings made on personnel expenses, which fell by 21.6%, mainly due to lower profit sharing, and savings were also made in supply expenses (-6.6% in local currency) as a result of the lower fixed-to-mobile tariff, despite the fact that consumption supplies were increased, because of the significant growth of the plant. Subcontracting expenses increased (+7.9% in local currency) due to the higher commercial activity.

There was a fall in bad debt provision (-31.3%) as a result of better recovery management, and the increased percentage of prepaid and consumption control infrastructure in the total of fixed telephone lines (59% of fixed telephone lines in December 2005, and 54% at 2004 end), which helped the bad debt provision as a percentage of revenues to stand at 1.2%.

The operating income before depreciation and Amortisation (OIBDA) amounts to 437.3 million euros, around 15.1% more than in 2004 in local currency, affected by the lower provision made for extraordinary contingencies and others. The OIBDA margin improved by 5.0 percentage points compared with 2004, to stand at 42.4%.

CapEx stands at 117.9 million euros, 1.5% lower in local currency than that recorded in 2004, placing the CapEx ratio as a percentage of revenues at 11.3% in local currency. The operating free cash flow (OIBDA-CapEx) grew by 22.6% year on year

in local currency to reach 319.4 million euros, due to the growth in OIBDA and the CapEx containment.

## Telefónica Empresas América

As in previous quarters, due to the change in the consolidation perimeter of Telefónica Empresas América (TEA), which incorporates TLD Puerto Rico operations, and the new segmentation of business and wholesale customers in Telefónica Empresas Chile, 2004 results are shown on comparable terms.

In 2005, TEA aggregate revenues stood at 620.9 million euros. This figure means 16.5% year-on-year growth (+8.3% in constant euros).

Broken down by business line, revenues from Data and Internet contributed about 62% of total revenues and show solid levels of growth (+23.3%; +12.5% in constant euros). Of particular note is the performance of data revenues in Brazil, which reach almost 50% of the total and show a growth of 25.2% in local currency. International Services and Telephony services for business are also showing positive levels of growth (+14.2% and +10.2% in constant euros, respectively.)

At 2005 year end, the operating income before depreciation and Amortisation (OIBDA) stood at 93.6 million euros, achieving a growth rate of 81.7% in current euros compared to 2004 (about 62.1% in constant euros). The accumulated OIBDA margin as a percentage of revenues stands at 15.1%, a year-on-year improvement of 5.4 percentage points. Aggregate investment to December stood at 72.5 million euros, meaning 23.5% growth in constant euros compared to 2004. As a result, the operating free cash flow (OIBDA-CapEx) amounted to 21.1 million euros, compared with 3.6 million euros the previous year.

Telefónica Empresas Brazil continues to be the group's largest operation in terms of revenues and OIBDA. In 2005, T-Empresas Brazil revenues stood at 245.9 million euros, showing year-on-year growth of 19.0% in local currency. T-Empresas Brazil aggregate OIBDA was 58.7 million euros, a 47.4% increase in local currency.

T-Empresas Argentina achieved revenues of 74.9 million euros, up 13.9% year on year in local currency. T-Empresas Peru kept its revenue levels practically stable compared with 2004 in 65.0 million euros (-0.1% in local currency). T-Empresas Chile, after the aforementioned resegmentation, recorded accumulated revenues of 124.3 million euros, a year-on-year fall of 3.1%. In other countries where Telefonica Group is not the incumbent operator (the US, Colombia and Mexico), the figures of T-Empresas USA are of particular note. Having incorporated TLD operations in Puerto Rico, it achieved total revenues of 71.0 million euros, corresponding to a growth rate of 15.4% in local currency compared with 2004.

### Telefónica International Wholesale Services (TIWS)

Revenues for 2005 stood at 188.0 million euros (+19.4% year on year, +18.9% in constant euros). The business line that contributed the most to revenues was IP International (54.6%) which showed year-on-year growth of 16.7% in constant terms. The other businesses also showed significant growth. Of particular note is the Bandwidth Capacity which grew 25.1% in constant euros. Significant savings were generated in terms of operating expenses, which, together with the growth of revenues, allowed an operating income before depreciation and Amortisation (OIBDA) of 58.3 million euros, equivalent to a year-on-year growth of 30.2% (+30.1% in constant euros), achieving a margin as a percentage of revenues of 31.0% (+2.6 percentage points compared with 2004).

## Telefónica Latinoamérica Group: Operating figures

Unaudited figures (Thousands)

|  | december        |                 |             |
|--|-----------------|-----------------|-------------|
|  | 2005            | 2004            | % Chg       |
| <b>Telesp</b>                            | <b>15,669.7</b> | <b>15,410.3</b> | <b>1.7</b>  |
| Fixed telephony accesses <sup>1</sup>    | 12,340.3        | 12,454.8        | (0.9)       |
| Internet and data accesses               | 3,329.4         | 2,955.5         | 12.7        |
| Narrowband                               | 1,986.7         | 1,996.7         | (0.5)       |
| Broadband                                | 1,206.8         | 826.4           | 46.0        |
| Retail                                   | 1,206.7         | 826.3           | 46.0        |
| <b>Telefónica de Argentina</b>           | <b>5,434.4</b>  | <b>5,192.1</b>  | <b>4.7</b>  |
| Fixed telephony accesses <sup>1</sup>    | 4,532.2         | 4,325.4         | 4.8         |
| Internet and data accesses               | 902.1           | 866.6           | 4.1         |
| Narrowband                               | 564.0           | 643.3           | (12.3)      |
| Broadband                                | 303.5           | 190.2           | 59.6        |
| Minorista <sup>2</sup>                   | 241.5           | 143.7           | 68.1        |
| <b>Telefónica CTC Chile</b>              | <b>2,912.7</b>  | <b>2,886.2</b>  | <b>0.9</b>  |
| Fixed telephony accesses <sup>1</sup>    | 2,429.1         | 2,412.5         | 0.7         |
| Internet and data accesses               | 483.6           | 473.7           | 2.1         |
| Narrowband                               | 130.5           | 239.4           | (45.5)      |
| Broadband                                | 314.2           | 200.8           | 56.5        |
| Retail                                   | 289.6           | 176.1           | 64.4        |
| <b>Telefónica del Peru</b>               | <b>3,213.0</b>  | <b>2,826.2</b>  | <b>13.7</b> |
| Fixed telephony accesses <sup>1</sup>    | 2,347.6         | 2,138.9         | 9.8         |
| Internet and data accesses               | 403.2           | 298.2           | 35.2        |
| Narrowband                               | 52.5            | 83.0            | (36.7)      |
| Banda ancha <sup>3</sup>                 | 340.4           | 205.4           | 65.7        |
| Broadband                                | 340.4           | 205.4           | 65.7        |
| Retail                                   | 462.2           | 389.2           | 18.8        |
| <b>Grupo Telefónica en Latinoamérica</b> | <b>28,168.5</b> | <b>26,314.8</b> | <b>7.0</b>  |
| Fixed telephony accesses <sup>1</sup>    | 21,649.1        | 21,331.6        | 1.5         |
| Internet and data accesses               | 6,057.1         | 4,594.1         | 31.8        |
| Narrowband <sup>4</sup>                  | 3,185.1         | 2,962.4         | 7.5         |
| Broadband <sup>3,5</sup>                 | 2,652.3         | 1,422.8         | 86.4        |
| Retail <sup>5</sup>                      | 2,078.2         | 1,351.6         | 53.8        |
| <b>Pay TV</b>                            | <b>462.2</b>    | <b>389.2</b>    | <b>18.8</b> |

<sup>1</sup> PSTN (including Public Use Telephony) x1; ISDN Basic access x1; ISDN Primary access; 2/6 Access x30. Company's accesses for internal use included.

<sup>2</sup> TASA includes ISP in the north part of the country.

<sup>3</sup> TdP cable modem included.

<sup>4</sup> Includes Narrowband ISP from Terra Brazil and Terra Colombia from the third quarter of 2005

<sup>5</sup> Includes Broadband ISP from Terra Brazil, Terra Mexico and Terra Guatemala from the third quarter of 2005

## Telefónica Latinoamérica Group: Selected operating data

Unaudited figures (Euros in millions)

|                                    | january - december |         |          |
|------------------------------------|--------------------|---------|----------|
|                                    | 2005               | 2004    | % Chg    |
| <b>Telesep</b>                     |                    |         |          |
| Revenues                           | 4,852.7            | 3,716.2 | 30.6     |
| OIBDA                              | 2,221.8            | 1,678.0 | 32.4     |
| OIBDA margin                       | 45.8%              | 45.2%   | 0.6 p.p. |
| <b>Telefónica de Argentina</b>     |                    |         |          |
| Revenues                           | 890.9              | 810.9   | 9.9      |
| OIBDA                              | 542.9              | 461.3   | 17.7     |
| OIBDA margin <sup>1</sup>          | 60.9%              | 56.9%   | 4.1 p.p. |
| <b>Telefónica CTC Chile</b>        |                    |         |          |
| Revenues                           | 890.0              | 806.9   | 10.3     |
| OIBDA                              | 362.4              | 776.0   | n.c.     |
| OIBDA margin                       | 40.7%              | n.s.    | n.c.     |
| <b>Telefónica del Peru</b>         |                    |         |          |
| Revenues                           | 1,031.4            | 980.9   | 5.1      |
| OIBDA                              | 437.3              | 367.1   | 19.1     |
| OIBDA margin                       | 42.4%              | 37.4%   | 5.0 p.p. |
| <b>Telefónica Empresas América</b> |                    |         |          |
| Revenues                           | 620.9              | 532.9   | 16.5     |
| OIBDA                              | 93.6               | 51.5    | 81.7     |
| OIBDA margin                       | 15.1%              | 9.7%    | 5.4 p.p. |
| <b>TIWS</b>                        |                    |         |          |
| Net Income                         | 188.0              | 157.5   | 19.4     |
| OIBDA                              | 58.3               | 44.8    | 30.2     |
| margin OIBDA                       | 31.0%              | 28.4%   | 2.6 p.p. |

OIBDA before management fees. Data for Telefónica de Argentina include the ISP business of Advance, while those of Telefónica del Peru includes CableMágico.

<sup>1</sup>Net of fixed to mobile interconnection.

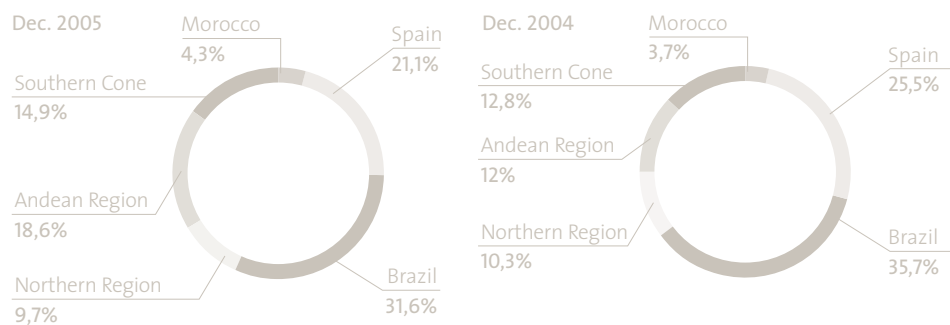
## Telefónica Latinoamérica Group: Consolidated income statement

Unaudited figures (Euros in millions)

|   | january - december |                |             | january - december |              |              |
|---|--------------------|----------------|-------------|--------------------|--------------|--------------|
|   | 2005               | 2004           | % Var       | 2005               | 2004         | % Var        |
| Revenues  | 8,265.5            | 6,748.4        | 22.5        | 2,352.0            | 1,742.9      | 34.9         |
| Internal expenditure capitalised in fixed assets <sup>1</sup> | 47.3               | 43.3           | 9.2         | 15.6               | 13.3         | 17.0         |
| Operating expenses  | (4,462.4)          | (3,648.2)      | 22.3        | (1,288.1)          | (961.1)      | 34.0         |
| Other net operating income (expense)                          | (205.4)            | (276.8)        | (25.8)      | (41.0)             | (140.6)      | (70.9)       |
| Gain (loss) on sale of fixed assets                           | 107.1              | 428.8          | (75.0)      | 29.6               | 2.0          | n.s.         |
| Impairment of goodwill and other assets                       | 6.3                | (0.7)          | c.s.        | 1.5                | (1.3)        | c.s.         |
| Operating income before D&A (OIBDA)                           | <b>3,758.3</b>     | <b>3,294.8</b> | <b>14.1</b> | <b>1,069.7</b>     | <b>655.2</b> | <b>63.3</b>  |
| Depreciation and Amortisation                                 | (1,792.5)          | (1,578.7)      | 13.5        | (483.9)            | (394.5)      | 22.7         |
| Operating income (OI)   | <b>1,965.8</b>     | <b>1,716.1</b> | <b>14.6</b> | <b>85.8</b>        | <b>260.7</b> | <b>124.7</b> |
| Profit from associated companies                              | 4.4                | 2.6            | 71.1        | 1.3                | 2.5          | (48.3)       |
| Net financial income (expense)                                | (383.6)            | (344.6)        | 11.3        | (144.8)            | (52.7)       | 174.6        |
| Income before taxes   | <b>1,586.7</b>     | <b>1,374.1</b> | <b>15.5</b> | <b>442.2</b>       | <b>210.4</b> | <b>110.2</b> |
| Income taxes  | (319.2)            | (292.6)        | 9.1         | (66.1)             | (86.0)       | (23.1)       |
| <b>Income from continuing operations</b>                      | <b>1,267.5</b>     | <b>1,081.4</b> | <b>17.2</b> | <b>376.1</b>       | <b>124.4</b> | <b>202.4</b> |
| Income (Loss) from discontinued operations                    | 0.0                | 0.0            | n.s.        | 0.0                | 0.0          | n.s.         |
| Minority interest   | (160.8)            | (327.1)        | (50.8)      | (52.3)             | (17.1)       | n.s.         |
| <b>Net income</b>   | <b>1,106.7</b>     | <b>754.3</b>   | <b>46.7</b> | <b>323.8</b>       | <b>107.3</b> | <b>201.8</b> |

<sup>1</sup>Including work in process.

## Distribution of managed customers in mobile telephony



Northern Region El Salvador, Guatemala, Mexico, Nicaragua and Panama  
 Andean Region: Colombia, Ecuador, Peru and Venezuela  
 Southern Cone: Argentina, Chile and Uruguay

## Mobile Business

### Telefónica Móviles Group

In a year marked by the integration of the 10 operators acquired from BellSouth in Latin America, technological migration in 8 countries and stiff competition in main markets of operation, Telefónica Móviles posted the highest net income in history in 2005 of 1,918.9 million euros, a year-over-year increase of 13.4%. Excluding the impact of the write down of the remaining value of the UMTS license of IPSE, net income would have been over 2,000 million euros in 2005, an increase of 18.7% over 2004.

At the same time, the Company has consolidated its position as one of the leading operators in the industry worldwide, with over 94.4 million managed customers by December 2005 (+26.9% vs. 2004).

With over 5.4 million new customers in the fourth quarter of 2005, Telefónica Móviles obtained net adds of 16.3 million in 2005, driven primarily by the sharp growth in the Latin American markets.

By geographical areas, 19.9 million of the total customer base corresponded to TME (+4.8% vs. 2004), 71 million to Latin American operators (+34%) and over 4 million corresponded to the Moroccan operator, Médi Telecom (+47%).

Among the key aspects of the full year 2005 results, we would highlight that all the growth targets established for the Group for the year were met. We would point out:

- Solid growth in revenues of 40.5% vs. 2004 to 16,513.5 million euros.

Organic growth of consolidated revenues stood at 14.2%.

- By components, service revenues in 2005 rose 40.4% to 14,353.5 million euros, while handset sales rose 41.4% to 2,160 million euros.
- Consolidated revenues registered year-over-year growth of 29.1% in the fourth quarter of 2005, compared to 45.3% in the nine first months of 2005, affected by the consolidation of 8 of the operators acquired from BellSouth since November 2004.
- By geographical areas, Telefónica Móviles España registered a 7.6% year-over-year growth in revenues in 2005, making it one of the European operators with the highest growth in its domestic market. Service revenues grew by 7% vs. 2004 (+8.2% excluding impact of loyalty points).
- The consolidated Latin American operators recorded 116.9% growth in revenues vs. 2004, representing 47% of the Group's total revenues (30% in 2004). Organic growth of these operators' revenues was 23.5% year-on-year.
- Consolidated OIBDA in 2005 of 5,817 million euros, 26.8% higher than in 2004. Year-over-year growth of consolidated OIBDA in the fourth quarter of 2005 of 45%, with sharp acceleration from previous quarters (+21% in the nine first months of 2005). Year-on-year organic growth of consolidated OIBDA in 2005 was 7.5%.
- Year-on-year growth of OIBDA at Telefónica Móviles España rebounded in the fourth quarter of 2005 (+4.4% vs. -2.3% in the nine first months of 2005), driven by the positive

performance of service revenues and control over commercial costs. OIBDA at Telefónica Móviles España in 2005 stood at 4,127.9 million euros, virtually unchanged vs. 2004, despite the increased commercial activity and the costs related to the rebranding. The OIBDA margin for 2005 stood at 46.7%, in line with the Company's targets.

- The consolidated Latin American operators contributed 554 million euros to Group OIBDA in the fourth quarter of 2005 and 1,755 million euros in 2005 (+218.4% vs. 2004). In organic terms, OIBDA from these operators increased 28.6% vs. 2004 and represented 30% of total OIBDA for the Group (12% in 2004).
- We would point out the sharp improvement in OIBDA margin at these operators in the fourth quarter of 2005 (+11.9 p.p. vs. the fourth quarter of 2005), mostly due to lower SACs. The OIBDA margin in 2005 stood at 22.8% vs. 15.5% in 2004.
- In all, the consolidated OIBDA margin stood at 35.6% in the fourth quarter of 2005 (+3.9 p.p. vs. the fourth quarter of 2004) and 35.2% in the full year 2005.

Regarding the rest of the main items, we would highlight:

- The 55.9% year-over-year increase in depreciation, primarily due to changes to the Group's consolidation perimeter and to the impact of 298 million euros of Amortisation of allocated intangible assets related to the acquisition of Telefónica Móvil Chile and the 10 Latin American operators acquired from BellSouth in 2004 and early 2005.

- Allocated intangible assets from these acquisitions related to customers and software pending Amortisation stood at 164 million euros and 21 million euros, respectively at the end of the year.
- Increased losses at companies consolidated by the equity method, impacted by the write-down of the remaining value of the UMTS license of IPSE in the fourth quarter of 2005. Excluding this effect, the contribution of these companies to Group results would have improved, with a decline of 54% in their losses compared to 2004, due to the improved results of Médi Telecom.
  - It should be noted that this asset write-down does not imply any cash outflow.
- The 4.7% year-over-year decrease in negative net financial results, despite the larger increase in the average net debt balance for the period (+59.0%).
  - At the end of 2005 consolidated net debt stood at 8,659 million euros (vs. 8,442 million euros in 2004), 8% lower than at the end of September, thanks to cash flow generation in the period.
  - Proportionate net debt at the end of the year stood at 8,759 million euros.
  - As it has been indicated in previous communications, if IPSE were forced to disburse the deferred payments related with the acquisition of its UMTS license, consolidated net debt would increase by the amount of the deposits made by Telefónica Móviles to guarantee a part of IPSE's deferred payments with the Italian government. This amount totalled 335 million euros at the end of 2005.
- 33.4% effective tax rate in 2005, mainly affected by the application of certain allowances for export activities in the second quarter of 2005, although the fact that there is no tax consolidation in various countries in Latin America detracts from this benefit, increasing the marginal rate. In this regard, the Brazilian companies have begun a corporate restructuring process (see significant events post closing) which will reduce this impact.
- Consolidated CapEx, excluding licenses, of 2,285 million euros in 2005. 45.2 million euros were recorded in 2005 for the acquisition of licenses in Mexico.
  - Assuming constant exchange rates compared to 2004, total CapEx would have been 2,023 million euros, in line with the Company's guidance.

Regarding the evolution of the Mobile Business of Telefónica Group (including Telefónica Móvil Chile since January 1st, 2004), as of December 2005, revenues and Operating Income before D&A would have registered year-on-year increases of 38.1% and 25.4%, respectively.



## Spain

In a year marked by stiffer competition, the Spanish wireless market reached over 43 million lines, equivalent to 97% penetration rate.

In this context, Telefónica Móviles España recorded net adds of nearly 260 thousand in the fourth quarter of 2005 and almost one million lines in 2005 (+48% vs. 2004). As a result, the Company ended December with nearly 20 million customers, a 4.8% year-over-year growth.

We would point out the strong commercial activity carried out in 2005. Including gross adds, migrations and handset upgrades, Telefónica Móviles España carried out 2.7 million commercial initiatives in the fourth quarter of 2005 (+9.4% vs. the fourth quarter of 2004) and 10.7 million in the full year 2005 (+19% vs. 2004), marking the highest figures in the Company's history.

Against a competitive backdrop featured by a large volume of number portability actions, Telefónica Móviles España's gross adds grew 23% vs. 2004, with a 41% year-over-year increase in number portability gross adds.

In line with the Company's focus on value, especially noteworthy is the increase in contract gross adds (+30% vs. 2004). As a result of this and with ongoing efforts to encourage prepaid to contract migrations (nearly 1 million in 2005), the contract segment represented nearly 54% of Telefónica Móviles España's total customer base (+5p.p vs. 2004).

The commercial initiatives targeting high-value customers were also reflected in number portability. Telefónica Móviles España recorded a positive net balance of 71 thousand lines in the contract segment in the fourth quarter of 2005 (+22% vs. the

fourth quarter of 2004) and 180 thousand lines in the full year 2005. In all, including prepaid and contract, the accumulated net balance in number portability in 2005 was a loss of 116,000 lines. This was also the result of Telefónica Móviles España's greater focus on acquiring prepaid clients through generic commercial campaigns, rather than through number portability.

Also worth highlighting are the efforts made in retention activities. The Company launched campaigns to reward customer loyalty and offered favourable conditions for handset upgrades to encourage greater commitment from our customers. Handset upgrades reached nearly 1.1 million in the fourth quarter of 2005 and more than 4.5 million in 2005 (+23.2% vs. 2004).

These activities and commercial initiatives such as "Ya te llamo yo" or the "100x1" promotion have proven to be important loyalty tools, enabling TME to contain the churn rate at a 1.8% level in 2005 despite competitors' commercial aggressiveness.

The new commercial offers have also boosted customer usage. The Company carried more than 13,000 million minutes of traffic in the fourth quarter of 2005 (+21.5% vs. the fourth quarter of 2004) and more than 50,000 million minutes in the full year 2005 (+20.3% vs. 2004). Despite the increase, Telefónica Móviles España networks' quality indices improved relative to previous years.

Particularly significant is the growth of on-net traffic (+30% vs. 2004), which now represents 43% of total traffic. MOU reached 152 minutes in the fourth quarter of 2005 (+12.6% vs. the fourth quarter of 2004) and 150 minutes in the full year 2005 (+15.9% vs. 2004).

We would also highlight the launch in December 2005 of "Mundo movistar" (movistar world), the first multi-country product and service distribution scheme. It complements the "Mi Favorito International" (My favourite international number) and "Mis Cinco International" (My five international numbers) products already offered by the Company. The Mundo movistar service, which sets Telefónica Móviles España apart from competitors, allows customers to buy a handset and a prepaid card at any sales point in the movistar network in Spain and have them available for pickup by a customer in Ecuador or Colombia the following day. Plans are to extend this service gradually to other markets in Latin America and Morocco.

Thanks to the positive performance of MOU and despite price cuts and lower termination rates, Telefónica Móviles España posted voice ARPU (excluding the impact of promotions) of 28.5 euros in the fourth quarter of 2005 (+0.8% vs. the fourth quarter of 2004) and 28.7 euros for the full year 2005 (+2.6% vs. 2004).

Moreover, throughout the fourth quarter of 2005 Telefónica Móviles España introduced new data transmission price schemes, with concepts similar to flat rate plans, enabling the Company to boast the most comprehensive and competitive offer in the data transmission market, with prices of 30 euros/month for 1 Giga and 58 euros/month for 5 Gigas.

TME's data ARPU (excluding the impact of promotions) stood at 4.7 euros in the fourth quarter of 2005 (+7.1% vs. the fourth quarter of 2004) and 4.4 euros in 2005 (+7.6% vs. 2004). Non-traditional SMS data services were the main growth driver.

Revenues from these services increased to represent 38% of the Company's total data revenues vs. 29% in 2004.

As a result, Telefónica Móviles España's total ARPU stood at 33.2 euros in the fourth quarter of 2005 (+1.6% vs. the fourth quarter of 2004) and 33.1 euros in 2005 (+3.3% vs. 2004).

Highlights of Telefónica Móviles España's financial results include:

- Revenues of 2,213 million euros in the fourth quarter of 2005 (+5.8% vs. the fourth quarter of 2004) and 8,834.2 million euros in the full year 2005 (+7.6% vs. 2004).
- The sharp growth in revenues, which should be seen in the European context and despite substantial cuts in prices, was driven by the positive performance of service revenues, which totalled 1,975 million euros in the fourth quarter of 2005 (+6.8% vs. the fourth quarter of 2004) and 7,794 million euros in the full year 2005 (+7.0% vs. 2004).
- Revenues from handset sales totalled 1,040 million euros in 2005, up 11.8% year-over-year vs. 2004 and to represent 11.8% of total revenues.
- Given the sharp increase in Telefónica Móviles España's commercial activity throughout the year, the weight of commercial costs (including SAC, SRC and advertising) over service revenues ex-loyalty points stood at 15.4% in 2005 (11.7% in 2004). These figures include the rebranding costs incurred in the second quarter of 2005.
- Year-on-year growth of OIBDA at Telefónica Móviles España rebounded in

the fourth quarter of 2005 (+4.4% vs. -2.3% in the nine first months of 2005), driven by the positive performance of service revenues and control over commercial costs. OIBDA for the full year 2005 stood at 4,127.9 million euros, virtually unchanged vs. 2004 despite the increased commercial activity and the costs related to rebranding. The OIBDA margin in 2005 stood at 46.7%, in line with the Company's targets.

- Telefónica Móviles España continued with the deployment of its UMTS network and investment to increase network capacity in order to meet the sharp growth in usage during 2005. CapEx in 2005 totalled 727 million euros (+15.8% vs. 2004). At the end of 2005, Telefónica Móviles España's UMTS network had more than 5,000 base stations, providing coverage to areas in which over 70% of the population lives.

## Morocco

At the end of 2005 Medi Telecom's customer base stood at 4.023.3 million (+47.4% vs. 2004). Net adds in the fourth quarter of 2005 stood at 185 thousand, 17% more than in the fourth quarter of 2004.

Regarding financial results, revenues in 2005 totalled 397 million euros (+21% vs. 2004), driven by growth in the customer base throughout the year.

OIBDA stood at 153 million euros while the OIBDA margin for the year was 39% (46% in 2004), impacted by the higher commercial activity (+40.4% vs. 2004). OIBDA increased by 2% vs. 2004.

## Latin America

### Brazil

In the last quarter of the year, the Brazilian market continued showing a solid performance despite slowing its pace of growth. At the end of 2005 the total market stood at 86.2 million customers (+31.4% vs. 2004), equivalent to a penetration rate of 46.6% (49.6% in Vivo's areas of operation).

In the fourth quarter of 2005, against a backdrop of intense competition, less commercial pressure was seen in the prepaid segment, with the main operators targeting their commercial initiatives at high-value segments. In this context, Vivo's customer base stood at 29.8 million at the end of December (+12.3% vs. the fourth quarter of 2004), with net adds in the fourth quarter of 2005 of nearly 1 million.

Vivo continues to target its commercial initiatives at the acquisition and retention of high-value customers and fostering prepaid to contract migration.

In terms of customer usage and traffic, MOU in the fourth quarter of 2005 was 74 minutes, while ARPU in the fourth quarter of 2005 was 29.0 reais, an increase of 2.5% compared to the third quarter of 2005, driven by higher contract ARPU.

Regarding Vivo's financial results, service revenues grew 5% in local currency vs. 2004, fuelled by higher outgoing revenues (+17%) in both the prepaid and contract segments, which in part offset the decline in incoming revenues (-7%).

The decrease in commercial activity led to a 2% year-over-year fall in revenues from handset sales vs. 2004, leading to a 4% increase in total revenues.

Higher entry barriers compared to the 2004 Christmas campaign and the decrease in commercial activity led to lower commercial costs (SAC, SRC and advertising) in the fourth quarter of 2005 compared to the fourth quarter of 2004, although higher provisions related to communications not attributable to customers (33 million euros in the fourth quarter of 2005) caused the OIBDA margin after management fees to fall to 21.0% in the fourth quarter of 2005 and to 26.3% in 2005. The Company is implanting detection systems in the short term to limit this risk. Excluding the impact of these provisions in 2005, the OIBDA margin would be 26.9% in the fourth quarter of 2005 and 28.8% in the full year 2005.

Finally, CapEx in 2005 totalled 400 million euros, driven primarily by the increased capacity of Vivo's networks.

## Northern Region

### Mexico

In the fourth quarter of 2005 Telefónica Móviles Mexico continued to focus on developing a quality distribution network and enhancing its processes, making changes to its commercial offering, reinforcing customer care and the quality of its services.

In this context, in a quarter marked by higher commercial activity, Telefónica Móviles Mexico posted net adds in the fourth quarter of 2005 of 392 thousand, compared to 129 thousand in the third quarter of 2005, bringing the total customer base at the end of December 2005 to 6.37 million (+12.9% vs. the fourth quarter of 2004).

This commercial effort should be seen in the context of the reshaping of the distribution network, with 190 distributors contracts cancelled in the year and 47 new ones incorporated, in order to increase the quality of gross adds.

MOU in the fourth quarter of 2005 stood at 50 minutes while ARPU was 124 Mexican pesos, unchanged compared to the third quarter of 2005. MOU in the full year 2005 was 51 minutes and ARPU was 136 Mexican pesos.

Regarding financial results, revenues grew by 9.9% year-over-year in 2005 in local currency. In the fourth quarter of 2005, revenues grew 10.2% vs. the third quarter of 2005, driven by higher revenues from handset sales and 6.7% growth in service revenues. Data revenues continued to show stronger growth, accounting for 12.3% of service revenues in the fourth quarter of 2005.

Y-o-y revenue growth in the fourth quarter of 2005 was affected by lower handset sales (-7% in local currency), as well as by the impact in service revenues of the 10% reduction in interconnection rates and the mandatory charge information on voice mail service introduced by the regulator in April. Despite the increase in commercial activity in the fourth quarter of 2005 compared to the third quarter of 2005, the higher revenues in the quarter have reduced OIBDA losses to 28.5 million euros in the fourth quarter of 2005 (vs. 33.6 million euros in the third quarter of 2005) and stand at 159 million euros in the full year 2005, in line with the level of 2004, in local currency terms.

By the end of December 2005, the coverage of Telefónica Móviles México's GSM network reached 90% of the urban population. CapEx in 2005, in local currency, declined by 54% year-over-year, leading to a sharp reduction in negative operating cash flow (-39% vs. 2004).

The auction of additional spectrum in the 1900 MHz band, which took place in April, was recorded as investment in licenses in the amount of 45.2 million euros

## Andean Region

### Venezuela

Commercial activity in the Venezuelan wireless market remained intense in the fourth quarter of 2005, leading to solid growth and an estimated penetration rate at the end of 2005 of 48%, 17 p.p. higher than in 2004.

Telefónica Móviles Venezuela's customer base reached 6.2 million in 2005 (+42.4% vs. 2004), with net adds of 841 thousand in the fourth quarter of 2005 (doubling the amount in the fourth quarter of 2004) and nearly 1.8 million new lines in 2005.

As for financial results, the strong growth in the customer base, coupled with higher traffic and steady improvement in data revenues led to a 21.3% growth in service revenues in the fourth quarter of 2005 vs. the third quarter of 2005 in local currency, and a 22.1% increase in total revenues, which in the full year 2005 stood at 1,438 million euros.

We would point out the performance of OIBDA, which totalled 178 million euros in the fourth quarter of 2005 (+14% vs. the third quarter of 2005 in local currency terms) and 585 million euros in the full year. This led to a

solid OIBDA margin of 40.7% in 2005, despite the increase in commercial activity.

Finally, the Company's innovation in the Venezuelan market led to the commercial launch of EV-DO services and of new mobile e-mail services. CapEx in 2005 reached 145.7 million euros.

### Colombia

The Colombian wireless market showed the strongest growth in the region in 2005, with an increase of almost 25 p.p. in the estimated penetration rate to 48% in December 2005.

Following the commercial launch of its GSM service in the third quarter of 2005, Telefónica Móviles Colombia accelerated again its rate of growth in commercial activity, with net adds of over 862 thousand in the fourth quarter of 2005, double the figure in the third quarter of 2005. At the end of 2005 its customer base stood at over 6 million, an increase of 83.0% compared to 2004.

The success of the Christmas campaign, targeting GSM customer acquisition, led to a high percentage of GSM gross adds (88% over total gross adds in the fourth quarter of 2005). In just 5 months after its launch, the GSM customer base surpassed 1.6 million (27% of the total customer base).

Regarding financial results, revenues totalled 750 million euros in 2005. The growth in revenues in the fourth quarter of 2005 vs. the third quarter of 2005 in local currency was due to higher revenues from handset sales as a result of stronger commercial activity in the fourth quarter of 2005 and to the positive performance of service revenues (+7.3% vs. the third quarter of 2005).

Against a backdrop of high commercial activity, we would point out the positive evolution in the OIBDA margin in the fourth quarter of 2005 (+0.4 p.p. vs. the third quarter of 2005) due to control over commercial costs and growth in revenues. The OIBDA margin in 2005 was 14.7%, but in the fourth quarter of 2005 reached 23.4%, leading to an OIBDA of 50 million euros in the fourth quarter of 2005 and of 110 million euros in full year 2005. Total CapEx in the year was over 272 million euros, reflecting the rollout of the GSM network, with coverage of 68% of the population as of December.

### Peru

The Peruvian market saw tougher competition in the fourth quarter of 2005. In this context, Telefónica Móviles Peru's customer base stood at 3.5 million at the end of December (+20.4% vs. December 2004). Net adds recorded a sharp increase in the fourth quarter of 2005 to 256 thousand (+82% vs. the third quarter of 2005), reaching 585 thousand in full year 2005.

Regarding financial results, quarterly growth in revenues in local currency remained solid (+13.2% vs. the third quarter of 2005), driven by the growth in customers and outgoing traffic, which offset the impact of lower incoming traffic and the 19% reduction in interconnection rates in the third quarter of 2005.

We would point out the solid performance of the OIBDA margin, which remained at 32% in the fourth quarter of 2005 despite the increased commercial activity. OIBDA stood at 33 million euros in the fourth quarter of 2005 (+12% vs. the third quarter of 2005 in local currency) and 118 million euros in 2005.

We would also highlight that Telefónica Móviles Peru began the deployment of its GSM network in the fourth quarter of 2005, recording its first GSM gross add at the beginning of February 2006.

## Southern Cone Region

### Argentina

The strong advance of the Argentine wireless market continued in the fourth quarter of 2005, with the pace of growth accelerating throughout 2005 thanks to the favourable macroeconomic situation in the country and an increasingly competitive environment. The estimated penetration rate at the end of 2005 stood at 55%, nearly 21 p.p. higher than at the end of 2004.

In this context, Telefónica Móviles Argentina's commercial efforts have been positive, leading customer base to 8.34 million clients at the end of December. GSM customers now represent 51% of the total. Net adds were over 940 thousand in the fourth quarter of 2005.

Regarding financial results, we would highlight the solid growth of service revenues in local currency (+11.1% in the fourth quarter of 2005 vs. the third quarter of 2005), driven by the increase in the customer base (+12.7% vs. the third quarter of 2005) and ARPU. Also worth highlighting is the increasing contribution of data revenues, which in 2005 represented 15% of service revenues (18% in the fourth quarter of 2005).

In line with the strong commercial activity in the quarter, which featured the year's two most important campaigns (Mother's Day and Christmas), the OIBDA margin declined vs. the third quarter of 2005. In 2005 the OIBDA margin stood at 15%.

As for the rollout of the GSM network, coverage at the end of the year stood at 95% of the population, with CapEx in 2005 totalling 132 million euros. In spite of the strong investment effort, the operator posted positive operating cash flow, with OIBDA for the full year totalling 151 million euros.

### Chile

Despite the penetration levels at the beginning of the year, the Chilean wireless market remained extremely buoyant in 2005, with an increase of 10 p.p. in the estimated penetration rate to over 71%.

In this context, Telefónica Móviles Chile ended December with 5.28 million customers, recording net adds in 2005 of 525 thousand. GSM customers now represent 51% of the total.

With regard to financial results, revenues totalled 661 million euros in 2005 and 202 million euros in the fourth quarter of 2005 (+11.3% vs. the third quarter of 2005 in local currency), driven by a positive performance in service revenues (+12.9% in the fourth quarter of 2005 vs. the third quarter of 2005). OIBDA margin in 2005 reached 35.5% in 2005.

Total CapEx in 2005 was 177 million euros, boosted by the deployment of the GSM network, with coverage of 96% of the population as of December.

## Celular Business Selected operating data: cellular customers

Unaudited figures (Thousands)

|                                  | december        |              |
|----------------------------------|-----------------|--------------|
|                                  | 2005            | % Chg 05/04  |
| <b>Telefónica Móviles España</b> | <b>19,889.9</b> | <b>4.8</b>   |
| Contract                         | 10,703.5        | 15.6         |
| Prepaid                          | 9,186.4         | (5.5)        |
| <b>Medi Telecom</b>              | <b>4,023.3</b>  | <b>47.4</b>  |
| Contract                         | 149.9           | 36.4         |
| Prepaid                          | 3,873.4         | 47.8         |
| <b>Brasilcel</b>                 | <b>29,804.6</b> | <b>12.3</b>  |
| Contract                         | 5,743.8         | 10.8         |
| Prepaid                          | 24,060.8        | 12.7         |
| <b>TEM Argentina</b>             | <b>8,335.0</b>  | <b>147.3</b> |
| Contract                         | 3,119.2         | 151.5        |
| Prepaid                          | 5,035.8         | 136.4        |
| Fixed Wireless                   | 179.9           | n.c.         |
| <b>TEM Peru</b>                  | <b>3,455.0</b>  | <b>20.4</b>  |
| Contract                         | 579.5           | 16.5         |
| Prepaid                          | 2,804.3         | 21.5         |
| Fixed Wireless                   | 71.1            | 10.2         |
| <b>TEM El Salvador</b>           | <b>537.8</b>    | <b>39.9</b>  |
| Contract                         | 79.0            | 1.5          |
| Prepaid                          | 435.3           | 48.0         |
| Fixed Wireless                   | 23.5            | 88.6         |
| <b>TEM Chile</b>                 | <b>5,275.8</b>  | <b>59.0</b>  |
| Contract                         | 891.7           | 84.3         |
| Prepaid                          | 4,384.1         | 54.7         |
| <b>TEM Colombia</b>              | <b>6,033.0</b>  | <b>83.0</b>  |
| Contract                         | 1,375.1         | 44.2         |
| Prepaid                          | 4,657.9         | 98.8         |

|                       | december        |              |
|-----------------------|-----------------|--------------|
|                       | 2005            | % Chg 05/04  |
| <b>TEM Guatemala</b>  | <b>1,040.7</b>  | <b>38.7</b>  |
| Contract              | 69.9            | (12.6)       |
| Prepaid               | 864.4           | 53.8         |
| <b>Fixed Wireless</b> | <b>106.3</b>    | <b>(2.0)</b> |
| TEM Mexico            | 6,368.1         | 12.9         |
| Contract              | 319.9           | 6.1          |
| Prepaid               | 6,047.7         | 13.3         |
| Fixed Wireless        | 0.6             | n.c.         |
| <b>TEM Venezuela</b>  | <b>6,160.3</b>  | <b>42.4</b>  |
| Contract              | 347.8           | 20.6         |
| Prepaid               | 5,203.7         | 47.1         |
| Fixed Wireless        | 608.8           | 21.9         |
| <b>TEM Ecuador</b>    | <b>1,884.6</b>  | <b>67.9</b>  |
| Contract              | 364.7           | 59.2         |
| Prepaid               | 1,517.5         | 70.4         |
| Fixed Wireless        | 2.4             | (12.6)       |
| <b>TEM Panama</b>     | <b>849.4</b>    | <b>35.8</b>  |
| Contract              | 67.9            | 19.1         |
| Prepaid               | 781.5           | 37.5         |
| <b>TEM Nicaragua</b>  | <b>371.6</b>    | <b>29.8</b>  |
| Contract              | 45.3            | 15.4         |
| Prepaid               | 310.4           | 33.9         |
| Fixed Wireless        | 15.9            | 4.8          |
| <b>TEM Uruguay</b>    | <b>418.9</b>    | <b>106.3</b> |
| Contract              | 62.4            | 16.8         |
| Prepaid               | 356.5           | 138.3        |
| <b>Total</b>          | <b>94,447.9</b> | <b>26.9</b>  |

The comparison is affected by the incorporation of BellSouth's Latam mobile operators in Colombia, Ecuador, Guatemala, Nicaragua, Panama, Peru, Uruguay and Venezuela from November 2004 and Argentina and Chile from January 2005.

December 2005 figures include the adjustment of 300,000 inactive prepaid lines in Mexico not longer considered in the reported customer base.



## Telefónica móviles Group: Selected financial data

Unaudited figures (Euros in millions)

|                            | january - december |                 |                   |
|----------------------------|--------------------|-----------------|-------------------|
|                            | 2005               | 2004            | %Chg              |
| <b>Spain</b>               |                    |                 |                   |
| Revenues                   | 8,834.2            | 8,213.8         | 7.6               |
| OIBDA                      | 4,127.9            | 4,158.2         | (0.7)             |
| OIBDA margin               | 46.7%              | 50.6%           | (3.9 p.p.)        |
| <b>Latin America</b>       |                    |                 |                   |
| Revenues                   | 7,704.5            | 3,552.4         | 116.9             |
| OIBDA                      | 1,754.6            | 551.2           | n.s.              |
| OIBDA margin               | 22.8%              | 15.5%           | 7.3 p.p.          |
| <b>Brazil</b>              |                    |                 |                   |
| Revenues                   | 1,889.3            | 1,502.3         | 25.8              |
| OIBDA                      | 496.5              | 491.0           | 1.1               |
| OIBDA margin               | 26.3%              | 32.7%           | (6.4 p.p.)        |
| <b>Northern Region</b>     |                    |                 |                   |
| Revenues                   | 1,263.6            | 912.3           | 38.5              |
| OIBDA                      | (1.2)              | (118.7)         | (99.0)            |
| OIBDA margin               | -0.1%              | -13.0%          | 12.9 p.p.         |
| <b>Andean Region</b>       |                    |                 |                   |
| Revenues                   | 2,837.4            | 607.7           | n.c.              |
| OIBDA                      | 866.2              | 116.4           | n.c.              |
| OIBDA margin               | 30.5%              | 19.2%           | 11.4 p.p.         |
| <b>Southern Cone</b>       |                    |                 |                   |
| Revenues                   | 1,714.2            | 530.1           | n.c.              |
| OIBDA                      | 393.1              | 62.5            | n.c.              |
| OIBDA margin               | 22.9%              | 11.8%           | 11.1 p.p.         |
| <b>Rest and intragroup</b> |                    |                 |                   |
| Revenues                   | (25.3)             | (12.3)          | 105.1             |
| OIBDA                      | (65.5)             | (121.5)         | (46.1)            |
| OIBDA margin               | n.s.               | n.s.            | n.s.              |
| <b>Total</b>               |                    |                 |                   |
| <b>Revenue</b>             | <b>16,513.5</b>    | <b>11,753.9</b> | <b>40.5</b>       |
| <b>OIBDA</b>               | <b>5,817.0</b>     | <b>4,587.9</b>  | <b>26.8</b>       |
| <b>OIBDA margin</b>        | <b>35.2%</b>       | <b>39.0%</b>    | <b>(3.8 p.p.)</b> |

The comparison is affected by the incorporation of TM Chile from August 2004, of BellSouth's Latam mobile operators in Colombia, Ecuador, Guatemala, Nicaragua, Panama, Peru, Uruguay and Venezuela from November 2004 and Argentina and Chile from January 2005.

## Telefónica Móviles Group: Consolidated income Statement

Unaudited figures (Euros in millions)

|   | january - december |                |             | october - december |                |             |
|---|--------------------|----------------|-------------|--------------------|----------------|-------------|
|   | 2005               | 2004           | %Chg        | 2005               | 2004           | %Chg        |
| Revenues  | 16,513.5           | 11,753.9       | 40.5        | 4,463.5            | 3,458.7        | 29.1        |
| Internal expenditure capitalised in fixed assets <sup>1</sup> | 123.6              | 89.5           | 38.1        | 37.8               | 40.7           | (7.0)       |
| Operating expenses  | (10,634.2)         | (7,178.9)      | 48.1        | (2,848.9)          | (2,371.4)      | 20.1        |
| Other net operating income (expense)                          | (174.8)            | (15.5)         | n.s.        | (52.1)             | 25.6           | c.s.        |
| Gain (loss) on sale of fixed assets                           | 0.2                | (57.2)         | c.s.        | 1.4                | (49.6)         | c.s.        |
| Impairment of goodwill and other assets                       | (11.2)             | (3.9)          | 183.7       | (11.2)             | (6.4)          | 74.6        |
| <b>Operating income before D&amp;A (OIBDA)</b>                | <b>5,817.0</b>     | <b>4,587.9</b> | <b>26.8</b> | <b>1,590.5</b>     | <b>1,097.6</b> | <b>44.9</b> |
| Depreciation and Amortisation                                 | (2,374.0)          | (1,522.9)      | 55.9        | (694.2)            | (467.9)        | 48.4        |
| <b>Operating income (OI)</b>                                  | <b>3,443.0</b>     | <b>3,064.9</b> | <b>12.3</b> | <b>896.3</b>       | <b>629.7</b>   | <b>42.3</b> |
| Profit from associated companies                              | (154.2)            | (38.1)         | n.s.        | (143.8)            | (6.9)          | n.s.        |
| Net financial income (expense)                                | (459.1)            | (481.9)        | (4.7)       | (158.9)            | (241.0)        | (34.1)      |
| <b>Income before taxes</b>                                    | <b>2,829.7</b>     | <b>2,544.9</b> | <b>11.2</b> | <b>593.6</b>       | <b>381.8</b>   | <b>55.5</b> |
| Income taxes  | (946.0)            | (868.5)        | 8.9         | (236.5)            | (126.5)        | 86.9        |
| <b>Income from continuing operations</b>                      | <b>1,883.7</b>     | <b>1,676.4</b> | <b>12.4</b> | <b>357.1</b>       | <b>255.2</b>   | <b>39.9</b> |
| Income (Loss) from discontinued operations                    | 0.0                | 0.0            | n.s.        | 0.0                | 0.0            | n.s.        |
| Minority interest   | 35.2               | 15.2           | 131.2       | 19.1               | 18.0           | 6.1         |
| <b>Net income</b>   | <b>1,918.9</b>     | <b>1,691.7</b> | <b>13.4</b> | <b>376.2</b>       | <b>273.3</b>   | <b>37.7</b> |

<sup>1</sup> Including work in process.

## Celular business: Consolidated income Statement

Unaudited figures (Euros in millions)

|   | january - december |                |             | october - december |                |             |
|---|--------------------|----------------|-------------|--------------------|----------------|-------------|
|   | 2005               | 2004           | %Chg        | 2005               | 2004           | %Chg        |
| Revenues  | 16,513.5           | 11,961.4       | 38.1        | 4,463.5            | 3,457.1        | 29.1        |
| Internal expenditure capitalised in fixed assets <sup>1</sup> | 123.6              | 90.7           | 36.3        | 37.8               | 40.7           | (7.1)       |
| Operating expenses  | (10,634.2)         | (7,335.8)      | 45.0        | (2,848.9)          | (2,370.2)      | 20.2        |
| Other net operating income (expense)                          | (174.8)            | (17.5)         | n.s.        | (52.1)             | 25.6           | c.s.        |
| Gain (loss) on sale of fixed assets                           | 0.2                | (57.2)         | c.s.        | 1.4                | (49.6)         | c.s.        |
| Impairment of goodwill and other assets                       | (11.2)             | (3.9)          | 183.7       | (11.2)             | (6.4)          | 74.6        |
| <b>Operating income before D&amp;A (OIBDA)</b>                | <b>5,817.0</b>     | <b>4,637.6</b> | <b>25.4</b> | <b>1,590.5</b>     | <b>1,097.1</b> | <b>45.0</b> |
| Depreciation and Amortisation                                 | (2,374.0)          | (1,580.1)      | 50.2        | (694.2)            | (471.8)        | 47.1        |
| <b>Operating income (OI)</b>                                  | <b>3,443.0</b>     | <b>3,057.5</b> | <b>12.6</b> | <b>896.3</b>       | <b>625.3</b>   | <b>43.3</b> |
| Profit from associated companies                              | (154.2)            | (39.5)         | n.s.        | (143.8)            | (7.1)          | n.s.        |
| Net financial income (expense)                                | (459.1)            | (496.1)        | (7.5)       | (158.9)            | (245.7)        | (35.3)      |
| <b>Income before taxes</b>                                    | <b>2,829.7</b>     | <b>2,521.9</b> | <b>12.2</b> | <b>593.6</b>       | <b>372.4</b>   | <b>59.4</b> |
| Income taxes  | (946.0)            | (864.4)        | 9.4         | (236.5)            | (124.3)        | 90.2        |
| <b>Income from continuing operations</b>                      | <b>1,883.7</b>     | <b>1,657.4</b> | <b>13.6</b> | <b>357.1</b>       | <b>248.1</b>   | <b>43.9</b> |
| Income (Loss) from discontinued operations                    | 0.0                | 0.0            | n.s.        | 0.0                | 0.0            | n.s.        |
| Minority interest   | 35.2               | 25.2           | 39.7        | 19.1               | 21.9           | (12.6)      |
| <b>Net income</b>   | <b>1,918.9</b>     | <b>1,682.7</b> | <b>14.0</b> | <b>376.2</b>       | <b>270.0</b>   | <b>39.4</b> |

Cellular Business included Telefónica Móvil Chile in 2004.

<sup>1</sup> Including work in process.

## Cesky Telecom

Telefónica Group consolidates Cesky Telecom financial statements for the second half of 2005, with a contribution of 1,035.2 million euros to Telefónica's revenues for the financial year with OIBDA accounting for 456.7 million euros and OI for 164.8 million euros, respectively.

Within the process to bring Cesky Telecom Group accounting practices and financial statements reporting in line with Telefónica Group, in December the following accounting adjustments, which fundamentally affected the Cesky Telecom fixed telephony business, have taken place:

- Deferral of connection fees revenues over the average period of expected economic life of the customers, i.e. expected lifetime of the fixed line subscribed by the customer, for new and past subscriptions (since 1996). These revenues were previously entirely recorded in the period corresponding to the time of the line activation.
- Traffic revenues and expenses related to payments to premium content providers for value added telephone services (known as "colour lines"), which were previously recognised separately as revenues and expenses and which are now accounted for as their net value in revenues.

The impact of these two adjustments on the annual results of Cesky Telecom gave rise to an increase in revenues of 353 million Czech korunas and 606 million Czech korunas in OIBDA, leading to a decrease in retained earnings of around 1,400 million Czech korunas. In order to give a true and fair view of this business' evolution, all year-on-year variations (in local currency) will be related to pro forma fiscal year 2004, adjusted by the two aforementioned effects.

Cesky Telecom total revenues in 2005 amounted to 2,049 million euros, a 6.3% increase year-on-year in euros and a 0.8% decrease in local currency. The growth rate recorded in the fourth quarter alone was 1.0% in local currency, reflecting the better performance of the mobile telephony business and the progress of broadband within the Group's fixed telephony business.

In 2005, consolidated operating expenses showed a slight increase in local currency of +0.2% increase year-on-year, mostly thanks to the cost discipline in the fixed telephony business that partially offset the greater expenses recorded in the mobile subsidiary.

Hence, the Group's operating income before depreciation and Amortisation (OIBDA) amounted to 916 million euros, showing a decrease of 0.3% increase year-on-year (-6.9% in local currency). The drop in the company's OIBDA would have been reduced to 2.6% in local currency if we had excluded the impairment charge (non-recurrent) of 1,251 million korunas from OIBDA calculation. As a result, the OIBDA margin amounted to 44.9% in 2005, compared with the 48.1% margin obtained in 2004. If the 2005 OIBDA were adjusted by the aforementioned non-recurrent expenses, the margin would have reached 47.0%.

Operating income (OI) increased by 11.0% year-on-year in local currency to reach 318 million euros as a result of lower Amortisation and depreciation charges arising from lower investments in recent years and changes in the Amortisation of goodwill and of certain intangible assets.

Total CapEx for Cesky Telecom Group amounted to 209.3 million euros, having increased by 5.5% in local currency compared to the previous year, on the back of higher investments in the growth areas of the business.

Operating free cash flow (OIBDA-CapEx) up to December 2005 stood at 706.7 million euros, showing a 9.9% year-on-year decrease in local currency as a result of the drop in OIBDA and the rise in CapEx, as indicated above.

### Fixed line Business

Total revenues in the fixed line business totalled 1,083.5 million euros for the year, a 4.5% drop in local currency year-on-year in a continuous shift from the traditional telephony services to broadband internet access, data and other value added services.

Revenues from traditional access fell by 3.7% year-on-year in local currency, primarily due to the 7.2% decline in the number of fixed telephony lines, which dropped to 3.1 million lines at year end 2005.

Total traffic generated by Cesky Telecom customers showed a 14.8% year-on-year decline as a result of the loss of lines and the increase in competition together with the ongoing fixed-to-mobile traffic substitution. Thus, revenues from voice services fell by 19.5% year-on-year in local currency, whereas those from interconnection traffic increased by 23.2%, mainly due to the extension of international traffic services within the Central and Eastern Europe market space. Revenues from traditional voice services therefore fell 5.2% year-on-year.

Revenues from Internet and Broadband services registered a year-on-year decrease of 3.1% in local currency due to the significant migration of customers from narrowband to broadband Internet access. Hence, revenues from narrowband Internet services fell by 44.9% in local currency whereas those from broadband services increased by 84.9%.

The total number of Internet broadband accesses at December 2005 amounted to 274,000 (approx. 80% retail), leading to a net gain of 173,000 connections over the year. Approximately two thirds of these were made during the second half of the year.

Revenues from data services showed a 0.9% year-on-year decrease in local currency due to the fact that the decrease in revenues from leased lines (-4.5%) was not fully offset by the increase in revenues from virtual private networks and IP connectivity solutions (+5.2%).

Operating expenses of the fixed line business fell by 4.6% year-on-year in local currency, having declined by 6.0% year-on-year in local currency in the fourth quarter alone. Supplies expenses increased by 2.4% in local currency, primarily due to the increase in international interconnection expenses, whereas personnel expenses, including headcount reduction costs, fell by 0.9%. External services expenses recorded a 7.0% year-on-year decrease, with the 10.3% drop in network operating and maintenance expenses being particularly noteworthy under this item.

OIBDA in the fixed line business amounted to 477 million euros, an 8.9% year-on-year drop in local currency to reach a 44.5% margin at year end, 2.8 percentage points down on that recorded at the end of 2004. CapEx for the Cesky Telecom fixed line business in 2005 amounted to 77.5 million euros, showing an 11.6% year-on-year decrease in local currency.

### Mobile business (EUROTEL)

Eurotel's total revenues for 2005 increased by 2.0% year-on-year in local currency to reach 1,008 million euros. The 4% growth in operating revenues recorded in the fourth quarter alone reflected the strong positioning of Eurotel in the Czech cellular market, recovering the first position in terms of the number of customers by year end.

The total number of Eurotel customers increased by 6.4% year-on-year to reach 4.7 million by year end. The successful migration of prepaid customers to postpaid tariffs led to a 46% increase in the number of contract customers who at the end of the year amounted to 1.5 million, a 33% of the total customer base in comparison with the 24% figure recorded in December 2004.

Revenues from voice services (monthly fees, customer and interconnection traffic) increased over the year by 0.2% in local currency, mostly due to the combined effect of the increase in revenues from monthly fees (+10.6%) as a result of the aforementioned larger contract customer base and to the drop in revenues from traffic (-3%), due to the greater number of contract customers purchasing minute packages, which explains the 10% year-on-year increase in traffic recorded in 2005.

## Cesky Telecom: Consolidated income statement

Unaudited figures (Euros in millions)

|   | july - december | october- december |
|---|-----------------|-------------------|
|   | 2005            | 2005              |
| Revenues  | 1,035.2         | 525.8             |
| Internal expenditure capitalised in fixed assets <sup>1</sup> | 11.5            | 6.4               |
| Operating expenses  | (566.6)         | (285.1)           |
| Other net operating income (expense)                          | 17.2            | (7.6)             |
| Gain (loss) on sale of fixed assets                           | 1.4             | 0.7               |
| Impairment of goodwill and other assets                       | (42.1)          | (36.3)            |
| <b>Operating income before D&amp;A (OIBDA)</b>                | <b>456.7</b>    | <b>204.0</b>      |
| Depreciation and Amortisation                                 | (291.9)         | (149.2)           |
| <b>Operating income (OI)</b>                                  | <b>164.8</b>    | <b>54.8</b>       |
| Profit from associated companies                              | 0.0             | 0.0               |
| Net financial income (expense)                                | (10.8)          | (6.1)             |
| <b>Income before taxes</b>                                    | <b>154.0</b>    | <b>48.7</b>       |
| Income taxes  | (36.0)          | (10.0)            |
| <b>Income from continuing operations</b>                      | <b>118.0</b>    | <b>38.7</b>       |
| Income (Loss) from discontinued operations                    | 0.0             | 0.0               |
| Minority interest   | 0.0             | 0.0               |
| <b>Net income</b>   | <b>118.0</b>    | <b>38.7</b>       |

<sup>1</sup>Including work in process.

As a result of the continuous increase in the number of customers with multiple SIM cards and the decrease in ARPU generated by new customers, the average ARPU recorded a 3.0% year-on-year decline in local currency, although 1.4% up on that recorded over the first half of the year as a result of the successful acquisition of contract customers.

The number of customers from the Eurotel Data Express service (CDMA-based broadband internet access service) exceeded 70,000, leading to a net gain of more than 40,000 customers over the year. This, together with the 14% increase in the number of customers from the Eurotel Data Nonstop service (GPRS-based internet access service), which stood at 67,000 in December 2005, led to revenues from Internet and Data nearly doubling compared to the previous year.

Revenues from equipment sales dropped by 9.5% year-on-year in local currency due to the increased number of clients to whom the Company offered lower rates in exchange for permanency agreements over a certain period of time.

Eurotel's operating expenses increased by 4.8% over the year in local currency, with a 6.9% year-on-year increase in the fourth quarter alone due to greater commercial activity during that period.

Personnel expenses were the major contributor to the increase in the operating expenses, growing by 27.2% year-on-year in local currency throughout the year as a result of one-off items that were already recorded in the second quarter.

Eurotel's operating income before depreciation and Amortisation (OIBDA) totalled 431.6 million euros for the year, a 5.5% decrease in local currency with its margin having dropped by 3.4 percentage points year-on-year to 42.8%.

CapEx for the mobile line business amounted to 131.5 million euros for the year, a 19.0% year-on-year increase in local currency, primarily due to the investments in the rollout of the UMTS network.

Other businesses

## Other businesses

### Directories business

TPI Group 2005 results include those of Telinver, the leader directory company acquired in Argentina for a firm value of 74 million dollar, which consolidates with Group figures from November 2005, and also, those coming from DA operation in Italy, from the moment it started operations on October 1st 2005.

The performance of the business in Italy in its first three months showed a satisfactory number of calls received, reflecting the successful advertising campaign.

TPI Group revenues rose 9.7% to 651.6 million euros. OIBDA was 219.3 million euros, showing an increase of 8.7% vs. 2004. Net income rose 10.3% to 126.93 million euros. These results are explained by:

- Advertising revenues increased 6.9% to 544.3 million euros.
- Strong performance of telephony traffic revenues, which grew 39.3% to 65.3 million euros, helped by the positive evolution of the business in Spain and the traffic coming from Italy.
- Positive evolution of operator revenues, with a 6.3% increase to 39.9 million euros.

## Directories business: Consolidated income statement

Unaudited figures (Euros in millions)

|   | january - december |              |            | october - december |             |             |
|---|--------------------|--------------|------------|--------------------|-------------|-------------|
|   | 2005               | 2004         | %Chg       | 2005               | 2004        | %Chg        |
| Revenues  | 660.5              | 616.4        | 7.1        | 190.1              | 166.5       | 14.2        |
| Internal expenditure capitalised in fixed assets <sup>1</sup> | 0.5                | 0.0          | n.s.       | 0.5                | 0.0         | n.s.        |
| Operating expenses  | (413.4)            | (375.4)      | 10.1       | (123.2)            | (108.8)     | 13.2        |
| Other net operating income (expense)                          | (26.4)             | (33.7)       | (21.7)     | (8.0)              | (11.7)      | (31.3)      |
| Gain (loss) on sale of fixed assets                           | (0.3)              | (0.4)        | (41.4)     | (0.0)              | (0.0)       | (33.3)      |
| Impairment of goodwill and other assets                       | (0.9)              | (2.1)        | (59.0)     | (1.4)              | 0.0         | n.s.        |
| <b>Operating income before D&amp;A (OIBDA)</b>                | <b>220.0</b>       | <b>204.8</b> | <b>7.4</b> | <b>57.9</b>        | <b>46.0</b> | <b>25.9</b> |
| Depreciation and Amortisation                                 | (24.0)             | (23.8)       | 0.8        | (6.3)              | (7.5)       | (16.4)      |
| <b>Operating income (OI)</b>                                  | <b>196.0</b>       | <b>181.0</b> | <b>8.3</b> | <b>51.7</b>        | <b>38.5</b> | <b>34.1</b> |
| Profit from associated companies                              | (0.0)              | (0.4)        | (87.7)     | 0.0                | (0.1)       | c.s.        |
| Net financial income (expense)                                | (6.7)              | (5.7)        | 17.8       | (2.0)              | (1.7)       | 17.9        |
| Income before taxes   | 189.3              | 175.0        | 8.2        | 49.7               | 36.7        | 35.2        |
| Income taxes  | (63.4)             | (60.2)       | 5.5        | (17.6)             | (14.1)      | 25.2        |
| <b>Income from continuing operations</b>                      | <b>125.8</b>       | <b>114.8</b> | <b>9.6</b> | <b>32.0</b>        | <b>22.7</b> | <b>41.3</b> |
| Income (Loss) from discontinued operations                    | 0.0                | 0.0          | n.s.       | 0.0                | 0.0         | n.s.        |
| Minority interest   | 0.0                | 0.5          | n.s.       | (0.0)              | (0.1)       | (66.1)      |
| <b>Net income</b>   | <b>125.8</b>       | <b>115.3</b> | <b>9.1</b> | <b>32.0</b>        | <b>22.6</b> | <b>41.6</b> |

<sup>1</sup>Including work in process.

Europe decreased its contribution to group revenues by 2 percentage points to 79%. This is the result of the combined effect of the positive performance of currency exchange rates in Latam, together with the acquisition of Telinver in Argentina. Geographical contribution to Group OIBDA, remained unchanged, with 87% and 13% for Europe and Latam, respectively.

Revenues in Europe<sup>1</sup> went up 6.1% to 515.1 million euros, which was driven by:

- Growth of 2.4% in advertising revenues to 421.3 million euros.
- Internet revenues reached 34.0 million euros with an increase of 20.1%, while those related to telephone information service went up 14.6% to 4.8 million euros.
- The strong rise achieved by traffic revenues, which went up 39.3% to 64.8 million euros.

The rise in revenues, along with the good results obtained from the group's cost-cutting, fed through to a 9.0% increase in the European OIBDA to 190.6 million euros. The OIBDA margin grew 1.0 percentage points to 37.0%.

Latin America performance, that contributes to 21% of revenues and 13% of OIBDA was driven by:

- Publiguías total revenues fell 4.4% in local currency, (+4.2% in euros). This is a result of both increased competition and

the write-off of default customers begun in January to improve bad debts.

- TPI Peru increased revenues by 6.8% in local currency to 33.9 million euros, and contributes 7.6 million euros to total Group OIBDA.
- Advertising revenues coming from TPI Brazil grew 10.3% in local currency to 17.2 million euros, and OIBDA improves 56.9% to -2.5 million euros.
- Telinver in Argentina contributed 17.45 million euros to Group revenues and 5.2 million euros to OIBDA through November and December 2005. These results cannot be extrapolated to the full year as directories published along the year in Telinver have different margins. They also do not include the new contract framework with TASA, which was applied from the beginning of 2006.

With these results, the TPI Group outperformed the revenue guidance (+5.5%/6.5%) and met the upper part of the range of the OIBDA guidance (7%/8%). At constant exchange rates, Group revenues and OIBDA increased 7.8% both.

The Board of Directors will propose the Annual General Shareholders Meeting the payment of a dividend of 40 cents of an euro per share, representing an increase of 33.3% compared to 2004. This dividend amounts to 114% of the Group's net income and to 123% of that of Telefónica Publicidad e Información, S.A. This would give a dividend yield of 4.8%.

In turn, the directories business of the Telefónica Group, which includes the Argentinean company Telinver in the whole twelve months of both 2004 and 2005, recorded 660.5 million euros in revenues, a 7.1% year-over-year increase. OIBDA, on the other hand, improves in a 7.4% in the fiscal year, reaching 220.0 million euros.

<sup>1</sup> Europe includes TPI, S.A., TPI Edita, TPI Direct, Edinet Europe, 11888 SCT and 1288 SCT

<sup>2</sup> Adjusted OIBDA does not include impairment of financial assets for its subsidiaries nor the results obtained by their capital operations



## TPI - Páginas Amarillas Group: Selected operating data in Europe

Unaudited figures

|   | january - december |              |             |
|---|--------------------|--------------|-------------|
|   | 2005               | 2004         | % Var       |
| Books Published                           |                    |              |             |
| Yellow Pages*                             | 124                | 110          |             |
| White Pages                               | 58                 | 60           |             |
| Revenue Breakdown (1) (Euros in millions) | <b>515.1</b>       | <b>485.3</b> | <b>6.1</b>  |
| <b>Advertising</b>                        | <b>421.3</b>       | <b>411.3</b> | <b>2.4</b>  |
| Publishing                                | 378.5              | 374.6        | 1.1         |
| Yellow Pages                              | 296.0              | 296.3        | (0.1)       |
| White Pages                               | 70.6               | 69.1         | 2.2         |
| Others paper revenues                     | 11.9               | 9.2          | 29.6        |
| Internet                                  | 34.0               | 28.3         | 20.1        |
| Operator Assisted Yellow Pages            | 4.8                | 4.2          | 14.6        |
| Others                                    | 4.1                | 4.3          | (4.9)       |
| <b>Telephony Traffic</b>                  | <b>64.8</b>        | <b>46.6</b>  | <b>39.3</b> |
| Operator                                  | 26.0               | 24.9         | 4.4         |
| <b>Others</b>                             | <b>2.9</b>         | <b>2.6</b>   | <b>13.7</b> |

\* Includes a breakdown by residential/business services and pocket guides.

1 TPI Europe includes the results of the companies Telefónica Publicidad e Información S.A., TPI Edita, TPI Direct and Edinet Europe, 11888 Servicio de Consulta Telefónica S.A.U., Servizio di Consultazioni Telefonica, S.R.L.

## TPI - Páginas Amarillas Group: Consolidated income statement

Unaudited figures (Euros in millions)

|   | january - december |              |             | october - december |             |             |
|---|--------------------|--------------|-------------|--------------------|-------------|-------------|
|   | 2005               | 2004         | %Chg        | 2005               | 2004        | %Chg        |
| Revenues  | 651.6              | 594.2        | 9.7         | 188.9              | 151.4       | 24.8        |
| Internal expenditure capitalised in fixed assets <sup>1</sup> | 0.5                | 0.0          | n.s.        | 0.5                | 0.0         | n.s.        |
| Operating expenses  | (405.5)            | (360.7)      | 12.4        | (122.1)            | (98.9)      | 23.4        |
| Other net operating income (expense)                          | (26.2)             | (29.2)       | (10.4)      | (8.0)              | (8.9)       | (10.1)      |
| Gain (loss) on sale of fixed assets                           | (0.3)              | (0.4)        | (41.4)      | (0.0)              | (0.0)       | (33.3)      |
| Impairment of goodwill and other assets                       | (0.9)              | (2.1)        | (59.0)      | (1.4)              | 0.0         | n.s.        |
| <b>Operating income before D&amp;A (OIBDA)</b>                | <b>219.3</b>       | <b>201.8</b> | <b>8.7</b>  | <b>57.8</b>        | <b>43.5</b> | <b>32.9</b> |
| Depreciation and Amortisation                                 | (23.6)             | (23.2)       | 1.4         | (6.2)              | (7.5)       | (17.0)      |
| <b>Operating income (OI)</b>                                  | <b>195.7</b>       | <b>178.6</b> | <b>9.6</b>  | <b>51.6</b>        | <b>36.0</b> | <b>43.3</b> |
| Profit from associated companies                              | (0.0)              | (0.4)        | (87.7)      | 0.0                | (0.1)       | c.s.        |
| Net financial income (expense)                                | (5.3)              | (2.0)        | 162.4       | (2.0)              | (0.9)       | 116.1       |
| <b>Income before taxes</b>                                    | <b>190.4</b>       | <b>176.2</b> | <b>8.0</b>  | <b>49.7</b>        | <b>35.0</b> | <b>41.8</b> |
| Income taxes  | (63.4)             | (61.7)       | 2.9         | (17.6)             | (15.6)      | 13.2        |
| <b>Income from continuing operations</b>                      | <b>126.9</b>       | <b>114.5</b> | <b>10.8</b> | <b>32.0</b>        | <b>19.5</b> | <b>64.6</b> |
| Income (Loss) from discontinued operations                    | 0.0                | 0.0          | n.s.        | 0.0                | 0.0         | n.s.        |
| Minority interest   | 0.0                | 0.5          | n.s.        | 0.0                | (0.0)       | n.s.        |
| <b>Net income</b>   | <b>126.9</b>       | <b>115.1</b> | <b>10.3</b> | <b>32.0</b>        | <b>19.5</b> | <b>64.6</b> |

<sup>1</sup>Including work in process.

## Atento GROUP: Consolidated income statement

Unaudited figures (Euros in millions)

|   | january - december |             |             | october - december |             |              |
|---|--------------------|-------------|-------------|--------------------|-------------|--------------|
|   | 2005               | 2004        | % Var       | 2005               | 2004        | % Var        |
| Revenues  | 856.5              | 606.5       | 41.2        | 247.9              | 174.3       | 42.2         |
| Internal expenditure capitalised in fixed assets <sup>1</sup> | 0.0                | 0.0         | n.s.        | 0.0                | 0.0         | n.s.         |
| Operating expenses  | (741.5)            | (522.3)     | 42.0        | (213.6)            | (150.4)     | 42.0         |
| Other net operating income (expense)                          | 1.4                | 1.1         | 23.6        | (0.6)              | 0.3         | c.s.         |
| Gain (loss) on sale of fixed assets                           | 0.0                | (0.3)       | c.s.        | 0.0                | 0.1         | (73.1)       |
| Impairment of goodwill and other assets                       | 0.0                | 0.0         | n.s.        | 0.0                | 0.0         | n.s.         |
| <b>Operating income before D&amp;A (OIBDA)</b>                | <b>116.4</b>       | <b>85.1</b> | <b>36.7</b> | <b>33.8</b>        | <b>24.3</b> | <b>38.8</b>  |
| Depreciation and Amortisation                                 | (27.9)             | (33.7)      | (17.3)      | (7.2)              | (7.6)       | (5.0)        |
| <b>Operating income (OI)</b>                                  | <b>88.5</b>        | <b>51.4</b> | <b>72.1</b> | <b>26.6</b>        | <b>16.8</b> | <b>58.5</b>  |
| Profit from associated companies                              | 0.0                | 0.0         | n.s.        | 0.0                | 0.0         | n.s.         |
| Net financial income (expense)                                | (20.2)             | (10.5)      | 93.0        | (7.1)              | (4.3)       | 65.9         |
| <b>Income before taxes</b>                                    | <b>68.2</b>        | <b>40.9</b> | <b>66.7</b> | <b>19.5</b>        | <b>12.5</b> | <b>55.9</b>  |
| Income taxes  | (16.6)             | (6.8)       | 143.5       | (1.8)              | (4.5)       | (60.1)       |
| <b>Income from continuing operations</b>                      | <b>51.6</b>        | <b>34.1</b> | <b>51.3</b> | <b>17.7</b>        | <b>8.0</b>  | <b>120.2</b> |
| Income (Loss) from discontinued operations                    | 0.0                | (0.1)       | n.s.        | 0.0                | 0.0         | n.s.         |
| Minority interest   | (3.4)              | (1.7)       | 99.4        | (1.1)              | (0.6)       | 92.0         |
| <b>Net income</b>   | <b>48.2</b>        | <b>32.3</b> | <b>49.3</b> | <b>16.6</b>        | <b>7.5</b>  | <b>122.3</b> |

<sup>1</sup>Including work in process.

### Atento Group

2005 was a year of strong growth in some of the Atento Group's business lines, with an increase in the net income. The following customers contributed the most to this increase, over the financial year as a whole:

- In Brazil, the increase in sales with Vivo, Sera, Speedy, Atento ao Cliente, the start of operations with Banco IBI and growth of customers in the financial sector (UBB, Bradesco, Redecard, Losango).
- In Spain, the services with Gas Natural, and the increase in the activity with Telefónica.
- In Mexico, the growth in business with BBVA and US Airways.
- In Chile, the increase in business with Telefónica CTC, movistar, VTR and Interamericana.
- In Argentina, with the start of operations with movistar.
- In Puerto Rico, growth with SunCom.
- In Venezuela, increase in sales with CANTV and movistar.

Operating revenues grew by 41.2% year-on-year, to stand at 856.5 million euros. In this year, all Atento operations have increased sales, except for Atento Morocco. It is important to highlight Atento Brazil, with a 52.7% growth in revenues over 2005. Its sales in euros make it the group's largest operation, with a weight of 35.5% over total Atento Group revenues. Sales in Spain

represent 34.2% of the total, having grown by 22.2% compared with 2004. Revenues in other countries, such as Argentina, Central America, Colombia, Mexico and Venezuela have grown by more than 50%.

Customers outside the Telefónica Group have once again increased their contribution to Atento total revenues, to stand at 44.8%, up 0.7 percentage points more than a year ago. By 2005 end, the Atento Group was the service provider to more than 400 companies, and had continued to diversify and specialise in the financial, telecommunications, mass market, energy, transport and tourism sectors, and government bodies.

Operating costs grew by 42.0% year on year, to stand at 741.5 million euros. Personnel expenses had the greatest impact on this increase (+44%), as a result of the year's increased activity.

The Atento Group OIBDA for 2005 rose to 116.4 million euros, a 36.7% increase on the 85.1 million euros for 2004. The downward pressure on pricing throughout the 2005 financial year resulted in a general reduction in operating margins in the sector, which Atento was able to face up to thanks to better optimisation of costs and to the increase in the scale, placing the OIBDA margin at 13.6%, just 0.4 percentage points lower than 2004.

Operating income amounted to 88.5 million euros, up 72.1% year on year, supported by the downward trend in depreciation, as a result of the degree of maturity achieved in operations.

Atento Group net income was again positive, for the second year in a row, standing at 48.2 million euros, 15.9 million more than last year.

At operating level, Atento Group had 39,705 positions in place as of 31st December 2005, up 29.9% on 2004. The average number of occupied positions for the 2004 financial year was 30,247. This was a significant improvement on the level of occupation achieved in 2004 (80% vs. 75% in 2004).

CapEx in the 2005 financial year reached 42.9 million euros, compared with 22.8 million euros in 2004, and the operating free cash flow grew by 17.7%, to 73.4 million euros.

## Content and media business: Consolidated income statement

Unaudited figures (Euros in millions)

|   | january - december |               |             | october - december |               |               |
|---|--------------------|---------------|-------------|--------------------|---------------|---------------|
|   | 2005               | 2004          | % Var       | 2005               | 2004          | % Var         |
| Revenues  | 1,269.1            | 1,219.1       | 4.1         | 390.3              | 387.2         | 0.8           |
| Internal expenditure capitalised in fixed assets <sup>1</sup> | 0.0                | 0.2           | n.s.        | 0.0                | 0.0           | n.s.          |
| Operating expenses  | (1,052.2)          | (1,049.1)     | 0.3         | (324.8)            | (344.0)       | (5.6)         |
| Other net operating income (expense)                          | 5.7                | 10.5          | (45.7)      | (2.7)              | 11.6          | c.s.          |
| Gain (loss) on sale of fixed assets                           | 47.5               | 6.9           | n.s.        | 40.0               | 1.9           | n.s.          |
| Impairment of goodwill and other assets                       | (0.8)              | (2.6)         | (69.0)      | (0.7)              | (0.1)         | n.s.          |
| <b>Operating income before D&amp;A (OIBDA)</b>                | <b>269.2</b>       | <b>185.0</b>  | <b>45.5</b> | <b>102.1</b>       | <b>56.6</b>   | <b>80.2</b>   |
| Depreciation and Amortisation                                 | (28.9)             | (28.9)        | 0.1         | (8.4)              | (9.3)         | (9.6)         |
| <b>Operating income (OI)</b>                                  | <b>240.3</b>       | <b>156.2</b>  | <b>53.9</b> | <b>93.7</b>        | <b>47.3</b>   | <b>97.8</b>   |
| Profit from associated companies                              | (6.4)              | (34.2)        | (81.2)      | (1.3)              | (10.8)        | (87.6)        |
| Net financial income (expense)                                | (96.7)             | (121.6)       | (20.5)      | (93.0)             | (96.7)        | (3.9)         |
| <b>Income before taxes</b>                                    | <b>137.2</b>       | <b>0.4</b>    | <b>n.s.</b> | <b>(0.6)</b>       | <b>(60.2)</b> | <b>(99.0)</b> |
| Income taxes  | (49.2)             | (35.9)        | 37.0        | (2.9)              | 20.4          | c.s.          |
| <b>Income from continuing operations</b>                      | <b>88.0</b>        | <b>(35.6)</b> | <b>n.s.</b> | <b>(3.5)</b>       | <b>(39.8)</b> | <b>(91.2)</b> |
| Income (Loss) from discontinued operations                    | 0.0                | 0.0           | n.s.        | 0.0                | 0.0           | n.s.          |
| Minority interest   | (9.1)              | (5.0)         | 82.8        | (4.9)              | (1.6)         | 197.3         |
| <b>Net income</b>   | <b>78.8</b>        | <b>(40.6)</b> | <b>c.s.</b> | <b>(8.4)</b>       | <b>(41.5)</b> | <b>(79.8)</b> |

<sup>1</sup>Including work in process.

### Content and media business

The Contents and Media business ended the last quarter of 2005 with revenues of 1,269.1 million euros, 4.1% higher of the figure reached in the same period of the previous year. This increase was basically due to the better performance of Endemol and the ATCO Group in this fourth quarter, fully offsetting the lower revenues from changes to the consolidation perimeter.

The consolidated operating income before depreciation and Amortisation (OIBDA) over the year amounted to 269.2 million euros, compared with the 185.0 million euros obtained over 2004. This represents a 45.5% year-on-year growth, primarily thanks to the positive progress of the results from all business lines, revenues obtained from the floating of 25% of Endemol, N.V. on the stock exchange and the sale of the radio business in ATCO.

### ENDEMOL NV

The company, floated on the Amsterdam exchange, recorded a 5.8% growth in revenues to total 900.1 million euros. Revenues from acquisitions amounted to 10.5 million euros of this figure and the remainder growth is organic.

The growth in revenues was reflected in all countries in which Endemol NV operates, with a particularly significant performance on the Spanish and British markets and Rest of the World (ROW), contributing towards the greater diversification of the Group's revenues and a greater relative weight of revenues from formats other than non-scripted (scripted and digital) that accounted for 23.3% of the total compared with the 21.4% represented in 2004.

The reported EBITDA of Endemol NV stood at 152.8 million euros, a 15.4% increase on the previous year and leading to a 17% margin, 1.4 percentage points up on 2004. The positive operational progress of the Company is explained by the growth in its revenues and the good performance of production costs in the US following the syndication of the four series of Fear Factor, offset by the lower operational profitability of some markets in the rest of the world in which the Company has most grown proportionally.

### ATCO

The advertising market in Argentina (Capital and Gran Buenos Aires regions) grew by 21% over the year with respect to the previous year. This growth can be compared with the 39% recorded in 2004, which reflected the market recovery recorded over that year.

In this favourable market context, Telefé reaffirmed its position as leader, obtaining 37.9% of the total audience by 2005 year end - very similar to the figure recorded over the previous year - followed by Canal 13, its main competitor, with an average share of 24.9%. The market share accumulated by Telefé by the end of 2005 stood at 41.2%, 3.7 percentage points lower than in 2004, once again, followed by Canal 13 with 32.1%.

Thus, ATCO recorded an improvement in its financial results in comparison with the previous year thanks to the growth in the Capital and Gran Buenos Aires advertising markets over the year, the good results regarding total audience obtained by Telefé that enabled it to increase its revenues and to the profits obtained from the sale of Radio Continental and Radio Estéreo.

## Telefónica Deutschland Group: Selected financial data

Unaudited figures (Euros in millions)

|                                     | january-december |         |           |
|-------------------------------------|------------------|---------|-----------|
|                                     | 2005             | 2004    | % Chg     |
| Revenues                            | 281.2            | 290.8   | (3.3)     |
| Operating income before D&A (OIBDA) | (3.1)            | (151.7) | (98.0)    |
| OIBDA margin                        | (1.1%)           | (52.2%) | 51.1 p.p. |

### Telefónica Deutschland Group

Telefónica Deutschland obtained revenues of 281.2 million euros in 2005, showing a year-on-year reduction of 3.3%, due primarily to the reduction in revenues from narrowband services which has not yet been offset by the increase in broadband business.

With respect to the broadband business, it is worth to highlight the increase in the number of connections resold on a retail basis by the company to its main clients. With it, the total number of equivalent ADSL lines in service in the German market exceeds the figure of 535 thousands at the end of 2005, which compares with the more than 481 thousands achieved in December 2004, providing services to four of the five top main ISPs in Germany.

Telefónica Deutschland has registered a negative operating income before depreciation and Amortisation (OIBDA) of 3.1 million euros at the end of the year, which compares with the negative figure of 151.7 million euros obtained in 2004, mainly due to the anticipated cancellation of Telefonica's UK goodwill.

# Appendix

## Companies included in each Financial Statement

Based on what was indicated at the start of this report, the results breakdown of Telefónica Group are detailed according to the business in which the Group has a presence. The main differences between this view and the one that would apply attending to the legal structure, are the following:

- Telefónica, S.A. directly participates in the share capital of Endemol Entertainment Holding, N.V., which has been included in Content and Media Business. The results from the Sogecable S.A. stake have been also assigned to Content and Media Business, even though a part of the investment is legally dependent upon Telefónica, S.A.
- Telefónica Holding Argentina, S.A. holds 6.98% of Atlántida de Comunicaciones, S.A. (ATCO) which, for those purposes, is considered to be part of Content and Media Business, consolidating 100% share capital of ATCO.
- Compañía de Telecomunicaciones de Chile, S.A. (CTC), participated by Telefónica Latinoamérica, sold Telefónica Móviles Chile to Telefónica Móviles Group in the third quarter of fiscal year 2004, although the results of this company have been assigned to the cellular business from the beginning of the year 2004.
- The participation of Telefónica Group in IPSE 2000 SpA is assigned to the cellular business, also including the investment legally dependent upon Telefónica DataCorp, S.A.
- Telefónica de Argentina (TASA), participated by Telefónica Latinoamérica Group, sold in November 2005 its 100% stake in Telinver, S.A. share capital to TPI Group. Nevertheless, the results from this company has been assigned to the directories business through 2004 and 2005 in line with our vision for the total Telefónica's directories business.
- Telefónica Data Group (denominated "Telefónica Empresas"), legally dependent upon Telefónica S.A., has been segregated and subsequently integrated into the fixed line activities both in Latin America and Spain for presentation purposes, and according to geographic criteria. The stakes not included in neither of the previous geographic areas will be consolidated directly by Telefónica S.A. In this sense, the stakes in Telefónica Data España, S.A.U. and Soluciones Group have been sold to Telefónica de España S.A.U. in the third quarter of 2004, although the results of both companies had been assigned to the fixed line business in Spain from the beginning of the year 2004.
- Telefónica International Wholesale Services Group (TIWS) financial results has been assigned to Telefónica Latinoamérica Group during 2004 and 2005, even though is legally dependent upon Telefónica, S.A. (92.5%) and Telefónica Data Corp (7.5%).
- The activities of Terra Networks España S.A., Maptel Networks, S.A.U. and Azeler Automoción, S.A. have been included in

Telefónica de España Group as of July 1st 2005; at the same time, Terra Networks Chile has been included in Telefónica Latinoamérica Group together with the rest of Latin American companies of Terra. As of December 31st 2005, Terra Networks España is directly held by Telefónica S.A., while Maptel Networks and Azeler Automoción are directly held by Terra Networks Asociadas, S.L. Terra Networks Chile was legally included in Telefónica Latinoamérica Group in the fourth quarter of 2005.

# Disclaimer

This annual report contains statements that constitute forward looking statement that reflect the current views of telefónica's management with respect to future events. These statements appear in a number of places in this document and include statements regarding the intent, belief or current expectations of the customer base, estimates regarding future growth in the different business lines and the global business, market share, financial results and other aspects of the activity and situation relating to the company. The forward-looking statements in this document can be identified, in some instances, by the use of words such as "expects", "anticipates", "intends", "believes", and similar language or the negative thereof or by forward-looking nature of discussions of strategy, plans or intentions.

Although telefónica believes that these statements are based on reasonable assumptions, such forward-looking statements, by their nature, are not guarantees of future performance and involve risks and uncertainties and actual results may differ materially from those in the forward looking statements as a result of various factors, most of which are difficult to predict and are generally beyond telefónica's control.

Shareholders, investors and analysts are cautioned not to place undue reliance on those forward looking statements which speak only as of the date of this document. Telefónica undertakes no obligation to release publicly the results of any revisions to these forward looking statements which may be made to reflect events and circumstances after the date of publication of this information, including, without limitation, changes in telefónica's business or acquisition strategy or to reflect the occurrence of unanticipated events. Shareholders, investors and analysts are encouraged to consult the company's annual report as well as periodic filings filed with the relevant securities markets regulators, and in particular with the spanish market regulator (comisión nacional del mercado de valores).

The financial information contained in this document has been prepared under international financial reporting standards (ifrs), although telefónica may also include financial information herein that is not prepared in accordance with ifrs. This non-gaap financial information should be considered in addition to, but not as a substitute for, financial information prepared in accordance with ifrs. Telefónica has included such non-gaap financial information because telefónica's management uses such financial information as part of its internal reporting and planning process and to evaluate telefónica's performance. Accordingly, telefónica believes that shareholders, investors and analysts may find such information useful. However, such non-gaap financial information is not prepared in accordance with ifrs or any other generally accepted accounting principles, and such non-gaap financial information, as defined and calculated by us, may be different from similarly-titled financial information used by other companies. Shareholders, investors and analysts are cautioned not to place undue reliance on such non-gaap financial information.



2004

Annual Report and  
Financial Accounts



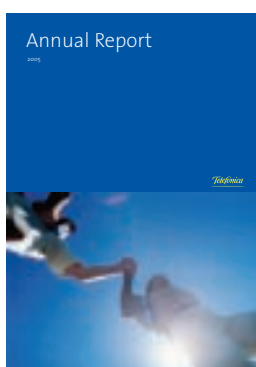
Annual Report of  
Corporate Governance



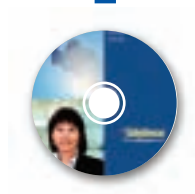
Annual Report of  
Corporate Responsibility



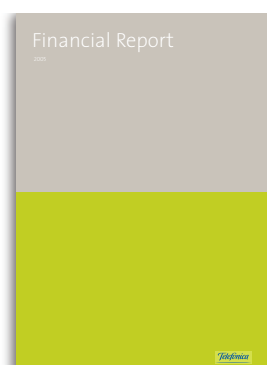
2005



Annual Report



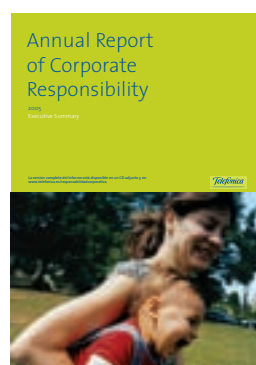
Annual Report CD



Financial Report\*



Annual Report of  
Corporate Governance\*



Annual Report of Corporate  
Responsibility  
Executive Summary\*

\*The documents included in the Annual Report CD are also available in printed format

**Telefónica, S.A.**  
Annual Report 2005

This Report is also available at Telefónica's Internet website:  
**[www.telefonica.com/eng](http://www.telefonica.com/eng)**

Shareholders may request copies of this Report from  
**Telefónica's Shareholder Attention Service** by calling freephone  
**900 111 004** (in Spain) or via email to  
**[accion.telefonica@telefonica.es](mailto:accion.telefonica@telefonica.es)**

The information required by law is also available to shareholders  
and to the general public

**Published by**  
Dirección General de Comunicación Corporativa. Telefónica, S. A

**Designed by**  
Addison

**Photography**  
Chairman's photograph: José Antonio Rojo  
Employees' photographs: Carlos Bandrés

**Printed by**  
T.F. Artes Gráficas

Publication date: June 2006  
Legal deposit: M-25252-2006

*Telefónica*

[www.telefonica.com/eng](http://www.telefonica.com/eng)



# Financial Report

2005









# Contents

## Financial Report 2005

|    |  |     |
|----|--|-----|
| 01 | Consolidated Financial Statements and Consolidated Management Report | 4   |
| 02 | Annual Financial Statements and Management Report, Telefónica, S.A.  | 142 |

# Consolidated Financial Statements and Consolidated Management Report

01

|         |   |    |
|---------|---|----|
| 01   01 | Auditor's Letter  | 06 |
| 01   02 | Consolidated Financial Statements<br>and Consolidated Management Report | 08 |

## INFORME DE AUDITORÍA DE CUENTAS ANUALES CONSOLIDADAS

A los Accionistas de  
Telefónica, S.A.

1. Hemos auditado las cuentas anuales consolidadas de Telefónica, S.A. y de las sociedades que componen el Grupo Telefónica (el Grupo), que comprenden el balance de situación consolidado al 31 de diciembre de 2005 y la cuenta de resultados consolidada, el estado de flujos de efectivo consolidado, el estado de ingresos y gastos reconocidos consolidado y las notas a los estados financieros consolidados correspondientes al ejercicio anual terminado en dicha fecha, cuya formulación es responsabilidad de los Administradores de la Sociedad dominante. Nuestra responsabilidad es expresar una opinión sobre las citadas cuentas anuales consolidadas en su conjunto, basada en el trabajo realizado de acuerdo con las normas de auditoría generalmente aceptadas en España, que requieren el examen, mediante la realización de pruebas selectivas, de la evidencia justificativa de las cuentas anuales consolidadas y la evaluación de su presentación, de los principios contables aplicados y de las estimaciones realizadas.

2. Las cuentas anuales consolidadas adjuntas del ejercicio 2005 son las primeras que el Grupo prepara aplicando las Normas Internacionales de Información Financiera adoptadas por la Unión Europea (NIIF-UE), que requieren, con carácter general, que los estados financieros presenten información comparativa. En este sentido, y de acuerdo con la legislación mercantil, los Administradores de la Sociedad dominante presentan, a efectos comparativos, con cada una de las partidas del balance de situación consolidado, de la cuenta de resultados consolidada, del estado de flujos de efectivo consolidado, del estado de ingresos y gastos reconocidos consolidado y de las notas a los estados financieros consolidados, además de las cifras del ejercicio 2005, las correspondientes al ejercicio anterior, que han sido obtenidas mediante la aplicación de las NIIF-UE vigentes al 31 de diciembre de 2005. Consecuentemente, las cifras correspondientes al ejercicio anterior difieren de las contenidas en las cuentas anuales consolidadas aprobadas del ejercicio 2004 que fueron formuladas conforme a los principios y normas contables vigentes en dicho ejercicio, detallándose en la Nota 2 de las cuentas anuales consolidadas adjuntas las diferencias que supone la aplicación de las NIIF-UE sobre el patrimonio neto consolidado al 1 de enero y al 31 de diciembre de 2004 y sobre los resultados consolidados del ejercicio 2004 del Grupo. Nuestra opinión se refiere exclusivamente a las cuentas anuales consolidadas del ejercicio 2005. Con fecha 4 de marzo de 2005 otros auditores emitieron su informe de auditoría acerca de las cuentas anuales consolidadas del ejercicio 2004, formuladas conforme a los principios y normas contables vigentes en dicho ejercicio, en el que expresaron una opinión favorable.

3. En nuestra opinión, las cuentas anuales consolidadas del ejercicio 2005 adjuntas expresan, en todos los aspectos significativos, la imagen fiel del patrimonio consolidado y de la situación financiera consolidada de Telefónica, S.A. y de las sociedades que componen el Grupo Telefónica al 31 de diciembre de 2005 y de los resultados consolidados de sus operaciones, de sus flujos de efectivo consolidados y de los ingresos y gastos reconocidos consolidados correspondientes al ejercicio anual terminado en dicha fecha y contienen la información necesaria y suficiente para su interpretación y comprensión adecuada, de conformidad con las Normas Internacionales de Información Financiera adoptadas por la Unión Europea que guardan uniformidad con las aplicadas en la preparación de los estados financieros consolidados correspondientes al ejercicio anterior que se han incorporado a las cuentas anuales consolidadas del ejercicio 2005 a efectos comparativos.

4. El informe de gestión consolidado adjunto del ejercicio 2005 contiene las explicaciones que los Administradores de la Sociedad dominante consideran oportunas sobre la situación de Telefónica, S.A. y de las sociedades que componen el Grupo Telefónica, la evolución de sus negocios y sobre otros asuntos y no forma parte integrante de las cuentas anuales consolidadas. Hemos verificado que la información contable que contiene el citado informe de gestión consolidado concuerda con la de las cuentas anuales consolidadas del ejercicio 2005. Nuestro trabajo como auditores se limita a la verificación del informe de gestión consolidado con el alcance mencionado en este mismo párrafo y no incluye la revisión de información distinta de la obtenida a partir de los registros contables de la Sociedad dominante y de las sociedades que componen el Grupo.



ERNST & YOUNG, S.L.

(Inscrita en el Registro Oficial de Auditores de Cuentas con el N° S0530)



José Miguel Andrés Torrecillas

1 de marzo de 2006



## Telefónica Group

### Consolidated Balance Sheets at December 31

Millions of Euros

| Assets   | 2005             | 2004             |
|--|------------------|------------------|
| <b>A) Non-current Assets</b>                           | <b>59,545.00</b> | <b>48,954.47</b> |
| Intangible assets (Note 5)                             | 7,877.11         | 5,674.13         |
| Goodwill (Note 6)                                      | 8,910.23         | 5,949.44         |
| Property, plant and equipment (Note 7)                 | 27,992.60        | 23,193.37        |
| Investment property                                    | 34.81            | 28.37            |
| Investments in associates (Note 9)                     | 1,664.35         | 1,651.68         |
| Non-current financial assets (Note 8)                  | 4,681.23         | 3,500.34         |
| Deferred tax assets (Note 16)                          | 8,384.67         | 8,957.14         |
| <b>B) Current Assets</b>                               | <b>13,628.77</b> | <b>11,124.39</b> |
| Inventories  | 919.51           | 655.52           |
| Trade and other receivables (Note 10)                  | 7,515.75         | 5,919.75         |
| Current financial assets (Note 8)                      | 1,517.76         | 2,556.61         |
| Current tax receivables (Note 16)                      | 1,448.26         | 1,069.49         |
| Cash and cash equivalents                              | 2,213.21         | 914.35           |
| Non-current assets held for sale                       | 14.28            | 8.67             |
| <b>TOTAL ASSETS (A + B)</b>                            | <b>73,173.77</b> | <b>60,078.86</b> |
| Equity and Liabilities                                 | 2005             | 2004             |
| <b>A) Equity (Note 11)</b>                             | <b>16,158.43</b> | <b>12,342.47</b> |
| Equity attributable to equity holders of the parent    | 12,733.29        | 10,439.76        |
| Minority interests                                     | 3,425.14         | 1,902.71         |
| <b>B) Non-current Liabilities</b>                      | <b>35,126.47</b> | <b>27,742.58</b> |
| Interest-bearing debt (Note 12)                        | 25,167.58        | 17,492.23        |
| Trade and other payables (Note 13)                     | 1,128.21         | 1,200.08         |
| Deferred tax liabilities (Note 16)                     | 2,477.44         | 1,642.61         |
| Provisions (Note 14)                                   | 6,353.24         | 7,407.66         |
| <b>C) Current Liabilities</b>                          | <b>21,888.87</b> | <b>19,993.81</b> |
| Interest-bearing debt (Note 12)                        | 9,235.87         | 10,210.40        |
| Trade and other payables (Note 13)                     | 9,718.56         | 7,696.05         |
| Current tax payables (Note 16)                         | 2,191.62         | 1,824.94         |
| Provisions   | 742.82           | 259.70           |
| Liabilities linked to non-current assets held for sale | –                | 2.72             |
| <b>TOTAL EQUITY AND LIABILITIES (A+B+C)</b>            | <b>73,173.77</b> | <b>60,078.86</b> |

The accompanying Notes 1 to 22 and Appendices I to VI are an integral part of these consolidated balance sheets.

## Telefónica Group

### Consolidated Income Statements for the Years Ended December 31

Millions of Euros

| Income Statement  | 2005             | 2004             |
|---|------------------|------------------|
| Revenues from operations (Note 17)  | 37,882.16        | 30,280.92        |
| Other income (Note 19)  | 1,418.26         | 1,133.41         |
| Supplies  | (10,065.05)      | (7,637.33)       |
| Personnel expenses (Note 19)  | (5,656.34)       | (5,095.17)       |
| Other expenses (Note 19)  | (8,302.60)       | (6,459.80)       |
| <b>I. OPERATING INCOME BEFORE DEPRECIATION AND AMORTIZATION (OIBDA)</b>                             | <b>15,276.43</b> | <b>12,222.03</b> |
| Depreciation and amortization   | (6,717.68)       | (5,666.03)       |
| <b>II. OPERATING INCOME</b>   | <b>8,558.75</b>  | <b>6,556.00</b>  |
| Share of profit (loss) of associates (Note 9)   | (128.21)         | (50.49)          |
| Net financial expenses  | (1,796.37)       | (1,462.06)       |
| Net exchange differences  | 162.04           | (177.05)         |
| Net financial income (expense) (Note 15)  | (1,634.33)       | (1,639.11)       |
| <b>III. PROFIT BEFORE TAXES FROM CONTINUING OPERATIONS</b>  | <b>6,796.21</b>  | <b>4,866.40</b>  |
| Corporate income tax (Note 16)  | (1,969.15)       | (1,512.78)       |
| <b>IV. PROFIT FOR THE YEAR FROM CONTINUING OPERATIONS</b>   | <b>4,827.06</b>  | <b>3,353.62</b>  |
| Profit from discontinued operations after taxes (Note 18)   | -                | 131.97           |
| <b>V. PROFIT FOR THE YEAR</b>   | <b>4,827.06</b>  | <b>3,485.59</b>  |
| Minority interests (Note 11)  | (381.21)         | (309.92)         |
| <b>VI. PROFIT FOR THE YEAR ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT</b>                         | <b>4,445.85</b>  | <b>3,175.67</b>  |
| Basic and diluted earnings per share attributable to equity holders of the parent (Note 19) (euros) | 0.913            | 0.637            |

The accompanying Notes 1 to 22 and Appendices I to VI are an integral part of these consolidated income statements.

## Telefónica Group

### Consolidated Cash Flow Statements for the Years Ended December 31

Millions of Euros

|   | 2005              | 2004              |
|---|-------------------|-------------------|
| <b>Cash flows from operating activities</b>   |                   |                   |
| Cash received from customers  | 44,353.14         | 36,367.10         |
| Cash paid to suppliers and employees  | (30,531.54)       | (24,674.10)       |
| Dividends received  | 70.58             | 71.24             |
| Net interest and other financial expenses paid                                      | (1,520.00)        | (1,307.11)        |
| Taxes paid  | (1,233.04)        | (326.00)          |
| <b>Net cash from operating activities</b>   | <b>11,139.14</b>  | <b>10,131.13</b>  |
| <b>Cash flows from investing activities</b>   |                   |                   |
| Proceeds on disposals of property, plant and equipment and intangible assets        | 113.20            | 241.27            |
| Payments on investments in property, plant and equipment and intangible assets      | (4,423.22)        | (3,488.15)        |
| Proceeds on disposals of companies, net of cash and cash equivalents disposed       | 501.59            | 531.98            |
| Payments on investments in companies, net of cash and cash equivalents acquired     | (6,571.40)        | (4,201.57)        |
| Proceeds on financial investments not included under cash equivalents               | 147.61            | 31.64             |
| Payments made on financial investments not included under cash equivalents          | (17.65)           | (76.35)           |
| Interest received on short term investments not included under cash equivalents     | 625.18            | 1,139.51          |
| Capital grants received   | 32.67             | 13.51             |
| <b>Net cash used in investing activities</b>  | <b>(9,592.02)</b> | <b>(5,808.16)</b> |
| <b>Cash flows from financing activities</b>   |                   |                   |
| Dividends paid (Note 11)  | (2,768.60)        | (2,865.81)        |
| Proceeds from issue of stock  | (2,054.12)        | (1,938.56)        |
| Proceeds on issue of debentures and bonds   | 875.15            | 572.99            |
| Proceeds on loans, credits and promissory notes                                     | 16,533.96         | 10,135.11         |
| Cancellation of debentures and bonds  | (3,696.52)        | (1,790.57)        |
| Repayments of loans, credits and promissory notes                                   | (9,324.54)        | (8,049.77)        |
| <b>Net cash from financing activities</b>   | <b>(434.67)</b>   | <b>(3,936.61)</b> |
| Effect of foreign exchange rate changes on collections and payments                 | 165.73            | 74.18             |
| Effect of changes in consolidation methods and other non-monetary effects           | 9.62              | (36.76)           |
| <b>Net increase (decrease) in cash and cash equivalents during the year</b>         | <b>1,287.80</b>   | <b>423.78</b>     |
| <b>CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR</b>                       | <b>914.35</b>     | <b>490.57</b>     |
| <b>CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR</b>                             | <b>2,202.15</b>   | <b>914.35</b>     |
| <b>RECONCILIATION OF NET CASH FLOWS AND CASH EQUIVALENTS WITH THE BALANCE SHEET</b> |                   |                   |
| Net increase (decrease) in cash and cash equivalents during the year                | 1,287.80          | 423.78            |
| <b>CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR</b>                       | <b>914.35</b>     | <b>490.57</b>     |
| Cash on hand and at banks   | 855.02            | 336.42            |
| Other cash equivalents  | 59.33             | 154.15            |
| <b>CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR</b>                             | <b>2,202.15</b>   | <b>914.35</b>     |
| Cash on hand and at banks   | 1,555.17          | 855.02            |
| Other cash equivalents  | 658.04            | 59.33             |
| Bank overdrafts (1)   | (11.06)           | -                 |

(1) Included under "Interest-bearing debt" on the consolidated cashflow statements.

The accompanying Notes 1 to 22 and Appendices I to VI are an integral part of these consolidated cash flow statements.

## Telefónica Group

### Consolidated Statements of Recognized Income and Expense for the Years Ended December 31

Millions of Euros

|  | 2005            | 2004            |
|--|-----------------|-----------------|
| Gain (loss) on available-for-sale investments                      | (79.78)         | 111.08          |
| Gain (loss) on cash flow hedges                                    | (125.60)        | (274.89)        |
| Translation differences  | 2,577.09        | (316.24)        |
| Share of income (loss) directly recognized in equity of associates | (49.67)         | (94.72)         |
| Tax effect of items recognized directly in equity                  | 71.88           | 90.50           |
| Net income (loss) recognized directly in equity                    | 2,393.92        | (484.27)        |
| Profit for the year  | 4,827.06        | 3,485.59        |
| <b>Total income and expense recognized in the year (Note 11)</b>   | <b>7,220.98</b> | <b>3,001.32</b> |
| Attributable to:   |                 |                 |
| Equity holders of the parent                                       | 6,397.33        | 2,699.37        |
| Minority interests   | 823.65          | 301.95          |
|  | <b>7,220.98</b> | <b>3,001.32</b> |

The accompanying Notes 1 to 22 and Appendices I to VI are an integral part of these consolidated statements of recognised income and expense.

## Telefónica, S.A. and Subsidiaries Composing the Telefónica Group

### Notes to the Consolidated Financial Statements (Consolidated Annual Accounts) for the Year Ended December 31, 2005

#### (1) Introduction and General Information

##### *Telefónica Group organizational structure*

Telefónica, S.A. and its subsidiaries and investees make up an integrated group of companies (the “Telefónica Group,” “the Group” or “the Company”) operating mainly in the telecommunications, media and entertainment industries.

The parent company of this Group is Telefónica, S.A. (“Telefónica”), incorporated on April 19, 1924. Its registered office is at calle Gran Vía 28, Madrid (Spain).

Appendix I lists the subsidiaries, associates and investees in which the Telefónica Group has direct or indirect holdings, their lines of business, their registered offices, their net worth and results at year end, their gross book value, their contribution to the reserves of the Consolidated Group and the consolidation method used.

##### *Corporate structure of the Group*

Telefónica’s basic corporate purpose, per Article 4 of its bylaws, is the provision of all manner of public and private telecommunications services, and all manner of ancillary or complementary telecommunications services or related services. All the business activities that constitute this stated corporate purpose may be performed either in Spain or abroad and may be carried out either wholly or partially by the Company, either through shareholdings or equity interests in other companies or legal entities with an identical or a similar corporate purpose.

The main groups of subsidiaries through which Telefónica carries out its corporate purpose and manages its business areas or basic lines of business are as follows:

- Telefónica de España Group: the wireline telephony business and the related supplementary services provided in Spain.
- Telefónica Móviles Group: the national and international wireless telephony business, except in the Czech Republic.
- Telefónica Internacional Group: investment and management of investments in the wireline telephony industry in Latin America.
- Telefónica Publicidad e Información, S.A. - TPI (the directories business), Atento, N.V. (call center services), Telefónica de Contenidos, S.A. (media, entertainment and content) and Cesky Telecom (the fixed line and wireless telephony business in the Czech Republic).

The business activities carried out by most of the Telefónica Group companies are regulated by broad ranging legislation, pursuant to which permits, concessions or licenses must be obtained in certain circumstances to provide the various services.

In addition, certain wireline and wireless telephony services are provided under regulated rate and price systems.

A more detailed breakdown of the activities carried out by the Group is provided in Note 17.

#### (2) Basis of Presentation of the Consolidated Financial Statements

The accompanying consolidated financial statements were prepared from the accounting records of Telefónica, S.A. and of each of the companies composing the Telefónica Group, which were drawn up in accordance with the generally accepted accounting principles prevailing in the various countries in which the companies composing the Consolidated Group are located, and presented in accordance with the International Financial Reporting Standards (IFRS) to give a true and fair view of the net worth, financial position, results of operations and cash flow obtained and used in 2005. The figures in these consolidated financial statements are expressed in millions of euros unless indicated otherwise. The euro is the Group’s operating currency.

The annual consolidated financial statements for the year ended December 31, 2004, approved at Telefónica, S.A.’s Ordinary Shareholders’ Meeting on May 31, 2005, were prepared in accordance with Spain’s generally accepted accounting principles (the Spanish General Chart of Accounts or “Spanish GAAP”). Pursuant to European Parliament regulation 1606/2002, of July 19, 2002, Telefónica is obliged to apply the International Financial Reporting Standards (IFRS) endorsed by the European Union for preparing and presenting its consolidated financial information as from January 1, 2005. Accordingly, the consolidated financial statements for the year ended December 31, 2005 have been prepared under IFRS, and the 2004 consolidated financial information included for comparative purposes was restated in accordance with IFRS.

The accompanying consolidated financial statements for the year ended December 31, 2005 were prepared by the Company’s Board of Directors at its meeting on February 28, 2006 for approval at the General Shareholders’ Meeting. The Board expects the financial statements to be approved without any modification.

Note 4 contains a detailed description of the most significant accounting policies used to prepare the financial statements for 2004 and 2005 (2004 information for comparative purposes only).

##### *First-time adoption of International Financial Reporting Standards*

The transition of the Telefónica Group’s consolidated financial statements to IFRS has been carried out by applying *IFRS 1: First-Time Adoption of International Financial Reporting Standards*, taking January 1, 2004 as the beginning of the first comparative period presented under the new accounting standards. This date is considered the IFRS transition date.

As a general rule, the accounting policies in force on December 31, 2005 must be applied retroactively to prepare an opening balance sheet for the date of transition and all following years. IFRS 1 provides for certain exceptions to the complete retroactive restatement of the opening balance sheet under IFRS. The main exceptions are as follows:

|  |  |
|--|--|
| <b>IFRS 3 – Business Combinations</b>                    | The Telefónica Group has elected to apply IFRS 3 <i>Business Combinations</i> prospectively from the transition date, i.e., it has not restated business combinations occurring prior to January 1, 2004.  |
| <b>IAS 16 – Fair value or revaluation as deemed cost</b> | The Telefónica Group has chosen to continue to carry its plant, property and equipment and intangible assets at their respective carrying amounts under former Spanish GAAP, without restating any of these items at their fair value at January 1, 2004.  |
| <b>IAS 19 – Employee Benefits</b>                        | The Telefónica Group has elected to recognize all cumulative actuarial gains and losses at January 1, 2004.  |
| <b>IAS 21– Accumulated translation differences</b>       | The Telefónica Group has elected to reset the accumulated translation adjustments up to the IFRS transition date to zero.  |
| <b>IAS 32 and IAS 39 – Financial instruments</b>         | The Telefónica Group has chosen not to apply the exception permitting the application of IAS 39 <i>Financial Instruments: Recognition and Measurement</i> and IAS 32 <i>Financial Instruments: Presentation and Disclosure</i> from January 1, 2005, applying these standards as from the IFRS transition date, i.e., January 1, 2004. |
| <b>IFRS 2 – Share-based Payment</b>                      | The Telefónica Group has elected not to apply IFRS 2 <i>Share-based Payments</i> to measure share-based payment schemes to be settled in shares and granted prior to November 7, 2002.   |

The preparation of our consolidated financial statements under IFRS requires a series of modifications to the presentation and measurement standards applied by the Company until December 31, 2004, as certain IFRS principles and requirements are substantially different from their Spanish GAAP equivalents.

The following is a detailed description of the main differences between the two sets of accounting principles as applied by the Company and the impact on equity at December 31, and January 1, 2004 and net profit in 2004.

#### *Reconciliation of consolidated equity under Spanish GAAP and IFRS at January 1, 2004 and December 31, 2004*

| Millions of euros   | Consolidated equity at 1-1-04 | Consolidated equity at 12-31-04 |
|---|-------------------------------|---------------------------------|
| <b>Equity under Spanish GAAP</b>  | <b>16,756.56</b>              | <b>16,225.10</b>                |
| Goodwill and other fair value adjustments made in business combinations | (3,609.98)                    | (3,341.74)                      |
| Treasury shares and own equity instruments                              | (367.95)                      | (846.76)                        |
| Revenue recognition   | (392.78)                      | (340.52)                        |
| Corporate income tax  | (416.76)                      | (403.46)                        |
| Capitalized expenses (start-up and share capital issuance expenses)     | (265.82)                      | (207.71)                        |
| Post-employment benefits and severance payments                         | (168.39)                      | (316.06)                        |
| Inflation adjustment (hyperinflationary economies)                      | (68.26)                       | (163.34)                        |
| Financial instruments and exchange changes                              | 66.26                         | (123.35)                        |
| Associates (significant influence)                                      | 18.80                         | (17.21)                         |
| Other adjustments   | 52.24                         | (25.19)                         |
| <b>Total adjustments</b>  | <b>(5,152.64)</b>             | <b>(5,785.34)</b>               |
| <b>Equity attributable to holders of the parent</b>                     | <b>11,603.92</b>              | <b>10,439.76</b>                |
| <b>Minority interests</b>   | <b>2,446.28</b>               | <b>1,902.71</b>                 |
| <b>Consolidated equity under IFRS</b>                                   | <b>14,050.20</b>              | <b>12,342.47</b>                |



### *Reconciliation between net profit for the year under Spanish GAAP and IFRS for 2004*

| Millions of euros   | Consolidated net income 12-31-04 |
|---|----------------------------------|
| <b>Net profit under Spanish GAAP</b>                                    | <b>2,877.29</b>                  |
| Goodwill and other fair value adjustments made in business combinations | 454.93                           |
| Revenue recognition   | 60.74                            |
| Corporate income tax  | (133.52)                         |
| Capitalized expenses (start-up and share capital issuance expenses)     | 67.50                            |
| Post-employment benefits and severance payments                         | (88.75)                          |
| Inflation adjustment (hyperinflationary economies)                      | (75.77)                          |
| Financial instruments and exchange rate changes                         | (49.57)                          |
| Other adjustments   | 62.82                            |
| <b>Total adjustments</b>  | <b>298.38</b>                    |
| <b>Net profit for the year under IFRS</b>                               | <b>3,175.67</b>                  |

The amounts in the preceding table were calculated after taxes and minority interests.

### *Goodwill and other fair value adjustments made in business combinations*

Under Spanish GAAP, goodwill and fair value adjustments in business combinations involving foreign companies may be translated at the historic exchange rate. Under IFRS, these items should be denominated in the currency of the foreign company and, accordingly, must be translated at the prevailing exchange rate at the balance sheet closing date.

Under IFRS, goodwill and intangible assets of indefinite useful life are no longer amortized, although they are subject to an annual impairment test to determine their recoverability. Under Spanish GAAP, goodwill and all intangible assets are systematically amortized on a straight-line basis over their estimated useful lives, which cannot exceed certain limits.

Under IFRS, the cost of administrative concessions is amortized on a straight-line basis over their useful lives. Under Spanish GAAP, the Telefónica Group systematically depreciated these concessions over their useful lives using methods based on revenues generated or the number of customers in each financial year.

These adjustments have a net negative impact on equity of 3,341.74 and 3,609.98 million euros at December 31, and January 1, 2004, respectively. The positive impact of these adjustments on the 2004 income statement totals 454.93 million euros.

The impact of translating these items at the closing exchange rate is a decrease in "Goodwill" of 1,114.76 million and 992.57 million euros at December 31, and January 1, 2004, respectively, and a decrease in "Administrative concessions" of 2,450.90 million and 2,521.73 million euros at December 31, and January 1, 2004, respectively.

The change in the license amortization method (from progressive to straight-line) results in disposals of 215.85 million euros and 166.62 million euros in "Administrative concessions" on the balance sheet at December 31, 2004 and January 1, 2004, respectively.

These reductions are partially offset by the 433.53 million euros reversal of goodwill amortization for 2004 under "Goodwill." Goodwill

amortizations taken in 2003 and before are not subject to reversal since the Telefónica Group elected not to apply IFRS 3 *Business Combinations* retroactively.

### *Treasury shares and own equity instruments*

Under Spanish GAAP, treasury shares are classified as an asset unless the shares are to be amortized by virtue of an agreement approved at the General Shareholders' Meeting prior to their acquisition. They are carried at the lower of cost, market value or underlying carrying amount, and restated as appropriate. Under IFRS, treasury shares are netted from equity; transactions with treasury shares impact capital and reserves and are not taken to consolidated net income.

Thus, the "Treasury shares" on the balance sheets at December 31, and January 1, 2004 (690.18 and 133.46 million euros, respectively) under Spanish GAAP are reclassified to "Own equity instruments" within equity under IFRS.

Under IFRS, certain instruments issued to hedge employee share option plans are considered equity instruments when the contract settlement terms provide for an exchange of a fixed number of shares for a fixed monetary amount. A liability is simultaneously recorded on the balance sheet under IFRS, since the issuer is obliged to acquire its own equity instruments to settle the contract.

Accordingly, "Interest-bearing debt" on the balance sheet under IFRS at December 31, 2004 and January 1, 2004 increases by 157.52 million euros, with an equivalent decrease in "Own equity instruments" under "Equity."

### *Revenue recognition*

Under Spanish GAAP, connection fees generated when customers connect to our network are recognized as revenues when a customer contracts our services, as are the related expenses. In addition, revenues from handset sales are recorded when the handset is delivered physically.

Under IFRS, connections fees are recognized in income together with the corresponding revenues from handset and other equipment sales, provided there are no amounts contingent on delivery of other devices that have yet to be delivered to the customer. Connection revenues not recognized together with revenues from equipment sales are deferred and recognized in income throughout the average estimated customer relationship period. Under IFRS, revenues from handset and equipment sales are recognized once the sale is considered complete, i.e., generally when delivered to the end customer.

These adjustments have a net negative impact on equity of 340.52 and 392.78 million euros at December 31, and January 1, 2004, respectively. The impact on the 2004 income statement is additional revenue of 60.74 million euros. These differences in revenue recognition policies result in the recognition of "Deferred revenues" of 489.14 million and 561.14 million euros on the liability side of the 2004 closing and opening balance sheets under IFRS, respectively. Revenues are taken to the income statement over the course of the average estimated length of the customer relationship.

### *Corporate income tax*

Under Spanish GAAP, the accounting treatment of deferred tax items is income-statement oriented, taking into consideration temporary differences between accounting income and the taxable income. Under IFRS, deferred taxes are recognized based on balance sheet analysis and the temporary differences considered are those generated as a result of the difference between the fiscal value of assets and liabilities and their respective carrying amounts.

As a result, the Company recorded additional deferred tax assets and liabilities under IFRS at December 31, 2004 of 407.18 million and 786.79 million euros, respectively. At January 1, 2004, the Company recorded deferred tax assets and liabilities under IFRS of 539.80 million and 537.61 million euros, respectively. A portion of these deferred tax liabilities was generated by business combinations taking place prior to 2004. The net negative impact on equity is 403.46 million and 416.76 million euros at December 31, and January 1, 2004, respectively. The negative impact on the income statement for the year ended December 31, 2004 is 133.52 million euros.

### *Capitalized expenses*

Under Spanish GAAP, start-up and pre-operating expenses can be capitalized and are amortized over a period of no more than five years. Under IFRS, outlays that do not meet the requirements for being considered qualifying assets must be expensed when incurred.

Costs associated with share capital increases are also capitalized and amortized over a period of no more than five years under Spanish GAAP. Under IFRS, these costs are taken to "Capital and reserves" and are deducted from the gross proceeds recorded for the corresponding capital increase.

These adjustments reduce equity by 207.71 million and 265.82 million euros at December 31, and January 1, 2004, respectively. The positive impact on the 2004 income statement amounts to 67.50 million euros.

### *Post-employment benefits and severance payments*

Both Spanish GAAP and IFRS require provisioning for pension plan commitments, although the standards differ in terms of the method used for measuring these commitments. Under Spanish GAAP, in certain instances a portion of the actuarial losses associated with pension plans may be deferred. Under IFRS, although some deferral is allowed, all known actuarial gains and losses must be recorded in the year in accordance with the method elected by the Telefónica Group.

As a result, restated pension provisions are 239.96 million euros higher on the IFRS balance at December 31, 2004 (108.58 million euros higher at January 1, 2004). The net negative impact on equity is 316.06 million and 168.39 million euros at December 31, and January 1 2004, respectively.

### *Minority interests*

Under Spanish GAAP, minority interests are presented in a specific, separate item on the liability side of the balance sheet. Under IFRS, minority interests are part of equity.

Preference shares issued by Telefónica Finance, a subsidiary of Telefónica, S.A., are reclassified under IFRS from “Minority interests” to a financial liability, because although they enjoy the unconditional right to avoid the cash payment of principal, there is the obligation to pay dividends on these instruments as long as there are distributable earnings.

The result of the application of these new accounting policies is a net increase in equity of 1,902.71 million euros at December 31, 2004, as well as a 1,877.50 million euro increase in “Interest-bearing debt”. The corresponding impact on equity at January 1, 2004 is 2,446.28 million euros.

### *Financial reporting in hyperinflationary economies*

Under Spanish GAAP, monetary adjustment of the financial statements of consolidated foreign subsidiaries is permitted under certain circumstances, where local accounting standards require inflation accounting.

Under IFRS, certain qualitative and quantitative indicators must be analyzed to determine whether hyperinflation exists and whether it is therefore necessary to restate financial statements for inflation in terms of current purchasing power at the balance sheet closing date. At year end, none of the countries in which the Telefónica Group operates was considered hyperinflationary economies under IFRS criteria.

The net negative impact under IFRS on equity of restating monetary correction adjustments made is 163.34 million and 68.26 million euros at December 31, and January 1, 2004, respectively. The negative impact on the income statement for the year ended December 31, 2004 is 75.77 million euros.

### *Definition of associates: significant influence*

Under Spanish GAAP, significant influence is presumed to exist in the case of as an investment of 3% or more in the voting rights of a listed company (20% or more in the case of unlisted companies). IFRS establishes the significant influence investment threshold at 20% or more of voting rights. Both cases allow for proof of the contrary, but the adoption of IFRS has meant that certain investments which were classified as “Investments in associates” under Spanish GAAP must be reconsidered as “available-for-sale financial assets” under IFRS. This implies restatement at market value at each closing date, taking any unrealized gains or losses arising from changes in market value directly to equity.

The application of this new policy results in a reduction in equity of 17.21 million euros and an increase of 18.80 million euros at December 31, and January 1, 2004, respectively.

### *Financial instruments and exchange rate movements*

Under Spanish GAAP, financial assets, including derivatives, are carried at the lower of cost or market value, while financial liabilities are carried at repayment value. Financial assets are removed from the balance sheet when they are sold, transferred or at maturity.

Under IFRS, financial assets and liabilities are classified according to a series of categories that determine whether they are carried at fair value or amortized cost. Similarly, certain gains and losses on financial instruments are taken directly to equity until the instrument in question is taken off the balance sheet or is written down in the event of impairment. In addition, IFRS establish very strict criteria for derecognizing financial assets from the balance sheet, based on an analysis of the risk and rewards of ownership of assets transferred.

The application of hedge accounting criteria under IFRS requires fulfilling very specific requirements. As a result, certain hedging transactions that meet hedge accounting criteria under Spanish GAAP do not meet the equivalent IFRS criteria.

Under Spanish GAAP, the difference between unrealized exchange rate gains in excess of exchange rate losses taken to the income statement for the period must be capitalized. Under IFRS, all exchange rate gains and losses must be taken to the income statement.

The impact of these new accounting policies for financial assets and liabilities is a decrease in equity of 123.35 million euros and an increase of 66.26 million euros at December 31, and January 1, 2004, respectively. The application of these policies results in a 49.57 million euro increase in expenses in the 2004 income statement.

Finally, under Spanish GAAP, exchange rate gains and losses generated on intra-group foreign currency loans (mainly dollar-denominated) are eliminated from the income statement on consolidation. Under IFRS, exchange rate gains and losses from intra-group loans are not eliminated on consolidation unless the loan can be considered part of the net investment in the foreign operation. This policy change has no impact on equity at December 31, 2004 or at January 1, 2004.

### *Other differences*

There are other accounting standards that do not affect capital and reserves, but do affect presentation of balance sheet items.

Among the reclassifications made, goodwill arising from the acquisition of investments in associates is included under “Investments in associates” in the IFRS balance sheet and amounts to 1,162.37 million and 806.37 million euros at the closing and opening balance sheet for 2004, respectively.

### *Comparative information and changes in the consolidation scope*

The main changes in the consolidation scope in 2005 (the full detail of all the changes in 2005 and 2004 is included in Appendix II) are as follows:

#### *Telefónica*

In July, Telefónica, S.A. took over and merged Terra Networks, S.A., effective for economic purposes from January 1, 2005. Terra Networks, S.A. was dissolved and all of its assets and liabilities were transferred to Telefónica, S.A. by means of a share swap consisting of two Telefónica, S.A. treasury shares for every nine Terra shares. Terra S.A., which was fully consolidated by the Telefónica Group, is accordingly no longer part of the consolidation scope.

In 2005, Endemol Investment B.V., a 99.7%-owned subsidiary of Telefónica, S.A. held a public offering of Endemol, N.V. shares. The offering price was 9 euros per share and the total number of shares sold amounted to 31,250,000 ordinary shares, representing 25% of the company's share capital. The sale generated a profit of 55.58 million euros, which was recognized in the Telefónica Group's income statement under "Gain on disposal of assets" under "Other income" (see Note 19).

The shares placed in the offering trade on the AEX Euronet Amsterdam index of the Amsterdam Stock Exchange since November 22, 2005.

On December 21, Portugal Telecom, S.G.P.S., S.A. cancelled a total of 37,628,550 treasury shares equivalent to 3.23% of its share capital. On conclusion of the share cancellation, the Telefónica Group's holding in the Portuguese telecom operator stood at 9.84% (9.96% in nominal terms). PT. is still accounted for in the Telefónica Group's consolidated financial statements by the equity method.

On June 10, the European Commission authorized Telefónica's bid to take over Czech operator Cesky Telecom a.s. by acquiring 51.1% of its share capital. The acquisition was concluded on June 16 at a price of 502 Czech crowns per share. Telefónica then launched a tender offer for the remaining 48.9% of Cesky Telecom then in the hands of minority shareholders. The offer concluded on September 19, with Telefónica acquiring 58,985,703 shares at a price of 456 Czech crowns per share. In all, Telefónica paid 3,662.53 million euros in exchange for its interest in the Czech telecom operator. After these acquisitions, Telefónica's owns 69.41% of the company. Cesky Telecom is now fully consolidated in the Telefónica Group.

#### *T.P.I. Group*

On November 11, 2005 Telefónica Publicidad e Información, S.A. (parent company) and Telefónica Publicidad e Información Internacional, S.A.U. bought from Telefónica de Argentina, S.A. 95% and 5%, respectively, of the shares constituting the total equity of Argentine company Telinver, S.A. for a total outlay of 57.0 million euros (66.72 million US dollars). The operation was financed by Telefónica de Argentina, S.A. via debt maturing in 2008. The company is still fully consolidated within the Telefónica Group's consolidation scope, with Telefónica now effectively owning 59.90% of the shares instead of 99.98%.

#### *Telefónica Móviles Group*

The acquisitions of 100% of the Chilean and Argentine operators owned by BellSouth were completed on January 7 and January 11, 2005, respectively, thereby completing the purchase of the Latin American operators from BellSouth begun the year before.

The total acquisition cost for Telefónica Móviles, adjusted for the outstanding net debt at these two operators, was 519.39 million euros for Radiocomunicaciones Móviles, S.A. (Argentina) and 317.56 million euros for Telefónica Móviles Chile, S.A.

On October 8, 2004, TCP approved a capital increase of approximately 2,054 million reais. The capital increase concluded on January 4, 2005, with Brasilcel, N.V. subscribing for the shares not subscribed by other shareholders. In the wake of this capital increase and the monetization of assets in July 2005 (details below), Brasilcel, N.V. increased its shareholding from 65.12% to 66.1%.

In July 2005, Brasilcel N.V. capitalized the assets used by Tele Centro Oeste Celular Participações, S.A. (TCO), Celular CRT, S.A. (CRT), Tele Sudeste Celular Participações (TSD), S.A. and Tele Leste Celular Participações, S.A. (TBE). This capitalization did not entail any cash outlay for Brasilcel, N.V., but did increase Telefónica's shareholdings in these companies. Brasilcel, N.V.'s equity stake in these subsidiaries thereby increased to 91.0% of TSD, 50.7% of TBE, 66.4% of CRT and 34.7% of TCO.

In December Telefónica Móviles, S.A. reached an agreement to buy 8% of Telefónica Móviles México, S.A. de C.V. in exchange for shares in Telefónica, S.A. The sale entailed an outlay of 177.27 million euros and gave Telefónica Móviles 100% control of the subsidiary, which is still fully consolidated in the Telefónica Group.

This acquisition cost Telefónica Móviles 177 million euros and was structured as an exchange of Telefónica Móviles México S.A. shares for 14,135,895 Telefónica S.A. shares.

### **(3) Proposed Distribution of Income Attributable to Equity Holders of the Parent**

Under Spanish GAAP, Telefónica, S.A. obtained income of 1,754.39 million euros in 2005.

The proposed distribution of 2005 income that the Company's Board of Directors will submit for approval at the General Shareholders' Meeting is as follows: a) 64.15 million euros of profit for the year to the legal reserve, which then would represent 20% of share capital; b) a fixed gross dividend of 0.25 euros per share for the Company's outstanding shares carrying dividend rights; and c) the remainder to voluntary reserves.

|  | Millions of euros |
|--|-------------------|
| Distributable income   | 1,754.39          |
| to:  |                   |
| Legal reserve  | 64.15             |
| Dividend (maximum distributable amount of 0.25 euros per share for all the shares comprising the Company's share capital (4,921,130,397 shares). | 1,230.28          |
| Voluntary reserve (minimum)  | 459.96            |
| <b>Total</b>   | <b>1,754.39</b>   |

At its meeting of February 28, 2006, the Company's Board of Directors agreed to distribute an interim dividend charged to 2005 income of a gross 0.25 euros per outstanding share carrying dividend rights up to a total amount of 1,230.28 million euros. This interim dividend will be paid on May 12, 2006. Consequently, the proposed dividend to be paid out of 2005 income will be fully settled through payment of the aforementioned interim dividend (see Subsequent Events - Note 22).

### **(4) Valuation Criteria**

As indicated in Note 2, pursuant to European Parliament regulation 1606/2002, of July 19, 2002, Telefónica is obliged to apply the International Financial Reporting Standards (IFRS) enclosed by the European Union for the preparation and presentation of its consolidated financial information as from January 1, 2005. Accordingly, the consolidated financial statements for the year ended December 31,

2005 have been prepared under IFRS, and the 2004 consolidated financial information included for comparative purposes has been presented in keeping with the same standards.

The main valuation methods used in preparing the 2004 and 2005 consolidated financial statements (the 2004 statements are for comparative purposes) were as follows:

#### *a) Goodwill*

For acquisitions taking place after January 1, 2004, the IFRS transition date, goodwill represents the excess of the acquisition cost over the acquirer's interest, at the acquisition date, in the fair values of identifiable assets, liabilities and contingent liabilities acquired from a subsidiary, associate or joint venture. After the initial measurement, goodwill is carried at cost, adjusted for any potential accumulated impairment.

Telefónica has elected to apply the exemption provided for in first-time adoption of IFRS permitting it not to restate business combinations taking place before January 1, 2004 (see Note 2). As a result, the accompanying consolidated balance sheets include goodwill on consolidation, net of amortization deducted until December 31, 2003, arising before the IFRS transition date, from the positive consolidation difference between the amounts paid to acquire the shares of consolidated subsidiaries, and their underlying carrying amounts plus amounts taken to equity accounts and recorded as an increase in the value of these assets.

In all cases, goodwill is recognized as an asset denominated in the currency of the company acquired.

Goodwill is tested for impairment annually or more frequently if there are certain events or changes indicating the possibility that the net carrying amount is not fully recoverable.

Impairment is determined based on analysis of the recoverable amount of the cash-generating unit (or group of cash generating units) to which goodwill allocated upon acquisition date. If this recoverable amount does not exceed the net carrying amount, an irreversible impairment loss is recognized in income (see Note 4 h).

#### *b) Translation methodology*

The financial statements of the Group's foreign subsidiaries were translated to euros at the year-end exchange rates, except for:

1. Capital and reserves, which were translated at historical exchange rates.
2. Income statements, which were translated at the average exchange rates for the year.

Goodwill and restatements of balance sheet items to reflect fair value arising when a stake is acquired in a foreign operation are recognized as assets and liabilities of the company acquired and therefore translated at the year-end exchange rate.

The exchange rate differences arising from application of this method are included in "Translation Differences" under "Equity attributable to equity holders of the parent" in the accompanying consolidated

balance sheets, net of the portion of said differences relating to minority interests, which is recorded under "Minority Interests." When a foreign operation is sold, totally or partially, translation differences in relation to said entity accumulated since January 1, 2004 -the IFRS transition date- recognized directly in equity are taken proportionally to the income statement as part of the gain or loss generated by the disposal.

#### *c) Foreign currency transactions*

Monetary transactions denominated in foreign currencies are translated to euros at the exchange rates prevailing on the transaction date, and are adjusted at year end to the prevailing exchange rates.

All realized and unrealized exchange gains or losses are taken to the income statement for the year, with the exception of gains or losses arising from specific-purpose financing of foreign currency investments in investees to hedge the exchange rate risk to which these investments are exposed, as well as exchange gains or losses on intra-group loans which are considered part of investment in the foreign operation, that are recorded under "Translation differences" in the consolidated balance sheet (see Note 4 v).

#### *d) Intangible assets*

"Intangible assets" are recorded at their acquisition or production cost less accumulated amortization or any impairment losses.

The useful economic life of an intangible asset is analyzed on a case-by-case basis to assess if it is indefinite or finite. Intangible assets with a finite useful life are amortized systematically over the course of their useful lives and are tested for impairment in the event indication that the net carrying amount may not be recoverable. Intangible assets with an indefinite useful life are not amortized, but are subject to impairment tests on at least an annual basis, and more frequently in the event of indicators that their net carrying amount may not be fully recoverable (see Note 4 h).

In all cases, amortization methods and schedules are revised annually and, where appropriate, adjusted prospectively.

#### *Research and development expenses*

Research expenses are expensed as incurred. Costs incurred in developing new products to be marketed or used for the Group's own network, and whose future economic viability is reasonably certain, are capitalized and amortized by the straight-line method over the period during which the project in question is estimated to generate economic benefits, starting upon its completion.

As long as intangible assets developed internally are not in use, the associated capitalized development costs are subject to impairment tests on at least an annual basis, and more frequently if there are indicators that their net carrying amount may not be fully recoverable. Costs incurred in connection with projects that are not economically viable are charged to the consolidated income statement for the year in which this circumstance becomes known.

### **Administrative concessions**

These relate to the acquisition cost of the licenses to operate of telephony services granted to the Telefónica Group by various public authorities and to the value assigned to licenses held by certain companies at the time they were included in the Telefónica Group.

These concessions are amortized on a straight-line basis over the duration of related licenses from inception.

### **Industrial property and software**

These items are recorded at cost and are amortized on a straight-line basis over their useful lives, generally estimated at three years.

### **e) Property, plant and equipment**

Property, plant and equipment are recorded at cost less accumulated depreciation and any impairment losses. Land is not depreciated.

Cost includes external and internal costs comprising warehouse materials used, direct labor used in installation work and the allocable portion of the indirect costs required for the related investment. The latter two items are recorded as revenues under "Internal expenditures capitalized" and "Other income." Cost includes, where appropriate, the initial estimate of decommissioning, withdrawal and site reconditioning costs when they correspond to obligations arising as a result of the use of the related assets.

Interest and other financial expenses incurred and directly attributable to the acquisition or construction of qualifying assets are capitalized. Qualifying assets at the Telefónica Group are those assets that require preparation of at least 18 months for their intended use or sale. Specifically, the financial expenses incurred in connection with the construction of the Telefónica Group's future headquarters in Madrid (*District C*), amounting to 8.79 million euros in 2005, were capitalized (1.7 million euros in 2004).

The costs of expansion, modernization or improvement leading to increased productivity, capacity or efficiency or to a lengthening of the useful lives of assets are capitalized when recognition requirements are met.

Upkeep and maintenance expenses are expensed as incurred.

The Telefónica Group assesses the need to write down, if appropriate, the carrying amount of each item of property, plant and equipment to its recoverable amount at each year end, whenever indicators exist that the assets' net carrying amount may not be fully recoverable through the generation of sufficient revenues to cover all the costs and expenses. The impairment provision is maintained only as long as the factors giving rise to the impairment exist (see Note 4 h).

The Group's subsidiaries depreciate their property, plant and equipment once they are in full working condition using the straight-line method based on the assets' estimated useful lives, calculated in accordance with technical studies which are revised periodically based on technological advances and the rate of dismantling, as follows:

|  | Years of estimated useful life |
|--|--------------------------------|
| Buildings  | 25-40                          |
| Plant and machinery  | 10-15                          |
| Telephone installations, networks and subscriber equipment | 5-20                           |
| Furniture, office equipment and other                      | 2-10                           |

Estimated residual value and the depreciation methods and schedules are revised at each balance sheet date and adjusted prospectively, where appropriate.

### **f) Investment property (real estate investments)**

Investment properties are carried at cost, net of accumulated depreciation and any accumulated impairment losses. Land is not depreciated. Other investment properties are depreciated over their estimated useful life on a straight-line basis. Recoverability is analyzed when there are indications that the net carrying amount may exceed recoverable amount (see Note 4 h).

The Telefónica Group includes under "Investment property" the carrying amount of real estate assets that are not part of operations and for which there are no defined disposal plans at the date of preparation of the consolidated financial statements.

### **g) Leases**

The determination of whether a contract represents a lease arrangement depends on an analysis of the nature of the agreement; specifically whether the terms of the contract refer to the use of a specific asset and whether the agreement grants the Telefónica Group the right to use said asset.

Leases in which the lessor preserves substantially all the risks and rewards associated with the ownership of the leased assets are considered operating leases. Payments made pursuant to such operating leases are expensed on a straight-line basis over the life of the lease.

Leases are classified as finance leases when the terms of the lease transfer substantially all the risks and rewards of ownership to the Group. These are recognized at the inception of the lease, classified in accordance with its nature and the associated debt, at the lower of the present value of the minimum lease payments and the fair value of the leased asset. Lease payments are apportioned between reduction of the lease principal, interest expense and financial charges, so as to achieve a constant rate of interest on the remaining balance of the liability. Financial charges are charged to the income statement over the lease term.



### *h) Impairment of non-current assets*

Non-current assets, including goodwill and intangible assets are evaluated at each balance sheet date for indications of impairment losses. Wherever such indications exist, or in the case of assets which are subject to an annual impairment test, the Company estimates recoverable value as the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects the time value of money and risks specific to the asset. An asset is considered to be impaired when its recoverable amount is less than its carrying amount. In this case, the net carrying amount is restated to recoverable amount and the resulting loss is taken to the income statement. Future depreciation charges are adjusted for the new carrying amount for the asset's remaining useful life. The Company carries out asset impairment tests on an individual basis, except when the cashflows generated by the assets are not independent of these generated by other assets (cash-generating units).

When indications of an impairment reversal exist, the corresponding asset's recoverable amount is recalculated. Impairment losses are only reversed if they arise from a change in the assumptions used to calculate the recoverable amount since the most recent impairment loss was recognized. In this case, the asset's carrying amount is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the cash-generating unit in prior years. The reversal is recognized in the income statement and future depreciation charges are adjusted to reflect the new carrying amount. Goodwill impairment losses may not be reversed in subsequent years.

### *i) Investments in associates*

The Telefónica Group's investments in companies in which it has significant influence, but which are neither a subsidiary nor a joint venture, are accounted for by the equity method. The carrying amount of investments in associates includes related goodwill and the consolidated income statement reflects the share in the income or loss on operations of the associate. If the associate recognizes any gains or losses directly in equity, the Group also recognizes the corresponding portion of these gains or losses directly in its own equity.

### *j) Financial assets*

All conventional financial asset purchases and sales are recognized on the balance sheet on the transaction date, i.e., when the Group assumes the commitment to purchase or sell such assets. The Telefónica Group classifies its financial assets into four categories for initial recognition purposes: financial assets measured at fair value through profit or loss, loans and receivables, held-to-maturity investments and available-for-sale financial assets. Classification is reviewed annually, where appropriate.

Financial assets held for trading, i.e., investments made with the aim of realizing short-term returns as a result of price changes, are classified as financial assets measured at fair value through profit or loss and are presented as current assets "All derivative financial

instruments fall under this category, with the exception of those qualifying as hedging instruments. Meanwhile, the Group classifies certain financial instruments under this category when doing so eliminates or mitigates measurement or recognition inconsistencies that could arise from the application of other criteria for recording assets and liabilities or for recognizing gains and losses on different bases, thereby providing more meaningful information. Also in this category are financial assets for which an investment and disposal strategy have been designed based on their fair value. Financial instruments included in this category are recorded at fair value and are measured again at subsequent reporting dates for fair value, with any realized or unrealized losses or gains taken to the income statement.

When the Company has the positive intention and ability (legal and financial) to hold financial assets to maturity, these are classified as held-to-maturity and are recorded under "Current assets" and "Non-current assets," depending on the time left until maturity. Financial assets falling into this category are carried at amortized cost using the effective interest rate method, with gains and losses recognized in the income statement at settlement or upon impairment, as well as due to scheduled amortization.

Financial assets which the Company intends to hold for an unspecified period of time and could be sold at any time to meet specific liquidity requirements or in response to interest-rate movements are classified as available-for-sale. These instruments are recorded as "Non-current assets," unless it is probable and feasible that they will be sold within 12 months. Available-for-sale investments are carried at fair value. Gains or losses arising from changes in fair value are recognized in equity at each closing date until the asset is disposed of or is determined to be impaired, at which time they are taken to the income statement. Dividends from available-for-sale shareholdings are taken to the income statement once the Company's right to receive said dividend is recognized. Fair value is determined in accordance with the following criteria:

#### 1. Listed securities on active markets:

Fair value is considered to be the market value on the closing date.

#### 2. Unlisted securities on active markets:

Fair value is determined using valuation techniques such as discounted cash flow analysis, option valuation models, or by referring to comparable transactions. When fair value cannot be determined reliably, these investments are carried at cost.

Loans and receivables include financial assets that are not traded on organized markets and do not fall into any of the previous categories. These assets are carried at amortized cost using the effective interest rate method. Gains and losses are taken to the income statement when the assets are disposed of or impaired, as well as due to scheduled amortization.

Financial instruments are subject to impairment testing at each closing date. If there is objective evidence of impairment of a financial asset recognized at amortized cost, the excess of the carrying amount over the estimated recoverable amount is recorded as an impairment loss in the income statement. The estimated recoverable amount is the net present value of the asset's estimated future cash flows (excluding potential future losses), discounted using the original effective interest rate of the asset. If there is objective evidence that an available-for-

sale financial instrument is impaired, the loss recognized in equity is taken to the income statement. This loss is calculated as the difference between the original cost (net of any principal repayments) and its fair value at that date, net of any impairment losses taken in prior periods.

Financial assets are only derecognized from the balance sheet in the following circumstances:

1. The rights to receive the cash flows associated with the asset have expired.
2. The Company has assumed payment of all cash flows received from the asset to a third party.
3. The Company has transferred the rights to receive the cash flows from the asset to a third party, transferring substantially all the risks and rewards associated with the asset.

#### *k) Inventories*

Materials stored for use in investment projects and inventories for consumption and replacement are stated at the lower of weighted average cost and net realizable value.

When the cash flows associated with the purchase of inventory are effectively hedged, the corresponding gains and losses accumulated in equity become part of the cost of purchased inventories.

Obsolete, defective or slow-moving inventories have been reduced to estimated net realizable value. The recoverable amount of inventory is calculated based on inventory age and turnover.

#### *l) Trade receivables*

Trade receivables are carried at their face value, subject to a valuation allowance if there is objective evidence of default risk on the part of the debtor. The allowance recognized is measured as the difference between the carrying amount of the doubtful trade receivables and their recoverable amount. As a general rule, short-term commercial bills are not discounted.

#### *m) Cash and cash equivalents*

Cash and cash equivalents comprise cash on hand and at banks, demand deposits and other highly liquid investments with maturity of less than three months. These items are stated at historical cost, which does not differ significantly from realizable value.

For the purposes of the consolidated cash flow statement, cash and cash equivalents are stated net of any bank overdrafts.

#### *n) Treasury shares*

Treasury shares are stated at cost and netted from equity. Any gain or loss arising on the acquisition, sale, issuance or cancellation of treasury shares is recognized directly in equity.

#### *o) Preference shares*

Preference shares are classified as a liability or equity instrument depending on the issuance terms. A preference share issue is considered equity only when the issuer is not obliged to give cash or another financial instrument in the form of either principle repayment or dividend payment, where as it is recorded as a financial liability on the balance sheet whenever the Telefónica Group does not have full discretion to avoid cash payments.

#### *p) Capital grants received*

Capital grants received are recorded in "Deferred revenues" under "Trade and other payables" on the balance sheet once there is reasonable certainty that they will be paid and the related requirements met. They are expensed to the income statement on a straight-line basis over the course of the useful life of the financial assets financed by the grants in "Capital grants" under "Other income." Operating grants are expensed in line with the expenses they are designed to cover.

Most of the subsidies have been received by Telefónica de España and the conditions under which they were granted are being met (see Note 13).

#### *q) Pensions and other employee obligations*

At year end the Group records in the consolidated balance sheet the provisions required to cover the accrued liability for the existing obligations that have not been externalized, based on the projected unit credit actuarial method, discounting the estimated future cash flows using interest rates of high-quality bonds. The liabilities recorded under "Pre-retirements, social security costs and voluntary severances" are measures at as indicated basis and are discounted by applying market yield curves.

For defined-contribution pension plans, the contributions accrued in the year are taken into the income statement under "Personnel expenses" (see Note 19).

The Group's main commitments in this regard are detailed in Note 14.

#### *r) Technical reserves*

These relate mainly to the mathematical reserves, which represent the amount by which the present value of life insurance, pension and reinsurance commitments exceeds the net premiums to be paid by the policyholders to the subsidiaries, Seguros de Vida y Pensiones Antares, S.A. and Casiopea Reaseguradora, S.A. These reserves are applied when the commitments covered are paid.

#### *s) Other provisions*

Provisions are made when a past event gives rise to a present obligation (legal or constructive) on the part of the Group, the settlement of which requires an outflow of resources embodying economic benefits that is considered probable and can be estimated reliably. If a total or partial recovery of a provision from a third party is considered virtually certain (for example by virtue of an insurance policy), an asset is recorded

on the balance sheet and the expense related to the provision is taken to income net of the expected reimbursement. If the impact of the time value of money is significant, the provision is discounted, and the corresponding increase in the provision is recorded as a financial expense.

#### *t) Share-based payments*

The Group has compensation systems linked to the market value of its shares (see Note 19), providing employees stock options. Certain compensation plans are settled in cash or shares, at the option of the beneficiary, while others are settled via the delivery of shares.

IFRS 2 is applied to compensation schemes linked to the share price granted after November 7, 2002 for employees of Endemol (see Note 2).

The accounting treatment in these cases is as follows:

Option plans that can be cash-settled or equity-settled at the option of the employee are recognized at the fair value on the grant date of the liability and equity components of the compound instrument granted. Considering the terms and conditions of the share option plan, the fair value of both components is the same and, accordingly, the accounting treatment of plans of this nature is that established for cash-settled transactions. In cash-settled share option plans, the total cost of the rights to shares granted are expensed over the period during which terms the beneficiary earns the full right to exercise the options (vesting period). The total cost of the options is initially measured based on their fair value at the grant date calculated by the Black-Scholes option pricing model, taking into account the terms and conditions established in each share option plan. At each subsequent reporting date, the Company revises its estimate of fair value and the number of options it expects to vest, booking any change in the liability through the income statement for the period, if appropriate.

For equity-settled share option plans, fair value at the grant date is measured using the binomial methodology. These plans are expensed during the vesting period with a credit to equity. At each subsequent reporting date, the Company revises its estimate of the number of options it expects to be exercised, with a corresponding adjustment to equity.

For the remaining share-based compensation schemes granted prior to November 7, 2002, the preceding valuation criteria is followed, consisting of recording a provision evenly throughout the duration of the plan based on the best estimate of the net future expenditure required to settle the obligation in accordance with its terms and conditions.

#### *u) Interest-bearing debt*

These debts are recognized initially at fair value of the consideration received, net of directly attributable transaction costs. In subsequent periods, the financial liabilities are carried at amortized cost using the effective interest rate method. Any difference between the cash received (net of transaction costs) and the repayment value is recognized in the income statement over the life of the debt. Financial debts are

considered non-current when their maturity is over 12 months or the Telefónica Group has full discretion to defer settlement for at least another 12 months from the closing date.

Financial liabilities are derecognized from the balance sheet when the corresponding obligation is settled, cancelled or matures. When a financial liability is replaced with another on substantially different terms, this is accounted for as a derecognition of the original liability and the recognition of a new one and the difference between their respective fair values is taken to income.

#### *v) Derivatives financial instruments and hedge accounting*

Derivative financial instruments are initially recognized at fair value, normally equivalent to cost. Their carrying amounts are adjusted at each subsequent balance sheet date to fair value, classified under current financial assets or current financial liabilities depending on whether fair value is positive or negative, respectively. Derivative financial instruments that meet all the criteria for consideration as long-term hedging instruments are recorded as non-current assets and liabilities depending on their fair value.

The accounting treatment of any gain or loss resulting from changes in the fair value of a derivative depends on whether the derivative in question meets all the criteria for hedge accounting and, if appropriate, on the nature of the hedge.

Accordingly, the Group designates certain derivatives as:

1. Instruments to hedge risk associated with the fair value of an asset or liability or of a firmly committed transaction (fair value hedge), or
2. Instruments to hedge risk associated with changes in cash flows due to risks associated with a recorded asset or liability or with an expected transaction (cash flow hedge), or
3. Instruments to hedge net investment in a foreign operation

An instrument designed to hedge foreign currency exposure in a firm transaction could be designated as either a fair value or a cash flow hedge.

Changes in fair value of derivatives that qualify as fair value hedges are recognized in the income statement, together with changes in the fair value of the hedged asset or liability attributable to the risk being hedged.

Changes in fair value of derivatives that qualify and have been assigned to hedge cash flows, which are highly effective, are recognized in equity. The portion considered ineffective is recognized directly in income. Fair value changes from hedges that relate to firm commitments or forecast transactions that result in the recognition of non-financial assets or liabilities are included in the initial measurement of those assets or liabilities. Otherwise, changes in fair value previously deferred to equity are recognized in the income statement in the period in which the hedged transaction affects income.

An instrument designed to hedge foreign currency exposure from a net investment in a foreign operation is accounted for in the same way as a cash flow hedge as described in the preceding paragraph.

The application of the company's corporate risk-management policies could result in financial risk-hedging transactions that make economic sense, yet are not strictly IFRS compliant for hedge accounting. Alternatively, the Group may opt not to apply hedge accounting criteria in certain instances. In these cases, gains or losses resulting from changes in the fair value of the derivatives are taken directly to the income statement. Derivatives used to reduce the exchange rate risk relating to the income contributed by Latin American subsidiaries are not treated as hedging transactions.

From inception, the Group formally documents the hedging relationship between the derivative and the hedged asset or liability, as well as the associated risk management objectives and strategies. This documentation includes identification of the hedge instrument, the hedged asset, liability or transaction and the nature of the risk hedged. In addition, it states the manner in which hedge effectiveness, i.e. the extent to which the hedge instrument offsets any changes in the underlying hedged item's fair value or cash flows that can be attributed to the risk hedged, is measured. Its effectiveness is measured, prospectively and retroactively, both at the beginning of the hedge transaction as well as on a systematic basis throughout the life of the hedge.

Hedge accounting is discontinued whenever the hedging instrument expires or is sold, terminated or settled, or no longer qualifies for hedge accounting. In these instances, gains or losses accumulated in equity are not recognized in income until the forecast of the committed transaction occurs. However, if the hedged transaction is no longer expected to occur, the cumulative gains or losses recognized directly in equity are taken immediately to income.

The fair value of derivative financial instruments used for hedging purposes is detailed in Note 15. In addition, the statement of recognized income and expense provides a detail of the movements in gains and losses from cash flow hedges.

The fair value of the derivative portfolio includes estimates based on calculations using observable market data, as well as specific pricing and risk-management tools commonly used by financial entities.

#### *w) Corporate income tax*

This heading in the accompanying consolidated income statement includes all the debits and credits arising from the corporate income tax levied on the Spanish Group companies and similar taxes applicable to the Group companies abroad (see Note 16).

Corporate income tax recorded each year includes both current and deferred taxes, if any.

The carrying amounts of assets and liabilities related to current tax and for prior periods taxes represents the estimated amount owed to/due from, the tax authorities. The tax rates and regulations used as a basis for calculating these amounts are those in effect at the closing date.

Deferred taxes are calculated based on balance sheet analysis. The temporary differences considered are those generated as a result of the difference between tax bases of the assets and liabilities and their respective carrying amount.

The main temporary differences arise due to discrepancies between the tax bases and carrying amounts of plant, property and equipment, intangible assets, non-deductible provisions as well as differences in the fair value and tax bases of net assets acquired of a subsidiary, associate or joint venture.

A part of deferred taxes arise from unused tax credits and tax loss carryforwards.

The Group estimates deferred tax assets and liabilities by applying the tax rates it believes will be effective when the corresponding asset is received or the liability settled, based on prevailing tax rates and regulations (practically enclosed) at the closing date.

At each closing, the carrying amount of deferred tax assets on the balance sheet is tested for impairment and the necessary restatements are made if there is uncertainty as to their recoverability. Also at each closing, deferred tax assets not recognized on the balance sheet are evaluated. These are recorded to the extent that their recoverability via future taxable profits becomes probable.

Deferred tax liabilities on investments in subsidiaries, branches, associates and joint ventures are not recognized if the parent company is in a position to control the timing of the reversal and if the reversal is unlikely to take place in the foreseeable future.

The tax effect of items taken to equity is recognized directly in equity. Deferred tax assets and liabilities resulting from business combinations are added to or netted from goodwill.

Deferred tax assets and liabilities are only offset when they relate to taxes imposed by the same fiscal authority on the same tax entity and where the right to offset current tax assets and liabilities is legally recognized.

#### *x) Revenues and expenses*

Revenues and expenses are recognized on the income statement on an accrual basis, i.e. when the actual flow of the related goods and services occurs, regardless of when the resulting monetary or financial flow arises.

Promotional offers and packages including different elements are sold in the wireline, wireless and internet businesses. They are assessed to determine whether it is necessary to separate out the different components and apply the corresponding revenue recognition policy to each one. Total package revenue is split among the identified components based on their respective fair values. Revenue is not taken on served elements if these are contingent upon delivery of the pending elements.

Connections fees originated when customers connect to our network are recognized as revenues together with the corresponding revenues from handset and other equipment sales, provided there are no amounts contingent on pending delivery of other goods or services to the customer. Connection revenues not recognized together with revenues from equipment sales are deferred and taken to the income statement throughout the average estimated customer relationship period.

Revenues from handset and equipment sales are recognized once the sale is considered complete, i.e., generally when delivered to the end customer.

In the wireless telephony business there are loyalty campaigns whereby customers obtain points for the telephone traffic they generate. These points can be exchanged for discounts on the purchase of handsets, traffic or other types of services based on the number of points earned and the type of contract involved. The accompanying consolidated balance sheets include the related provision, based on an estimate of the value of the points accumulated at year end, under "Trade and other payables."

"Deferred revenues" under "Trade and other payables" on the liability side of the consolidated balance sheet includes the amount relating to purchases made by customers of the prepaid phone cards and recharges that at year end had still not been earned and recognized as revenue since the customers had not consumed the total amount of traffic relating to their cards.

In the directories publishing business, advertising revenues and the associated costs are generally recognized when the advertisement is published, regardless of when the related monetary or financial flow arises. The revenues related to billings for advertising in unpublished guides are recorded under "Deferred revenues" in the "Trade and other payables" in liabilities, whereas the associated costs are recorded as "Inventories" until the guides are published.

### y) Use of estimates in recognizing assets and liabilities

The main assumptions made and other significant sources of uncertainty in the estimates made at the closing date that could have a material impact on the carrying amount of assets and liabilities in the next financial year are:

A significant change in the facts and circumstances on which these estimates are based could have a material negative impact on the Group's earnings and financial position.

#### **Property, plant and equipment and goodwill**

The accounting treatment of property, plant and equipment and intangible assets entails the use of estimates to determine their useful lives for depreciation and amortization purposes to assess fair value at their acquisition dates, especially for assets acquired in business combinations.

Determining useful lives requires making estimates in connection with future technological developments and alternative uses for assets. There is a significant element of judgment involved in making technological development assumptions, since the timing and scope of future technological advances are difficult to predict.

When property, plant and equipment are considered to be impaired, the corresponding loss is taken to the income statement for the period. The decision to recognize an impairment loss involves estimates of the timing and potential scope of the impairment, as well as analysis of the reasons for the potential loss. Furthermore, additional factors, such as technological obsolescence, the suspension of certain services and other circumstantial changes are taken into account.

The Telefónica Group evaluates its cash-generating units' performance regularly to identify potential goodwill impairments. Determining the recoverable amount of the cash-generating units to which goodwill is allocated also entails the use of assumptions and estimates and requires a significant element of judgment.

#### **Deferred tax assets and liabilities**

The Group evaluates the recoverability of deferred tax assets based on estimates of future earnings. The ability to recover these taxes depends ultimately on the Group's ability to generate taxable earnings over the course of the period for which the deferred tax assets remain deductible. This analysis is based on the estimated schedule for reversing deferred taxes as well as estimates of taxable earnings, which are sourced from internal projections and are continuously updated to reflect the latest trends.

The appropriate classification of tax assets and liabilities depends on a series of factors, including estimates as to the timing and materialization of deferred tax assets and the forecast tax payment schedule. Actual Group company income tax receipts and payments could differ from the estimates made by the Group as a result of changes in tax legislation or unforeseen transactions that could affect tax balances.

#### **Provisions**

Provisions are recognized when an event in the past gives rise to a current obligation for the Group, the settlement of which requires an outlay that is considered probable and can be estimated reliably. This obligation may be legal or constructive, deriving from *inter alia* regulations, contracts, normal practices or public commitments that lead third parties to reasonably expect that the Group will assume certain responsibilities. The amount of the provision is determined based on the best estimate of the outflow of resources required to settle the obligation, bearing in mind all available information at the closing date, including the opinions of independent experts such as legal counsel or consultants.

No provision is recognized if the amount of liability cannot be estimated reliably. In this case, the relevant information is provided in the notes to the financial statements.

Given the uncertainties inherent in the estimates used to determine the amount of provisions, actual outflows of resources may differ from the amounts recognized originally on the basis of the estimates.

### z) Consolidation methods

The consolidation methods applied are as follows:

- The companies over which the Company exercises effective control, or which it controls by virtue of agreements with the other shareholders, are fully consolidated.
- Companies which are jointly controlled with third parties (joint ventures) are proportionally consolidated. Similar items are grouped together such that the corresponding proportion of these companies' overall assets, liabilities, expenses and revenues and

---

cash flows are integrated line by line into the consolidated financial statements.

- The companies in which there is significant influence, but not control or joint control with third parties, are accounted for by the equity method.

In certain circumstances, some of the Group's investees may require a qualified majority to adopt certain resolutions. This, together with other factors, is taken into account when selecting the consolidation method.

All material accounts and transactions between the consolidated companies were eliminated on consolidation. The returns generated on transactions involving capitalizable goods or services by subsidiaries with other Telefónica Group companies were eliminated on consolidation.

The financial statements for the consolidated subsidiaries have the same financial year end as the parent company's individual financial statements and are prepared using the same accounting policies. In the case of Group companies whose accounting and valuation methods differed from those of Telefónica, adjustments were made on consolidation in order to present the consolidated financial statements on a uniform basis.

The consolidated income statement and cash flow statement include the revenues and expenses and cash flows of companies that are no longer in the Group up to the date on which the related holding is sold or the company is liquidated, and those of the new companies included in the Group from the date on which the holding is acquired or the company is incorporated through year-end.

Revenues and expenses associated with discontinued businesses are presented in a separate line on the consolidated income statement. Discontinued operations are those with identifiable operations and cash flows (for both operating and management purposes) and represent a line of business or geographic unit which has been disposed of or is available for sale.

The value of stakes held by minority investors in the equity and earnings of the fully consolidated subsidiaries is consolidated and presented under "Minority interests" on the consolidated balance sheet and income statement (see Note 11).



### aa) IFRS and IFRIC interpretations not yet effective

At the date of preparation of the consolidated financial statements, the following IFRS and IFRIC interpretations have been published but their application is not mandatory:

| Standards and amendments to standards |   | Effective date                         |
|---------------------------------------|---|--|
| <b>IFRS 6</b>                         | Exploration for and Evaluation of Mineral Assets  | January 1, 2006                        |
| <b>IFRS 7</b>                         | Financial Instruments: Disclosures  | January 1, 2007                        |
| <b>Amendment to IAS 1</b>             | Presentation of Financial Statements – Capital Disclosures  | January 1, 2007                        |
| <b>Amendment to IAS 19</b>            | Employee Benefits   | January 1, 2006                        |
| <b>Amendment to IAS 21</b>            | The Effects of Changes in Foreign Exchange Rates – Net Investment in a Foreign Operation                  | January 1, 2006                        |
| <b>Amendment to IAS 39</b>            | Financial Instruments: Recognition and Measurement – Fair Value Option                                    | January 1, 2006                        |
| <b>Amendment to IAS 39</b>            | Financial Instruments: Recognition and Measurement - Cash Flow Hedges of Forecast Intragroup Transactions | January 1, 2006                        |
| <b>Amendment to IAS 39</b>            | Financial Instruments: Recognition and Measurement – Financial Guarantee Contracts                        | January 1, 2006                        |
| Interpretations                       |   | Effective date                         |
| <b>IFRIC 4</b>                        | Determining Whether an Arrangement Contains a Lease   | January 1, 2006                        |
| <b>IFRIC 5</b>                        | Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds      | January 1, 2006                        |
| <b>IFRIC 6</b>                        | Liabilities Arising from Participating in a Specific Market - Waste Electrical and Electronic Equipment   | Years beginning after December 1, 2005 |
| <b>IFRIC 7</b>                        | Applying the Restatement Approach under IAS 29 Financial Information in Hyperinflationary Economies       | March 1, 2006                          |
| <b>IFRIC 8</b>                        | Scope of IFRS 2 Share-based Payment   | May 1, 2006                            |

In accordance with the recommendation of advance application and temporary provisions, the Group has adopted the amendment to IAS 39 *Financial Instruments: Recognition and Measurement – Fair Value Option* before the effective date.

The Group believes that the first-time adoption of the aforementioned standards and interpretations will not have a significant impact on its consolidated financial statements.

## (5) Intangible assets

The detail of the movements in intangible assets in 2005 and 2004 is as follows:

| Millions of euros                     | Balance at<br>12/31/04 | Additions       | Disposals       | Transfers       | Translation<br>differences | Inclusion of<br>companies | Exclusion of<br>companies | Balance at<br>12-31-05 |
|---------------------------------------|------------------------|-----------------|-----------------|-----------------|----------------------------|---------------------------|---------------------------|------------------------|
| <b>Cost:</b>                          |                        |                 |                 |                 |                            |                           |                           |                        |
| Development costs                     | 1,281.61               | 93.48           | (0.89)          | (48.42)         | 4.80                       | 6.79                      | -                         | 1,337.37               |
| Administrative concessions            | 4,636.84               | 48.85           | (2.18)          | (45.65)         | 1,019.11                   | 370.23                    | -                         | 6,027.20               |
| Industrial property<br>and software   | 4,176.06               | 722.19          | (46.17)         | 214.57          | 343.42                     | 210.11                    | -                         | 5,620.18               |
| Other intangible assets               | 729.01                 | 212.80          | (64.49)         | (228.08)        | 121.22                     | 1,161.80                  | (0.06)                    | 1,932.20               |
| <b>Total gross intangible assets</b>  | <b>10,823.52</b>       | <b>1,077.32</b> | <b>(113.73)</b> | <b>(107.58)</b> | <b>1,488.55</b>            | <b>1,748.93</b>           | <b>(0.06)</b>             | <b>14,916.95</b>       |
| <b>Accumulated amortization:</b>      |                        |                 |                 |                 |                            |                           |                           |                        |
| Development costs                     | 1,177.50               | 80.57           | (0.89)          | (1.37)          | 0.35                       | -                         | -                         | 1,256.16               |
| Administrative concessions            | 1,089.37               | 338.25          | (2.42)          | 0.60            | 259.72                     | -                         | -                         | 1,685.52               |
| Industrial property<br>and software   | 2,785.61               | 820.41          | (55.25)         | (31.58)         | 223.07                     | -                         | -                         | 3,742.26               |
| Other intangible assets               | 89.59                  | 255.21          | (36.38)         | (15.84)         | 58.33                      | -                         | -                         | 350.91                 |
| <b>Total accumulated amortization</b> | <b>5,142.07</b>        | <b>1,494.44</b> | <b>(94.94)</b>  | <b>(48.19)</b>  | <b>541.47</b>              | <b>-</b>                  | <b>-</b>                  | <b>7,034.85</b>        |
| <b>Provisions for impairment</b>      | <b>7.32</b>            | <b>1.40</b>     | <b>(0.15)</b>   | <b>(4.63)</b>   | <b>1.05</b>                | <b>-</b>                  | <b>-</b>                  | <b>4.99</b>            |
| <b>Net intangible assets</b>          | <b>5,674.13</b>        | <b>(418.52)</b> | <b>(18.64)</b>  | <b>(54.76)</b>  | <b>946.03</b>              | <b>1,748.93</b>           | <b>(0.06)</b>             | <b>7,877.11</b>        |

| Millions of euros                     | Balance at<br>1-1-04 | Additions       | Disposals      | Transfers     | Translation<br>differences | Inclusion of<br>companies | Exclusion of<br>companies | Balance at<br>12-31-04 |
|---------------------------------------|----------------------|-----------------|----------------|---------------|----------------------------|---------------------------|---------------------------|------------------------|
| <b>Cost:</b>                          |                      |                 |                |               |                            |                           |                           |                        |
| Development costs                     | 1,199.63             | 86.92           | (2.29)         | (0.09)        | (2.56)                     | -                         | -                         | 1,281.61               |
| Administrative concessions            | 3,757.90             | 7.34            | -              | (4.35)        | (80.12)                    | 956.07                    | -                         | 4,636.84               |
| Industrial property<br>and software   | 3,709.85             | 499.13          | (18.59)        | 81.33         | (11.50)                    | 65.80                     | (149.96)                  | 4,176.06               |
| Other intangible assets               | 478.19               | 44.91           | (45.49)        | (5.69)        | 1.52                       | 273.52                    | (17.95)                   | 729.01                 |
| <b>Total gross intangible assets</b>  | <b>9,145.57</b>      | <b>638.30</b>   | <b>(66.37)</b> | <b>71.20</b>  | <b>(92.66)</b>             | <b>1,295.39</b>           | <b>(167.91)</b>           | <b>10,823.52</b>       |
| <b>Accumulated amortization:</b>      |                      |                 |                |               |                            |                           |                           |                        |
| Development costs                     | 1,089.79             | 88.05           | -              | (0.27)        | (0.07)                     | -                         | -                         | 1,177.50               |
| Administrative concessions            | 904.70               | 200.34          | -              | (7.76)        | (7.91)                     | -                         | -                         | 1,089.37               |
| Industrial property<br>and software   | 2,114.49             | 776.64          | (10.31)        | 7.63          | (12.94)                    | -                         | (89.90)                   | 2,785.61               |
| Other intangible assets               | 88.98                | 60.07           | (35.07)        | (1.00)        | (3.97)                     | -                         | (19.42)                   | 89.59                  |
| <b>Total accumulated amortization</b> | <b>4,197.96</b>      | <b>1,125.10</b> | <b>(45.38)</b> | <b>(1.40)</b> | <b>(24.89)</b>             | <b>-</b>                  | <b>(109.32)</b>           | <b>5,142.07</b>        |
| <b>Provisions for impairment</b>      | <b>26.97</b>         | <b>1.04</b>     | <b>(3.65)</b>  | <b>(9.02)</b> | <b>0.43</b>                | <b>-</b>                  | <b>(8.45)</b>             | <b>7.32</b>            |
| <b>Net intangible assets</b>          | <b>4,920.64</b>      | <b>(487.84)</b> | <b>(17.34)</b> | <b>81.62</b>  | <b>(68.20)</b>             | <b>1,295.39</b>           | <b>(50.14)</b>            | <b>5,674.13</b>        |

The main additions in 2005 relate to investments in software.

Inclusions of companies in 2005 mainly correspond to the addition of the Cesky Telecom assets, which gave rise to a 350.70 million euro increase in costs. In addition, the process of allocating the acquisition price was completed before year end, giving rise to increases in "Administrative concessions," "Industrial property and software" and "Other intangible assets" of 60.07 million, 102.86 million and 1,018.95 million euros, respectively, under "Inclusion of companies."

In addition, the inclusion of Telefónica Móviles Chile, S.A. and Radiocomunicaciones Móviles, S.A. led to an increase in cost of 127.47 million euros. As a result of the allocation of the acquisition price for these two companies, 84.69 million euros were included under "Other intangible assets."

Meanwhile, because of the acquisition of a further 1.78% of Tele Centro Oeste Participações, S.A. (see Note 2), 27.32 million euros were assigned to the net value of "Administrative concessions."

The main item under "Inclusion of companies" in 2004 was the addition of the assets relating to the companies acquired by Telefónica Móviles from BellSouth, which gave rise to an increase in cost of 246.58 million euros.

Independent appraisals of the assets acquired from BellSouth resulted in the allocation in 2004 of 644.27 million euros to "Administrative concessions," a 20.83 million euro increase in "Industrial property and software" and 193.32 million euros as customers acquired recorded under "Other intangible assets."

The main decrease in 2004 related to the deconsolidation of Lola Films, with a cost and accumulated amortization of 140.55 million and 83.20 million euros, respectively.

In 2005, Group companies capitalized 136.21 million euros (2004: 175.90 million euros) of intangible assets corresponding primarily to software development. Related projects may or may not have been fully completed.

At December 31, 2005 and 2004, the Company carried intangible assets of indefinite useful life at 145.30 million and 66.99 million euros, respectively, related primarily to permanent licenses to operate wireless telecommunications services in Argentina.

The Company's management reviews the indefinite useful life classification of these assets each year.

They are also subject to impairment tests whenever there are indications of a potential loss in value and, in any event, at the end of each year. There was no impact on the consolidated financial statements for 2005 or 2004 as a result of these impairment tests.

Intangible assets with a defined useful life are amortized on a straight-line basis over their estimated useful lives. Amortization charges in 2005 and 2004 amounted to 1,494.44 million and 1,125.09 million euros, respectively, of which 13.61 million euros correspond to assets related to operations discontinued in 2004.

The amount of fully amortized intangible assets at December 31, 2005 and 2004 were 3,658.77 and 2,497.57 million euros, respectively.

## (6) Goodwill and Business Combinations

The movement in this heading in 2005 and 2004 were as follows:

|                            | Millions of euros |
|----------------------------|-------------------|
| <b>Balance at 1-01-04</b>  | <b>3,981.77</b>   |
| Additions                  | 2,288.82          |
| Disposals                  | (55.79)           |
| Impairment losses          | (120.67)          |
| Transfers                  | (13.80)           |
| Translation differences    | (130.89)          |
| <b>Balance at 12-31-04</b> | <b>5,949.44</b>   |
| Additions                  | 2,452.91          |
| Disposals                  | (179.28)          |
| Transfers                  | (140.32)          |
| Translation differences    | 827.48            |
| <b>Balance at 12-31-05</b> | <b>8,910.23</b>   |

Goodwill generated in the acquisition of foreign companies is treated as an asset denominated in the currency of the company acquired,

and is therefore subject to exchange rate differences, which are included under "Translation differences."

The detail of the movements in goodwill of the Group's main companies is shown in Appendix III.

Impairment tests carried out in 2005 did not uncover the need to write down goodwill as recoverable amounts were higher than carrying amounts in all cases.

In 2004 impairment testing uncovered the need to write down goodwill by 120.67 million euros. The goodwill written off in 2004 included mainly 109.51 million euros relating to the investment in Telefónica UK.

The Company uses business plans (generally five years) of various cash-generating units to which goodwill is allocated, applying a before-tax, risk-adjusted (country and business) discount rate to carry out its impairment tests. Forecasted growth rates are applied and growth beyond the fifth year is extrapolated at a constant rate. These tests are performed annually and each time there are indications that the recoverable amount of goodwill may be impaired.

### 2005

The main increases in goodwill in 2005 related to the following companies:

|  | Millions of euros |
|--|-------------------|
| Radiocomunicaciones Móviles, S.A.          | 547.22            |
| Telefónica Móviles Chile Inversiones, S.A. | 219.44            |
| Cesky Telecom                              | 912.66            |
| Eurotel Praha                              | 443.56            |
| Telefónica Móviles Mexico Group            | 90.95             |
| Other                                      | 239.08            |
| <b>Total</b>                               | <b>2,452.91</b>   |

Disposals in goodwill in 2005 relate mainly to the sale of 25% of Endemol N.V.'s share capital (see Note 2).

The acquisition price of the companies acquired from BellSouth and Cesky Telecom were assigned to assets acquired and liabilities and contingent liabilities assumed on the basis of conclusions drawn from the valuation performed by independent appraisers (see Notes 5 and 7).

### 2004

The main increases in goodwill in 2004 were as follows:

|                                | Millions of euros |
|--------------------------------|-------------------|
| Olympic, Ltda.                 | 536.09            |
| Otecel, S.A.                   | 451.37            |
| Telcel, C.A.                   | 491.12            |
| Telefónica Móviles Panamá      | 305.15            |
| Telefonía Celular de Nicaragua | 76.65             |
| Other companies                | 428.44            |
| <b>Total</b>                   | <b>2,288.82</b>   |

The exclusions of companies in 2004 mainly include the sale of Lycos, Inc. for 55.79 million euros.

## (7) Property, plant and equipment

The detail and accumulated depreciation of property, plant and equipment in 2005 and 2004 are as follows:

| Millions of euros                     | Balance at<br>12-31-04 | Additions       | Disposals         | Inclusion<br>of<br>companies | Exclusion<br>of<br>companies | Translation<br>differences | Transfers       | Balance at<br>12-31-05 |
|---------------------------------------|------------------------|-----------------|-------------------|------------------------------|------------------------------|----------------------------|-----------------|------------------------|
| <b>Cost:</b>                          |                        |                 |                   |                              |                              |                            |                 |                        |
| Land and buildings                    | 6,427.52               | 129.26          | (97.83)           | 2,183.39                     | (1.29)                       | 577.22                     | 174.85          | 9,393.12               |
| Plant and machinery                   | 59,499.89              | 1,350.01        | (2,219.45)        | 905.72                       | (5.11)                       | 5,899.94                   | 1,851.92        | 67,282.92              |
| Furniture, tools and other items      | 2,832.24               | 336.02          | (261.70)          | 118.50                       | (0.95)                       | 363.38                     | 177.13          | 3,564.62               |
| <b>Total PP&amp;E in service</b>      | <b>68,759.65</b>       | <b>1,815.29</b> | <b>(2,578.98)</b> | <b>3,207.61</b>              | <b>(7.35)</b>                | <b>6,840.54</b>            | <b>2,203.90</b> | <b>80,240.66</b>       |
| Construction in progress              | 1,168.52               | 2,255.25        | (1.91)            | 39.47                        | (0.01)                       | 180.52                     | (1,966.52)      | 1,675.32               |
| Advances payments for PP&E            | 9.05                   | 7.55            | 0.17              | 5.09                         | -                            | 1.25                       | (4.87)          | 18.24                  |
| Installation materials                | 264.18                 | 313.23          | (6.26)            | 9.18                         | -                            | 8.69                       | (279.00)        | 310.02                 |
| <b>Gross PP&amp;E</b>                 | <b>70,201.40</b>       | <b>4,391.32</b> | <b>(2,586.98)</b> | <b>3,261.35</b>              | <b>(7.36)</b>                | <b>7,031.00</b>            | <b>(46.49)</b>  | <b>82,244.24</b>       |
| <b>Accumulated depreciation:</b>      |                        |                 |                   |                              |                              |                            |                 |                        |
| Buildings                             | 2,374.18               | 388.82          | (34.60)           | -                            | (0.77)                       | 211.05                     | (10.43)         | 2,928.25               |
| Plant and machinery                   | 42,524.11              | 4,439.96        | (2,132.85)        | -                            | (4.14)                       | 3,952.87                   | 12.91           | 48,792.86              |
| Furniture, tools and other items      | 2,016.90               | 394.46          | (255.77)          | -                            | (0.65)                       | 274.52                     | (8.84)          | 2,420.62               |
| <b>Total accumulated depreciation</b> | <b>46,915.19</b>       | <b>5,223.24</b> | <b>(2,423.22)</b> |                              | <b>(5.56)</b>                | <b>4,438.44</b>            | <b>(6.36)</b>   | <b>54,141.73</b>       |
| <b>Provisions for impairment</b>      | <b>92.84</b>           | <b>41.83</b>    | <b>(29.20)</b>    | <b>-</b>                     | <b>-</b>                     | <b>9.01</b>                | <b>(4.57)</b>   | <b>109.91</b>          |
| <b>Net PP&amp;E</b>                   | <b>23,193.37</b>       | <b>(873.75)</b> | <b>(134.56)</b>   | <b>3,261.35</b>              | <b>(1.80)</b>                | <b>2,583.55</b>            | <b>(35.56)</b>  | <b>27,992.60</b>       |

| Millions of euros                     | Balance at<br>1-1-04 | Additions         | Disposals         | Inclusion<br>of<br>companies | Exclusion<br>of<br>companies | Translation<br>differences | Transfers       | Balance at<br>12-31-04 |
|---------------------------------------|----------------------|-------------------|-------------------|------------------------------|------------------------------|----------------------------|-----------------|------------------------|
| <b>Cost:</b>                          |                      |                   |                   |                              |                              |                            |                 |                        |
| Land and buildings                    | 6,117.22             | 197.17            | (137.80)          | 112.66                       | (5.50)                       | (40.62)                    | 184.39          | 6,427.52               |
| Plant and machinery                   | 58,293.73            | 1,158.26          | (1,205.89)        | 488.50                       | (7.35)                       | (347.52)                   | 1,120.16        | 59,499.89              |
| Furniture, tools and other items      | 2,766.95             | 179.01            | (187.29)          | 44.79                        | (26.99)                      | (26.68)                    | 82.45           | 2,832.24               |
| <b>PP&amp;E in service</b>            | <b>67,177.90</b>     | <b>1,534.44</b>   | <b>(1,530.98)</b> | <b>645.95</b>                | <b>(39.84)</b>               | <b>(414.82)</b>            | <b>1,387.00</b> | <b>68,759.65</b>       |
| Construction in progress              | 1,060.52             | 1,331.42          | (4.66)            | 50.62                        | -                            | (26.90)                    | (1,242.48)      | 1,168.52               |
| Advance payments for PP&E             | 6.92                 | 1.05              | (0.04)            | 0.66                         | -                            | (0.43)                     | 0.89            | 9.05                   |
| Installation materials                | 182.34               | 294.29            | (4.69)            | 10.39                        | -                            | (1.79)                     | (216.36)        | 264.18                 |
| <b>Gross PP&amp;E</b>                 | <b>68,427.68</b>     | <b>3,161.20</b>   | <b>(1,540.37)</b> | <b>707.62</b>                | <b>(39.84)</b>               | <b>(443.94)</b>            | <b>(70.95)</b>  | <b>70,201.40</b>       |
| <b>Accumulated depreciation:</b>      |                      |                   |                   |                              |                              |                            |                 |                        |
| Buildings                             | 2,216.46             | 225.08            | (48.85)           | -                            | (1.18)                       | (8.08)                     | (9.25)          | 2,374.18               |
| Plant and machinery                   | 39,880.33            | 3,985.85          | (1,128.82)        | -                            | (6.66)                       | (202.85)                   | (3.74)          | 42,524.11              |
| Furniture, tools and other items      | 1,883.76             | 347.35            | (166.50)          | -                            | (12.83)                      | (22.77)                    | (12.11)         | 2,016.90               |
| <b>Total accumulated depreciation</b> | <b>43,980.55</b>     | <b>4,558.28</b>   | <b>(1,344.17)</b> |                              | <b>(20.67)</b>               | <b>(233.70)</b>            | <b>(25.10)</b>  | <b>46,915.19</b>       |
| <b>Provisions for impairment</b>      | <b>101.13</b>        | <b>14.49</b>      | <b>(26.60)</b>    | <b>-</b>                     | <b>-</b>                     | <b>(2.62)</b>              | <b>6.44</b>     | <b>92.84</b>           |
| <b>Net PP&amp;E</b>                   | <b>24,346.00</b>     | <b>(1,411.57)</b> | <b>(169.60)</b>   | <b>707.62</b>                | <b>(19.17)</b>               | <b>(207.62)</b>            | <b>(52.29)</b>  | <b>23,193.37</b>       |

Inclusion of companies in 2005 include Cesky Telecom's assets for a gross amount of 3,091.15 million euros and Telefónica Móviles Chile, S.A. and Radiocomunicaciones Móviles, S.A. for a gross amount of 154.97 million euros.

Inclusion of companies in 2004 include the assets relating to the companies acquired by Telefónica Móviles from BellSouth, which gave rise to an increase in costs of 701.50 million euros. As with intangible assets, Telefónica Móviles appraised the property, plant and equipment acquired as part of the purchase of the BellSouth operators in order to recognize them at fair value.

Among the investments made in 2005 and 2004 were additions by Telefónica de España of 1,073.08 and 911.32 million euros, respectively. These were mainly to develop the RIMA network (high performance IP network) and launch ADSL and, more recently, to provide integrated broadband services and solutions. The company has invested 2,440.61

million euros since launching broadband services in August 2001 (1,988.61 million euros at year end 2004).

Also included are the enlargement and rollout of the GSM and GPRS networks, as well as the Telefónica Móviles Group operators' UMTS network.

"Translation differences" reflect the impact of exchange rate movements on opening balances. The effect of exchange rates on movements in the year is included in the appropriate column for each movement.

Depreciation in 2005 and 2004 based on the various assets' estimated useful lives (see Note 4.e) totaled 5,223.24 million and 4,558.28 million euros, respectively, of which 3.73 million euros in 2004 corresponded to assets related to discontinued operations.

At December 31, 2005 and 2004, the following items had been fully depreciated:

| Millions of euros   | 12-31-05         | 12-31-04         |
|---------------------|------------------|------------------|
| Buildings           | 710.25           | 354.45           |
| Plant and machinery | 26,969.59        | 23,121.34        |
| Other PP&E          | 1,636.18         | 1,744.06         |
| <b>Total</b>        | <b>29,316.02</b> | <b>25,219.85</b> |

Telefónica de España's property, plant and equipment used to provide services currently regulated by the related license cannot be mortgaged without prior authorization by the government.

Telefónica Group companies have taken out insurance policies to reasonably cover the possible risks to which their property, plant and equipment used in operations are subject, with suitable limits and coverage. These policies include certain franchises for local and domestic long-distance networks and subscriber equipment.

Additions in 2005 and 2004 included in-house developments by the Telefónica Group totaling 482.11 and 223.28 million euros, respectively, recorded under "Internal expenditures capitalized" (see Note 19).

The net amount of "Plant, property and equipment" temporarily out of service at December 31, 2005 and 2004 totaled 39.37 million and 32.98 million euros, respectively.

## (8) Financial Assets

### *Non-current financial assets*

The detail of this heading and the corresponding provision at December 31, 2005 and 2004 is as follows:

| Millions of euros          | Other investments | Other loans     | Derivative financial assets | Deposits and guarantees | Prepayments   | Provisions      | Total           |
|----------------------------|-------------------|-----------------|-----------------------------|-------------------------|---------------|-----------------|-----------------|
| <b>Balance at 01-01-04</b> | <b>1,617.40</b>   | <b>1,399.50</b> | <b>637.61</b>               | <b>644.55</b>           | <b>121.85</b> | <b>(56.92)</b>  | <b>4,363.99</b> |
| Additions                  | 21.60             | 327.46          | 685.42                      | 476.93                  | 54.22         | (50.43)         | 1,515.20        |
| Disposals                  | (423.38)          | (130.81)        | (702.98)                    | (496.34)                | (96.15)       | 6.44            | (1,843.22)      |
| Inclusion of companies     | 0.01              | (12.58)         | –                           | 1.50                    | 1.44          | –               | (9.63)          |
| Exclusion of companies     | (0.61)            | –               | –                           | –                       | (0.23)        | 12.89           | 12.05           |
| Translation differences    | 3.84              | (9.82)          | (9.92)                      | 0.68                    | (2.07)        | 0.94            | (16.35)         |
| Fair value restatements    | 124.75            | 61.72           | (169.77)                    | 0.01                    | 40.57         | –               | 57.28           |
| Transfers                  | (456.84)          | (93.21)         | (12.02)                     | 16.44                   | (3.07)        | (30.28)         | (578.98)        |
| <b>Balance at 12-31-04</b> | <b>886.77</b>     | <b>1,542.26</b> | <b>428.34</b>               | <b>643.77</b>           | <b>116.56</b> | <b>(117.36)</b> | <b>3,500.34</b> |
| Additions                  | 1,736.13          | 277.17          | 34.14                       | 349.82                  | 97.91         | (4.39)          | 2,490.78        |
| Disposals                  | (136.09)          | (259.96)        | (77.79)                     | (380.56)                | (50.16)       | 25.33           | (879.23)        |
| Inclusion of companies     | –                 | 8.89            | –                           | (0.58)                  | 13.45         | (0.04)          | 21.72           |
| Exclusion of companies     | –                 | –               | –                           | (0.14)                  | –             | (0.01)          | (0.15)          |
| Translation differences    | 10.05             | 48.23           | 7.60                        | 32.92                   | 14.57         | (11.93)         | 101.44          |
| Fair value restatements    | 43.44             | 16.12           | (28.31)                     | (0.03)                  | (0.57)        | –               | 30.65           |
| Transfers                  | (19.67)           | (190.19)        | (52.63)                     | (33.32)                 | (16.72)       | (271.79)        | (584.32)        |
| <b>Balance at 12-31-05</b> | <b>2,520.63</b>   | <b>1,442.52</b> | <b>311.35</b>               | <b>611.88</b>           | <b>175.04</b> | <b>(380.19)</b> | <b>4,681.23</b> |

“Other investments” include the market value of investments in companies where Telefónica does not exercise significant control and for which there is no specific disposal plan for the short term. We would highlight the investment in Banco Bilbao Vizcaya Argentaria, S.A. (BBVA), valued at 546.13 million euros (472.61 million euros at December 31, 2004).

“Additions” in 2005 reflects the shares acquired in O2, Plc. on the London Stock Exchange subsequent to the takeover bid launched by Telefónica for 100% of the UK operator’s share capital. At December 31, 2005, 4.97% of the company’s capital had been acquired for 1,265.83 million euros (see Subsequent Events - Note 22).

Meanwhile, in July Telefónica Internacional, S.A.U. (TISA) acquired 2.99% of the share capital of Chinese operator China Netcom Group Corporation (Hong Kong) Limited (CNC) at a price of 11.45 Hong Kong dollars per share, representing a total investment of 240 million euros. In September, TISA acquired a further 2.01% of the Chinese company for 184 million euros. After this second acquisition, the Telefónica Group’s holding in the Chinese operator stood at 5%.

Disposals in 2005 include the sale in March of 14.41% of US company Infonet Services Corporation, Inc. The profit on the sale was 80.00 million euros, recognized under “Gains on disposal of assets” (see Note 19).

Disposals in 2004 correspond mainly to the sale of the shareholding in Pearson Plc.

Also in 2004, Telefónica increased its stake in Portugal Telecom, S.G.P.S., S.A. to 9.58%. Therefore, it began consolidating the Portuguese operator by the equity method as an investment in an associate (see Note 19 and Appendix II). The impact of this change is recognized in “Transfers” under “Other investments.”



“Other loans” includes mainly the investment of the net level premium reserves of the Group’s insurance companies, mainly in fixed-income securities, amounting to 754.68 million and 823.28 million euros at December 31, 2005 and 2004, respectively, carried at market value. It also includes long-term loans to associates (see Note 9).

“Derivative financial assets” includes the fair value of derivatives to hedge assets or liabilities whose maturity is 12 months or greater, as part of the Group’s financial risk-hedging strategy (see Note 15).

“Deposits and Guarantees” includes mainly 611.88 million euros to cover guarantees at December 31, 2005 (643.77 million euros at December 31, 2004). These deposits will decrease as the respective obligations they are guaranteeing are reduced.

“Prepayments” refer to amounts already paid but not yet included in the consolidated income statement goods or services acquired have not yet been consumed or their ownership has not been transferred.

### *Current financial assets*

This heading in the accompanying consolidated balance sheet at December 31, 2005 and 2004 includes mainly the following items:

- “Current financial assets” recognized at market value to cover commitments assumed by the Group’s insurance companies, amounting to 447.72 million euros at December 31, 2005 (440.96 million euros at December 31, 2004). The maturity schedule for these financial assets is established on the basis of payment projections for the commitments.
- Investments corresponding to the Telefónica Móviles Group amounting to 140.16 million euros (525.48 million euros in 2004).
- Derivative financial assets not used to hedge non-current balance sheet items expected to mature within less than 12 months, which amounted to 169.64 million euros (466.26 million euros in 2004) (see Note 15).
- Current investments of cash surpluses which, given their characteristics, have not been classified as “Cash and cash equivalents.”
- Loans to associates (see Note 9).

Current financial assets that are highly liquid and are expected to be sold within three months or less are recorded under “Cash and cash equivalents” on the accompanying consolidated balance sheet.

## (9) Investments in Associates, Joint Ventures and other Related-party

### Associates

The detail of associates and key financial highlights are:

Millions of euros

| December 31, 2005  | %       | Total            | Total            | Current         | Income              |                 | Carrying        | Fair            |
|--|---------|------------------|------------------|-----------------|---------------------|-----------------|-----------------|-----------------|
| Company  | Holding | assets           | liabilities      | revenues        | (loss) for the year | Goodwill        | amount          | value           |
| Sogecable, S.A. (Spain)  | 23.83   | 2,380.00         | 2,040.88         | 1,518.96        | 7.73                | 603.48          | 675.94          | 1,077.76        |
| Portugal Telecom, S.G.P.S., S.A. (Portugal) (i)                          | 9.84    | 15,511.60        | 11,780.40        | 4,663.80        | 318.60              | 509.81          | 796.07          | 961.65          |
| Lycos Europe, N.V. (Netherlands)   | 32.10   | 171.73           | 45.36            | 126.13          | (20.24)             | –               | 40.60           | 355.20          |
| Médi Telecom, S.A. (Morocco)   | 29.90   | 1,154.92         | 991.36           | 390.58          | 26.43               | 9.82            | 52.63           | 52.63           |
| Sistemas Técnicos de Loterías del Estado, S.A. (Spain)                   | 31.75   | 90.19            | 11.59            | 56.85           | 6.38                | –               | 23.07           | 23.07           |
| Telefónica Factoring Establecimiento Financiero de Crédito, S.A. (Spain) | 50.00   | 91.67            | 82.07            | 7.43            | 2.76                | –               | 5.00            | 5.00            |
| Mobipay España, S.A. (Spain)   | 12.41   | 3.17             | –                | –               | (4.79)              | –               | 0.42            | 0.42            |
| Ipse 2000, S.p.A. (Italy)  | 46.44   | 42.26            | 1,033.59         | –               | (1,223.39)          | –               | –               | –               |
| Other  | N/A     | N/A              | N/A              | N/A             | N/A                 | –               | 70.62           | 70.62           |
| <b>Total</b>   |         | <b>19,445.54</b> | <b>15,985.25</b> | <b>6,763.75</b> | <b>(886.52)</b>     | <b>1,123.11</b> | <b>1,664.35</b> | <b>2,546.35</b> |

(i) Figures at September 30, 2005.

Millions of euros

| December 31, 2004  | %            | Total            | Total            | Current         | Income              |                 | Carrying        | Fair            |
|--|--------------|------------------|------------------|-----------------|---------------------|-----------------|-----------------|-----------------|
| Company  | shareholding | assets           | liabilities      | revenues        | (loss) for the year | Goodwill        | amount          | value           |
| Sogecable, S.A. (Spain)  | 23.83        | 2,519.99         | 2,351.82         | 1,477.17        | (152.83)            | 603.48          | 664.55          | 971.62          |
| Portugal Telecom, S.G.P.S., S.A. (Portugal)                              | 9.58         | 13,579.61        | 10,533.68        | 6,174.00        | 577.09              | 512.61          | 766.64          | 1,029.08        |
| Lycos Europe, N.V. (Netherlands)   | 32.10        | 194.06           | 47.86            | 107.73          | (45.48)             | –               | 46.57           | 205.64          |
| Médi Telecom, S.A. (Morocco)   | 29.75        | 1,144.38         | 1,010.52         | 324.81          | (26.88)             | 9.58            | 43.07           | 43.07           |
| Sistemas Técnicos de Loterías del Estado, S.A. (Spain)                   | 31.75        | 81.61            | 10.33            | 50.10           | 4.95                | –               | 22.57           | 22.57           |
| Telefónica Factoring Establecimiento Financiero de Crédito, S.A. (Spain) | 50.00        | 86.41            | 77.12            | 6.75            | 2.44                | –               | 4.80            | 4.80            |
| Mobipay España, S.A. (Spain)   | 12.35        | 15.91            | 7.94             | 2.92            | (4.61)              | –               | 0.88            | 0.88            |
| Ipse 2000, S.p.A. (Italy)  | 46.23        | 797.68           | 724.88           | 0.56            | (61.84)             | –               | 32.76           | 32.76           |
| Other  | N/A          | N/A              | N/A              | N/A             | N/A                 | –               | 69.84           | 69.84           |
| <b>Total</b>   |              | <b>18,419.65</b> | <b>14,764.15</b> | <b>8,144.04</b> | <b>292.84</b>       | <b>1,125.67</b> | <b>1,651.68</b> | <b>2,380.26</b> |

The detail of the movements in investments in associates in 2005 and 2004 was as follows:

| Investments in associates  | Millions of euros |
|----------------------------|-------------------|
| <b>Balance at 01-01-04</b> | <b>981.32</b>     |
| Additions                  | 578.19            |
| Disposals                  | (97.72)           |
| Exclusion of companies     | (0.24)            |
| Translation differences    | (47.46)           |
| Income (loss)              | (50.49)           |
| Dividends                  | (13.84)           |
| Transfers                  | 301.92            |
| <b>Balance at 12-31-04</b> | <b>1,651.68</b>   |
| Additions                  | 44.69             |
| Disposals                  | (7.18)            |
| Inclusion of companies     | 0.38              |
| Exclusion of companies     | (0.32)            |
| Translation differences    | 74.19             |
| Income (loss)              | (128.21)          |
| Dividends                  | (36.47)           |
| Transfers                  | 65.59             |
| <b>Balance at 12-31-05</b> | <b>1,664.35</b>   |

The additions and disposals at December 31, 2005 and 2004 reflect the amounts resulting from transactions detailed in the changes to the consolidation scope (see Appendix II).

As detailed in Appendix II, Telefónica acquired an additional 4.88% shareholding in Portugal Telecom, S.G.P.S., S.A., taking a total (direct and indirect) holding to 9.58% at the end of 2004. As a result, Telefónica became the Portuguese operator's core shareholder. As a result of this and other significant agreements with the company, the Company was considered to have significant influence and therefore began consolidating Portugal Telecom, S.G.P.S., S.A. by the equity method in 2004. The impact of this change is reflected in "Transfers" in 2004 (see Note 8).

In the course of 2005 Sogecable, S.A. increased its share capital by 7,560,261 shares with a par value of 2 euros each and bearing an issue premium of 22.47 euros. The Telefónica Group subscribed for 1,801,689 of these shares, paying a total of approximately 44.10 million euros. As result, the Group's shareholding in Sogecable is unchanged, at 23.83% of its total share capital.

Noteworthy in connection with the balances receivable from associated companies at December 31, 2005 and 2004, is the financing granted to Sogecable, S.A. in accordance with the commitments assumed in relation to the integration of the satellite platforms (see Note 21.b). "Other loans – Non-current financial assets" at December 31, 2005 includes 242.37 million euros to Sogecable, S.A. (262.31 million euros at December 31, 2004) (see Note 8).

The figure at year end 2005 also includes 78.18 million euros owed from Medi Telecom and 351.03 million euros from Ipse 2000, S.p.A. (74.17 and 313.69 million euros, respectively, at December 31, 2004).

On January 31, 2006, the Italian Government informed Ipse 2000, S.p.A. of its decision to revoke the UMTS license granted to it in 2000. This impairment was recognized in the 2005 income statement and this investment was completely written-off in the Group's balance sheet. Net exposure at December 31, 2004, including financing granted, stood at 136.78 million euros. "Share of profit (loss) of associates" includes the impact of this decision. In 2005 and 2004, Ipse 2000, S.p.A.'s

statutory accounts include items previously written off by the Telefónica Móviles Group of 26.09 and 95.04 million euros, respectively, and these are include under "Transfers" in the preceding table (see Subsequent Events - Note 22).

### Joint ventures

On December 27, 2002, having complied with Brazilian regulatory provisions, Telefónica Móviles, S.A. and PT Movéis Serviços de Telecomunicações, SGPS, S.A. (PT Movéis) set up a 50/50 joint venture, Brasilcel, N.V., via the contribution of 100% of the groups' direct and indirect shares in Brazilian cellular operators. This company is consolidated in the consolidated financial statements of the Telefónica Group by the proportional method.

The contributions of Brasilcel, N.V. to the Telefónica Group's 2004 and 2005 consolidated balance sheets and income statements are as follows:

| Millions of euros       | 2005     | 2004     |
|-------------------------|----------|----------|
| Current assets          | 1,242.02 | 948.35   |
| Non-current assets      | 3,448.29 | 2,634.30 |
| Current liabilities     | 1,132.16 | 1,156.44 |
| Non-current liabilities | 1,028.98 | 502.09   |
| Revenues                | 1,955.26 | 1,550.83 |
| Expenses                | 1,857.98 | 1,353.16 |

### Other related parties

Following is a summary of the main transactions between Telefónica Group companies and significant shareholders of Telefónica, S.A.

Banco Bilbao Vizcaya Argentaria, S.A. (BBVA) and subsidiaries comprising the consolidated group:

- Financing transactions arranged under market conditions, with approximately 719.91 million euros drawn down at December 31, 2005.
- Derivative transactions contracted under market conditions, for a nominal amount of approximately 3,320.17 million euros.
- Guarantees granted by BBVA for approximately 16.50 million euros.
- The rendering, mainly of telecommunications and telemarketing services, by Telefónica Group companies to the BBVA Group, under market conditions.
- Telefónica, S.A. reached an agreement with BBVA whereby Terra Networks, S.A. (now Telefónica, S.A.) acquired a 49% holding in Uno-e-Bank. Telefónica and BBVA also signed a deal establishing the procedures and conditions for the integration of the BBVA group's Spanish and international call center business in Atento, a Telefónica Group subsidiary (See Note 21.b).

Caja de Ahorros y Pensiones de Barcelona, La Caixa, and subsidiaries comprising the consolidated group:

- Financing transactions arranged under market conditions, with approximately 835.97 million euros drawn down at December 31, 2005.
- Telefónica Group companies provide La Caixa group companies mainly telecommunications services, under market conditions.

## (10) Trade and other receivables

The detail of this heading at December 31, 2005 and 2004 is as follows:

| Millions of euros          | Balance at<br>12-31-05 | Balance at<br>12-31-04 |
|----------------------------|------------------------|------------------------|
| Customers                  | 8,148.92               | 6,570.42               |
| Receivable from associates | 71.80                  | 83.00                  |
| Sundry receivables         | 653.88                 | 612.97                 |
| Bad debt reserves          | (1,712.17)             | (1,568.44)             |
| Short-term prepayments     | 353.32                 | 221.80                 |
| <b>Total</b>               | <b>7,515.75</b>        | <b>5,919.75</b>        |

Public-sector trade receivables in the countries in which the group operates amounted to 552.31 million euros at December 31, 2005.

The detail of trade receivables at December 31, 2005 is as follows:

|                              | Millions of euros |
|------------------------------|-------------------|
| Trade receivables billed     | 5,252.41          |
| Trade receivables unbilled   | 2,205.71          |
| Bills of exchange receivable | 690.80            |
| <b>Total</b>                 | <b>8,148.92</b>   |

In 2005 the reserves made for bad debt amounted to 498.85 million euros (322.72 million euros in 2004) recorded under "Changes in trade provisions" of "Other expenses" (see Note 19).

## (11) Equity

The detail of the movements in equity accounts in 2005 and 2004 is as follows:

|   | Attributable to equity holders of the parent company |                 |                        |                   |                         |                  | Minority interests | Total equity     |
|---|--|-----------------|------------------------|-------------------|-------------------------|------------------|--------------------|------------------|
|   | Share capital  | Share premium   | Own equity instruments | Other reserves    | Translation differences | Total            |                    |                  |
| <b>Balance at January 1, 2004</b>         | <b>4,955.89</b>                                      | <b>7,987.14</b> | <b>(133.46)</b>        | <b>(1,205.65)</b> | <b>-</b>                | <b>11,603.92</b> | <b>2,446.28</b>    | <b>14,050.20</b> |
| Dividends                                 | -  | (951.64)        | -                      | (972.53)          | 7.65                    | (1,916.52)       | (949.29)           | (2,865.81)       |
| Net purchase of own equity instruments    | -  | (1,747.82)      | (556.72)               | 273.49            | -                       | (2,031.05)       | -                  | (2,031.05)       |
| Movements and sales of minority interests | -  | -               | -                      | -                 | -                       | -                | 79.65              | 79.65            |
| Income and expense recognized in the year | -  | -               | -                      | 3,007.65          | (308.28)                | 2,699.37         | 301.95             | 3,001.32         |
| Other movements                           | -  | -               | -                      | 91.69             | (7.65)                  | 84.04            | 24.12              | 108.16           |
| <b>Balance at December 31, 2004</b>       | <b>4,955.89</b>                                      | <b>5,287.68</b> | <b>(690.18)</b>        | <b>1,194.65</b>   | <b>(308.28)</b>         | <b>10,439.76</b> | <b>1,902.71</b>    | <b>12,342.47</b> |
| Dividends                                 | -  | (1,296.27)      | -                      | (1,083.15)        | 7.17                    | (2,372.25)       | (396.35)           | (2,768.60)       |
| Capital reduction                         | (34.76)  | (122.68)        | 157.44                 | -                 | -                       | -                | -                  | -                |
| Net movements in own equity instruments   | -  | (1,769.08)      | 159.67                 | (74.02)           | -                       | (1,683.43)       | -                  | (1,683.43)       |
| Purchases and sales of minority interests | -  | -               | -                      | (22.66)           | -                       | (22.66)          | 1,042.42           | 1,019.76         |
| Transfers                                 | -  | (428.82)        | -                      | 428.82            | -                       | -                | -                  | -                |
| Income and expense recognized in the year | -  | -               | -                      | 4,262.68          | 2,134.65                | 6,397.33         | 823.65             | 7,220.98         |
| Other movements                           | -  | -               | -                      | (18.28)           | (7.18)                  | (25.46)          | 52.71              | 27.25            |
| <b>Balance at December 31, 2005</b>       | <b>4,921.13</b>                                      | <b>1,670.83</b> | <b>(373.07)</b>        | <b>4,688.04</b>   | <b>1,826.36</b>         | <b>12,733.29</b> | <b>3,425.14</b>    | <b>16,158.43</b> |

### a) Share capital and share premium

At December 31, 2005, Telefónica S.A.'s share capital amounted to 4,921,130,397 euros and consisted of 4,921,130,397 fully paid ordinary shares of a single series and of 1 euro par value each, all recorded by the book-entry system and traded on the Spanish computerized trading system ("Continuous Market"), where they form part of the "Ibex 35" index, on the four Spanish Stock Exchanges (Madrid, Barcelona, Valencia and Bilbao) and on the New York, London, Paris, Frankfurt, Tokyo, Buenos Aires, São Paulo and Lima Stock Exchanges.

On June 15, 2001, authorization was given at the Shareholders' Meeting of Telefónica, S.A. for the Board of Directors to increase the Company's capital, at one or several times, within a maximum period of five years from that date, under the terms of Article 153.1 b) of the Spanish Corporation Law (authorized capital) up to a maximum of 2,274.68 million euros, by issuing new ordinary shares, be they ordinary redeemable or of any other type permitted by the Law, with a fixed or variable premium, with or without pre-emptive subscription rights and, in all cases, in exchange for cash. At December 31, 2005, the Board of Directors had not made use of this authorization.

In addition, at the April 11, 2003 Shareholders' Meeting, authorization was given for the Board of Directors to issue fixed-income securities at one or several times within a maximum period of five years from that date. These may be in the form of debentures, bonds, promissory notes or any other kind of fixed-income security, simple or, in the case of debentures and bonds, exchangeable for shares of the Company or of any of the group companies and/or convertible into shares of the Company. At December 31, 2005, the Board of Directors had not exercised these powers, except to approve three programs to issue corporate promissory notes for 2004, 2005 and 2006.

On May 31, 2005, shareholders voted to authorize the derivative acquisition by the Board of Directors of treasury shares, for a consideration, up to the limits and pursuant to the terms and conditions established by the Shareholders' Meeting, within a maximum period of 18 months from that date. However, it specified that in no circumstances could the par value of the shares acquired, added to that of the treasury shares already held by Telefónica, S.A. and by any of its controlled subsidiaries, exceed 5% of Telefónica's share capital.

#### Share capital and share premium in 2005

The detail of the movements in these headings in 2005 was as follows:

| Millions of euros                | Date     | Number of Shares     | Share capital   | Share premium   |
|----------------------------------|----------|----------------------|-----------------|-----------------|
| <b>Balance at 12-31-04</b>       |          | <b>4,955,891,361</b> | <b>4,955.89</b> | <b>5,287.68</b> |
| Capital reduction                | 6/6/05   | (34,760,964)         | (34.76)         | (122.68)        |
| Distribution of treasury shares  | 6/28/05  | –                    | –               | (2,571.27)      |
| Cash dividend                    | 11/11/05 | –                    | –               | (1,296.27)      |
| Value of treasury shares         | –        | –                    | –               | 802.19          |
| Merger with Terra Networks, S.A. | –        | –                    | –               | (428.82)        |
| <b>Balance at 12-31-05</b>       |          | <b>4,921,130,397</b> | <b>4,921.13</b> | <b>1,670.83</b> |

On June 6, 2005, the deed of capital reduction formalizing the implementation by the Company's Board of Directors of the resolution adopted at the Shareholders' Meeting on May 31, 2005, was executed. Capital was reduced through the cancellation of treasury shares previously acquired by the Company as authorized at the Shareholders' Meeting. As a result, 34,760,964 Telefónica S.A. treasury shares were cancelled and the Company's share capital was reduced by a par value of 34,760,964 euros. Article 5 of the Corporate bylaws was reworded accordingly, to restate share capital at 4,921,130,397 euros as of that date. Likewise, to render null and void the right of opposition provided for in Article 166 of the same Law, it was likewise decided, as permitted by Article 167.3 of the Spanish Corporation Law, to record a reserve for cancelled share capital for an amount equal to the par value of the cancelled shares, which can only be used if the same requirements as those applicable to the reduction of share capital are met. The cancelled shares were delisted on June 9, 2005.

#### *Share capital and share premium in 2004*

The detail of the movements in these headings in 2004 was as follows:

| Millions of euros          | Date     | Number<br>of Shares  | Share<br>capital | Share<br>premium |
|----------------------------|----------|----------------------|------------------|------------------|
| <b>Balance at 01-01-04</b> |          | <b>4,955,891,361</b> | <b>4,955.89</b>  | <b>7,987.14</b>  |
| Cash dividend              | 11/12/04 | -                    | -                | (951.64)         |
| Value of treasury shares   | -        | -                    | -                | (1,747.82)       |
| <b>Balance at 12-31-04</b> |          | <b>4,955,891,361</b> | <b>4,955.89</b>  | <b>5,287.68</b>  |



In 2004 the Company did not increase or decrease capital.

### **2005 dividends**

At its meeting of February 23, 2005, Telefónica, S.A.'s Board of Directors resolved to pay an interim dividend against 2004 income entailing a fixed gross 0.23 euros for each of the Company's outstanding shares carrying dividend rights. This dividend was paid on May 13, 2005, and the total amount paid was 1,083.15 million euros.

In addition, on May 31, 2005, shareholders voted a distribution by paying a gross 0.27 per share for each of the Company's outstanding shares eligible at the payment date, charged against "Share premium reserve." This dividend was paid on November 12, 2005, and the total amount paid was 1,296.27 million euros.

At the same meeting shareholders voted to distribute treasury shares from the share premium reserve to Telefónica S.A. shareholders in the proportion of one share for every twenty-five held. This distribution took place on June 28, 2005 giving rise to a 2,571.28 million euro charge against "Share premium reserve."

### **2004 dividends**

On April 30, 2004, an agreement was reached at the Shareholders' Meeting to pay a cash dividend against 2003 income of 0.20 euros per outstanding share. This amount was paid on May 14, 2004, and the total amount paid was 972.53 million euros.

Also on April 30, 2004, shareholders voted to distribute 0.20 euros per outstanding share, charged against the share premium reserve. This amount was paid on November 12, 2004, and the total amount paid was 951.63 million euros.

## **b) Reserves**

### **Legal reserve**

Under the revised Spanish Corporation Law, 10% of income for each year must be transferred to the legal reserve until the balance of this reserve reaches at least 20% of share capital. The legal reserve can be used to increase capital provided that the balance of the remaining reserve does not fall below 10% of the increased share capital amount. Otherwise, until the legal reserve exceeds 20% of share capital, it can only be used to offset losses provided other reserves are insufficient for this purpose.

### **Revaluation reserves**

"Revaluation Reserves" arose as a result of revaluations made from 1946 to 1987 and of the revaluation made pursuant to Royal Decree-Law 7/1996, June 7.

At December 31, 2005 and 2004 the revaluation amounted to contained 1,357.86 million euros.

Revaluation reserves, with no tax effect, may be used to offset future losses that may arise and to increase capital. From January 1, 2007, they may be allocated to unrestricted reserves, provided the capital gain has been realized. The capital gain will be deemed to have been realized in respect of the portion on which amortization has been taken for accounting purposes or when the revalued non current assets have been transferred or retired.

#### **Consolidation reserves**

The movement in this heading corresponds to the prior years' retained earnings.

#### *c) Translation differences on consolidation*

Translation differences relate mainly to the effect of exchange rate fluctuations on the net assets of the companies located abroad after elimination of intergroup balances and transactions (see Note 4-b). They also include exchange rate differences resulting from specific-purpose foreign-currency financing transactions relating to investments in investees and which hedge the exchange rate risk on these investments.

The Company has taken an exemption that allows all translation differences generated up to the IFRS transition date to be reset to zero (see Note 2). The related impact on prior years is recognized in "Consolidation reserves."

Appendix I provides the detail of the contribution by Group companies to the translation differences on consolidation.

#### *d) Own equity instruments*

At December 31, 2005 and 2004, Telefónica group companies held the following shares in the Telefónica, S.A. parent company:

|                             | Number<br>of shares | Euros per share   |               | Market<br>Value | %        |
|-----------------------------|---------------------|-------------------|---------------|-----------------|----------|
|                             |                     | Acquisition price | Trading price |                 |          |
| Treasury shares at 12-31-05 | 136,647,061         | 12.996            | 12.710        | 1,736.78        | 2.77674% |
| Treasury shares at 12-31-04 | 207,245,179         | 11.833            | 13.228        | 2,741.44        | 4.18179% |

Telefónica S.A. owns the only treasury shares in the group. No other group company owns any Telefónica treasury shares.

In 2005 and 2004 the Company bought a total of 230,038,870 and 166,712,310 treasury shares amounting to 2,744.03 million and 2,031.05 million euros, respectively.

In addition, in 2005 the Company sold 48,503,517 shares for a total of 647.45 million euros and used 29,274,686 shares for the Terra Networks S.A. share exchange, 34,760,964 treasury shares for the capital reduction described above (see Note 2) and 188,096,296 treasury shares for the return of the share premium to shareholders through the delivery of treasury shares. The company also granted 1,525 treasury shares to employees under the EN-SOP share option plan (see Note 19).

The underlying carrying amount of treasury shares is recorded under "Own equity instruments" under "Equity" and the difference with respect to cost is recognized in equity under "Other reserves" (unrestricted reserves) and "Share premium."

### e) Equity attributable to minority interests

"Minority interests" represents the share of minority shareholders in the equity and income or loss for the year of fully consolidated Group companies. The movements in this heading of the 2005 and 2004 consolidated balance sheets were as follows:

|  | Millions of euros |
|--|-------------------|
| <b>Balance at 01-01-04</b>                       | <b>2,446.28</b>   |
| Capital contributions and inclusion of companies | 243.62            |
| Income (loss) for the year                       | 309.92            |
| Translation differences                          | (7.97)            |
| Incorporations and exclusion of companies        | (163.97)          |
| Dividends paid                                   | (949.29)          |
| Other movements                                  | 24.12             |
| <b>Balance at 12-31-04</b>                       | <b>1,902.71</b>   |
| Capital contributions and inclusion of companies | 1,346.53          |
| Income (loss) for the year                       | 381.21            |
| Translation differences                          | 442.44            |
| Incorporations and exclusion of companies        | (304.11)          |
| Dividends paid                                   | (396.35)          |
| Other movements                                  | 52.71             |
| <b>Balance at 12-31-05</b>                       | <b>3,425.14</b>   |

Appendix IV provides details of this heading and the movements affecting the main Group companies.

### 2005

Changes in minority interests in 2005 included the first-time consolidation of Cesky Telekom (1,197.80 million euros), the acquisition of 23.20% of Terra Networks (300.35 million euros) following the takeover bid, and profit for the year attributable to minority interests (381.21 million euros).

### 2004

The main movements in minority interests in 2004 were those relating to the distribution of dividends by Telefónica Empresas CTC Chile, S.A., Terra Networks, S.A. and Telesp Participações, S.A.

### f) Legislation regulating the sale of holdings

Law 62/2003, December 30, on Tax, Administrative, Labor and Social Security Measures, based on the judgment of the European Court of Justice of May 13, 2003, amended the administrative authorization system set out in Law 5/1995, March 23, on the legal regime applicable to the disposal of public shareholdings in certain companies, to which certain corporate transactions and agreements of Telefónica S.A., Telefónica Móviles S.A., Telefónica Móviles España, S.A.U. and Telefónica de España, S.A.U. are subject pursuant to Royal Decree 8/1997, January 10.

The reform introduced a new model for administrative involvement, replacing the system of prior authorization with that of subsequent notification. The cases that must be notified were also reduced.

Specifically, provided no change in control occurs, it is now no longer necessary to notify the sale or encumbrance of shares representing up to 50% of the share capital in transactions concerning (i) Telefónica S.A.'s shares in Telefónica de España S.A.U., (ii) Telefónica S.A.'s shares in Telefónica Móviles S.A. and (iii) Telefónica Móviles S.A.'s shares in Telefónica Móviles España S.A.U.

Notification is still required, however, for any direct, indirect or triggered acquisition, even through third-party trusts or third parties intermediaries, of shares in Telefónica S.A. or in Telefónica Móviles S.A. when they result in the disposal of at least 10% of the share capital. However, cases constituting mere financial transactions that do not have as their objective the control and/or management of these companies are excluded.

In addition, the disposal or encumbrance by Telefónica de España and Telefónica Móviles España of certain strategic assets located in Spain still have to be notified, except when these transactions are carried out between Group companies.

Pursuant to the reasoned opinion sent by the European Commission to the Spanish government on November 25, 2005, the Spanish Cabinet approved a bill to do away with this framework for the disposal of publicly-owned holdings in certain companies. If passed, this bill would bring forward the end of this system, which in Telefónica's case was scheduled to finish on February 18, 2007.

## (12) Interest-bearing Debt and Loans

The detail of this heading in the years ending December 31, 2005 and 2004 is as follows:

|                          | Balance at<br>12-31-05 | Balance at<br>12-31-04 |
|--------------------------|------------------------|------------------------|
| Millions of euros        |                        |                        |
| Issues                   | 15,834.07              | 16,668.06              |
| Interest-bearing debt    | 18,569.38              | 11,034.57              |
| <b>Total</b>             | <b>34,403.45</b>       | <b>27,702.63</b>       |
| <b>Total non-current</b> | <b>25,167.58</b>       | <b>17,492.23</b>       |
| <b>Total current</b>     | <b>9,235.87</b>        | <b>10,210.40</b>       |

## a) Issues

### Debentures, bonds and other marketable securities

The detail of the movements in the balances relating to issues of debentures, bonds and other marketable debt securities in the years ended December 31, 2005 and 2004 were as follows:

| Millions of euros                      | Simple domestic-currency issues | Simple foreign-currency issues | Promissory notes & Commercial paper programs | Other marketable debt securities | Total            |
|--|---------------------------------|--------------------------------|--|----------------------------------|------------------|
| <b>Balance at 21-31-2004</b>           | <b>7,556.99</b>                 | <b>5,235.25</b>                | <b>1,890.47</b>                              | <b>1,985.35</b>                  | <b>16,668.06</b> |
| New issues                             | 22.33                           | 852.82                         | 4,615.08                                     | 17.09                            | 5,507.32         |
| Redemptions, conversions and exchanges | (2,296.96)                      | (1,399.56)                     | (4,043.57)                                   | 0.07                             | (7,740.02)       |
| Restatements and other movements       | 193.95                          | 1,157.63                       | 35.97  | 11.16                            | 1,398.71         |
| <b>Balance at 12-31-2005</b>           | <b>5,476.31</b>                 | <b>5,846.14</b>                | <b>2,497.95</b>                              | <b>2,013.67</b>                  | <b>15,834.07</b> |
| Maturity:                              |                                 |                                |  |                                  |                  |
| Long term                              | 3,907.99                        | 5,466.20                       | –  | 2,013.67                         | 11,387.86        |
| Short term                             | 1,568.32                        | 379.94                         | 2,497.95                                     | –                                | 4,446.21         |

The main issues in 2005 were as follows (in millions of euros):

Issues by Telefónica de Argentina, S.A.:

| Item                  | Date       | Face value (millions) | Currency | Maturity | Interest rate    |
|-----------------------|------------|-----------------------|----------|----------|------------------|
| Marketable debentures | 02/08/2005 | 29.03                 | ARS      | 02/11/06 | 8.00%            |
| Marketable debentures | 02/08/2005 | 13.98                 | ARS      | 02/11/07 | SURVEY + 2.5 (*) |

Issues by Telefónica del Perú, S.A.A.:

| Item  | Date       | Face value (millions) | Currency | Maturity | Interest rate |
|---|------------|-----------------------|----------|----------|---------------|
| Bonds T. Perú 3 <sup>rd</sup> Program (5 <sup>th</sup> -Series A) | 01/12/2005 | 16.85                 | PEN      | 01/12/07 | 5.50%         |
| Bonds T. Perú 3 <sup>rd</sup> Program (6 <sup>th</sup> )          | 03/07/2005 | 24.69                 | PEN      | 12/07/06 | 5.19%         |
| Bonds T. Perú 3 <sup>rd</sup> Program (7 <sup>th</sup> )          | 04/20/2005 | 17.28                 | PEN      | 10/20/06 | 5.50%         |
| Bonds T. Perú Senior Notes  | 10/11/2005 | 186.16                | PEN      | 04/11/16 | 8.00%         |

Issues by Telefónica Finanzas México:

| Item                                 | Date       | Face value (millions) | Currency | Maturity | Interest rate   |
|--------------------------------------|------------|-----------------------|----------|----------|-----------------|
| Certificados bursátiles – peso bonds | 09/30/2005 | 275.28                | MXN      | 09/24/10 | CETES 91 + 0.61 |
| Certificados bursátiles – peso bonds | 09/30/2005 | 117.8                 | MXN      | 09/21/12 | 9.25            |

Issues by Brasilcel:

| Item                 | Date       | Face value (millions) | Currency | Maturity | Interest rate |
|----------------------|------------|-----------------------|----------|----------|---------------|
| Nonconvertible bonds | 05/01/2005 | 144.86                | BRL      | 05/01/10 | 104.2% CDI    |
| Nonconvertible bonds | 05/01/2005 | 36.21                 | BRL      | 05/01/09 | 103.3% CDI    |

The main issues in 2004 were as follows (in millions of euros):

Issues by Telefónica de Argentina, S.A.:

| Item                  | Date       | Face value (millions) | Currency | Maturity | Interest rate            |
|-----------------------|------------|-----------------------|----------|----------|--------------------------|
| Marketable debentures | 05/05/2004 | 40.24                 | ARS      | 05/06/05 | 8.05%                    |
| Marketable debentures | 10/28/2004 | 33.23                 | ARS      | 10/28/05 | 8.25%                    |
| Marketable debentures | 10/28/2004 | 16.06                 | ARS      | 05/02/06 | Floating BADLAR+2.4% (*) |

(\*) 15% ceiling and 7% floor

Issues by Telesp Celular Participações, S.A.:

| Item                  | Date     | Face value<br>(millions) | Currency | Maturity | Interest rate  |
|-----------------------|----------|--------------------------|----------|----------|----------------|
| Marketable debentures | 09/01/04 | 414.87                   | BRL      | 09/01/07 | 103.5% CDI (*) |

(\*) Brazilian interbank deposit rate.

Issues by Telefónica de Perú, S.A.A. under its bond programs:

| Item  | Date     | Face value<br>(millions) | Currency | Maturity | Interest rate |
|---|----------|--------------------------|----------|----------|---------------|
| T. Perú 3 <sup>rd</sup> Program (2 <sup>nd</sup> -Series A) | 04/20/04 | 6.71                     | PEN      | 04/20/07 | 5.3125%       |
| T. Perú 3 <sup>rd</sup> Program (3 <sup>rd</sup> )          | 06/30/04 | 6.71                     | PEN      | 12/30/07 | 8.1250%       |

### Corporate promissory notes

The features of the main corporate promissory note issue program at December 31, 2005 and 2004 were as follows:

| Millions of euros |                        | Euros      |                                      |
|-------------------|------------------------|------------|--------------------------------------|
| Limit             | Aimed at               | Face value | Method of sale                       |
| 2,000             | Participating entities | 1,000      | 15-day tenders at least once a month |
|                   |                        | 100,000    | Specific transactions                |

The average interest rate on the outstanding position at December 31, 2005, was 2.39% (2.24% at December 31, 2004).

### Commercial paper

The features of Telefónica Europe, BV's commercial paper issue program are as follows:

| Millions of euros |           | Euros           |                       |
|-------------------|-----------|-----------------|-----------------------|
| Limit             | Aimed at  | Face value      | Method of sale        |
| 2,000             | Investors | 500,000 USD     | Specific transactions |
|                   |           | 500,000 EUR     | Specific transactions |
|                   |           | 100,000,000 JPY | Specific transactions |
|                   |           | 100,000 GBP     | Specific transactions |

The average interest rate on the outstanding position at December 31, 2005, was 2.36% (2.27% at December 31, 2004).

In addition, at December 31, 2005 Telefónica del Perú, S.A.A. had a commercial paper issue program with a maximum outstanding limit of 180 million dollars or its equivalent in local currency. As of that date 143 million dollars had not been used, and the remaining 37 million dollars, or its equivalent in local currency, had been drawn down in regular tranches at a weighted average interest rate at December 31, 2005 of 4.40%. At December 31, 2004, 151.8 million dollars had not been used and the remaining 28.2 million dollars or its equivalent in local currency had been drawn down in regular tranches at a 4.55% interest rate.

Telesp has a local bond program, with a maximum limit outstanding of 3,000 million reais, which allows the issue, up to this amount, of commercial paper and local bonds, at any maturity, with interest in reais at fixed rates, floating rates (CDI) or tied to other indices, e.g. inflation (GPI – M or CPI – A). In 2004, 1,500 million reais were drawn down. No amounts were drawn down in 2005, so until the program ends on October 15, 2006 there are still 1,500 million reais available.

Telesp Celular Participações runs a similar program to Telesp in terms of total issuance, maturity and interest rates for up to 2,000 million reais. In 2005 1,000 million were drawn down and further issues up to the remaining value until August 20, 2006, when the program ends.

#### Other marketable debt securities

This heading consists mainly of preference shares issued by Telefónica Finance USA, LLC, with a redemption value of 2,000.00 million euros. These shares were issued in 2002 and have the following features:

- Interest rate up to December 30, 2012 of 3-month Euribor, and maximum and minimum effective annual rates of 7% and 4.25%, respectively, and from then 3-month Euribor plus a 4% spread.
- Interest is paid every three calendar months provided the Telefónica Group obtains consolidated net income.

#### b) Interest-bearing debt

Balances with banks are as follows:

| Millions of euros                          | Balance at 12-31-05 |                  |                  | Balance at 12-31-04 |                 |                  |
|--|---------------------|------------------|------------------|---------------------|-----------------|------------------|
|  | Current             | Non-current      | Total            | Current             | Non-current     | Total            |
| Loans and other payables (principal)       | 4,371.554           | 12,453.50        | 16,825.05        | 3,864.37            | 4,849.39        | 8,713.76         |
| Loans and other payables (interest)        | 48.46               | 12.53            | 60.99            | 43.83               | 3.92            | 47.75            |
| Derivative financial liabilities (Note 15) | 369.65              | 1,313.69         | 1,683.34         | 825.21              | 1,447.85        | 2,273.06         |
| <b>Total</b>                               | <b>4,789.66</b>     | <b>13,779.72</b> | <b>18,569.38</b> | <b>4,733.41</b>     | <b>6,301.16</b> | <b>11,034.57</b> |

The average interest rate on bank overdrafts and loans at December 31, 2005 was 4.35% (5.31% in 2004). This percentage does not include the impact of hedging arranged by the group.

The most significant financial transactions in 2005 and 2004 were as follows:

| Item   | Amount (millions) | Currency | Date     | Maturity |
|--|-------------------|----------|----------|----------|
| Loan to CTC from BBVA                          | 150.00            | USD      | 11/04/05 | 06/21/11 |
| Telefónica, S.A. syndicated loan               | 6,000.00          | EUR      | 06/28/05 | 06/28/11 |
| Loan to CTC from Citibank                      | 150.00            | USD      | 05/09/05 | 12/09/08 |
| Syndicated loan to Tel. Mvles Perú (1)         | 200.00            | USD      | 02/25/05 | 02/24/06 |
| Syndicated loan to Tel. Mvles Chile (2)        | 180.00            | USD      | 01/07/05 | 01/05/11 |
| ABN Amro Bank N.V.                             | 377.08            | USD      | 11/26/04 | 11/15/10 |
| Santander Overseas Bank                        | 273.93            | USD      | 10/28/04 | 10/28/06 |
| Telefónica, S.A. syndicated loan from Citibank | 3,000.00          | EUR      | 07/06/04 | 07/06/09 |

(1) This syndicated loan was originally arranged with a number of financial institutions, the first tranche (30 million dollars) on November 28, 2003 and the remaining two tranches (totaling 170 million dollars) on December 8, 2003; i.e. before the acquisition of BellSouth's operators in Peru. The entire amount was renewed on February 25, 2005 until maturity on February 24, 2006, to which the guarantee of Telefónica, S.A. was added. On August 25, 2005, 40 million dollars were prepaid, leaving an outstanding balance at the end of 2005 of 160 million dollars.

(2) This syndicated loan was originally signed on April 22, 1997 by BellSouth; i.e. before Telefónica acquired its operators in Chile. Accordingly, on January 7, 2005 it was modified due to the change in the shareholder structure deriving from the acquisition and including Telefónica, S.A.'s guarantee. A one-year maturity was established from this date. On December 29, 2005 the terms were renegotiated again to remove Telefónica, S.A. as an underwriter and extend the maturity to five years, until January 5, 2011.

Compañía de Telecomunicaciones de Chile concluded the renegotiation of its two syndicated loans in 2005, originally arranged for 180 and 225 million dollars. The maturity of the first, now for 150 million dollars, has been extended from April 2007 to December 2008 and has been adjusted to market rates. The second, also for 150 million dollars, has been rescheduled and rather than maturing in April 2008, with partial repayments from April 2006, now matures in June 2011, with the spread adjusted to market conditions.



On June 28, 2005 Telefónica S.A. arranged a 6,000 million euro syndicated loan with 40 Spanish and international financial institutions maturing June 28, 2011. The loan is denominated in euros and can be drawn down in either euros, US dollars, UK pound sterling, yen, Swiss francs or any other currency subject to prior agreement by the banking institutions. By the end of 2005, the entire amount had been drawn down in various stages.

On November 26, 2004, Telefónica, S.A. and several branches of ABN Amro Bank N.V. entered into a credit facility agreement amounting to 377.08 million dollars underwritten by the export credit agencies of Finland ("Finnvera") and Sweden ("EKN"), bearing fixed interest of 3.26% and with final maturity on November 15, 2010. This financing will cover up to 85% of the purchases of network equipment to be made by Telefónica Móviles Group companies from Ericsson and Nokia.

In addition, Santander Overseas Bank granted financing of 273.93 million dollars, underwritten by Telefónica, S.A., to Telefónica Móviles' subsidiary in Colombia to refinance its debt. The financing bears a floating interest rate tied to three-month Libor plus a spread of 0.125%. This amount was renewed in October 2005.

On July 6, 2004, Telefónica arranged a 3,000 million euro syndicated loan with several Spanish and foreign banks. This loan matures in five years (July 6, 2009) and bears interest of Euribor/Libor plus a spread based on the Company's credit rating. The commitments and obligations of the parties are those ordinarily assumed in syndicated financing transactions. In 2005, 1,300 million euros and 392 million dollars were drawn down and in 2004, 500 million euros and 760 million dollars.

The main repayments made in 2005 and 2004 were as follows:

| Item  | Amount<br>(millions) | Currency | Date     |
|---|----------------------|----------|----------|
| Telefónica, S.A. loan from BSCH                     | 135.23               | EUR      | 11/25/05 |
| CTC loan from ABN (*)                               | 150.00               | USD      | 11/04/05 |
| Telefónica, S.A. loan from BSCH                     | 97                   | EUR      | 07/07/05 |
| Telefónica, S.A. loan from BSCH                     | 50.35                | EUR      | 03/17/05 |
| Repayment of BSCH syndicated loan (Tranche A)       | 254.25               | EUR      | 02/19/04 |
| Early repayment of BSCH syndicated loan (Tranche A) | 120.00               | EUR      | 01/30/04 |

(\*) This loan was refinanced by BBVA as indicated in the table of main financial transactions.

In 2004, Telefónica, S.A. made an early repayment and a prepayment on the 1,200 million euro syndicated loan arranged in 1999 with several financial institutions, the first amounting to 120 million euros on January 30 and the second amounting to 254.25 million euros on February 19. Both were made to Banco Santander Central Hispano (BSCH) from the A tranches of the syndicated loan.

Some of the financing arranged by various Telefónica group companies is subject to compliance with certain financial covenants. All the covenants were being complied with at the date these consolidated financial statements were drawn up.

The maturity schedule of interest-bearing debt at December 31, 2005 is as follows:

| Millions of euros                |                 |                 |                 |                 |                |                  |                  |
|----------------------------------|-----------------|-----------------|-----------------|-----------------|----------------|------------------|------------------|
| Item                             | 2006            | 2007            | 2008            | 2009            | 2010           | Subsequent years | Total            |
| Loans and other payables         | 4,371.55        | 1,121.45        | 1,035.10        | 3,214.90        | 285.76         | 6,796.29         | 16,825.05        |
| Interest payable                 | 48.46           | 12.51           | 0.02            | –               | –              | –                | 60.99            |
| Financial derivative liabilities | 369.65          | 166.18          | 221.52          | 51.34           | 763.20         | 111.45           | 1,683.34         |
| <b>Total</b>                     | <b>4,789.66</b> | <b>1,300.14</b> | <b>1,256.64</b> | <b>3,266.24</b> | <b>1048.96</b> | <b>6,907.74</b>  | <b>18,569.38</b> |

At December 31, 2005 the Telefónica Group had total financial facilities available from all sources of over 4,500 million euros (7,500 million euros at December 31, 2004), plus options to reschedule various existing finance facilities. It also had a 18,000 million pounds sterling syndicated loan arranged but not yet drawn related to the O2 takeover (see Subsequent Events - Note 22).

### Foreign-currency loans

The detail of foreign-currency loans at December 31, 2005 and 2004, along with the equivalent value in euros, is as follows:

| Outstanding balance (in millions) |          |          |                 |                 |
|-----------------------------------|----------|----------|-----------------|-----------------|
| Currency                          | Currency |          | Euros           |                 |
|                                   | 12-31-05 | 12-31-04 | 12-31-05        | 12-31-04        |
| US dollars                        | 5,892    | 4,540    | 4,415.39        | 3,305.50        |
| Brazilian reais                   | 530      | 877      | 96.45           | 242.27          |
| Argentine pesos                   | 129      | 191      | 36.20           | 47.06           |
| Colombian pesos                   | 120,017  | 90,172   | 44.53           | 27.77           |
| Yen                               | 46,616   | 45,488   | 267.65          | 351.55          |
| Chilean pesos                     | 67,057   | 125,363  | 110.65          | 165.48          |
| New soles                         | 507      | 363      | 125.35          | 81.21           |
| Pound sterling                    | 1        | –        | 2.35            | 0.06            |
| Mexican pesos                     | 42       | 109      | 3.34            | 7.13            |
| Other currencies                  | –        | –        | 15.94           | 6.56            |
| <b>Group total</b>                | <b>–</b> | <b>–</b> | <b>5,177.85</b> | <b>4,234.59</b> |

## (13) Trade and other Payables

The detail of this heading is as follows:

| Millions of euros           | 12-31-05        |                 | 12-31-04        |                 |
|-----------------------------|-----------------|-----------------|-----------------|-----------------|
|                             | Non-current     | Current         | Non-current     | Current         |
| Trade creditors             | –               | 6,911.97        | –               | 5,553.09        |
| Advances received on orders | –               | 20.95           | –               | 79.18           |
| Other payables              | 438.21          | 1,922.61        | 533.58          | 1,422.93        |
| Deferred revenues           | 690.00          | 818.28          | 666.50          | 604.67          |
| Payable to associates       | –               | 44.75           | –               | 36.18           |
| <b>Total</b>                | <b>1,128.21</b> | <b>9,718.56</b> | <b>1,200.08</b> | <b>7,696.05</b> |

The breakdown of current and non-current deferred revenues at December 31, 2005 and 2004 is as follows:

| Millions of euros                           | 12-31-05      |               |                 | 12-31-04      |               |                 |
|---|---------------|---------------|-----------------|---------------|---------------|-----------------|
|   | Non-current   | Current       | Total           | Non-current   | Current       | Total           |
| Connection fees and other Deferred revenues | 616.05        | 818.28        | 1,434.33        | 564.81        | 604.67        | 1,169.48        |
| Capital grants                              | 73.95         | –             | 73.95           | 101.69        | –             | 101.69          |
| <b>Total</b>                                | <b>690.00</b> | <b>818.28</b> | <b>1,508.28</b> | <b>666.50</b> | <b>604.67</b> | <b>1,271.17</b> |

The amount recognized for connection fees covers the amount of customer connection charges not yet taken to the income statement. It will be recognized as income over the remaining estimated period of the customer relationship.

The 2005 consolidated income statement includes 42.30 million euros under "Sales and revenues from services" in respect of connection fees deferred from previous years.

Deferred connection fees levied in 2005 were 32.94 million euros.

Capital grants:

The detail of capital grants not yet recognized in income is as follows:

Millions of euros

| <b>Grantor</b>                            | <b>12-31-05</b> | <b>12-31-04</b> |
|---|-----------------|-----------------|
| Government and regional bodies            |                 |                 |
| provincial and municipal governments etc. | 8.14            | 13.78           |
| <b>EU</b>                                 |                 |                 |
| ERDF 94/99 Program                        | 38.33           | 84.18           |
| ERDF 00/06 Program                        | 26.16           | –               |
| Other                                     | 1.32            | 3.73            |
| <b>Total</b>                              | <b>73.95</b>    | <b>101.69</b>   |

The detail of "Other payables - Current" at December 31, 2005 and 2004 is as follows:

|  | <b>Balance at<br/>12-31-05</b> | <b>Balance at<br/>12-31-04</b> |
|--|--------------------------------|--------------------------------|
| Dividends payable by Group companies                   | 255.81                         | 148.53                         |
| Payables to suppliers of property, plant and equipment | 408.94                         | 390.48                         |
| Guarantees and deposits                                | 39.03                          | 45.66                          |
| Unpaid employee compensations                          | 620.93                         | 443.13                         |
| Other non-financial non-trade payables                 | 597.90                         | 395.13                         |
| <b>Total</b>   | <b>1,922.61</b>                | <b>1,422.93</b>                |

## (14) Provisions

The detail of the movements in "Non-current provisions" in 2005 and 2004 is as follows:

| Millions of euros   | <b>Balance at<br/>12-31-04</b> | <b>Additions</b> | <b>Retirements/<br/>Amount<br/>applied</b> | <b>Inclusion of<br/>companies</b> | <b>Transfers<br/>and other</b> | <b>Balance at<br/>12-31-05</b> |
|---------------------|--------------------------------|------------------|--|-----------------------------------|--------------------------------|--------------------------------|
| Employee benefits   | 2,501.49                       | 122.66           | (543.66)                                   | 0.45                              | 8.64                           | 2,089.58                       |
| Services rendered   | 159.18                         | 23.42            | (15.84)                                    | –                                 | (7.20)                         | 159.56                         |
| Staff restructuring | 2,744.84                       | 689.98           | (429.98)                                   | –                                 | 16.63                          | 3,021.47                       |
| Other provisions    | 2,002.15                       | 147.88           | (284.62)                                   | 100.81                            | (883.59)                       | 1,082.63                       |
| <b>Total</b>        | <b>7,407.66</b>                | <b>983.94</b>    | <b>(1,274.10)</b>                          | <b>101.26</b>                     | <b>(865.52)</b>                | <b>6,353.24</b>                |

| Millions of euros   | <b>Balance at<br/>1-1-04</b> | <b>Additions</b> | <b>Retirements/<br/>Amount<br/>applied</b> | <b>Inclusion of<br/>companies</b> | <b>Transfers<br/>and other</b> | <b>Balance at<br/>12-31-04</b> |
|---------------------|------------------------------|------------------|--|-----------------------------------|--------------------------------|--------------------------------|
| Employee benefits   | 2,867.49                     | 191.43           | (577.98)                                   | 26.44                             | (5.68)                         | 2,501.49                       |
| Services rendered   | 150.03                       | 26.76            | (17.62)                                    | –                                 | –                              | 159.18                         |
| Staff restructuring | 2,322.20                     | 778.18           | (376.04)                                   | –                                 | 20.50                          | 2,744.84                       |
| Other provisions    | 2,044.33                     | 206.42           | (207.35)                                   | 9.80                              | (50.95)                        | 2,002.15                       |
| <b>Total</b>        | <b>7,384.05</b>              | <b>1,202.79</b>  | <b>(1,178.99)</b>                          | <b>36.24</b>                      | <b>(36.13)</b>                 | <b>7,407.66</b>                |

The main provisions and commitments to employees recorded under this consolidated balance sheet heading are as follows.

## Employee benefits

Detail of provisions for employee benefits:

| Millions of euros                   | 12-31-05        | 12-31-04        |
|-------------------------------------|-----------------|-----------------|
| Supplementary employee pensions (a) | 1,923.45        | 2,345.06        |
| Group life insurance (b)            | 11.96           | 12.63           |
| Technical reserves (c)              | 154.17          | 143.80          |
| <b>Total</b>                        | <b>2,089.58</b> | <b>2,501.49</b> |

- a) On July 8, 1992, Telefónica de España reached an agreement with its employees whereby it recognized supplementary pension payments for employees who had retired before June 30, 1992, equal to the difference between the pension payable by the social security system and that which would be paid to them by ITP (Institución Telefónica de Previsión). Once the aforementioned supplementary pension payments had been quantified, they became fixed, lifelong and nonupdateable. 60% of the payments are transferable to the surviving spouse recognized as such as of June 30, 1992, and to underage children. Remaining employees and employees hired after June 30, 1992 have a defined-contribution plan with a fixed contribution of 4.51% of their regulatory base salary plus at least a 2.21% obligatory contribution by the participating employee. There is no provision whatsoever for this plan as it has been externalized in external funds.
- b) Serving employees who did not join the pension plan continue to be entitled to receive survivorship benefits at the age of 65.
- c) Reserves relating to the insurance policies taken out to cover early retirement of employees who availed themselves of the labor force reduction plans implemented by Telefónica de España in the past and which were externalized.

The companies bound by these commitments calculated provisions required at 2005 year end using actuarial assumptions pursuant to current legislation, including the PERM/F-2000 C mortality tables and a variable interest rate based on market yield curves.

In addition, group subsidiary Telecomunicações de São Paulo, S.A. (Telesp) had various pension plan, medical insurance and life insurance commitments with its employees. In 2000, this company and other companies which were formerly included in the Telebras telecommunications system in Brazil entered into negotiations with their employees. The negotiations ended in October 2000 with the conversion of the former defined-benefit pension plan into a new defined-contribution pension plan and the elimination of the life insurance plan. Virtually all serving employees of these companies availed themselves of the new plan. The liability recorded at December 31, 2005, for this item, which amounted to 16.3 million euros, relates to the accrued commitments to be covered through future payments, net of the value of assets covering them (12.3 million euros in 2004).

At December 31, 2005, Telefónica de Argentina and CTC Chile had commitments of 50.4 million euros (compared to 45.2 million euros in 2004).

The movements in "Transfers and other" in 2005 and 2004 relate mainly to translation differences.

## Services rendered

It corresponds to the amount recorded by Telefónica de España for accrued long-service bonuses to be awarded to employees after 25

years' service (159.18 million euros in 2004). Provisions are updated applying actuarial criteria (PERM / F - 2000C tables) and market yield curves.

## Staff restructuring

In order to adapt to the competitive environment, in prior years Telefónica implemented early retirement and technology renewal plans, in order to adapt its cost structure to the new environment, and made certain strategic decisions relating to its sizing and organization policy.

In this respect, on July 29, 2003, the Ministry of Labor and Social Affairs approved a labor force reduction plan for Telefónica de España that includes up to 15,000 job losses in the period from 2003 to 2007, through voluntary, universal and non-discriminatory programs. The approval of the labor force reduction plan was announced on July 30, 2003. In 2005 and 2004, the Company approved a total of 1,877 and 2,417 requests for voluntary severance, for which provisions amounting to 577.92 million and 706.68 million euros, respectively, were allocated, with a charge to "Personnel expenses" in the consolidated income statement. The outstanding balances at December 31, 2005 and 2004, were 3,021.48 million and 2,744.84 million euros, respectively.

These provisions are calculated based on estimates of future payments applying actuarial criteria (PERM / F - 2000C tables) and market yield curves.

## Other provisions

This item includes a 2,371.46 million euro provision recorded in 2002 for value adjustments to UMTS licenses held by group investees in Germany, Austria, Switzerland and Italy. The balances, net of the amounts used, at the end of 2005 and 2004 were 437.04 million and 1,128.29 million euros, respectively.

The movements in "Other provisions – Non-current" for 2005 include the impact of applying the 632.40 million euro provision at December 31, 2004 due to impairment of the value of Ipse 2000, SpA, to loans and guarantees provided by Telefónica Móviles Group companies and reported under "Non-current financial assets" and "Current financial assets" at a value of 335.45 and 351.03 million euros, respectively.

In addition, certain Group companies, mainly in the Endemol Group, include earn-out clauses in their acquisitions, whereby part of the price is conditional on the newly-acquired company meeting some future target, usually growth in revenue, income, etc. Since a part of the acquisition price is therefore not fixed, estimates are made each year, using variables, some of which may need to be ratified by the sellers, to value the likely liabilities on these transactions and the related goodwill. Amounts provisioned at December 31, 2005, under "Non-current Provisions" and "Current provisions" were 319.22 and 15.60 million euros, respectively (19.15 million and 324.84 million euros, respectively, at December 31, 2004).

Finally, "Other Provisions" in 2005 and 2004 also includes the provisions recorded (or used) by the Group companies to cover the risks inherent to the realization of certain assets, the contingent assets and liabilities derived from their respective business activities and the risks arising from commitments acquired in other transactions.

## (15) Derivatives Financial Instruments and Risk Management Policies

Telefónica Group is exposed to various financial market risks as a result of (i) its ordinary business, (ii) debt taken on to finance its business, (iii) investments in associated companies, and (iv) other financial instruments related to the above commitments.

The main market risks affecting the Group are as follows:

### 1. Exchange rate risk

Exchange rate risks arise mainly from two sources. The first is Telefónica's international presence, through its investments and businesses in countries that use currencies other than the euro. These are largely in Latin America, but also in the Czech Republic and, since 2006, in the UK. The second is debt denominated in currencies other than that of the country where the business is conducted or the home country of the company taking on the debt.

### 2. Interest rate risk

This arises from changes in (i) financial expenses on floating rate debt (or short-term debt likely to be renewed), due to changes in interest rates and (ii) the value of long-term liabilities at fixed interest rates (whose market value rises as interest rates fall).

### 3. Share price risk

This arises from changes in the value of equity investments that may be bought, sold or otherwise involved in transactions, from changes in the value of derivatives associated with such investments, from treasury shares and from equity derivatives.

The Group is also exposed to liquidity risk if a mismatch arises between its financing needs (operating and financial expense, investment, debt redemptions and dividend commitments) and its sources of finance (revenues, divestments, credit lines from financial institutions and capital market operations). The cost of finance could also be affected by movements in the credit spreads (over benchmark rates) demanded by lenders.

Finally, there is so-called "country risk" (which overlaps with market and liquidity risks). This refers to the possible decline in assets, cash flows generated or cash flows returned to the parent company as a result of political, economic or social instability in the countries where Telefónica Group operates, especially in Latin America.

Telefónica Group actively manages these risks with a view to stabilizing:

- cash flows, to facilitate financial planning and take advantage of investment opportunities,
- the income statement, to make it easier for investors to understand and forecast company results,
- share capital, to protect the value of the investment.

Where these aims conflict, the Group's financial management will decide which should be given priority.

Telefónica uses derivatives to manage risks, basically on exchange rates, interest rates and shares.

## *Exchange rate risk*

The core aim of the Group's exchange rate risk management policy is to offset (at least partly) any losses in the value of assets related to Telefónica's business due to declines in exchange rates versus the euro, with savings on the euro value of foreign denominated debt (which will decline simultaneously). The degree of hedging (i.e. the proportion of foreign currency debt as a percentage of foreign currency assets) tends to be higher in the following circumstances:

- the closer the estimated correlation between the value of the asset and the value of the currency,
- the cheaper the estimated cost of hedging, measured as the difference between the additional financial expenses of borrowing in local currency and the expected depreciation in the local currency versus the euro.
- the more liquid the local currency and derivative markets.

In general, the correlation between asset values and the exchange rate is closer when cash flows generated by the asset in the early years of the investment represent a large proportion of its estimated value.

The group's primary method of protecting itself against future depreciation of Latin American currencies versus the euro is to take on debt denominated in Latin American currencies. At December 31, 2005, debt denominated in Latin American currencies was nearly 5,400 million euros. However, this debt is not evenly distributed as a proportion of cash flows generated in each country. Its future effectiveness as a hedge of exchange rate risks therefore depends on which currencies suffer devaluations.

The group further protects itself against declines in Latin American exchange rates affecting its assets through the use dollar denominated debt, either in Spain (where such debt is associated with the investment as long as it is considered to be an effective hedge) and in the country itself, where the market for local currency finance may be inadequate or non-existent. At December 31, the Group had dollar debt equivalent to 2,999 million euros.

The Group also manages exchange rate risk by seeking to minimize the negative impact of any remaining exchange rate exposure on the income statement. Such exposure can arise for any of three reasons: (i) a thin market for local derivatives or difficulty in sourcing local currency finance which makes it impossible to arrange a low-cost hedge (as in Argentina for example), (ii) financing through intra-group loans, where the accounting treatment of exchange rate risk is different from that for financing through capital contributions, (iii) as the result of a deliberate policy decision.

In 2005 exchange rate management resulted in gains of 162.0 million euros, mostly because it was decided not to fully hedge the dollar loans granted to Latin American subsidiaries. This resulted in a gain from these currencies' appreciation against the dollar and the dollar's appreciation against the euro.

In addition, in 2005 the Group booked the acquisition of 69.4% of Cesky Telecom for the equivalent of 3,658 million euros. This acquisition was financed from debt, a significant part of which (equivalent to 1,839 million euros) was translated through exchange rate derivatives into synthetic Czech crown debt. This means that a significant part of the acquisition's value remained exposed to the risk of fluctuations in

the crown/euro exchange rate. This position was taken deliberately and reflected the same bullish outlook on the Czech economy that had motivated the acquisition in the first place. Between the acquisition date and December 31, 2005 the crown rose by 3.5% versus the euro.

The acquisition in January 2006 of UK company O2 plc was financed with a multi-currency loan agreed in 2005. The final currency structure of the liabilities from this acquisition will take into account the contribution to O2's value from its euro zone businesses (Germany and Ireland). It will also take account of the imperfect correlation between the value of the UK business and the euro/sterling exchange rate, which makes it inadvisable to fund the purchase wholly in sterling.

### *Interest rate risk*

Telefónica's financial expenses are exposed to changes in interest rates. In 2005, the rates applied to the largest volumes of short-term debt were based on the Euribor, Brazilian SELIC, dollar Libor and Chilean UF. At December 31, 2005, 55% of total debt (or 66% of long-term debt) was at rates fixed for more than one year. Of the remaining 45% (either floating rate or at rates fixed for less than one year) 14% had interest rates capped for more than one year (16% of long-term debt). At December 31, 2004, 83% of long-term debt was at fixed rates. New debt taken on in 2005 has created a new exposure to long-term rates applying at the time of borrowing or hedging, notably, the 6,000 million euro syndicated loan and the associated interest rate swaps used to fix the financial expense.

Finally, early retirement liabilities were discounted to present value over the year using the implied interest rate curve on the swap markets. The decline in interest rates has increased the size of these liabilities.

Finance costs in 2005 were 1,634.33 million euros, 0.3% less than in 2004. Stripping out the impact of exchange rate differences, however, the figures for 2005 and 2004 would be 1,796.4 and 1,462.1 million euros, respectively. This means that, at constant currency, interest expenses were 22.9% higher in 2005 than in 2004. Most of this rise is due to the 18.6% rise in total average net debt to 29,533.9 million euros at December 31, 2005, including early retirement commitments. The rest is due to the rise in Brazilian interest rates (average SELIC of 19.14% in 2005 compared to 16.38% in 2004) and in Latin American debt, following acquisitions of cellular operators in 2004 and the start of 2005. The figure for financial expenses in 2005 gives an average cost of average total net debt of 5.5%, or 6.1% stripping out exchange rate gains.

The acquisition of O2 plc for nearly 17,900 million pounds sterling funded by a syndicated loan that was then refinanced, will raise the Group's interest rate exposure and introduce a new exposure to sterling. In January 2006 Telefónica issued long-term bonds for 4,000 million euros and 1,250 million pounds sterling with the aim of extending the average maturity of its debt. Interest rates were fixed at similar levels to those used to value the newly acquired O2 (see Subsequent Events - Note 22).

### *Share price risk*

One of the equity risks to which Telefónica is exposed is on the price of its own share. This arises from the share buyback program notified in October 2003 and renewed in April 2005, for a value estimated at

6,000 million euros to 2007 (inclusive), which depends on the generation of cash flows and on the share price.

At December 31, 2005, Telefónica S.A. held more than 136 million treasury shares (see Note 11) and had call options on 56 million more, expiring in the first four months of 2006. This option strategy affords some protection against a rise in share price that would reduce the number of shares it could buy with the preallocated funds. The maximum possible financial loss given the strategy in place is the premium on the options, if the share price is lower than the option strike price at maturity. On the other hand, in such a case Telefónica could buy shares more cheaply on the market.

Telefónica is also exposed to fluctuations in the share price of its investees, especially where these fall outside its core business and could be sold.

### *Liquidity risk*

Telefónica seeks to match the schedule for its debt maturity payments to its capacity to generate cash flows to pay them, allowing some leeway. In practice this translates into two key principles:

1. Group debt must have a longer average maturity than the time it will take to earn the cash to pay it (assuming internal projections are met, and all cash flows generated go to pay down debt rather than on dividends or acquisitions).
2. The Group must be able to pay all commitments over the next 12 months without recourse to new borrowing or the capital markets (although including firm credit lines arranged with banks), assuming budget projections are met.

At December 31, 2005, the average maturity of the Group's 30,066.9 million euros net financial debt was 5 years. As announced at the conference held for investors in April 2005, Telefónica Group expects to generate more than 36,000 million euros in the four years from 2005-2008, assuming exchange rates remain at their 2004 levels. This therefore fulfils the first of the two principles: the Group can repay all its debt in less than four years, which is earlier than its average maturity date.

In addition, gross debt maturing in 2006 (8,824 million euros) is less than the financing available. Financing available is calculated as the sum of: i) financing available at December 31 of 3,561 million euros (current financial investments of 1,348 million euros and 2,213 million euros in cash), ii) forecast cash flow for 2006 (expected to be higher than in 2005 at 6,975 million euros), iii) unused credit lines arranged with banks whose initial maturity is over one year or extendible at Telefónica Group's option (3,029 million euros at December 31 including Cesky Telecom and Endemol, B.V.), iv) 1,264 million euros in credit lines with an initial maturity of over one year or extendible at Telefónica's option that were used to buy shares in O2 plc, transferable to the 18,500 million pounds sterling syndicated loan put in place to fund the O2 acquisition. This structure allows sufficient leeway for the company to maintain its current dividend distribution policy and its share buyback program.

The O2 plc acquisition makes it appropriate to analyze liquidity beyond 2006 and estimate possible additional sums maturing in 2007. After exercise of the extension option these could be 2,175 million pounds sterling (around 3,175 million euros). This is because it has been possible



to cancel part of the syndicated loan arranged to make the acquisition (see Note 22) due to, i) an adjustment in the cost of acquisition to near 17,900 million pounds sterling, ii) requests to exchange O2 shares for loan notes, and iii) the January 2006 long-term bond issue which raised 4,000 million euros and 1,250 million pounds sterling. The size of the loan was therefore reduced to 14,175 million of pounds which only 2,175 million cannot be extended beyond October 2007.

In addition, nearly 2,400 million euros of long-term debt is due to mature in 2007, giving a figure of around 5,500 million euros, similar to net maturities in 2006 (gross maturities less cash). This figure will change, however, as a result of the refinancing scheduled for 2006, which will have two contradictory impacts:

- an increase in maturities in 2007 due to short-term renewal of part of the debts maturing in 2006 (especially commercial paper) and
- a reduction in 2007 maturities due to the raising of long-term finance (bonds and loans) largely to pay off the syndicated loan taken out to acquire O2 plc.

The use of long-term finance exposes the Group to financial market risks both in terms of volumes and expense. Fluctuations in financial expense are due not only to changes in benchmark rates (on sovereign bonds and swap rates) but also to changes on the credit spread paid over these benchmarks.

That said, given the scale of 2007 maturities, the Group should be able to meet its second principle – to cover its 12-month commitments with available finance – at the end of 2006, assuming operations generate cash flow as expected.

The O2 acquisition has also made it more important to be able to access credit rapidly, cheaply and on good terms.

To do this Telefónica has defined two targets as key to its financial policy:

1. To maintain a minimum credit rating of BBB+/Baa1,
2. To maintain net debt and similar financial commitments equal to or less than 2.5 times OIBDA (operating income before depreciation and amortization) in the medium term.

The group is currently rated BBB+ by Standard & Poor's, Baa1 by Moody's and A- by Fitch. Pro-forma analysis using unaudited data to September 2005 (as though the O2 acquisition had already taken place by then) shows a net financial debt level of 3 times OIBDA.

The main credit ratings at the end of 2005<sup>1</sup> are as follows:

| Unaudited figures | 2005 operating highlights                                  |          |
|-------------------|--|----------|
| I                 | OIBDA  | 15,276.4 |
| II                | Free cash flow   | 7,108.1  |
| III               | Capex  | 4,409.9  |
| IV                | Telefónica S.A. dividends                                  | 2,379.5  |
| V = II + III-IV   | Retained cash flow (before capex)                          | 9,138.5  |
| VII               | Pro-forma OIBDA  | 15,733.1 |
|                   | <b>Liabilities at December 31, 2005</b>                    |          |
| A                 | Interest-bearing debt                                      | 30,067.0 |
| B                 | Guarantees   | 449.0    |
| C                 | Net commitment from labor force reduction                  | 3,057.7  |
| D = A + B + C     | Total debt + Commitments                                   | 33,573.7 |
|                   | Financial ratios   |          |
|                   | Interest-bearing debt/Pro-forma OIBDA                      | 1.91     |
|                   | Total Debt + Commitments/Pro-forma OIBDA                   | 2.13     |
|                   | Retained cash flow (before capex)/Total Debt + Commitments | 27.23%   |

Deducting the amount spent on O2 shares in 2005 reduces debt to 28,803 million euros. This would improve debt/pro-forma OIBDA ratios by 0.08 percentage points and cash flow/total debt + commitments by 1.07 percentage points.

### Country risk

Latin American sovereign risk priced into the market at the end of 2005 was less than 280bps, an all-time low<sup>2</sup>, due to a number of macroeconomic developments. GDP grew by over 4% in 2005, continuing a trend of high and stable growth that has seen per capita income in the region rise by 11% since 2003, its highest growth rate since the 1970s. In addition, this growth has occurred with no rise in inflation (6%) and, most importantly, with the current account showing a record surplus of 30,000 million US dollars.

True, the favorable climate of international growth and high raw materials prices have produced clear improvements in the region's terms of trade (31% above the 1990s average), helping drive export growth of near 10%. This inflow of export earnings has been accompanied by a sharp rise in remittances from expatriate workers to 47,400 million dollars.

The current account surplus, equal to 1.3% of GDP, has been further strengthened by 47,000 million dollars of direct foreign investment. This has made it possible to cancel 42,000 million dollars of foreign debt and accumulate 35,000 million dollars in international reserves, the highest level since 1990. In other words, the region has taken advantage of the favorable climate to address its weakest points of external vulnerability: high foreign debt and low reserves.

In addition, some regional governments have taken advantage of recent surplus liquidity and appetite for emerging market risk to swap external debt for domestic debt on favorable terms (Argentina, Colombia and Peru) or to redeem debt issued on foreign markets (Argentina, Brazil, Mexico, Panama and Peru) and thereby increase debt maturities in the long term and the percentage of foreign debt denominated in local currency (especially in Mexico and Brazil).

1. Credit rating agencies also adjust ratios to take into account operating leases and other commitments.

2. Source: JP Morgan EMBI.

These measures – designed to bring the region's credit rating up to investment grade – have been reflected in the lowest levels of country risk ever discounted by the markets, a 4% increase in the real trade-weighted exchange rate of the region versus the rest of the world and lower ratios of public borrowing to GDP (42.9%). This in turn has boosted investor confidence and allowed a return to the historical high levels of investment of 1998 (near 23% of GDP), before the slump that lasted until 2002.

Although the macro-economic scenario looks stable and the economic policies being followed seem to us appropriate, Latin America still presents a number of micro-economic risks that distinguish it from the more developed countries. These notably include regulations, a bureaucratic way of doing business and rigid markets for some factors of production. These prevent the continent achieving higher levels of growth through investment and productivity. Also there needs to be greater change to the tax, education and health systems to build on the human development achieved in the last few years if the region is to meet the World Bank's Millennium Development Goals.

Despite the improved economic climate mentioned above and the positive outlook for the region, Telefónica continues to monitor carefully the risk of unforeseen impairments to the value of its Latin American assets from possible social, economic or political instability. It has done this by pursuing two lines of action (in addition to its normal business practices):

1. By partly matching assets to liabilities in its Latin American companies, not guaranteed by the parent company, such that any loss of the assets would also reduce liabilities,
2. By repatriating funds generated in Latin America where there seems to be no adequately profitable opportunity to reinvest them in the future business development in the region.

Regarding this first point, Telefónica's Latin American companies now have external net debt unguaranteed by the Spanish companies of 2,716 million euros, 9% of the Group's total net financial debt, with Brazil (1,583 million euros) and Argentina (760 million euros) particularly prominent.

Some ex-BellSouth companies had other debt guaranteed by Telefónica S.A. left over from the acquisition process. Part of this has now been refinanced without guarantees. In December 2005, for instance, the Chilean mobile subsidiary agreed a credit of nearly 180 million dollars (without parent company guarantees) to replace another similar-sized loan guaranteed by Telefónica S.A. This was included in the total external debt without recourse in Latin America (although the replacement actually took effect at the start of January). In addition, Telefónica's Peruvian mobile subsidiary refinanced a 200 million dollar loan, originally underwritten by Telefónica S.A., in the course of 2005 and at the start 2006, without guarantee from the parent company, for its outstanding balance at December 31 of 163 million dollars (not included in non-recourse Latin American debt at December 31).

In addition, exceptionally, Telefónica S.A. guaranteed a *certificados bursátiles* (peso bond) issuance program for up to 12,000 million Mexican pesos by its indirect subsidiary Telefónica Finanzas de México, S.A. de C.V. The amount issued under this program at December 31, 2005 came to 5,000 million pesos. Subsequent issues have raised this to 11,500 million pesos. The figure given for non-recourse Latin American

debt includes neither this program nor the total unused cash at December 31. The special factors that led to the guarantee being extended in this case are:

- Difficulties in making contributions from Telefónica Group either in capital (there is a minority shareholder) or in debt (for tax reasons).
- Impossibility of raising sufficient external finance at reasonable cost. This is because the company has embarked on a long expansion phase, which means it is making operating losses due to the heavy marketing spend and investment in infrastructure involved.
- Possibility of legally implementing the guarantee without creating a structural subordination for other Telefónica creditors (from the point of view of the rating agencies).

Regarding the second point – repatriation of funds – Telefónica repatriated a net 1,684 million euros from Latin America (excluding Mexico) in 2005 mostly in dividends (884 million euros) and the rest as interest or repayments on loans to Latin American subsidiaries or management fees. Moving in the other direction, finance continued to flow into Mexico mainly to fund Telefónica Móviles's capex (261 million euros) and OIBDA losses (159 million euros).

Finally, the exposure of Telefónica S.A.'s OIBDA to other countries has altered slightly as a result of final completion of the Bell South subsidiary takeover in early 2005 and the Cesky Telecom purchase. The largest contributors to OIBDA are now the euro zone (61.8%), Brazil (18.5%), Argentina (4.7%), Chile (4.2%), Venezuela (3.9%) and Peru (3.8%). Exposure to the Czech Republic was around 3% of Telefónica Group 2005 OIBDA.

### Derivatives policy

At December 31, 2005, the nominal value of outstanding derivatives with external counterparties came to 58,134.5 million euros. This figure is inflated by the use in some cases of several levels of derivatives applied to the nominal value of a single underlying. For instance, a foreign currency loan can be hedged into floating rate, and then each interest rate period can be fixed using an FRA. Even using such techniques to reduce the position, it is still necessary to take extreme care in the use of derivatives to avoid problems arising through error or a failure to understand the real position and its associated risks.

The Group's derivatives policy emphasized the following points:

#### 1. Derivatives based on a clearly identified underlying.

Acceptable underlying include profits, income and cash flows in either a company's operating currency or another currency. These flows can be contractual (debt and interest payments, settlement of foreign currency payables, etc.), reasonably certain or foreseeable (investment program, future debt issues, commercial paper programs, etc.). The acceptability of an underlying asset in the above cases does not depend on whether it complies with IFRS requirements for hedged items, as is required in the case of certain intra-group transactions, for instance. Parent company investments in subsidiaries with operating currencies other than the euro also qualify as acceptable underlying assets.

Economic hedges, i.e. hedges with a designated underlying asset and which in certain circumstances offset fluctuations in the

underlying asset, do not always meet the requirements and effectiveness tests laid down by the various accounting standards for treatment as hedges. The decision to maintain positions that cease to qualify as effective or fail to meet other requirements will depend on the marginal impact on the income statement and how far this might compromise the aim of a stable income statement. In any event the results are recognized on the income statement.

On this point, in 2004 hedging relationships were adjusted to take into account of the different treatment of certain transactions under IFRS from the previous GAAP, so as to maintain the full economic hedge while limiting the combined impact of the hedge and its underlying in the income statement.

## 2. Matching of the underlying to one side of the derivative.

This matching basically applies to foreign currency debt and derivatives hedging foreign currency payments by group subsidiaries. The aim is to eliminate the risk arising from changes in foreign currency interest rates. Nonetheless, even when the aim is to achieve perfect hedging for all cash flows, the lack of depth to certain markets, especially in Latin American currencies, has meant that historically there have been mismatches between the terms of the hedges and those of the debts they are meant to cover. Telefónica Group's intention is to reduce these mismatches, wherever this does not entail disproportionate transaction costs. Where no perfect match is possible for these reasons the aim is to modify the financial duration of the foreign currency underlying to minimize foreign currency interest rate risk.

Sometimes, the timing of the underlying as defined for derivative purposes may not be exactly the same as the timing of the contractual underlying.

## 3. Identity of the company contracting the derivative and the company that owns the underlying.

Generally, Telefónica aims to ensure that the hedging derivative and the corresponding underlying asset or risk should belong to the same company. Sometimes, however, the holding companies (Telefónica S.A., Telefónica Móviles S.A. and Telefónica International S.A.) have taken out hedges on behalf of a subsidiary that owns the underlying asset. Such transactions fail to meet IFRS hedging criteria and resulting gains or losses are therefore recognized in the income statement. The main reasons for separating the hedge and the underlying asset were possible differences in the legal validity of local and international hedges (as a result of unforeseen legal changes) and the different credit ratings of the counterparties (whether group companies or the banks).

## 4. Capacity to measure the derivative's market value using the valuation systems available to the Group.

Telefónica uses a number of tools to measure and manage risks in derivatives and debt. These include notably Kondor+, licensed by Reuters, which is widely used in financial institutions, and MBRM specialist financial calculator libraries.

## 5. Sale of options only when there is an underlying exposure.

Options can only be sold when: i) there is an underlying exposure (on the balance sheet or associated with a highly probable external cash flow) that would offset the potential loss for the year if the counterparty exercises the option, or ii) the option is part of

a structure in which another derivative offsets any loss. The sale of options is also permitted in option structures where, at the moment they are taken out, the net premium is either positive or zero.

For instance, it would be allowed to sell short-term options on interest rate swaps that entitle the counterparty to receive a certain fixed interest rate, below the level prevailing at the time the option was sold. This would mean that if rates fell and the counterparty exercised its option, Telefónica would swap part of its debt from floating rate to a lower fixed rate and would in addition have received a premium.

## 6. Hedge accounting:

The main risks that may qualify for hedge accounting (i.e. where there is symmetry between the underlying asset and the hedge) are:

- Variations in market interest rates (either money-market rates, credit spreads or both) that affect the value of the underlying asset or the measurement of the cash flows.
- Variations in exchange rates that change the value of the underlying asset in the company's operating currency and affect the measurement of the cash flow in the operating currency.
- Variations in the volatility of any financial variable, asset or liability, that affects either the valuation or the measurement of cash flows on debt or investments with embedded options whether or not these options are separable.
- Variations in the valuation of any financial asset, particularly shares of companies held in the available-for-sale portfolio.

Regarding the underlying asset

- Hedges can cover the whole or part of the value of the underlying asset.
- The risk to be hedged can be for the whole period of the transaction or for only part of the period.
- The underlying asset may be a highly probable future transaction, or a contractual underlying asset (loan, foreign currency payment, investment, financial asset, etc.) or a combination of both that defines an underlying asset with a longer term. This may on occasion mean that hedges have longer terms than the contractual underlying assets that they cover. This happens when Telefónica enters into long-term swaps, caps or collars to protect itself against interest rate rises that may raise the financial expense of its promissory notes, commercial paper and some floating rate loans which mature earlier than their hedges. These floating rate financing programs are highly likely to be renewed and the company commits to this by defining the underlying asset in a more general way as a floating rate financing program whose term coincides with the maturity of the hedge.

Hedges can be of three types:

- Fair value hedges.
- Cash flow hedges. These can be set at any value of the risk to be hedged (interest rates, exchange rates, etc.) or for a defined range (interest rates between 2% and 4%, interest rates above 4%, etc). In this last case, the hedging instrument used is

options and only the intrinsic value of the option is recognized as an effective hedge. Changes in the time value of the option are taken to earnings.

- Hedges on net investment by consolidated subsidiaries. Generally such hedges will be put in place by Telefónica S.A. and the other Group holding companies. Wherever possible, these hedges are implemented through real debt in foreign currency. Often, however, this is not possible as many Latin American currencies are non-convertible making it impossible for non-resident companies to issue local currency debt. It may also be that the debt market in the currency concerned is too thin to accommodate the required hedge (Czech crown, UK pound sterling), or that an acquisition is made in cash with no need for market finance. In these circumstances the Group uses derivatives, either forwards or cross-currency swaps to hedge the net investment. "Pay fixed-rate foreign currency" cross-currency swaps are valued using the forward method (the interest spread and changes in value of the derivative due to movements in interest rates are taken to equity). "Pay floating rate foreign currency" swaps are valued by the spot method (the interest spread and changes in value of the derivative due to movements in interest rates are taken to earnings). As an exception to this general rule, for currencies with high interest spreads to the euro (such as Brazil) the Group opts for short-term structures (around 1 year) and uses the spot method even when it is paying fixed-rate foreign currency, to make the income statement easier to understand. Hedges using forwards are analyzed on a currency by currency basis. Where technical market issues arise or the perception of exchange rate risk changes, the Group may decide to cancel the designation of a position as a hedge early, irrespective of its maturity. Similarly, for hedging positions nearing maturity (less than 3 months) for technical market reasons such as liquidity etc. maturity may be brought forward (by taking an offsetting position or selling the derivative in the market). If it has been decided not to renew the hedge, the designation will be cancelled and the operation can then be treated as effectively the same as the hedge reaching maturity. Otherwise, the hedge can be renewed early, in which case the first hedge's designation is cancelled and the new hedge designated in its stead. Sometimes, a derivative-based hedge may be renewed using foreign currency debt instruments.

interests of each company and those of the Group). The Corporate Finance Department may allow exceptions to this policy where this can be justified, normally when the market is too thin for the volume of transactions required or on clearly limited and small risks. New companies joining the Group as a result of mergers or acquisitions may also need time to adapt.

Hedges can comprise a combination of different derivatives.

There is no reason to suppose management of accounting hedges will be static, with an unchanging hedging relationship lasting right through to maturity. In fact, hedging relationships may change to allow appropriate management that serve the Group's stated principles of stabilizing cash flows, stabilizing net financial income/expense and protecting the Group's share capital. The designation of hedges may therefore be cancelled, before maturity, either because of a change in the underlying asset or because of a change in perceived risk on the underlying asset. Derivatives included in these hedges may be reassigned to new hedges where they meet the effectiveness test and the new hedge is well documented.

The main guiding principles for risk management are laid down by Telefónica Group's Corporate Finance Department and implemented by company CFOs (responsible for balancing the

Details of derivatives contracted by the Group are as follows:

| Millions of euros                                    | Fair<br>value<br>12/31/05 | Notional value<br>Maturity |                 |                 |                     |                   |
|--|---------------------------|----------------------------|-----------------|-----------------|---------------------|-------------------|
|  |                           | 2006                       | 2007            | 2008            | Subsequent<br>years | Total             |
| <b>Derivatives</b>                                   |                           |                            |                 |                 |                     |                   |
| <b>Interest rate hedges</b>                          | <b>(58.73)</b>            | <b>228.60</b>              | <b>318.62</b>   | <b>106.05</b>   | <b>9,605.18</b>     | <b>10,258.45</b>  |
| Cash flow hedges                                     | 69.73                     | 180.93                     | 318.62          | 106.05          | 8,428.64            | 9,034.24          |
| Fair value hedges                                    | (128.45)                  | 47.67                      | –               | –               | 1,256.55            | 1,304.22          |
| <b>Exchange rate hedges</b>                          | <b>729.54</b>             | <b>7,020.84</b>            | <b>77.64</b>    | <b>(342.82)</b> | <b>2,366.50</b>     | <b>9,122.16</b>   |
| Cash flow hedges                                     | 718.96                    | 8,217.20                   | 77.64           | 36.51           | 2,366.50            | 10,697.84         |
| Fair value hedges                                    | 10.53                     | (1,196.36)                 | –               | (379.33)        | –                   | (1,575.69)        |
| <b>Interest and exchange rate hedges</b>             | <b>354.28</b>             | <b>511.16</b>              | <b>404.72</b>   | <b>816.01</b>   | <b>631.55</b>       | <b>2,363.44</b>   |
| Cash flow hedges                                     | 111.39                    | 70.67                      | 52.32           | 481.03          | 224.27              | 828.28            |
| Fair value hedges                                    | 242.89                    | 440.49                     | 352.40          | 334.98          | 407.28              | 1,535.16          |
| <b>Hedge of net investment in foreign operations</b> | <b>127.53</b>             | <b>(904.56)</b>            | <b>(81.06)</b>  | <b>(274.59)</b> | <b>(1,136.37)</b>   | <b>(2,396.58)</b> |
| <b>Derivatives not designated as hedges</b>          | <b>50.55</b>              | <b>(420.72)</b>            | <b>(277.83)</b> | <b>(88.70)</b>  | <b>197.45</b>       | <b>(589.80)</b>   |
| Interest rate  | 13.94                     | (79.03)                    | 110.35          | 87.01           | 226.46              | 344.79            |
| Currency   | 12.60                     | 386.59                     | (214.71)        | (47.84)         | 40.58               | 164.62            |
| Interest and exchange rate                           | 24.01                     | (728.28)                   | (173.47)        | (127.87)        | (69.59)             | (1,099.21)        |

For hedges, the positive amount is in terms of fixed "payment"

For exchange rate hedges, a positive amount means payment of operating vs. foreign currency.

Details of derivative products taken out at December 31, 2005 and 2004 are provided in Appendix VI.

## (16) Tax Matters

### Consolidated tax group

Pursuant to a Ministerial Order dated December 27, 1989, since 1990 Telefónica, S.A. has filed consolidated tax returns for certain Group companies. In 2005, the consolidated tax group comprised 48 companies (54 in 2004).

### Deferred tax assets and liabilities

The detail of the movements in these headings in 2005 and 2004 was as follows:

| Millions of euros                   | Deferred tax assets | Deferred tax liabilities |
|-------------------------------------|---------------------|--------------------------|
| <b>Balance at January 1, 2005</b>   | <b>8,957.14</b>     | <b>1,642.61</b>          |
| Additions                           | 1,838.76            | 788.90                   |
| Disposals                           | (2,696.68)          | (610.48)                 |
| Transfers                           | (57.57)             | 62.77                    |
| Net international movements         | 198.55              | 269.01                   |
| Company movements and others        | 144.47              | 324.63                   |
| <b>Balance at December 31, 2005</b> | <b>8,384.67</b>     | <b>2,477.44</b>          |

| Millions of euros                   | Deferred tax assets | Deferred tax liabilities |
|-------------------------------------|---------------------|--------------------------|
| <b>Balance at January 1, 2004</b>   | <b>9,568.80</b>     | <b>1,339.23</b>          |
| Additions                           | 1,194.85            | 535.62                   |
| Disposals                           | (1,909.28)          | (220.47)                 |
| Transfers                           | 54.86               | (5.05)                   |
| Net international movements         | 0.19                | (32.02)                  |
| Company movements and others        | 47.72               | 25.30                    |
| <b>Balance at December 31, 2004</b> | <b>8,957.14</b>     | <b>1,642.61</b>          |

At December 31, 2005, the Telefónica tax group has 515.35 million euros (519.81 million euros in 2004) of unused tax deductions from the years 1999 to 2005, in addition to those that could derive from investments made in 2005 and that are currently being evaluated by the Company.



The tax loss carryforwards in Spain at December 31, 2005 at the main Group companies totaled 11,562.60 million euros, of which 10,913.79 million, 113.77 million and 49.91 million were incurred in 2002, 2001 and 2000, respectively. These can only be offset over 15 years. The financial statements include a 3,152.35 million euro deferred tax asset corresponding to 9,006.71 million euros of tax loss carryforwards.

At December 31, 2004 the tax loss carryforwards in Spain at the main Group companies totaled 18,140.23 million euros, of which 15,848.57 million, 1,128.38 million and 633.42 million were incurred in 2002, 2001 and 2000, respectively. These can be offset over 15 years. The balance at December 31, 2004 includes a 4,473.34 million euro deferred tax asset corresponding to 12,780.97 million euros of tax loss carryforwards.

The 2002 income return included a negative adjustment for 2,137.24 million euros from Telefónica Móviles. This arose through the transfer of certain holdings acquired in previous years where the market value differed from the carrying amount as a result of having implemented Article 159 of the Corporation Law. However, as past rulings by the tax authorities differ from the interpretation being put forward by the company, no adjustment has been made to the financial statements in this respect. From Terra Networks España and Terra Networks Asociadas, the Group had unused tax losses at December 31, 2005 of 375.49 million and 31.16 million euros, respectively.

In connection with the sale of the holding in Lycos Inc. (see Appendix II), Terra Networks, S.A. (now Telefónica, S.A.) recognized a tax asset of 272 million euros in 2004, which was included in the total tax asset of 306 million euros recognized in 2004. This tax asset arose from the difference between the sale price of Lycos Inc. shares for 88 million euros and the carrying amount of the capital increase held to acquire the company, net of adjustments (mainly provisions for impairment) which had already been considered tax deductible prior to the sale.

In addition, the company has begun procedures to file a higher tax loss for 2004, of up to 7,418 million. It is arguing that for tax purposes the Lycos Inc. shares received should be valued at market value, rather than carrying amount, in conformity with Article 159 of the Spanish Corporation Law. However, as the tax authorities have opposed such claims in other similar cases and the final decision remains uncertain, no booking has been made for this concept as of the date of preparation of these consolidated financial statements.

### Temporary differences

Temporary differences are generated as a result of the difference between tax bases of the assets and liabilities and their respective carrying amounts. Deductible temporary differences, tax deductions and credits and tax loss carryforwards give rise to deferred tax assets on the balance sheet, whereas taxable temporary differences in tax bases give rise to deferred tax liabilities. Details of the sources of deferred tax assets and liabilities from temporary differences recorded at December 31, 2005 and 2004 are as follows:

| Millions of euros  | 2004                |                          | 2005                |                          |
|--|---------------------|--------------------------|---------------------|--------------------------|
|  | Deferred tax assets | Deferred tax liabilities | Deferred tax assets | Deferred tax liabilities |
| Property, plant and equipment                              | 77.57               | 452.93                   | 109.10              | 652.43                   |
| Intangible assets  | 162.69              | 769.01                   | 77.80               | 1,149.74                 |
| Personnel expenses   | 1,791.54            | 8.58                     | 1,744.95            | 11.05                    |
| Inventories and accounts receivable                        | 142.26              | (2.41)                   | 186.17              | (1.93)                   |
| Provisions   | 538.83              | 156.19                   | 545.97              | 137.43                   |
| Investments in associates, subsidiaries and joint ventures | 1,119.25            | 58.03                    | 1,197.37            | 63.48                    |
| Other  | 455.13              | 200.28                   | 503.16              | 465.24                   |
| <b>Total</b>   | <b>4,287.27</b>     | <b>1,642.61</b>          | <b>4,364.52</b>     | <b>2,477.44</b>          |

## Taxes payable and tax receivables

Current tax payable and receivable at December 31, 2005 and 2004 are as follows:

| Millions of euros            | Balance at<br>12-31-05 | Balance at<br>12-31-04 |
|------------------------------|------------------------|------------------------|
| <b>Taxes payable:</b>        |                        |                        |
| Tax withholdings             | 78.15                  | 89.52                  |
| Indirect taxes payable       | 966.96                 | 811.97                 |
| Social Security              | 177.74                 | 171.02                 |
| Current income taxes payable | 818.35                 | 629.65                 |
| Other                        | 150.42                 | 122.78                 |
| <b>Total</b>                 | <b>2,191.62</b>        | <b>1,824.94</b>        |

| Millions of euros                                  | Balance at<br>12-31-05 | Balance at<br>12-31-04 |
|--|------------------------|------------------------|
| <b>Tax receivables:</b>                            |                        |                        |
| Recoverable taxes and excess charges<br>and others | 6.59                   | 6.84                   |
| Indirect tax receivables                           | 710.70                 | 632.41                 |
| Current income taxes receivable                    | 522.34                 | 371.31                 |
| Other  | 208.63                 | 58.93                  |
| <b>Total</b>                                       | <b>1,448.26</b>        | <b>1,069.49</b>        |

## Reconciliation of the book profit before taxes to the taxable income

The reconciliation of the book profit before taxes to the taxable income for corporate income tax purposes and the determination of the corporate income tax expense for 2005 and 2004 is as follows:

| Millions of euros   | 2005            | 2004            |
|---|-----------------|-----------------|
| <b>Book profit before taxes</b>   | <b>6,796.21</b> | <b>4,866.40</b> |
| Tax expense at prevailing statutory<br>tax rate (1)                       | 1,831.16        | 1,661.17        |
| Changes in tax expense from new taxes                                     | 26.25           | 98.64           |
| Permanent differences   | 672.14          | (93.23)         |
| Changes in deferred tax charge due to changes<br>in tax rate              | 2.18            | (0.23)          |
| Capitalization of tax deduction and tax relief                            | (176.51)        | (169.14)        |
| Capitalized of tax assets from previous years                             | (373.63)        | (51.08)         |
| Losses not recognized against tax   | 65.74           | 0.96            |
| Disposals of tax assets for losses or tax credits<br>and tax relief       | 39.48           | 41.67           |
| Increase/(decrease) in tax expense arising<br>from temporary differences  | (53.91)         | 44.91           |
| Consolidation adjustments   | (59.64)         | (69.21)         |
| Adjustment to income tax for changes<br>in previous year's tax settlement | (4.11)          | 48.32           |
| <b>Corporate income tax charge</b>  | <b>1,969.15</b> | <b>1,512.78</b> |
| Detail of current/deferred tax expense                                    |                 |                 |
| Current tax expense   | 2,657.63        | 1,742.35        |
| Deferred tax expense  | (688.48)        | (229.57)        |
| <b>Total corporate income tax charge</b>                                  | <b>1,969.15</b> | <b>1,512.78</b> |

(1) Considering prevailing taxes in each country.

Permanent differences arise mainly from events that produce taxable income not recognized in the consolidated income statement.

The capitalization of tax deductions mainly include the 163.12 million euros used by the Spanish Tax Group in the year (double tax

treaties and export promotion activity deductions). The use of prior years' tax credits in 2005 derives mainly from the tax losses in Colombia and Argentina.

Tax losses were also generated in 2005 that are not recognized as deferred tax assets given that tax consolidation is not applicable in the Brazilian and Mexican wireless business (in Mexico due to the impact of the minority shareholding).

On September 25, 2002, began the tax inspections of several companies included in Tax Group 24/90, of which Telefónica, S.A. is the parent company. The taxes open to inspection are corporate income tax (for the years from 1998 to 2000) and VAT and tax withholdings and prepayments relating to personal income tax, tax on income from movable capital, property tax and nonresident income tax (1998 to 2001). The tax audits were concluded in 2005 with a final tax assessment, signed under protest, of approximately 135 million euros. This is not expected to give rise to material liabilities on the Telefónica Group consolidated financial statements as the Company expects to be successful in its appeal against the assessment presented before the Central Economic-Administrative Tribunal.

The years open for review by the tax inspection authorities for the main applicable taxes vary from one consolidated company to another, based on each country's tax legislation, taking into account their respective statute-of-limitations periods. In Spain, as a result of the tax audit currently in progress, the Tax Group has the following years open for review: the years since 2002 for tax withholdings and prepayments relating to personal income tax, tax on income from movable capital, property tax, nonresident income tax and VAT; and the years since 2001 for corporate income tax (since 2001 and 2000, respectively, for the other Spanish companies).

In the other countries in which the Telefónica Group has a significant presence, the years open for inspection by the relevant authorities are generally as follows:

- The last five years in Argentina, Brazil, Mexico, Colombia, Uruguay and the Netherlands.
- The last four years in Peru, Guatemala and Venezuela.
- The last three years in Chile, El Salvador, Ecuador, the USA and Panama.

The tax audit of the open years is not expected to give rise to additional material liabilities for the Group.

## (17) Segment Information

The Telefónica group is structured around the Business Lines it operates. Each is separately managed and organized to suit delivery of the specific products or services it provides. The group's core Business Lines are:

- Telefónica de España: wireline telephony in Spain.
- Telefónica Móviles: wireless telephony in Spain and Latin America.
- Telefónica Latinoamérica: wireline telephony in Latin America.
- Cesky Telecom: integrated telecommunications provider in the Czech Republic.
- Telefónica Contenidos: audio-visual media and content in Europe and Latin America.

- Directories business: publication, development and sale of advertising for telephone directories throughout Europe and Latin America.
- Atento: call centers in Europe, Latin America and North Africa.

Key information by business segment:

| Millions of euros  | Telefónica de España | Telefónica Móviles | Telefónica Latinoamérica | Cesky Group   | Telefónica de Contenidos | Directories Business | Atento        | Other & intragroup eliminations | Total            |
|--|----------------------|--------------------|--------------------------|---------------|--------------------------|----------------------|---------------|---------------------------------|------------------|
| <b>Ejercicio 2005</b>  |                      |                    |                          |               |                          |                      |               |                                 |                  |
| External sales   | 11,019.45            | 15,068.41          | 7,902.02                 | 1,035.24      | 1,251.21                 | 559.57               | 383.85        | 662.41                          | 37,882.16        |
| Inter-segment sales  | 720.05               | 1,445.10           | 363.46                   | 0.00          | 17.84                    | 92.04                | 472.61        | (3,111.10)                      | -                |
| Other operating income   | 351.40               | 269.76             | 269.47                   | 21.38         | 74.04                    | 2.62                 | 2.29          | 427.30                          | 1,418.26         |
| Supplies   | (3,032.00)           | (5,365.45)         | (1,922.52)               | (285.74)      | (732.70)                 | (67.34)              | (76.39)       | 1,417.09                        | (10,065.05)      |
| Personnel expenses   | (2,695.84)           | (799.67)           | (762.26)                 | (137.44)      | (205.79)                 | (120.28)             | (579.80)      | (355.26)                        | (5,656.34)       |
| Other operating expenses   | (1,596.27)           | (4,801.14)         | (2,091.85)               | (176.76)      | (135.40)                 | (247.33)             | (86.20)       | 832.35                          | (8,302.60)       |
| <b>OIBDA</b>   | <b>4,766.79</b>      | <b>5,817.01</b>    | <b>3,758.32</b>          | <b>456.68</b> | <b>269.20</b>            | <b>219.28</b>        | <b>116.36</b> | <b>(127.21)</b>                 | <b>15,276.43</b> |
| Depreciation and amortization  | (2,139.15)           | (2,374.01)         | (1,792.47)               | (291.85)      | (28.88)                  | (23.58)              | (27.87)       | (39.87)                         | (6,717.68)       |
| <b>Operating Income</b>  | <b>2,627.64</b>      | <b>3,443.00</b>    | <b>1,965.85</b>          | <b>164.83</b> | <b>240.32</b>            | <b>195.70</b>        | <b>88.49</b>  | <b>(167.08)</b>                 | <b>8,558.75</b>  |
| Financial income (loss)  | (393.47)             | (459.08)           | (383.58)                 | (10.82)       | (96.73)                  | (5.29)               | (20.24)       | (265.12)                        | (1,634.33)       |
| Share in income (loss) from companies accounted for by the equity method | (2.14)               | (154.21)           | 4.40                     | -             | (6.43)                   | (0.04)               | -             | 30.21                           | (128.21)         |
| Corporate income tax   | (737.31)             | (946.04)           | (319.20)                 | (35.98)       | (49.20)                  | (65.07)              | (16.65)       | 200.30                          | (1,969.15)       |
| Income (loss) from discontinued operations                               | -                    | -                  | -                        | -             | -                        | -                    | -             | -                               | -                |
| Minority interests   | (0.46)               | 35.24              | (160.80)                 | -             | (9.13)                   | -                    | (3.38)        | (242.68)                        | (381.21)         |
| <b>Profit (loss) for the Year</b>  | <b>1,494.26</b>      | <b>1,918.91</b>    | <b>1,106.67</b>          | <b>118.03</b> | <b>78.83</b>             | <b>125.30</b>        | <b>48.22</b>  | <b>(444.37)</b>                 | <b>4,445.85</b>  |
| Investment in PP&E   | 1,406.56             | 2,330.44           | 1,061.21                 | 147.03        | 135.59                   | 24.06                | 42.94         | 320.82                          | 5,468.65         |
| Investment in Associates   | 3.49                 | 53.56              | 25.90                    | -             | 730.85                   | 1.01                 | -             | 849.54                          | 1,664.35         |
| Segment Assets   | 18,474.61            | 26,970.60          | 20,840.19                | 4,282.80      | 3,849.08                 | 781.00               | 454.84        | (2,479.35)                      | 73,173.77        |
| Segment Liabilities  | 14,337.14            | 20,715.89          | 12,110.50                | 1,008.05      | 2,931.60                 | 537.86               | 386.75        | 4,987.56                        | 57,015.35        |

| Millions of euros  | Telefónica de España | Telefónica Móviles | Telefónica Latinoamérica | Telefónica de Contenidos | Directories Business | Atento       | Other & intragroup eliminations | Total            |
|--|----------------------|--------------------|--------------------------|--------------------------|----------------------|--------------|---------------------------------|------------------|
| <b>Ejercicio 2004</b>  |                      |                    |                          |                          |                      |              |                                 |                  |
| External sales   | 10,566.91            | 10,492.09          | 6,420.08                 | 1,200.16                 | 535.55               | 267.56       | 798.57                          | 30,280.92        |
| Inter-segment sales  | 635.32               | 1,469.28           | 328.30                   | 18.97                    | 80.89                | 338.93       | (2,871.69)                      | -                |
| Other operating income   | 343.48               | 199.84             | 589.87                   | 25.53                    | 2.56                 | 4.61         | (32.48)                         | 1,133.41         |
| Supplies   | (2,789.98)           | (3,687.93)         | (1,593.34)               | (705.03)                 | (60.73)              | (48.82)      | 1,248.50                        | (7,637.33)       |
| Personnel expenses   | (2,716.97)           | (555.47)           | (655.43)                 | (213.43)                 | (118.92)             | (402.59)     | (432.36)                        | (5,095.17)       |
| Other operating expenses   | (1,478.73)           | (3,280.21)         | (1,794.64)               | (141.19)                 | (234.51)             | (74.59)      | 544.07                          | (6,459.80)       |
| <b>OIBDA</b>   | <b>4,560.03</b>      | <b>4,637.60</b>    | <b>3,294.84</b>          | <b>185.01</b>            | <b>204.84</b>        | <b>85.10</b> | <b>(745.39)</b>                 | <b>12,222.03</b> |
| Depreciation and amortization  | (2,367.66)           | (1,580.14)         | (1,578.73)               | (28.86)                  | (23.80)              | (33.69)      | (53.15)                         | (5,666.03)       |
| <b>Operating Income</b>  | <b>2,192.37</b>      | <b>3,057.46</b>    | <b>1,716.11</b>          | <b>156.15</b>            | <b>181.04</b>        | <b>51.41</b> | <b>(798.54)</b>                 | <b>6,556.00</b>  |
| Financial income (loss)  | (523.72)             | (496.10)           | (344.63)                 | (121.65)                 | (5.70)               | (10.48)      | (136.83)                        | (1,639.11)       |
| Share in income (loss) from companies accounted for by the equity method | (0.51)               | (39.51)            | 2.57                     | (34.15)                  | (0.36)               | -            | 21.47                           | (50.49)          |
| Corporate income tax   | (554.75)             | (864.42)           | (292.62)                 | (35.92)                  | (61.68)              | (6.84)       | 303.45                          | (1,512.78)       |
| Income (loss) from discontinued operations                               | -                    | -                  | -                        | -                        | -                    | (0.11)       | 132.08                          | 131.97           |
| Minority interests   | (0.18)               | 25.22              | (327.10)                 | (5.00)                   | 0.52                 | (1.69)       | (1.69)                          | (309.92)         |
| <b>Income (loss) for the Year</b>  | <b>1,113.21</b>      | <b>1,682.65</b>    | <b>754.33</b>            | <b>(40.57)</b>           | <b>113.82</b>        | <b>32.29</b> | <b>(480.06)</b>                 | <b>3,175.67</b>  |
| Investment in PP&E   | 1,207.55             | 1,669.00           | 748.49                   | 24.28                    | 21.50                | 22.76        | 73,530.00                       | 3,767.11         |
| Investment in Associates   | 6.20                 | 75.37              | 254.58                   | 718.10                   | 1.08                 | 0.00         | 596.35                          | 1,651.68         |
| Segment Assets   | 18,831.49            | 23,197.01          | 19,071.70                | 4,074.93                 | 658.03               | 328.94       | (6,083.24)                      | 60,078.86        |
| Segment Liabilities  | 14,778.30            | 19,370.49          | 12,730.20                | 2,846.15                 | 461.58               | 337.26       | (2,787.60)                      | 47,736.38        |

The items broken down in the tables above were selected to reflect the main factors affecting management and strategic decisions in each segment.

In parallel with its Business Line management structure, Telefónica group also monitors its activities by geographical area with a view to maximizing the efficiency of the various businesses in each region.

Key information by geographical segment:

| Millions of euros      | 2005       |               |                |                                   |           |
|------------------------|------------|---------------|----------------|-----------------------------------|-----------|
|                        | Spain      | Latin America | Rest of Europe | RoW & intragroup eliminations (1) | Total     |
| Sales to third parties | 19,674.74  | 15,707.53     | 2,099.73       | 400.16                            | 37,882.16 |
| Total assets           | 122,491.87 | 37,478.56     | 19,624.83      | (106,421.49)                      | 73,173.77 |
| Investments in PP&E    | 2,483.47   | 2,674.19      | 180.62         | 13.76                             | 5,352.04  |

| Millions of euros      | 2004       |               |                |                                   |           |
|------------------------|------------|---------------|----------------|-----------------------------------|-----------|
|                        | Spain      | Latin America | Rest of Europe | RoW & intragroup eliminations (1) | Total     |
| Sales to third parties | 18,578.07  | 10,330.50     | 1,095.56       | 276.79                            | 30,280.92 |
| Total assets           | 123,069.62 | 29,661.69     | 15,974.86      | (108,627.31)                      | 60,078.86 |
| Investments in PP&E    | 1,912.31   | 1,761.88      | 36.25          | 56.67                             | 3,767.11  |

(1) Total assets under "RoW and intragroup eliminations" mainly include the impact of eliminations of investments in Group companies on consolidation.

## (18) Discontinued Operations

The Company did not discontinue any of its operations in 2005.

In October 2004 Terra Networks S.A. (now Telefónica, S.A.) agreed to sell Lycos Inc. to Daum Communications Corp. for 108 million dollars. For comparison purposes, Lycos' results up to the effective date of its sale are recognized under "Income (loss) from discontinued operations" in the consolidated income statement for 2004.

Lycos Inc's results in 2004 until the effective date of its sale were as follows:

|   | Millions of euros |
|---|-------------------|
| Operating income  | 82.34             |
| Operating expense   | (93.70)           |
| <b>Operating loss</b>   | <b>(11.36)</b>    |
| Financial income (loss)   | (11.60)           |
| Share in income/loss of companies consolidated by the equity method | (0.58)            |
| <b>Loss before minority interests and tax</b>                       | <b>(23.54)</b>    |
| Corporate income tax  | 155.51            |
| <b>Income from discontinued operation</b>                           | <b>131.97</b>     |

Net cash flow in 2004 until the effective date of sale:

|  | Millions of euros |
|--|-------------------|
| From operating activities                    | (16.50)           |
| From investing activities                    | 11.72             |
| From financing activities                    | 0.18              |
| <b>Total increase (decrease) in net cash</b> | <b>(4.6)</b>      |

The result of the company's disposal was as follows:

|                                 | Millions of euros |
|---------------------------------|-------------------|
| Non-current assets              | 49,41             |
| Current assets                  | 53,29             |
| Non-current liabilities         | (1,65)            |
| Current liabilities             | (52,81)           |
| <b>Total</b>                    | <b>48,24</b>      |
| Sale price                      | 87,86             |
| <b>Income from the disposal</b> | <b>39,62</b>      |

Taxable income from the disposal of Lycos was 155.36 million euros.

## (19) Revenues and Expenses

### Other income

The detail of this heading is as follows:

| Millions of euros                           | 2005            | 2004            |
|---|-----------------|-----------------|
| Non-core and other current operating income | 438.98          | 424.86          |
| Internal expenditures capitalized           | 601.34          | 470.25          |
| Capital grants                              | 74.80           | 112.37          |
| Gain on disposal of assets                  | 303.14          | 125.93          |
| <b>Total</b>                                | <b>1,418.26</b> | <b>1,133.41</b> |

Among gains on asset disposals is a gain obtained from the Telefónica Group's real estate efficiency plan via the selective sale of properties, which generated proceeds of 65.83 million euros in 2005 (34.32 million euros in 2004).

The figure for 2005 also includes the proceeds from the sale of the 14.41% shareholding in US company Infonet Services Corporation, Inc. of 80.00 million euros (see Note 8) and from the offering of Endemol shares of 55.58 million euros (see Note 2).

In 2004, the Group recorded proceeds from the sales of 2.13% of Eutelsat, Terra México and Radio Móvil Digital of 21.43, 10.75 and 10.23 million euros, respectively.

### Other expenses

The detail of this heading in 2004 and 2005 is as follows:

| Millions of euros                   | 2005            | 2004            |
|-------------------------------------|-----------------|-----------------|
| External services                   | 6,715.28        | 5,072.03        |
| Local taxes                         | 782.65          | 525.29          |
| Other operating expenses            | 228.99          | 225.73          |
| Changes in operating allowances     | 498.85          | 361.83          |
| Impairment of goodwill (Note 6)     | –               | 120.67          |
| Loss on disposal non-current assets | 76.83           | 154.25          |
| <b>Total</b>                        | <b>8,302.60</b> | <b>6,459.80</b> |

Research and development costs expenses in 2005 amounted to 47.41 million euros.

### Personnel expenses and employee benefits

The detail of personnel expenses is as follows:

| Millions of euros                            | 2005            | 2004            |
|--|-----------------|-----------------|
| Wages, salaries and other personnel expenses | 5,045.14        | 4,346.06        |
| Staff restructuring expenses                 | 611.20          | 749.11          |
| <b>Total</b>                                 | <b>5,656.34</b> | <b>5,095.17</b> |

Staff restructuring expenses recorded by the Group include the costs of the Telefónica de España labor force reduction program of 577.92 and 706.68 million euros in 2005 and 2004, respectively.

### Inclusion in the general social security system

Since January 1, 1992, Telefónica de España S.A.U. and its employees, who were formerly covered by a company employee welfare system, have been transferred to the general social security system. As a result of the inclusion of serving employees in the social security system, Telefónica de España S.A.U. must make additional social security contributions (2.2%) until 2016, based on the serving employees' effective contribution bases applicable at the time during that period. These contributions totaled 23.68 million euros in 2005 (24.17 million euros in 2004).

### Severance

"Wages, salaries and other personnel expenses" includes severance payments made to five executives who left the company in 2005 in line with the terms of their senior executive contracts.

Generally, senior executive contracts are associated with Executive Committee members and include a severance clause entailing three years of salary plus another year based on years of service at the Company. The annual salary comprises fixed compensation and an arithmetical average of the sum of the two most recent variable compensations received by contract.

### Supplementary pension plan for employees

Various Telefónica Group companies have arranged a defined-contribution pension plan pursuant to Royal Decree-Law 1/2002, November 29, approving the revised Pension Plans and Funds Law. Under this plan, contributions of between 4.50% and 6.87% of the participating employees' regulatory base salary (based on each employee's respective hiring date and the company in question) are made to the plan. The obligatory contribution of the employee participant is generally a minimum of 2.2% of the employee's regulatory base salary. The scheme uses an individual financial capitalization system.

At December 31, 2005, 45,262 Group employees were covered by the pension plans managed by the subsidiary Fonditel Entidad Gestora de Fondos de Pensiones, S.A. compared to 42,446 at December 31, 2004. The contributions made by the various companies in 2005 amounted to 93.99 million euros (93.55 million euros in 2004).

## Number of employees

The following is a breakdown of the Telefónica Group's average number of employees in 2005 and 2004, together with headcount at December 31 each year. The employees shown for each subgroup include the Telefónica Group companies with similar activities in order to present the employees by business.

|                                | 2005           |                | 2004           |                |
|--------------------------------|----------------|----------------|----------------|----------------|
|                                | Average        | Year end       | Average        | Year end       |
| Telefónica, S.A.               | 627            | 650            | 668            | 622            |
| Telefónica de España Group     | 35,855         | 35,053         | 37,281         | 36,425         |
| Telefónica Móviles Group       | 22,471         | 22,739         | 14,071         | 19,797         |
| Telefónica Internacional Group | 27,381         | 28,856         | 25,951         | 25,905         |
| Directories Business           | 2,931          | 2,942          | 2,898          | 2,876          |
| Cesky Telecom                  | 9,402          | 10,051         | –              | –              |
| Telefónica de Contenidos Group | 5,735          | 5,734          | 5,520          | 5,860          |
| Atento Group                   | 84,365         | 95,907         | 62,429         | 74,829         |
| Terra Networks Group           | –              | –              | 1,997          | 1,584          |
| Other                          | 6,319          | 5,709          | 6,004          | 5,656          |
| <b>Total</b>                   | <b>195,086</b> | <b>207,641</b> | <b>156,819</b> | <b>173,554</b> |

The figures in the preceding table relate to consolidated companies.

In addition, group company Telefónica de España has filed various appeals for judicial review against the government in connection with a monetary claim relating to healthcare services provided in the years from 1999 to 2003 (inclusive). The company has recorded an account receivable of 90.47 million euros in this regard. Proceedings have likewise been instigated by or against the regulator, some of which are being conducted in the administrative jurisdiction and others before the courts.

## Share-based payments

At year end 2005 Telefónica Group maintained the following shared-based compensation plans based on the share price of either Telefónica, S.A. or one of its subsidiaries.

### *a) Telefónica, S.A. share option plan targeted at all the employees of certain Telefónica group companies ("TIES Program")*

February 15, 2005 was the third and final exercise date for the TIES Program, a compensation plan based on the Telefónica S.A. share price involving share subscriptions and granting of share options, targeted at non-executive personnel of Telefónica group and created by resolutions of the Shareholders' Meeting of April 7, 2000. However, as the initial reference value was higher than the market price at that time, there were no exercisable options and therefore all options were expired and cancelled and the TIES program was terminated.



Accordingly, the shares which were acquired in the past to cover the plan are relieved of their coverage consideration.

|   | Number of options | Average strike price (euros) |
|---|-------------------|------------------------------|
| <b>Options outstanding at December 31, 2003</b> | <b>30,113,539</b> | <b>4.53</b>                  |
| Options expired/cancelled                       | (321,112)         |                              |
| <b>Options outstanding at December 31, 2004</b> | <b>29,792,427</b> | <b>4.53</b>                  |
| Options expired/cancelled                       | (29,792,427)      |                              |
| <b>Options outstanding at December 31, 2005</b> | <b>-</b>          |                              |

In February 2005, in accordance with a report issued by the Board of Directors on the resolutions adopted by the Shareholders' Meeting on April 7, 2000, in connection with item IX on the agenda (relating to the establishment of the TIES Program), Telefónica, S.A. acquired 34,760,964 shares from the two financial institutions acting as agents for the plan. These institutions had subscribed and fully paid in these shares when they were issued with the intention that they would subsequently be delivered to the plan's beneficiaries. The shares were then cancelled by resolution of the Shareholders' Meeting of May 31, 2005 (see Note 11).

#### **b) Telefónica Móviles, S.A. share option plan ("MOS Program")**

On October 26, 2000, authorization was given at the Extraordinary Shareholders' Meeting of Telefónica Móviles, S.A. to establish a corporate share option plan for the executives and employees of Telefónica Móviles, S.A. and its subsidiaries and, in order to facilitate coverage of the Company's obligations to the beneficiaries of the plan, it was resolved to increase the share capital of Telefónica Móviles, S.A. by 11,400,000 euros through the issuance of 22,800,000 shares of 0.50 euro par value each.

Subsequently, at the Shareholders' Meeting on June 1, 2001, Telefónica Móviles, S.A. introduced certain modifications and clarifications of the share option plan with a view to making it more attractive and efficient to encourage the loyalty of its beneficiaries.

Finally, on September 21, 2001, the Board of Directors of Telefónica Móviles S.A. resolved to develop and establish the terms and conditions of the share option plan in conformity with the aforementioned resolutions of the Shareholders' Meetings on October 26, 2000 and June 1, 2001. The main features of this plan are as follows:

1. The plan is open to all the executive directors, executives (including general managers or similar) and employees who on December 1, 2001 were working for companies in which Telefónica Móviles, S.A. directly or indirectly, during the term of the plan, (i) has a holding with voting rights of over 50%, or (ii) has the right to appoint over 50% of the members of the Board of Directors.

Without prejudice to the above, the MOS Program envisaged the possibility of awarding new options at dates subsequent to its initial implementation. In order to carry this out, following the issuance of a report by the Appointments and Compensation Committee, the Board of Directors resolved to assign options to both the employees of the new companies which, when joining

the Telefónica Móviles Group, met the aforementioned requirements and the employees hired by companies already participating in the MOS Program. The Board also resolved that employees could join the plan until December 31, 2003. Consequently, new beneficiaries joined the plan in 2002 and 2003. In 2003 certain companies were excluded from the MOS Program because they no longer meet the related requirements.

2. There are three types of options:

- Type-A options, with a strike price of 11 euros.
- Type-B options, with a strike price of 16.5 euros.
- Type-C options, with a strike price of 7.235 euros.

Each beneficiary of the program will receive an equal number of type-A and type-B options and a number of type-C options equal to the sum of the type-A and type-B options received.

3. The executive directors and executives who are beneficiaries of the MOS Program must deposit one share of Telefónica Móviles, S.A. for every 20 options assigned to them.
4. Each option, regardless of type, entitled its holder to receive one share of Telefónica Móviles, S.A.
5. The options may be exercised at a rate of one-third each year from the day after the day on which two, three and four years have elapsed from the option grant date (January 2, 2002). The first exercise period commenced on January 2, 2004. The second period commenced on January 3, 2005. The third and last exercise period commenced on January 3, 2006.
6. At the exercise date, the options may be settled, at the beneficiary's request, either (i) through delivery of shares of Telefónica Móviles, S.A., once the beneficiary has paid the option strike price, or (ii) cash settlement.

In 2004, in the second exercise period, 778 employees exercised a total of 79,823 options. Of these employees, two beneficiaries opted for settlement by delivery of shares and the remainder by cash settlement. The amount received by these beneficiaries upon the exercise of their options was 109 thousand euros. In addition, in 2004, 859 employees, owning a total of 1,681,928 options, left the program as a result of early settlement or voluntary withdrawal. 844 thousand euros were paid for this concept in 2004.

In 2005, in the third exercise period, 1,019 employees exercised a total of 383,116 options. Of these employees, six beneficiaries opted for settlement via the delivery of shares and the remainder for cash settlement. The amount received by these beneficiaries upon the exercise of their options was 320.4 thousand euros. In addition, in 2005, 605 employees, owning a total of 1,307,655 options, left the program as a result of early settlement or voluntary withdrawal. 791.7 thousand euros were paid for this concept in 2005.

The total number of beneficiaries of the MOS Program was 6,970 at December 31, 2005. Of these beneficiaries, one is an executive director of Telefónica Móviles, S.A. and 10 are general managers or similar executives. 9,446,373 options had been assigned at December 31, 2005.

The detail of the movements in 2005 and 2004 was as follows:

|   | Number of options | Average strike price (euros) |
|---|-------------------|------------------------------|
| <b>Options outstanding at December 31, 2003</b> | <b>12,819,072</b> | <b>10.49</b>                 |
| Options exercised                               | (1,681,928)       |                              |
| <b>Options outstanding at December 31, 2004</b> | <b>11,137,144</b> | <b>10.49</b>                 |
| Options exercised                               | (1,690,771)       |                              |
| <b>Options outstanding at December 31, 2005</b> | <b>9,446,373</b>  | <b>10.49</b>                 |

**c) Share option plan of Terra Networks, S.A.  
(now of Telefónica Móviles, S.A.)**

The Terra Networks, S.A. share option plan was approved at the Shareholders' Meeting on October 1, 1999 and implemented by Board of Directors' resolutions adopted on October 18, 1999 and December 1, 1999.

The plan provides, through the exercise of the share options by their holders, for the ownership by the employees and executives of the Terra-Lycos Group companies of a portion of the capital of Terra Networks, S.A. up to a maximum of 14,000,000 shares.

The approval and implementation of this compensation system were notified to the CNMV and were made public through the complete information memorandum verified and registered in the CNMV Official Register on October 29, 1999, and in the Prospectus presented to the US Securities and Exchange Commission (SEC).

On December 1, 1999 and June 8, 2000, the Board of Directors, pursuant to the powers granted to it at the Shareholders' Meeting, implemented the first phase of the plan by granting options to employees of the Terra Group. The main features of these options are as follows:

1. Each of the shares options under the plan entitles the holder (employee or executive) to acquire one share of Terra Networks, S.A. at a strike price of 11.81 euros per share.
2. Duration of four years and three months (therefore, it ended on February 28, 2004), and the options could be exercised at a rate of one-third of those granted each year from the second year onwards.
3. The exercise of the options is conditional upon the beneficiary remaining a Terra-Lycos Group employee.

In 2001 the Board of Directors implemented the second phase of the Terra Networks, S.A. share option plan, which was approved at the Shareholders' Meeting on June 8, 2000, and launched pursuant to a resolution adopted by the Board of Directors on December 22, 2000, at the recommendation of the Appointments and Compensation Committee based on a proposal of its Chairman, through the assignment of options to executives and employees who were already beneficiaries of the share option plan, in addition to the assignment of options to new employees who had joined the Terra-Lycos Group at that date.

The main features established by the Board of Directors for this assignment were as follows:

1. Each of the share options under the plan entitles the holder to acquire one share of Terra Networks, S.A. at a strike price of 19.78 euros per share.

2. The duration of the Plan was modified by a resolution adopted at the Shareholders' Meeting on June 8, 2000, and was set at six years with a two-year grace period. The options can be exercised at a rate of one-quarter of those granted each year from the third year through the sixth year.
3. The exercise of the options is conditional upon the beneficiary remaining a Terra Group employee.
4. Options were granted to one executive director and four general managers and persons of a similar category, and this was duly notified to the CNMV on December 29, 2000.

On February 21, 2001, the Board of Directors resolved to modify the resolution adopted on December 22, 2000, in respect of the duration and method of accrual of the share options. Accordingly, the period for the exercise of the options assigned was set at five years, and the options may be exercised at a rate of one-quarter each year from the end of the first year.

On June 7, 2001, a resolution was passed at the Shareholders' Meeting of Terra Networks, S.A. to partially modify the resolution relating to the share option plan that was ratified and approved at the Shareholders' Meeting on June 8, 2000, as regards the extension of the share option plan to executives and directors, and extended the option exercise period to 10 years from that in which they were granted, stipulating that the options could be partially exercised each year during this period. In 2001 the Board of Directors did not extend the option exercise period.

On July 22, 2004, the Board of Directors of Terra Networks, S.A., after obtaining a favorable report from the Audit and Compliance Committee, resolved to reduce by 2 euros the strike price of the Terra Networks, S.A. share options granted to the beneficiaries of the Terra Group's share option plans, on or after the date of dividend payment with a charge to share premium approved at the Shareholders' Meeting of Terra Networks, S.A., i.e. July 30, 2004.

On December 31, 2004, options on 2,383,820 shares had been assigned to Terra Group employees and executives, all of which relate to the second phase of the option plan since the rights relating to the first phase expired in April. The weighted average share option strike price was 14.21 euros.

On December 31, 2004, the Terra Group's executives held 650,000 share options under the Terra Networks, S.A. share option plan, the weighted average strike price of which is 16.37 euros.

On December 31, 2004, no directors of Terra Networks, S.A. owned share options.

As a result of the Telefónica S.A. and Terra Networks S.A. merger approved at the Shareholders' meeting on May 31, 2005 and recorded in the Madrid Mercantile Register on July 16, 2005, Telefónica S.A. took over responsibility for Terra Networks S.A.'s outstanding share option plans.

Consequently, the options on Terra Networks, S.A. shares were automatically translated into options on Telefónica S.A. shares in the terms resulting from the exchange ratio of the merger.

The plan provides, through the exercise of the share options by their holders, for the ownership of a portion of the capital of

Telefónica, S.A. by the employees and executives who then belonged to the Terra Group companies.

At December 31, 2005, a total of 117,900 call options on Telefónica, S.A. shares had been assigned. After the execution of the merger, the weighted average strike price was 28.28 euros.

The detail of the movements in 2005 and 2004 was as follows:

|   | Number of options | Average strike price (euros) |
|---|-------------------|------------------------------|
| <b>Options outstanding at December 31, 2003</b>                                   | <b>6,438,696</b>  | <b>14.70</b>                 |
| Options expired/cancelled   | (4,054,876)       |                              |
| <b>Options outstanding at December 31, 2004 (on Terra shares)</b>                 | <b>2,383,820</b>  | <b>14.21</b>                 |
| <b>Equivalent outstanding options at December 31, 2004 (on Telefónica shares)</b> | <b>529,738</b>    | <b>63.95</b>                 |
| Options granted   | 33,276            |                              |
| Options expired/cancelled   | (445,114)         |                              |
| <b>Options outstanding at December 31, 2005</b>                                   | <b>117,900</b>    | <b>28.28</b>                 |

***c) Share option plan of Terra Networks, S.A. (now of Telefónica, S.A.) resulting from its assuming the share option plans of Lycos, Inc.***

Under the agreements entered into for the acquisition of Lycos, Inc., it was agreed to exchange options on the shares of Lycos, Inc. for options on the shares of Terra Networks, S.A.

On June 8, 2000, a resolution was passed at the Shareholders' Meeting of Terra Networks, S.A. to take over Lycos, Inc.'s share option plan provided that the two companies merged.

On October 25, 2000, the Board of Directors of Terra Networks, S.A. approved (i) the exchange of options on Lycos, Inc. shares existing prior to the conclusion of the transaction for options on Terra Networks, S.A. shares; (ii) the transfer to Citibank N.A. (Agent Bank) of all the options on Lycos, Inc. shares for their early exercise; and (iii) the entering into of a contract between Terra Networks, S.A. and the Agent Bank in connection with the new Terra Networks, S.A. share option plan.

As a result of the exchange of Lycos, Inc. share options for Terra Networks, S.A. share options, the employees, executives and directors of Lycos, Inc. received call options on 62,540,249 shares of Terra Networks, S.A. owned by the Agent Bank.

On June 7, 2001, a resolution was passed at the Shareholders' Meeting of Terra Networks, S.A. to partially modify the resolution relating to the share option plan, which was ratified and approved at the Shareholders' Meeting on June 8, 2000. This change affected the obligations arising from the assumption of the Lycos, Inc. share options by Terra Networks, S.A., following the exchange of shares between the latter and Lycos, Inc., which may be covered with Terra Networks, S.A. shares held by Citibank, N.A., as a result of the exchange of Lycos, Inc. shares held by Citibank, N.A. to cover the share options of the employees and executives of Lycos, Inc.

On December 16, 2003, the Board of Directors of Terra Networks, S.A., pursuant to the powers granted to it at the Shareholders' Meetings on June 8, 2000 and April 2, 2003, approved the acquisition by Terra Networks, S.A. of 26,525,732 shares of Terra Networks, S.A. owned by Citibank, N.A. as Agent Bank of the option plans assumed by the

Company at the time of the integration of Lycos, Inc. These shares still covered the share options of the Lycos, Inc. employees outstanding as of that date.

On June 22, 2004, a resolution was passed at the Shareholders' Meeting of Terra Networks, S.A. to, inter alia, reduce share capital by 53,052,804 euros for the purpose of canceling 26,526,402 treasury shares. The resolution expressly stated that 26,507,482 of the shares to be cancelled had been acquired by Terra Networks, S.A. from Citibank N.A. and were classified as treasury shares to fund the obligations arising from Lycos Inc. share option plans taken over by Terra Networks, S.A. under section D) of the resolution adopted at the Shareholders' Meeting on June 8, 2000, in connection with item five on the agenda (in the revised version approved at the Shareholders' Meeting on June 7, 2001).

On July 22, 2004, the Board of Directors of Terra Networks, S.A., after obtaining a favorable report from the Audit and Compliance Committee, resolved to reduce by 2 euros the strike price of the Terra Networks, S.A. share options granted to the beneficiaries of the Terra Group's share option plans, on or after the date of dividend payment with a charge to share premium approved at the Shareholders' Meeting of Terra Networks, S.A., i.e. July 30, 2004.

On July 31, 2004, Terra Networks, S.A. and Korean company Daum Communications executed the contract for the sale of all the Lycos, Inc. shares. The transaction was finally carried out on October 5, 2004, after obtaining the required administrative authorizations and, specifically, approval from the U.S. Antitrust Authorities.

Under the sale contract, Terra Networks, S.A. undertook to continue to assume the obligations arising from the share option plans of Terra Networks, S.A. vis-à-vis the beneficiaries of Lycos, Inc., although Lycos, Inc. would be authorized to perform, for the account and at the expense of Terra Networks, S.A., any action that might be necessary or appropriate in connection with the exercise of the options by the beneficiaries.

At December 31, 2004, the employees, executives and directors of Lycos had exercised 1,089,238 options, and 10,863,239 options remained outstanding, at a weighted average price of 20.39 US dollars.

After the merger of Terra Networks, S.A. with Telefónica, S.A., these options became options on Telefónica, S.A. shares.

At December 31, 2005, employees of Lycos, Inc. had been assigned options on 527,425 shares, at a post-merger weighted average price of 59.57 US dollars.

The detail of the movements in 2005 and 2004 was as follows:

|   | Number of<br>options | Average<br>strike price<br>(USD) |
|---|----------------------|----------------------------------|
| <b>Options outstanding at December 31, 2003</b>                                   | <b>19,272,198</b>    | <b>20.77</b>                     |
| Options exercised   | (1,089,238)          |                                  |
| Options expired/cancelled   | (7,319,721)          |                                  |
| <b>Options outstanding at December 31, 2004 (on Terra shares)</b>                 | <b>10,863,239</b>    | <b>20.39</b>                     |
| <b>Equivalent outstanding options at December 31, 2004 (on Telefónica shares)</b> | <b>2,414,053</b>     | <b>91.76</b>                     |
| Options exercised   | (161,982)            |                                  |
| Options expired/cancelled   | (1,724,646)          |                                  |
| <b>Options outstanding at December 31, 2005</b>                                   | <b>527,425</b>       | <b>59.57</b>                     |

**e) Telefónica, S.A. share option plan aimed at employees of Endemol ("EN-SOP Program")**

In order to fulfill the commitments assumed by Telefónica, S.A. in the acquisition of the Dutch company Endemol (in mid-2000), and in order to establish a competitive compensation system similar to that in place at other companies in the industry in which Endemol operates, on April 25, 2001, the Standing Committee of the Board of Directors of Telefónica, S.A. approved the establishment of a Telefónica, S.A. share option plan targeted at the employees of Endemol Entertainment N.V. (Endemol) and its subsidiary companies (Endemol Group), known as the EN-SOP Program.

This program consists of the grant to the beneficiaries (all the Endemol Group's permanent employees on January 1, 2001, who are not participating in another similar share or share option plan), effective January 1, 2001, 2002, 2003 and 2004, of a variable number (based on the various wage and functional categories) of purchase options on Telefónica, S.A. shares. The duration of the options will be four years from the grant date, and the options may be exercised at a rate of one-half each year three and four years after the related grant date.

The total number of options to be delivered each year will be determined by dividing 27,500,000 euros by the annual reference value of the Telefónica, S.A. shares, which will be taken to be the arithmetic mean of the closing prices of the Telefónica, S.A. shares on the Spanish Continuous Market for the last five trading days prior to that on which the Board of Directors of Telefónica, S.A. holds the meeting calling the General Shareholders' Meeting.

The option strike price will be the related annual reference value, and the exercise terms will be the customary terms in programs of this nature. The beneficiaries must remain uninterruptedly permanent employees of Endemol until the options are exercised, without prejudice to the regulation of cases of early settlement of the options in certain cases in which the employment relationship is interrupted prior to the exercise of the options.

The options may be settled through the acquisition by the beneficiary of the underlying shares or, alternatively, through a cash settlement.

Under the EN-SOP Program, in 2001 1,281,040 purchase options on Telefónica, S.A. shares were delivered to the employees of the Endemol Group (with the distribution agreed on by the Appointments and Compensation Committee of the Board of Directors of Telefónica, S.A., the governing body responsible for this as established when the resolution to set up this program was adopted), at a strike price of 19.2898 euros per share (annual reference value). In 2001, 972 people were participating in the program.

Under the EN-SOP Program, in 2002 1,933,504 call options on Telefónica, S.A. shares were delivered to the 977 employees of the Endemol Group participating in the program at a strike price of 12.61 euros per share (annual reference value).

In 2003, 2,767,084 call options on Telefónica, S.A. shares were delivered to the 1,048 employees of the Endemol Group participating in the program at a strike price of 9.03 euros per share (annual reference value).

In 2004, 2,246,732 call options on Telefónica, S.A. shares were delivered to the 947 employees of the Endemol Group participating in the program at a strike price of 12.24 euros per share (annual reference value).

In 2005, since the period for the four annual grants of options envisaged in the plan had concluded, no further purchase options on Telefónica, S.A. shares were delivered to the employees of the Endemol Group. In 2005, 919 persons were participating in the program.

As noted, the purchase options on Telefónica, S.A. shares delivered in 2001, 2002, 2003 and 2004 have a duration of four years from the grant date, and the options may be exercised at a rate of one-half each year three and four years after the related grant date.

The detail of the movements in 2005 and 2004 was as follows:

|   | Number of options | Average strike price (euros) |
|---|-------------------|------------------------------|
| <b>Options outstanding at December 31, 2003</b> | <b>5,679,562</b>  | <b>11.81</b>                 |
| Options granted                                 | 2,246,732         |                              |
| Options expired/cancelled                       | (1,243,495)       |                              |
| <b>Options outstanding at December 31, 2004</b> | <b>6,682,799</b>  | <b>11.54</b>                 |
| Options exercised                               | (492,277)         |                              |
| Options expired/cancelled                       | (1,280,688)       |                              |
| <b>Options outstanding at December 31, 2005</b> | <b>4,909,834</b>  | <b>10.78</b>                 |

Of all the options exercised in 2005, which totaled 1.02 million euros, 1,525 were settled via the delivery of shares (see Note 11) and the remainder via cash.

The Black-Scholes option pricing model was used for the valuation of this plan. Fair value data at the end of 2005 and 2004 and the main assumptions were as follows:

| Fair value of options and main assumptions           | December 31, 2005 | December 31, 2004 |
|--|-------------------|-------------------|
| Average fair value at the closing (euros per option) | 2.20              | 3.70              |
| Share price (euros)                                  | 12.71             | 13.86             |
| Average strike price (euros)                         | 10.78             | 11.54             |
| Estimated average volatility                         | 17.16%            | 17.70%–17.80%     |
| Average option life (years)                          | 0.83              | 1.51              |
| Estimated dividend yield                             | 3.93%             | 3.61%             |
| Risk-free interest rate range                        | 2.18%–2.75%       | 2.21%–3%          |

The payable arising from these plans is recorded under "Interest-bearing debt – Non-current" and "Trade and other payables – Current" on the accompanying consolidated balance sheets and amounts to 64.21 and 226.21 million euros at December 31, 2005 and 2004, respectively.

**f) Endemol N.V. long-term incentive scheme: share option and share option rights plans**

When the subsidiary Endemol, N.V. first floated on the stock exchange, two compensation plans based on the company's share price were created for employees of Endemol N.V. and its subsidiaries:

- a. Rights on shares: employees were given rights to free shares subject to a number of conditions concerning the share price and their continuing to work for Endemol for three years, with a number of restrictions on the subsequent sale of shares granted. The number of share rights delivered and outstanding at December 31, 2005 was 839,067, with an estimated fair value at the delivery date of 4.5 euros per right.
- b. Share option plan: employees were granted options to acquire Endemol N.V. shares at a price fixed at the time. These were exercisable in three years provided certain conditions were met concerning the share price and the employees continuing to work for Endemol in the interim. The strike price expires five years after the vesting period. The number of options delivered and outstanding at December 31, 2005 was 2,346,383, with an average strike price of 9 euros per option. The estimated fair value at the delivery date was 2.11 euros per option.

Both plans are equity settled, so the 0.24 million euro expenses recorded in 2005 is recognized directly in equity.

The following methods and main assumptions were used to determine the fair values of these two plans:

| Main assumptions              | Share plan  | Option plan   |
|-------------------------------|-------------|---------------|
| Valuation method              | Monte Carlo | Black-Scholes |
| Share price (euros)           | 9.00        | 9.00          |
| Average strike price (euros)  | 0           | 9.00          |
| Estimated average volatility  | 40%         | 40%           |
| Vesting period (years)        | 3           | 3             |
| Estimated dividend yield      | 3.977%      | 3.977%        |
| Risk-free interest rate range | 3.106%      | 3.106%        |

### Earnings per share

Basic earnings per share is calculated by dividing net profit for the year attributable to equity holders of the parent by the weighted average number of shares outstanding over the period.

Diluted earnings per share is calculated by dividing net profit for the year attributable to equity holders of the parent (adjusted for any dilutive effects inherent in converting potential ordinary shares in issue) by the weighted average number of ordinary shares outstanding over the period, plus the weighted average number of ordinary shares that would be created if all the potentially dilutive ordinary shares outstanding in the period were to be converted into ordinary shares.

Both basic and diluted earnings per share attributable to equity holders of the parent are calculated based on the following data:

Millions of euros

| Profit (loss)   | 2005            | 2004            |
|---|-----------------|-----------------|
| Profit from continuing operations attributable to equity holders of the parent                                  | 4,445.85        | 3,101.33        |
| Profit from discontinued operations attributable to equity holders of the parent                                | –               | 74.34           |
| <b>Total profit for the purposes of basic earnings per share attributable to equity holders of the parent</b>   | <b>4,445.85</b> | <b>3,175.67</b> |
| Adjustment for dilutive effects of the conversion of potential ordinary shares                                  | –               | –               |
| <b>Total profit for the purposes of diluted earnings per share attributable to equity holders of the parent</b> | <b>4,445.85</b> | <b>3,175.67</b> |



Thousands

| Number of shares   | 2005        | 2004        |
|--|-------------|-------------|
| Weighted average number of shares outstanding over the period for the purposes of basic earnings per share (excluding treasury shares) | 4,870,852.4 | 4,987,750.8 |
| Dilutive effect of conversion of potential ordinary shares   |             |             |
| – Endemol employee share option plans  | 832.6       | 281.7       |
| – Terra Lycos employee share option plans  | 22.2        | –           |
| Weighted average number of ordinary shares outstanding for the purposes of diluted earnings per share (excluding treasury shares)      | 4,871,707.2 | 4,988,032.5 |

The denominators used in the calculation of both basic and diluted earnings per share have been adjusted to reflect any transactions that changed the number of shares outstanding without a corresponding change in the company's equity if these had taken place at the start of the period under consideration. Specifically, an adjustment was made for the distribution of part of the share premium via the delivery of shares (1-for-25) approved at the Shareholders' Meeting of May 31, 2005, which was carried out in June 2005 (see Note 11).

There have been no operations involving existing or potential ordinary shares between the end of 2005 and the date of preparation of the consolidated financial statements.

Basic and diluted earnings per share attributable to equity holders of the parent broken down by continuing and discontinued operations is as follows:

| Figures in euros           | Continuing operations |       | Discontinued operations |       |
|----------------------------|-----------------------|-------|-------------------------|-------|
|                            | 2005                  | 2004  | 2005                    | 2004  |
| Basic earnings per share   | 0.913                 | 0.622 | –                       | 0.015 |
| Diluted earnings per share | 0.913                 | 0.622 | –                       | 0.015 |

These amounts have been calculated based on the earnings figures in the first table, since no adjustment for the dilutive effects of converting potential ordinary shares are required. The denominators used are the same as those used for the purposes of calculating basic and diluted earnings per share.

## (20) Directors' and Senior Executive Compensation and other Benefits

### *a) Directors' and senior executive compensation and other benefits*

The compensation of Telefónica, S.A.'s directors is governed by Article 28 of the bylaws, which states that the compensation paid by the Company to its directors shall be determined by the Shareholders' Meeting and shall remain in force until the Shareholders' Meeting resolves to change it. The Board of Directors is responsible for setting the exact amount to be paid within the stipulated limits and distributing it among the directors. In this regard, on April 11, 2003, shareholders set the maximum gross annual amount to be paid to the Board of Directors at 6 million euros. This includes a fixed payment and fees for attending meetings of the Board of Directors' advisory or control committees.

Therefore, the compensation of Telefónica's directors in their capacity as members of the Board of Directors and/or of the Standing Committee and the advisory and control committees

consists of a fixed amount payable monthly plus fees for attending the meetings of the Board's advisory or control committees. In addition, executive directors receive the appropriate amounts for discharging their executive duties as stipulated in their respective contracts.

In 2005 the members of the Board of Directors of Telefónica, S.A. earned the following total compensation for discharging their duties as such: Fixed payments of 4,578,161.61 euros (including the compensation earned as members of the Boards of Directors or of the advisory or control committees of other Telefónica Group companies) and attendance fees of 228,394.18 for attending the Board of Directors advisory committee meetings (including fees for attending Board advisory committee meetings of other Telefónica Group companies).

In their capacity as company executives the executive directors César Alierta Izuel, Antonio J. Alonso Ureba (who left Telefónica group on September 30, 2005), Luis Lada Díaz, Julio Linares López (appointed member of the Board of Directors of Telefónica, S.A. on December 21, 2005), Mario E. Vázquez and Antonio Viana-Baptista received: 7,422,040.98 euros in salaries and variable compensation; 169,541.43 euros in compensation in kind, which included life insurance premiums; and 47,000.00 euros in contributions made to Company-sponsored pension plans.

The detail of the compensation and benefits received by Telefónica's directors in 2005 is as follows:

**Board of Directors.** Fixed payment for each director (euros):

| Position              | 2005           |
|-----------------------|----------------|
| Chairman              | 240,000.00     |
| Vice chairman         | 200,000.00     |
| Directors (1):        |                |
| Executives            | 120,000.00 (*) |
| Nominee directors     | 120,000.00     |
| Independent directors | 120,000.00     |

(1) One of the directors, non-resident in Spain, receives an additional annual payment of 60,101.16 euros due to the key importance to the company of his experience and dedication in Latin America.

(\*) Antonio Alonso Ureba left the Telefónica group on September 30, 2005, having received fixed compensation to that date of 90,000 euros.

**Standing Committee.** Fixed payment for each director forming part of the Standing Committee, by post (euros):

| Position      | 2005          |
|---------------|---------------|
| Chairman      | 80,000.04     |
| Vice chairman | 80,000.04     |
| Members       | 80,000.04 (*) |

(\*) Antonio Alonso Ureba left Telefónica group on September 30, 2005, having been paid fixed compensation in the year to that date of 60,000 euros.

Directors receive no attendance fees for Board and Standing Committee meetings.

#### Other Board committees

a) Fixed payment for each director forming part of one of the Board committees, by post (euros):

| Position | 2005      |
|----------|-----------|
| Chairman | 20,000.00 |
| Members  | 10,000.00 |

b) Total fees paid to directors in 2005 for attending meetings of the advisory or control committees (euros):

| Committee  | 2005  |
|--|---|
| Audit and Compliance Committee                     | Attendance fee per meeting: 1,250.00<br>Number of meetings: 12<br>Total paid: 51,250.00 |
| Appointments and Compensation, and Good Governance | Attendance fee per meeting: 1,250.00<br>Number of meetings: 11<br>Total paid: 43,750.00 |
| Human Resources and Corporate Reputation           | Attendance fee per meeting: 1,250.00<br>Number of meetings: 6<br>Total paid: 27,500.00  |
| Regulation   | Attendance fee per meeting: 1,250.00<br>Number of meetings: 10<br>Total paid: 41,250.00 |
| Service Quality and Customer Service               | Attendance fee per meeting: 1,250.00<br>Number of meetings: 4<br>Total paid: 15,000.00  |
| International Affairs                              | Attendance fee per meeting: 1,250.00<br>Number of meetings: 6<br>Total paid: 31,086.10  |

**Executive directors.** Total paid to executive directors César Alierta Izuel, Antonio J. Alonso Ureba (who left Telefónica group on September, 30 2005), Luis Lada Díaz, Julio Linares López (appointed member of the Board of Directors of Telefónica, S.A. on December 21, 2005), Mario E. Vázquez and Antonio Viana-Baptista for performing their functions as group executives by concept (euros): Julio Linares López is include solely for the compensation received from the month of his appointment as director.

| Items                          | 2005         |
|--------------------------------|--------------|
| Salary                         | 3,572,766.84 |
| Variable compensation          | 3,849,274.14 |
| Compensation in kind           | 169,541.43   |
| Contributions to pension plans | 47,000.00    |

In addition, it should be noted that the non-executive directors do not receive and did not receive in 2005 any compensation in the form of pensions or life insurance, and they do not participate in the compensation plans linked to share market price.

The Company does not grant and did not grant in 2005 any advances, loans or credits to the directors, or to its top executives, thus complying with the requirements of the Sarbanes-Oxley Act passed in the U.S. which is applicable to Telefónica as a listed company in that market.

Finally, the six Company directors who are members of the Catalonia, Andalusia and Valencia advisory committees received a total 84,999.77 euros in 2005.

The nine directors who hold past as senior executives of the Company in December 2005 –in accordance with the provisions of Royal Decree-Law 377/1991 March 15, director is understood to be general managers or similar who perform senior management functions and report directly to the Management Bodies, Executive Committees or CEOs of the listed company- excluding those who are members of the Board of Directors were paid a total in 2005 for all items of 7,715,244.43 euros. One of these directors, Julio Linares López, is only included in the compensation paid from January to November 2005 as he was appointed to the Board in December.

*b) Detail of the equity interests in companies engaging in an activity that is identical, similar or complementary to that of the Company and the performance of similar activities by the directors on their own behalf or on behalf of third parties*

Pursuant to Article 127 ter. 4 of the Spanish Corporation Law, introduced by Law 26/2003 July 17, which amends Securities Market Law 24/1988 July 28, and the revised Spanish Corporation Law, in order to reinforce the transparency of listed corporations, a detail is offered below of the companies engaging in an activity that is identical, similar or complementary to the corporate purpose of Telefónica, S.A., in which the members of the Board of Directors own equity interests, and of the functions, if any, that they discharge in them:

| Name                   | Investee                       | Activity           | % of ownership <sup>1</sup> | Position           |
|------------------------|--------------------------------|--------------------|-----------------------------|--------------------|
| Isidro Fainé Casas     | Abertis Infraestructuras, S.A. | Telecommunications | < 0.01%                     | Chairman           |
| Maximino Carpio García | Telefónica Móviles, S.A.       | Telecommunications | < 0.01%                     | Director           |
| Miguel Horta e Costa   | Portugal Telecom, SGPS S.A.    | Telecommunications | < 0.01%                     | Executive Chairman |

<sup>1</sup> < 0.01% is shown if the holding is less than 0.01% of the share capital.

| Name                      | Investee  | Activity   | % of ownership | Position           |
|---------------------------|---|--|----------------|--------------------|
| Luis Lada Díaz            | Telefónica Móviles S.A.   | Telecommunications   | < 0.01%        | Director           |
|                           | Sogecable S.A.  | Television, telecommunications and audiovisual production services | < 0.01%        | Director           |
| Julio Linares López       | Telefónica Móviles, S.A.  | Telecommunications   | < 0.01%        | —                  |
| Antonio Massanell Lavilla | Telefónica Móviles S.A.   | Telecommunications   | < 0.01%        | Director           |
| Enrique Used Aznar        | Amper, S.A.   | Telecommunications equipment supplier                              | 0.39%          | Chairman           |
| Antonio Viana-Baptista    | Telefónica Móviles, S.A.  | Telecommunications   | < 0.01%        | Executive Chairman |
|                           | PT Multimedia-Serviços de Telecomunicações e Multimedia, SGPS, S.A. | Internet   | < 0.01%        | —                  |
|                           | Portugal Telecom, SGPS S.A.   | Telecommunications   | < 0.01%        | Director           |

The table below, in accordance with the same Law, gives details of activities carried out, on their own account or on behalf of third parties, by the various members of the Company Board of Directors that are identical, or similar or complementary to the corporate purpose of Telefónica, S.A.

| Name                                    | Activity   | Arrangement under which the activity is performed | Company through which the activity is performed                         | Position held or functions performed |
|---|--|---|---|--------------------------------------|
| Isidro Fainé Casas                      | Telecommunications   | As behalf of third parties o employee             | Abertis Infraestructuras, S.A.  | Chairman                             |
| Gregorio Villalabeitia Galarraga        | Telecommunications   | As behalf of third parties o employee             | Telefónica Internacional, S.A.  | Director                             |
| José Fernando de Almansa Moreno-Barreda | Telecommunications   | As behalf of third parties o employee             | Telefónica Móviles, S.A.  | Director                             |
|   | Telecommunications   | As behalf of third parties o employee             | Telefónica del Perú, S.A.A.   | Director                             |
|   | Telecommunications   | As behalf of third parties o employee             | Telefónica de Argentina, S.A.   | Director                             |
|   | Telecommunications   | As behalf of third parties o employee             | Telecomunicaciones de Sao Paulo, S.A.                                   | Director                             |
|   | Telecommunications   | As behalf of third parties o employee             | Telefónica Internacional, S.A.  | Director                             |
| Maximino Carpio García                  | Telecommunications equipmente provider                             | As behalf of third parties o employee             | Abengoa, S.A.   | Member of Advisory Council           |
|   | Telecommunications   | As behalf of third parties o employee             | Telefónica Móviles, S.A.  | Director                             |
| Alfonso Ferrari Herrero                 | Telecommunications   | As behalf of third parties o employee             | Compañía de Telecomunicaciones de Chile, S.A.                           | Director                             |
|   | Telecommunications   | As behalf of third parties o employee             | Telefónica de Perú, S.A.A.  | Director                             |
|   | Telecommunications   | As behalf of third parties o employee             | Telefónica Internacional, S.A.  | Director                             |
| Miguel Horta e Costa                    | Telecommunications   | As behalf of third parties o employee             | Portugal Telecom, SGPS S.A.   | Executive Chairman                   |
|   | Telecommunications   | As behalf of third parties o employee             | PT Comunicações, S.A.   | Executive Chairman                   |
|   | Telecommunications   | As behalf of third parties o employee             | PT Multimedia-Serviços de Telecomunicações e Multimédia, SGPS, S.A.     | Chairman                             |
|   | Telecommunications   | As behalf of third parties o employee             | TMN-Telecomunicações Móveis Nacionais, S.A.                             | Chairman                             |
|   | Telecommunications   | As behalf of third parties o employee             | PT Movéis-Serviços de Telecomunicações e Multimedia, SGPS, S.A.         | Chairman                             |
|   | Telecommunications   | As behalf of third parties o employee             | PT Sistemas de Informação, S.A.   | Chairman                             |
|   | Telecommunications   | As behalf of third parties o employee             | PT Corporate-Soluções Empresariais de Telecomunicações e Sistemas, S.A. | Chairman                             |
|   | Telecommunications   | As behalf of third parties o employee             | PT Compras-Serviços de Consultoria e Negociação, S.A.                   | Chairman                             |
|   | Telecommunications   | As behalf of third parties o employee             | PT Investimentos Internacionais-Consultoria Internacional, S.A.         | Chairman                             |
|   | Telecommunications   | As behalf of third parties o employee             | PT Prime, S.G.P.S., S.A.  | Chairman                             |
| Gonzalo Hinojosa Fernández de Angulo    | Telecommunications   | As behalf of third parties o employee             | Telefónica Internacional, S.A   | Director                             |
| Luis Lada Díaz                          | Telecommunications   | As behalf of third parties o employee             | Telefónica de España, S.A.  | Executive Chairman                   |
|   | Telecommunications   | As behalf of third parties o employee             | Telefónica Móviles, S.A.  | Director                             |
|   | Television, telecommunications and audiovisual production services | As behalf of third parties o employee             | Sogecable, S.A.   | Director                             |
|   | Telecommunications   | As behalf of third parties o employee             | Telefónica Internacional, S.A.  | Director                             |
|   | Telecommunications   | As behalf of third parties o employee             | Cesky Telecom, a.s.   | Vice Chairman of Supervisory Board   |
| Julio Linares López                     | Telecommunication equipment sales                                  | As behalf of third parties o employee             | Teleinformática y Comunicaciones, S.A. (TELYCO)                         | Chairman                             |
|   | Telecommunications   | As behalf of third parties o employee             | Cesky Telecom, a.s.   | Chairman of Supervisory Board        |
|   | Telecommunications   | As behalf of third parties o employee             | Telefónica de España, S.A.  | Director                             |
|   | Telecommunications   | As behalf of third parties o employee             | Telefónica DataCorp, S.A.   | Director                             |
|   | Telecommunications   | As behalf of third parties o employee             | Telefónica Data España, S.A.  | Director                             |

| Name                      | Activity                              | Arrangement under which the activity is performed | Company through which the activity is performed    | Position held or functions performed |
|---------------------------|---------------------------------------|---|--|--------------------------------------|
| Antonio Massanell Lavilla | Telecommunications                    | As behalf of third parties o employee             | Telefónica Móviles, S.A.                           | Director                             |
| Enrique Used Aznar        | Telecommunications Equipment provider | As behalf of third parties o employee             | Amper, S.A.  | Chairman                             |
|                           | Telecommunications                    | As behalf of third parties o employee             | Telecomunicaciones de Sao Paulo, S.A.              | Director                             |
|                           | Telecommunications                    | As behalf of third parties o employee             | Telefónica de Perú, S.A.A.                         | Director                             |
|                           | Telecommunications                    | As behalf of third parties o employee             | Telefónica Internacional, S.A.                     | Director                             |
| Mario Eduardo Vázquez     | Telecommunications                    | As behalf of third parties o employee             | Telefónica Internacional, S.A.                     | Director                             |
|                           | Telecommunications                    | As behalf of third parties o employee             | Telefónica de Argentina, S.A.                      | Chairman                             |
|                           | Telecommunications                    | As behalf of third parties o employee             | Telefónica Holding de Argentina, S.A.              | Vice Chairman                        |
|                           | Telecommunications                    | As behalf of third parties o employee             | Compañía Internacional de Telecomunicaciones, S.A. | Vice Chairman                        |
|                           | Telecommunications                    | As behalf of third parties o employee             | Telefónica Móviles Argentina, S.A.                 | Chairman                             |
|                           | Telecommunications                    | As behalf of third parties o employee             | Telefónica Comunicaciones Personales, S.A.         | Owner/director                       |
|                           | Telecommunications                    | As behalf of third parties o employee             | Radio Servicios S.A.                               | Owner/director                       |
|                           | Telecommunications                    | As behalf of third parties o employee             | Telinver, S.A.                                     | Chairman                             |
|                           | Internet and e-commerce               | As behalf of third parties o employee             | Terra Networks Argentina, S.A.                     | Vice chairman                        |
| Mario Eduardo Vázquez     | Telecommunications                    | As behalf of third parties o employee             | Telefónica Data Argentina, S.A.                    | Chairman                             |
| Antonio Viana Baptista    | Telecommunications                    | As behalf of third parties o employee             | Telefónica Móviles, S.A.                           | Executive Chairman                   |
|                           | Telecommunications                    | As behalf of third parties o employee             | Telefónica Internacional, S.A.                     | Director                             |
|                           | Telecommunications                    | As behalf of third parties o employee             | Telefónica Móviles España, S.A.                    | Chairman                             |
|                           | Telecommunications                    | As behalf of third parties o employee             | Brasilcel, N.V.                                    | Director                             |
|                           | Telecommunications                    | As behalf of third parties o employee             | Portugal Telecom, SGPS, S.A.                       | Director                             |
|                           | Telecommunications                    | As behalf of third parties o employee             | Telefónica de España, S.A.                         | Director                             |
|                           | Telecommunications                    | As behalf of third parties o employee             | Cesky Telecom, a.s.                                | Member of Supervisory Board          |

Pursuant to Article 114.2 of the Spanish Corporation Law, also introduced by Law 26/2003 July 17, it is stated that in the year to which these consolidated financial statements refer, the directors, or persons acting on their behalf, did not perform any transactions with Telefónica or any other company in the Telefónica Group other than in the normal course of the Company's business or that were not at arm's length.

## (21) Other Information

### a) Litigation

Telefónica, S.A. and its group companies are party to several lawsuits which are currently in progress in the law courts and the arbitration bodies of the various countries in which the Telefónica group is present.

Based on the advice of the Company's legal counsel it is reasonable to assume that this litigation will not materially affect the financial position or solvency of Telefónica group, even should the company lose. We highlight the following unresolved cases:

**1. A proceeding contesting certain resolutions adopted at the General Shareholders' of Telefónica, S.A. on June 15, 2001.**

Shareholder Javier Sotos García filed a complaint contesting some of the resolutions adopted at the General Shareholders' Meeting of June 15, 2001. The suit was heard by the Madrid Court of First Instance no. 15, case number 628/2001.

The complaint was based on an alleged infringement of the contesting shareholder's right to information and the legal rules for disapplication of pre-emptive subscription rights in capital increases.

On January 23, 2004, the Company was notified that the proceeding had been stayed until such time as either the parties applied for its resumption or the instance lapsed.

Based on the opinion of its legal counsel, the Company believes that the outcome of the aforementioned court proceeding will be wholly satisfactory for the Company.

**2. Procedures deriving from bankruptcy proceeding of Sistemas e Instalaciones de Telecomunicación, S.A.U. (Sintel).**

As a result of the voluntary bankruptcy proceeding heard by Madrid Court of First Instance no. 42, case number 417/2001, two criminal proceedings have commenced which affect Telefónica, S.A.

"Abbreviated" proceeding no. 273/2001 being heard before Central Examining Court no. 1, in relation to which, on September 24, 2002, Telefónica, S.A. and Telefónica de España, S.A. filed a civil suit for damages against the directors of Sintel and of Mastec Internacional, S.A.

Preliminary proceeding no. 362/2002, which commenced on October 23, 2002, before Central Examining Court no. 1 for a possible offence of extortion. This proceeding was subsequently assimilated to the preliminary proceedings in case no. 273/2001 above.

The two proceedings having been combined, on April 2004, the motion filed by counsel for Telefónica, S.A. to have the case dismissed was rejected and it was ruled that the preliminary proceedings should continue. It is important to emphasize that so far no liability has been established and the plaintiffs' claim in this regard has been explicitly dismissed.

On June 29, 2004, notice was given of a plea filed by counsel for former Sintel employees seeking to further expand the criminal complaint. This time they alleged a purported offence of criminal insolvency committed in the sale of Sintel to Mastec Internacional, Inc in April 1996. On July 4 and August 5, 2004, Telefónica, S.A. filed submissions to have this latest allegation declared inadmissible. The court has yet to rule on whether it will admit this extension of the criminal complaint.

**3. Class actions filed by shareholders of Terra in the U.S. in connection with Telefónica, S.A.'s takeover bid for Terra Networks, S.A.**

On May 29, 2003, certain Terra Networks, S.A. shareholders filed two class actions with the Supreme Court of New York State against Telefónica, S.A., Terra Networks, S.A. and certain directors of Terra Networks, S.A.

These actions are founded mainly on the claim that, in the view of the plaintiffs, the price offered to the shareholders of Terra Networks, S.A. was not in keeping with the intrinsic value of the shares of that company, and they are seeking to block the takeover or, alternatively, to win damages.

It should be noted that since the filing of the complaints, the related proceedings have remained inactive.

Based on the opinion of its legal counsel, the Company considers that it has a sound defense against both the form and the substance of the claims filed against it and, accordingly, is confident that the outcome of the litigation should not be adverse for Telefónica.

**4. Appeal for judicial review no. 6/461/03 filed at the National Appellate Court by the World Association of Shareholders of Terra Networks, S.A. (ACCTER) against the administrative decision made by the Spanish National Securities Market Commission (CNMV) on June 19, 2003, to authorise the share offer by Telefónica, S.A. for Terra Networks S.A.**

Telefónica S.A. appears in these proceedings as an intervening non-party in the case to defend the lawfulness of the CNMV's decision.

On March 8, 2005, ACCTER filed a plea to extend the facts in the case to cover the announcement of the merger between Telefónica S.A. and Terra Networks, S.A. Both Telefónica S.A. and the Government Legal Service filed submissions contesting this pleading.

Scheduled for January 10, 2006, the ruling was made and notified on January 27, 2006 (see events subsequent events Note 22).

**5. Proceeding contesting the merger resolution voted at the General Shareholders' Meeting of Terra Networks, S.A. held on June 2, 2005.**

On June 30, 2005 the World Association of Shareholders of Terra Networks, S.A. (ACCTER) and its President, on his own account, filed a complaint contesting the merger resolution adopted by the Shareholders' Meeting of Terra Networks S.A. of June 2, 2005 alleging a breach of article 60.4 of the Securities Market Law. The plaintiffs maintain that before the merger, Telefónica S.A. should have presented a public tender for the rest of the company's outstanding voting shares admitted to trading.

On December 21, 2005 Telefónica S.A. filed its answer to the claim.

**6. Claim at the ICSID.**

As a result of the enactment by the Argentine Government of Public Emergency and Exchange Rules Reform Law 25561, of January 6, 2002, Telefónica considered that the terms and conditions of the Share Transfer Agreement approved by Decree 2332/90 and the Pricing Agreement ratified by Decree 2585/91, both of which were executed by the Company with the Argentine Government, were affected appreciably, since the Law renders ineffective any dollar or other foreign currency adjustment clauses, or indexation clauses based on price indexes of other countries, or any other indexation mechanism in contracts with the public authorities. The law also requires that prices and rates derived from such clauses are denominated in pesos at an exchange rate of one peso (ARS 1) to one US dollar (US\$1).



Accordingly, since negotiations with the Argentine Government were unsuccessful, on May 14, 2003, Telefónica filed a request for arbitration with the International Center for Settlement of Investment Disputes (ICSID) pursuant to the Agreement for the Promotion and Reciprocal Protection of Investments between the Argentine Republic and the Kingdom of Spain. On July 6, 2004, the first hearing at the ICSID took place in Washington and a 90-day stay was ordered in an attempt to reach a settlement. Following the expiration of the stay without any settlement having been achieved, on December 6, 2004, Telefónica filed the “memorial” or claim with the ICSID together with the initial supporting testimonies. The Court is currently considering a plea filed by the Argentine government alleging that the matter is outside the jurisdiction of the arbitration court (see Subsequent Events - Note 22).

#### 7. Proceedings filed by Jazz Telecom, S.A.U. (Jazztel) against Telefónica de España S.A.U.

Jazztel began a number of legal proceedings in 2005 related to the Local Loop Unbundling Reference Offer (OBA) approved by the Spanish Telecommunications Market Commission, the CMT.

It filed a claim under ordinary court procedure seeking 337.36 million euros in damages for alleged delays in fulfilling contracts concluded under the OBA. This suit is currently before Madrid Court of First Instance no. 54 with case number 1619/2005. Telefónica de España S.A.U. filed its answer to this claim on February 3, 2006.

Jazztel's parent company, Jazztel Public Limited Company, filed an ordinary court claim for 456.53 million euros in damages against the Directors of Telefónica S.A. and the directors of Telefónica de España S.A.U. holding them responsible for Telefónica de España's alleged failure to comply with the OBA. The suit is currently before by Madrid Court of First Instance no. 1, with case number 585/2005.

The third claim filed by Jazztel alleges unfair trade practices by Telefónica de España S.A.U. in relation to the OBA, though without seeking any damages. In this proceeding, Telefónica de España S.A.U. has argued for a want of jurisdiction by the court. The court is currently considering this and the term for filing an answer to the claim has therefore been suspended until it rules.

#### 8. Appeal for judicial review against the administrative decision rendered by the Telecommunications Market Commission (CMT) on July 23, 2002.

The administrative decision concluded proceedings brought against Telefónica de España S.A.U. relating to the commercial terms offered to Closed User Groups and imposed an 18 million euro fine on the company.

Telefónica de España S.A.U. filed an appeal for judicial review of this decision, which was heard by Panel 8 of the Judicial Review Chamber of the National Appellate Court (case no. 8217/2004), which dismissed the appeal in its ruling dated June 29, 2004.

On October 18, 2004, Telefónica de España S.A.U. filed a cassation appeal against this ruling which has yet to come to court.

#### 9. Appeal for judicial review against the administrative decision rendered by the CMT on July 10, 2003.

This administrative decision concluded proceedings brought against Telefónica de España for alleged failure to comply with a

CMT decision in the prices applied to VIC TELEHOME and imposed an 8 million euro fine on the company.

Telefónica de España S.A.U. appealed this administrative decision on September 10, 2003 before the Judicial Review Chamber of the National Appellate Court (case no. 731/2003) and also demanded suspension of the fine. The ruling is currently pending.

#### 10. Appeal for judicial review against the administrative decision rendered by the CMT on October 24, 2002.

The contested decision arose from proceedings brought against Telefónica de España S.A.U. for alleged failure to comply with a previous CMT decision on its interconnection obligations regarding voice+data capacity, which imposed a 13.5 million euro fine.

On February 10, 2003 Telefónica de España S.A. filed an appeal for judicial review of this decision, heard by the Judicial Review Chamber of the National Appellate Court (case no. 97/2003), which ruled on July 5, 2005 to dismiss the appeal.

On October 24, 2005 the company filed a cassation appeal against this ruling.

#### 11. Appeal for judicial review of the Spanish Competition Court (TDC) ruling of April 1, 2004.

On April 1, 2004, the TDC ruled that Telefónica de España S.A.U. had engaged in anti-competitive practices and had abused its dominant market position, imposing a fine of 57 million euros.

Telefónica de España S.A.U. filed an appeal for judicial review of this decision on April 16, 2004, which is currently before Panel 6 of the Chamber of Judicial Review of the National Appellate Court (appeal no. 162/2004). It also sought to stay implementation of certain parts of the April 1 ruling, including those relating to the fine.

In its judgment of June 29, 2004, the Chamber granted an injunctive stay of execution on the fine, subject to the Telefónica de España, S.A.U. depositing a guarantee for the amount of the fine.

The main proceeding is awaiting a date for judgment.

Based on the opinion expressed by its legal counsel, the Company considers that there are strong factual and legal arguments that could lead to the appeal being upheld in whole or in part.

### b) Commitments

#### Agreements with Portugal Telecom (Brazil)

On January 23, 2001, Telefónica, S.A. and its subsidiary Telefónica Móviles, S.A., on the one hand, and Portugal Telecom SGPS, S.A. and its subsidiary PT Móveis, SGPS, S.A., on the other, agreed to group together all their wireless telephony businesses in Brazil. They therefore undertook to contribute all their wireless telephony assets in Brazil to a joint venture, which, subject to the necessary regulatory authorizations, would be a subsidiary of the two groups, and in which they would each have a 50% ownership interest. In addition, under the terms of this agreement, the two parties expressed their interest in increasing their reciprocal ownership interests, subject to compliance with the applicable regulations and bylaws.

On October 17, 2002, Telefónica Móviles, S.A., on the one hand, and Portugal Telecom SGPS, S.A. and its subsidiary PT Móveis SGPS, S.A., on the other, entered into the definitive agreements (Shareholders' Agreement and Subscription Agreement) that implement the aforementioned agreement signed in January 2001. On December 27, 2002 (after having obtained the necessary authorizations), the two groups' holdings in their respective Brazilian wireless telephony operators were contributed to a Dutch joint venture, Brasilcel N.V., in accordance with the provisions of the aforementioned Subscription Agreement.

In accordance with the aforementioned definitive agreements, Telefónica Móviles, S.A. and the Portugal Telecom group will have the same voting rights at Brasilcel, N.V. This equality in voting rights will cease to exist if, as a result of capital increases at Brasilcel, N.V., the percentage ownership of either of the parties falls below 40% during an uninterrupted period of six months. In this event, if the group with the reduced interest were the Portugal Telecom group, it would be entitled to sell to Telefónica Móviles, S.A., which would be obliged to buy (directly or through another company), all the Portugal Telecom group's ownership interest in Brasilcel N.V. This right expires on December 31, 2007. The price for the acquisition of the Portugal Telecom group's holding in Brasilcel, N.V. would be calculated on the basis of an independent appraisal (in the terms provided for in the definitive agreements) performed by investment banks, selected using the procedure established in these agreements. Subject to certain conditions, the payment could be made, at Telefónica Móviles' choice, in (i) cash, (ii) Telefónica Móviles S.A. shares and/or Telefónica, S.A. shares, or (iii) a combination of the two. This put option would be exercisable in the 12 months subsequent to the end of the aforementioned six-month period, provided that the Portugal Telecom group had not increased its ownership interest to 50% of the total capital share of Brasilcel N.V.

In addition, in accordance with the definitive agreements, the Portugal Telecom group will be entitled to sell to Telefónica Móviles, S.A., which will be obliged to buy, its holding in Brasilcel, N.V. should there be a change in control at Telefónica, S.A., at Telefónica Móviles, S.A. or at any other subsidiary of the latter that held a direct or indirect ownership interest in Brasilcel N.V. Similarly, Telefónica Móviles, S.A. will be entitled to sell to the Portugal Telecom group, which will be obliged to buy, its holding in Brasilcel, N.V. if there is a change of control at Portugal Telecom SGPS, S.A., at PT Móveis SGPS, S.A. or at any other subsidiary of either company that held a direct or indirect ownership interest in Brasilcel N.V. The price will be determined on the basis of an independent appraisal (in the terms provided for in the definitive agreements) performed by investment banks, selected using the procedure established in these agreements. The related payment could be made, at the choice of the group exercising the put option, in cash or in shares of the wireless telephony operators contributed by the related party, making up the difference, if any, in cash.

#### ***Newcomm Wireless Services, Inc. (Puerto Rico)***

On December 23, 2003, Telefónica Móviles, S.A. arranged a counter guarantantee for Telefónica, S.A. for the obligation of Newcomm Wireless Services, Inc. de Puerto Rico, regarding a 61 million dollar bridging loan granted by ABN AMRO which matures on June 30, 2005. These guarantees are deemed to be recoverable on the basis of the company's business plan and of the seniority of their claim over equity.

Subsequently, on April 20, 2005, it was agreed to extend the term of the bridging loan to June 30, 2008, and the possibility of a further 2-year extension, with a corresponding extension of the counter guarantantee.

On April 20, 2005, Telefónica Móviles S.A. arranged a counter guarantantee for Telefónica, S.A. for the obligation of Newcomm Wireless Services, Inc. de Puerto Rico, regarding a subordinated loan of up to 40 million dollars granted by ABN AMRO to meet Newcomm's license payments to the FCC (Federal Communications Commission) maturing June 30, 2010.

#### ***Medi Telecom (Morocco)***

Telefónica Móviles España S.A.U., as a shareholder of Medi Telecom, signed a "Shareholders' Support Agreement" together with Portugal Telecom and the BMCE group. This commitment requires the signatories to jointly and severally provide up to 210 million euros of financial assistance to Medi Telecom in the event of non-compliance with financial clauses or a shortfall in funds at Medi Telecom that would prevent it from meeting its debt servicing obligations. If Medi Telecom obtains a specific level of operating income before depreciation and amortization during a certain period of time and if it fulfils all its obligations under the loan agreement, this financial commitment will automatically be cancelled.

As a result of the loans and capital increases subscribed by, inter alia, Telefónica Móviles España, S.A.U., the aforementioned commitment between the latter, Portugal Telecom and the BMCE group was reduced to 118.3 million euros at December 31, 2005.

#### ***Guarantees provided for Ipse 2000 (Italy)***

The Telefónica group has provided guarantees securing financial transactions for the Italian company Ipse 2000 S.p.A. (holder of a UMTS license in Italy) in which it owns an indirect stake through Telefónica Móviles, S.A. and Telefónica DataCorp, S.A.U.. These transactions are mainly to finance sums payable to the Italian Government in connection with the grant of the license amounting to 483.93 million euros.

On December 27, 2002, Telefónica Móviles, S.A. arranged a counter guarantantee for Telefónica, S.A., which in turn was counter guaranteed by Telefónica Móviles España, S.A.U. Under this agreement, subject to certain terms and conditions, Telefónica Móviles, S.A. undertakes vis-à-vis Telefónica, S.A. to pay 91.79% of any amounts Telefónica S.A. may be legally, contractually or judicially obliged to pay in connection with the guarantee that it (jointly with other strategic partners of Ipse 2000, S.p.A.) provided to certain banks, which in turn provided a bank guarantee for the Italian authorities as security for the deferred payment of the UMTS license. On November 30, 2005, to avoid the Italian Government calling in the guarantee, the company paid 120.33 million euros representing a quarter of the amount outstanding owed as deferred payment for the additional 5 MHz of spectrum awarded to Ipse 2000 SpA by the Italian Government for an original total value of 826.33 million euros. On December 31, 2005, the amount outstanding was 601.67 million euros. This additional 5MHz of spectrum was returned by Ipse 2000, S.p.A., and the validity of said return is currently in dispute with the Italian Government.

On October 25, 2000, Ipse 2000, S.p.A. signed an agreement with Ferrovie dello Stato, S.p.A., an Italian railroad company, whereby Ipse 2000, S.p.A. was granted certain access and user rights to certain specific sites owned by the railroad company. Telefónica, S.A. provided a guarantee of up to 48.2 million euros to secure the amounts owed under this agreement. On May 9, 2005 the parties executed the cross-border agreement through the payment of 93.36 million euros. Of this amount, the Telefónica Móviles Group paid 39.39 million euros.

#### **Telefonica Deutschland GMBH (Germany)**

On March 31, 2005 Telefonica Deutschland GMBH signed an agreement with AOL Europe Services S.A.R.L. to lease its local loop. This contract is guaranteed by Telefónica, S.A., which, under certain terms, is obliged to guarantee AOL Europe continuity of the service for six months and, as appropriate, to bear the migration costs of AOL Europe customers to another provider up to a maximum of 20 million euros. Telefónica Deutschland GmbH also has guarantees with a German lending institution, Commerzbank, for a total of 12.84 million euros at December 31, 2005 to ensure the appropriate provisions of services to third parties.

#### **Atento**

Within the framework of the strategic agreement entered into on February 11, 2000, by Banco Bilbao Vizcaya Argentaria S.A. (BBVA) and Telefónica, on December 4, 2001, the two signed an agreement establishing the procedure and conditions for the integration in Atento, a Telefónica group subsidiary, of the BBVA group's Spanish and international call center business.

The agreement provided for the initial contribution by Telefónica S.A. of all its contact center business to a newly-formed subsidiary (Atento N.V.) and the subsequent inclusion of the BBVA group in the shareholder structure of Atento N.V. through the contribution of the Spanish companies Procesos Operativos, S.A. and Leader Line, S.A., which entailed the transfer to Atento of the BBVA group's Spanish and international call center business.

The transaction also envisaged the signing of various specific agreements for the provision to the BBVA group by Atento of call center services in Spain and Portugal and in several Latin American countries.

Atento N.V. was incorporated on May 31, 2002. All Telefónica, S.A.'s call center business was contributed to it on that date. The contributions by the BBVA group under the terms of the agreement discussed in this section have not yet been made.

On October 24, 2003, BBVA, Telefónica, S.A. and Atento N.V. entered into an Agreement establishing the terms and conditions under which BBVA, through General de Participaciones Empresariales, S.L. (GPE) became a shareholder of Atento N.V. by contributing all the shares of Procesos Operativos, S.A. As a result of this Agreement, Telefónica, S.A. currently owns shares representing 91.35% of Atento N.V.'s share capital, while GPE (a BBVA group company) owns the remaining 8.65%.

Subsequently, on December 1, 2003, the Atento Group company Atento Teleservicios España, S.A. acquired all the shares of Leader Line, S.A.

On November 27, 2003, BBVA and Atento N.V. entered into a framework contract for services, with a term of four years, establishing the terms under which Atento N.V. and its subsidiaries will provide call center activities and services to the BBVA group.

At the same time as the aforementioned acquisition of Leader Line, S.A., Telefónica and GPE entered into a put option contract whereby GPE has the right to sell to Telefónica, which will be obliged to buy, all the shares of Atento N.V. that GPE owns at the time the option is exercised.

#### **Commitments in relation to Sogecable**

As a result of the agreements dated May 8, 2002 and January 29, 2003, between Telefónica, S.A., Telefónica de Contenidos, S.A.U. and Sogecable, S.A., relating to the merger of Via Digital into Sogecable, on January 29, 2003, Telefónica, S.A. informed the Spanish securities exchange commission (the SEC) through a relevant event notification that its strategic plans at that date did not envisage the disposal of the 16.38% shareholding within a period of at least three years from the date of the exchange.

#### **Commitments relating to audiovisual content (Telefónica de Contenidos)**

At December 31, 2004, Telefónica de Contenidos had the following commitments relating to sports broadcasting rights:

1. In December 2004, Canal Satélite Digital, S.A. gave its approval to allow Telefónica de Contenidos to broadcast on a non-exclusive basis under the pay-per-view (PPV) system the signal for the soccer games of the First and Second Divisions of the Spanish National Soccer League and of the King's Cup (Copa de S.M. El Rey) (except for the final) produced by Audiovisual Sport, from January 1, 2005, at current market prices for this type of content and for a period that will depend on the soccer seasons for which the content provider will be able to renew the current agreements with the soccer clubs.
2. Likewise in December 2004, an agreement was entered into with Audiovisual Sport for the latter to provide the broadcast signal to Telefónica de Contenidos and/or the Telefónica Group companies to which Telefónica de Contenidos assigns the signal, for the soccer games specified in the agreement with Canal Satélite Digital, at market prices for this type of content for each soccer game, with guaranteed minimum payments per season to Audiovisual Sport from January 1, 2005, and for a period that will depend on the soccer seasons for which the content provider will be able to renew the current agreements with the soccer clubs.

#### **Terra Networks, S.A. (now Telefónica, S.A.) – BBVA (Uno-e Bank, S.A.)**

By virtue of the agreements entered into in February 2000 by Telefónica, S.A. and Banco Bilbao Vizcaya Argentaria, S.A. (BBVA), in August 2001 Terra Networks, S.A. acquired a 49% holding in Uno-e Bank, S.A. for 160.43 million euros.

On May 15, 2002, Terra Networks, S.A. and BBVA entered into a memorandum of understanding to integrate the consumer finance lines of business of Finanzia Banco de Crédito, S.A. (a wholly-owned subsidiary of BBVA) and Uno-e Bank, S.A. The agreement relating to this integration was subject to a legal, financial and business review, and to the relevant internal and administrative authorizations. After the integration, Terra Networks, S.A.'s ownership interest in Uno-e Bank, S.A. was 33% and that of the BBVA Group was 67%.

On that same date (May 15, 2002), BBVA and Terra Networks, S.A. entered into a liquidity agreement in which they established certain liquidity mechanisms (call and put options) relating to the Uno-e Bank, S.A. shares owned by Terra Networks, S.A., which would be modified if a definitive agreement were reached regarding the aforementioned integration of the consumer finance lines of business of Finanzia Banco de Crédito, S.A. and Uno-e Bank, S.A., to the effect that BBVA would lose its call option and Terra Networks, S.A. would retain its put option, but only at the market value as determined by an investment bank.

On January 10, 2003, Terra Networks, S.A. and BBVA entered into an agreement for the integration of the consumer finance line of business of Finanzia Banco de Crédito, S.A. and Uno-e Bank, S.A., in terms more suited to their respective interests than those established in the memorandum of understanding of May 15, 2002, which was then rendered void. The definitive agreement was subject to the related internal and administrative authorizations, which had to be granted before June 30, 2003, as a condition for the formalization and execution of the integration transaction. After the integration had taken place, Terra Networks, S.A.'s ownership interest in Uno-e Bank, S.A. was 33% and that of the BBVA Group was 67%.

On that same date (January 10, 2003), BBVA and Terra Networks, S.A. entered into a liquidity agreement that replaced that dated May 15, 2002, when the aforementioned integration took place. This agreement establishes the following liquidity mechanism (put options) relating to the Uno-e Bank, S.A. shares owned by Terra Networks, S.A.: Terra Networks, S.A. has the right to sell to BBVA, and BBVA is obliged to acquire, Terra Networks, S.A.'s holding in Uno-e Bank, S.A. between April 1, 2005 and September 30, 2007, at market value, established as the higher of the two following values: (i) that determined by an investment bank; and (ii) that obtained by multiplying the income after taxes of Uno-e Bank, S.A. by the P/E ratio of BBVA, multiplied by the percentage of ownership held by Terra Networks, S.A. that it intended to sell as of that date.

In addition, the strike price of the aforementioned option may not be lower than 148.5 million euros if Uno-e Bank, S.A. does not achieve the net ordinary revenue and pre-tax income targets set for 2005 and 2006 in the above-mentioned liquidity agreement.

In accordance with the terms of the aforementioned agreement dated January 10, 2003, once the relevant authorizations had been obtained, on April 23, 2003, approval was given at the Extraordinary Shareholders' Meeting of Uno-e Bank, S.A. for a capital increase at Uno-e Bank, S.A. to be subscribed in full by Finanzia Banco de Crédito, S.A., through the nonmonetary contribution of the latter's consumer finance business line, at whose Extraordinary Shareholders' Meeting held on the same date approval was given for the contribution and the subscription in full of the capital increase.

This capital increase led to the integration of the consumer finance business line of Finanzia Banco de Crédito, S.A. into Uno-e Bank, S.A.,

following which the holdings of the BBVA Group and Terra Networks, S.A. (now Telefónica, S.A.) in Uno-eBank, S.A. are 67% and 33%, respectively.

#### ***Other commitments in the form of performance bonds for concessions or licenses***

1. Telefónica Móviles España, S.A.U., a subsidiary of Telefónica Móviles, S.A., which is in turn a subsidiary of Telefónica, S.A., provided certain financial guarantees to the Spanish State amounting to 1,100 million euros in relation to the UMTS license in Spain granted to Telefónica Móviles España, S.A.U. These guarantees ensure fulfillment of the commitments assumed by the company awarded the license in relation to network deployment, job creation, investments, etc.

Telefónica Móviles España, S.A.U. initiated negotiations with the Ministry of Science and Technology with a view to changing the existing system of guarantees. This process was completed through an Official Notice issued by the Secretary of State for Telecommunications and for the Information Society on July 28, 2003, as a result of which the 71 guarantees in force at that date amounting to 630.9 million euros that were securing the commitments assumed under the UMTS license were returned to Telefónica Móviles España, S.A.U., after the latter had arranged, in the same month, a guarantee of 167.5 million euros with the Government Depositary, to secure compliance with the UMTS service commitments prior to launch of the UMTS and the commitments of the first year from the date of commercial launch, in accordance with the new system of guarantees. In September 2003, Telefónica Móviles España, S.A.U. cancelled the returned guarantees at the respective banks.

On June 23, 2004, the Ministry of Industry, Tourism and Commerce issued an order authorizing the change in the commitments assumed by Telefónica Móviles España, S.A.U. in connection with the operation of the third-generation wireless telecommunications (UMTS) service. Under this, order the requests filed by Telefónica Móviles España, S.A.U. in this respect were upheld, compliance with certain commitments was reinterpreted and other commitments were eliminated for the benefit of public interest.

As a result of this change, the amount to be guaranteed by Telefónica Móviles España, S.A.U. as a performance bond for the commitments assumed prior to the launch of the UMTS service and in the first year of service was reduced to 157.5 million euros. The guarantee therefore amounted to 157.5 million euros at December 31, 2005.

Telefónica Móviles de España, S.A. has begun the procedures to accredit its first year of operating the UMTS service before the Ministry. Compliance with the commitment would reduce the amount guaranteed.

2. Telefónica Móviles, S.A. is backing the commitments assumed by Grupo de Telecomunicaciones Mexicanos, S.A. de C.V. (GTM) with the regulator, COFETEL, for its domestic long-distance (DLD) license. The maximum amount of this support is 124.15 million Mexican pesos. As of the date of preparation of these consolidated financial statements no disbursements had been made in this respect.

3. In 1999 Telefónica de Argentina, S.A. provided guarantees for the promissory notes amounting to 22.5 million dollars provided by Telefónica Comunicaciones Personales, S.A. to the Argentine Government to guarantee the fulfillment of the obligations assumed in the obtainment of the PCS licenses for areas I and III. In addition, Telefónica de Argentina, S.A. jointly and severally guaranteed, with Telecom Argentina Stet-France Telecom, S.A., the promissory notes amounting to 45 million Argentine pesos provided jointly by Telefónica Comunicaciones Personales, S.A. and Telecom Personal, S.A. to the Argentine Government to guarantee the fulfillment of the obligations assumed in the obtainment of the PCS licenses for area II. These guarantees are still in force, pending verification by the Regulatory Authority of the fulfillment of the PCS network coverage obligations secured by these guarantees. In 2003 the Regulatory Authority verified substantially all the coverage obligations in areas I and III, leaving only the cities of La Rioja, Córdoba and Catamarca. The Regulatory Authority completed the verification of the PCS network coverage obligations in the aforementioned cities and in area II in 2004. The Regulatory Authority must now decide whether to return the guarantees.

Telefónica, S.A. and its subsidiaries, which in turn head subgroups, perform, as holding companies, various equity investment purchase and sale transactions in the course of their business activities, in which it is standard practice to receive or provide guarantees regarding the nonexistence of liabilities, contingencies, etc. in the investments forming the subject matter of the related transactions.

The contingencies arising from the commitments described above were evaluated when the consolidated financial statements at December 31, 2005, were prepared, and the provisions recorded with respect to the commitments taken as a whole are not representative.

### c) Environmental matters

Through its investees and in line with its environmental policy, the Telefónica Group has undertaken various environmental-management initiatives and projects. In 2005 and 2004 these initiatives and projects resulted in expenditure and investment for insignificant amounts, which were recognized in the consolidated income statement and consolidated balance sheet, respectively.

The Group has launched various projects with a view to reducing the environmental impact of its existing installations, with project costs being added to the cost of the installation to which the project relates.

The Group has also rolled out internal control mechanisms sufficient to pre-empt any environmental liabilities that may arise in future, which are assessed at regular intervals either by Telefónica staff or renowned third-party institutions. No significant risks have been identified in these assessments.

### d) Auditors' fees

In 2005 fees paid to the various companies forming part of the Ernst&Young International Group, to which Ernst&Young, S.L. (the auditors of the Telefónica Group) belongs, amounted to 14.84 million

euros. In 2004 fees paid to the various companies forming part of the Deloitte Touche Tohmatsu International Group, to which Deloitte, S.L. (the auditors of the Telefónica Group) belongs, amounted to 12.53 million euros.

The detail of these amounts is as follows:

| Millions of euros             | 2005         | 2004         |
|-------------------------------|--------------|--------------|
| Audit of financial statements | 11.19        | 8.56         |
| Other audit services          | 1.96         | 2.95         |
| Non-audit work                | 1.69         | 1.02         |
| <b>Total</b>                  | <b>14.84</b> | <b>12.53</b> |

These fees include amounts paid in respect of fully and proportionally consolidated Spanish and foreign Telefónica Group companies. A total of 0.61 million euros, corresponding to 50% of the fees paid by proportionally consolidated companies, was included in 2004.

Fees paid to other auditors in 2005 and 2004 amounted to 15.22 million euros and 11.20 million euros, respectively, with the following detail:

| Millions of euros             | 2005         | 2004         |
|-------------------------------|--------------|--------------|
| Audit of financial statements | 4.30         | 2.55         |
| Other audit services          | 3.78         | 0.23         |
| Non-audit work                | 7.14         | 8.42         |
| <b>Total</b>                  | <b>15.22</b> | <b>11.20</b> |

These fees include amounts paid in respect of fully and proportionally consolidated Spanish and foreign Telefónica Group companies. A total of 0.86 million euros, corresponding to 50% of the fees paid by proportionally consolidated companies, was included in 2005.



### e) Contractual obligations

The detail and estimated schedule of contractual obligations that could require significant cash outlays in the future at December 31, 2005 and 2004 are as follows:

| Millions of euros             |                  |                     |                      |                      |                      |
|-------------------------------|------------------|---------------------|----------------------|----------------------|----------------------|
| 12-31-05                      | Total            | Less than<br>1 year | From 1 to<br>3 years | From 3 to<br>5 years | More than<br>5 years |
| Long-term borrowings          | 34,403.46        | 9,235.88            | 4,735.90             | 7,936.70             | 12,494.98            |
| Operating leases              | 2,107.44         | 365.87              | 683.90               | 363.00               | 694.67               |
| Purchase commitments          | 1,005.18         | 908.01              | 62.18                | 7.19                 | 27.80                |
| Other non-current obligations | 6,353.24         | 945.81              | 1,567.45             | 1,128.34             | 2,711.64             |
| <b>Total</b>                  | <b>43,869.32</b> | <b>11,455.57</b>    | <b>7,049.43</b>      | <b>9,435.23</b>      | <b>15,929.09</b>     |

| Millions of euros             |                  |                     |                      |                      |                      |
|-------------------------------|------------------|---------------------|----------------------|----------------------|----------------------|
| 12-31-04                      | Total            | Less than<br>1 year | From 1 to<br>3 years | From 3 to<br>5 years | More than<br>5 years |
| Long-term borrowings          | 27,702.63        | 10,210.40           | 4,050.98             | 4,081.18             | 9,360.07             |
| Operating leases              | 1,524.28         | 279.18              | 542.71               | 265.84               | 436.55               |
| Purchase commitments          | 1,201.50         | 804.85              | 273.78               | 108.02               | 14.85                |
| Other non-current obligations | 7,407.66         | 864.57              | 2,242.31             | 1,095.31             | 3,205.47             |
| <b>Total</b>                  | <b>37,836.07</b> | <b>12,159.00</b>    | <b>7,109.78</b>      | <b>5,550.35</b>      | <b>13,016.94</b>     |

## (22) Subsequent Events

The main events for the Telefónica Group taking place in the period from December 31, 2005 to the date of preparation of these consolidated financial statements (consolidated annual accounts) are as follows:

### *Ipse 2000, S.p.A. (Italy)*

On January 31, 2006, the Italian Government informed Ipse 2000, S.p.A., in which Telefónica Móviles and Telefónica Datacorp have indirect stakes of 45.59% and 4.08%, respectively, of its decision to revoke the UMTS license granted to it in 2000. The company is studying potential courses of action (see Note 9).

### *EMTN Program for the issuance of debt instruments (Telefónica Emisiones, S.A.U.)*

On February 2, 2006, Telefónica Emisiones, S.A.U., a subsidiary of Telefónica, S.A., held four bond issues, two in euros (for a combined amount of 4,000 million euros) and two in pounds sterling (for a combined 1,250 million pounds sterling) in line with the 15,000 million euro EMTN (issue of medium-term notes) arranged on July 8, 2005. This program is underwritten by Telefónica, S.A. (see Note 15).

### *Brasilcel corporate restructuring*

In February 2006, approval was given at the respective shareholders' meetings of Telesp Celular Participações, S.A. ("TCP"), Tele Centro Oeste Celular Participações, S.A. ("TCO"), Tele Sudeste Celular Participações, S.A. ("TSD"), Tele Leste Celular Participações, S.A. ("TLE") and Celular CRT Participações, S.A. ("CRT Part") for a corporate restructuring for the exchange of TCO shares for TCP shares and absorption at TSD, TLE and CRT part. As a result, TCP became a 100% subsidiary.



### Takeover bid for O2 plc

With respect to the takeover bid for 100% of UK operator O2 plc, on January 3, 2006 Telefónica, S.A. waived the minimum acceptance restriction on the offer made November 21, 2005, declaring it “unconditional as to acceptances,” in accordance with the procedures established by the UK City Code on Takeovers and Mergers (see Note 8).

On January 10, 2006, Telefónica, S.A. received notification of the European Commission’s decision to authorize the concentration resulting for Telefónica, S.A.’s acquisition of the UK wireless operator, O2 plc.

On January 23, 2006, Telefónica, S.A. stated that it had complied with all the requirements of the full takeover of O2 plc made on November 21, 2005 and that, in accordance with the procedures established by the UK City Code on Takeovers and Mergers, the offer was wholly unconditional.

On January 27, 2006, having acquired or received acceptances representing more than 90% of the O2 plc shares included in the bid, Telefónica, S.A. announced its intention of initiating the forced sale of outstanding O2 plc shares in accordance with sections 428 to 430F (inclusive) of the UK Companies Act. Subsequent to this announcement, on February 22, 2006, notification was made that the procedure against shareholders rejecting the offer had commenced.

Meanwhile, on February 7, 2006 O2 plc announced the beginning of the process to delist O2 plc from the London Stock Exchange. The delisting is expected to occur on March 7, 2006.

### Litigation

On January 27, 2006, the Group was notified of ruling of January 24 mentioned above, with Panel 6 of the Chamber of Judicial Review of the National Appellate Court ruling that the appeal filed by ACCTER was inadmissible and rejecting that lodged by Mr. Fabian López against the decision of June 19, 2003 made by the Spanish National Securities Market Commission (CNMV) to authorize the takeover bid by Telefónica, S.A. for Terra Networks S.A.

### Memorandum of understanding with the Argentine government

On February 15, 2006, Telefónica Argentina, S.A. signed a memorandum of understanding with the Argentine government as a prerequisite to reaching an agreement to renegotiate the transfer contract approved by Royal Decree-Law 2332/90 pursuant to the provisions of Article 9° of Law 25,561.

Among other issues, this memorandum of understanding envisages the suspension by Telefónica de Argentina, S.A. and Telefónica, S.A., for a period of 210 working days, of the procedure for all claims, appears and demands planned or underway, with the administrative, arbitral or legal courts of Argentina or abroad, which are based on facts or measures taken from the emergency situation established by Law N° 25,561 with regard the Transfer Contract and the licence granted to the Company (see Note 21). This suspension

shall be levied 30 days after the completion of the Public Hearing to be called by the Public Service Contract Renegotiation and Analysis Unit (*Unidad de Renegociación y Análisis de Contratos de Servicios Públicos*, or UNIREN) of Argentina to address the memorandum of understanding. This hearing has yet to be called.

### Formal complaint by the European Commission

The European Commission (EC) has announced its decision to initiate formal proceedings against Telefónica via notification dated February 22, 2006 of a list of charges and preliminary conclusions.

In this list, the EC considers that Telefónica, S.A. and its Telefónica de España, S.A.U., Telefónica Data España, S.A.U. and Terra Networks España, S.A.U. subsidiaries could, at least in the year 2001, have taken abusive advantage of their dominant position by putting a so-called ‘margin squeeze’ on broadband internet access prices.

### Deregulation by the CMT of wireline rates

The CMT has decided to deregulate retail wireline telephone rates for both individuals and businesses. At its meeting of February 9, 2006, the regulator’s Board agreed to eliminate the regulated tariff system of Telefónica known as the price cap for this type of traffic from August 1, 2000.

The measure, which will come into effect following the publication in the Official State Gazette (*Boletín Oficial del Estado*), implies the end of the current price cap on telephone traffic from the wireline network. From then, the market rather than the government will set the maximum price.

### Interim dividend charged to 2005 income

At its meeting of February 28, 2006, Telefónica, S.A.’s Board of Directors based on the financial information furnished to it, agreed, pursuant to Article 216 of the Spanish Corporation Law, to distribute a fixed interim dividend out of 2005 income of a gross 0.25 euros per share for the Company’s outstanding shares carrying dividend rights, up to a maximum total amount of 1,230.28 million euros, proposing that this interim dividend be paid on May 12, 2006 (see Note 3).

### Accounting Statement Supporting the Distribution of the Interim Dividend:

|  | Millions of euros |
|--|-------------------|
| Income obtained by the parent company from January 1, 2005 through December 31, 2005 | 1,754.39          |
| Mandatory appropriation to reserves  | (64.15)           |
| Unrestricted income  | 1,690.24          |
| Proposed interim dividend (maximum amount)   | 1,230.28          |

---

**Cash Position:**

As shown in the Telefónica, S.A. 2005 individual annual accounts prepared by the Board of Directors at its meeting of February 28, 2006, at December 31, 2005, there was sufficient liquidity for the payment of dividends. This liquidity also existed at February 17, 2006, as evidenced by the following statement of liquidity:

| <b>Funds available for distribution</b>    | <i>Millions of euros</i> |
|--|--------------------------|
| Cash and cash equivalents                  | 683.00                   |
| Unused credit facilities                   | 6,750.00                 |
| Proposed interim dividend (maximum amount) | (1,230.28)               |
| Difference                                 | 6,202.72                 |

## (23) Additional Note for English Translation

These financial statements are presented on the basis of International Reporting Standards adopted by the European Union. Consequently, certain accounting practices applied by the Group not conform with generally accepted principles in other countries.

## Appendix I

### *Contribution of Group companies to translation differences*

The contributions by Group companies to translation differences of the parent company at December 31, 2005 and 2004 were as follows:

Millions of euros

| <b>Company</b>                              | <b>12-31-05</b> | <b>12-31-04</b> |
|---|-----------------|-----------------|
| Telefónica Internacional Group              | 1,057.85        | (46.31)         |
| Telefónica Móviles Group                    | 683.67          | (184.65)        |
| Cesky Telecom Group                         | 120.86          | -               |
| Atento Group                                | 6.70            | (8.50)          |
| Telefónica Contenidos Group                 | 0.38            | 4.02            |
| Telefónica Publicidad e Información Group   | 5.51            | 0.74            |
| Telefónica de España Group                  | 0.06            | 0.06            |
| T- Gestiona Group                           | 1.31            | (0.30)          |
| Other companies and intergroup transactions | (49.97)         | (73.34)         |
| <b>Total Telefónica Group</b>               | <b>1,826.37</b> | <b>(308.28)</b> |

## Subsidiaries, Associates and Investees as of 12-31-2005

| (millions of euros)  | % Ownership    |          |                  | Capital         | Reserves        | Interim Dividend | Income (loss) | Gross Carrying Amount | Consolidation Method | Value in Consolidation (10) |
|--|----------------|----------|------------------|-----------------|-----------------|------------------|---------------|-----------------------|----------------------|-----------------------------|
|  | Direct         | Indirect | Telefónica Group |                 |                 |                  |               |                       |                      |                             |
| <b>Telefónica de Contenidos, S.A.U. (SPAIN) (*) (**) (1) (6) (9)</b><br><b>Organization and operation of multimedia service-related businesses</b><br><i>Paseo de la Castellana, 141 - 28046 Madrid</i>              | <b>100.00%</b> |          | <b>100.00%</b>   | <b>2,163.60</b> | <b>(948.54)</b> | -                | <b>78.83</b>  | <b>2,241.88</b>       | <b>FC</b>            | -                           |
| <b>Telefónica Media Argentina, S.A. (ARGENTINA) (1)</b><br>Participation in media-related businesses<br><i>Tucumán, 1 Pta. 17º - Buenos Aires</i>  |                | 100.00%  | 100.00%          | 4.85            | (7.24)          | -                | -             | 790.72                | FC                   | -                           |
| <b>Atlántida Comunicaciones, S.A. (ARGENTINA) (1) (6)</b><br>Free-to-air TV and radio<br><i>Tucumán, 1 Pta. 20 - Buenos Aires</i>  |                | 100.00%  | 100.00%          | 491.88          | (567.37)        | -                | 89.98         | -                     | FC                   | -                           |
| Other shareholdings  |                | N/A      | N/A              | N/A             | N/A             | N/A              | N/A           | N/A                   | EM                   | 0.06                        |
| <b>Telefónica Servicios Audiovisuales, S.A. (SPAIN) (*) (**) (1)</b><br>Provision of all type of audiovisual telecommunications services<br><i>Virgilio, 2 - Edificio 2 - Ciudad de la Imagen (*) - 28223 Madrid</i> | 100.00%        |          | 100.00%          | 6.01            | 13.95           | -                | 0.28          | 8.37                  | FC                   | -                           |
| <b>Andalucía Digital Multimedia, S.A. (SPAIN)</b><br>Development of the audiovisual industry in Andalusia<br><i>Edificio Azul, Parque Tecnológico de Andalucía - Málaga</i>  |                | 24.00%   | 24.00%           | 1.26            | (0.98)          | -                | -             | 0.43                  | EM                   | 0.02                        |
| <b>Hispasat, S.A. (SPAIN) (2)</b><br>Operation of a satellite telecommunications system<br><i>Gobelas, 41 - 28023 Madrid</i>   |                | 13.23%   | 13.23%           | 121.95          | 158.01          | -                | 12.72         | 17.59                 | EM                   | 38.73                       |
| <b>Telefónica Servicios de Música, S.A.U. (SPAIN) (*) (**) (4)</b><br>Provision of telemarketing services<br><i>Luchana, 23, 1º - 28010 Madrid</i>   |                | 100.00%  | 100.00%          | 1.36            | (0.01)          | -                | 1.15          | 2.79                  | FC                   | -                           |
| <b>Sogetecable, S.A. (SPAIN) (1) (6) (11)</b><br>Indirect management of public service television<br><i>Gran Vía, 32 - 3ª Pta. - 28013 Madrid</i>  | 1.60%          | 22.23%   | 23.83%           | 267.13          | 29.17           | -                | 7.73          | 1,064.70              | EM                   | 675.94                      |
| <b>Patagonik Film Group, S.A. (ARGENTINA) (2)</b><br>Audiovisual content producer<br><i>Godoy Cruz, 1540 - 1414 Buenos Aires</i>   |                | 30.00%   | 30.00%           | 2.42            | (0.42)          | -                | -             | 8.58                  | EM                   | 0.74                        |
| Other Shareholdings (1)  |                | N/A      | N/A              | N/A             | N/A             | N/A              | N/A           | 13.28                 | C                    | 13.28                       |
| <b>Endemol Holding, N.V. (NETHERLANDS) (1) (6)</b><br><b>Holding company</b><br><i>Bergweg 70, 1217 SC Hilversum</i>   | <b>99.70%</b>  |          | <b>99.70%</b>    | <b>0.69</b>     | <b>271.90</b>   | -                | <b>334.82</b> | <b>842.16</b>         | <b>FC</b>            | -                           |
| <b>Endemol Investment B.V. (NETHERLANDS) (1)</b><br>Holding company. Financing and operation of intellectual property rights<br><i>Bergweg 70, 1217 SC Hilversum</i>   |                | 100.00%  | 99.70%           | 0.67            | 275.96          | -                | 293.77        | N/A                   | FC                   | -                           |
| <b>Endemol Holding France (3)</b><br>Holding and service company   |                | 100.00%  | 99.70%           | 100.04          | (83.31)         | -                | (17.91)       | N/A                   | FC                   | -                           |
| <b>Endemol France (Holding) SAS (FRANCE) (3)</b><br>Holding and service company<br><i>8-10 rue Torricelli, 75017 Paris, France</i>   |                | 100.00%  | 99.70%           | 0.04            | (0.60)          | -                | 34.06         | N/A                   | FC                   | -                           |
| <b>Endemol NV (NETHERLANDS) (1) (11)</b><br>Holding company. Financing and operation of intellectual property rights<br><i>Bergweg 70, 1217 SC Hilversum</i>   |                | 75.00%   | 74.77%           | 12.50           | 109.79          | -                | -             | N/A                   | FC                   | -                           |
| <b>Endemol Holding BV (NETHERLANDS) (1)</b><br>Holding company. Financing and operation of intellectual property rights<br><i>Bergweg 70, 1217 SC Hilversum</i>  |                | 75.00%   | 74.77%           | 0.02            | 127.77          | -                | (3.49)        | N/A                   | FC                   | -                           |
| <b>Endemol International B.V. (NETHERLANDS) (1)</b><br>Audiovisual content producer<br><i>Bergweg 70, 1217 SC Hilversum</i>  |                | 75.00%   | 74.77%           | 0.02            | 3.75            | -                | 7.31          | N/A                   | FC                   | -                           |
| <b>Endemol Nederland Holding, B.V. (NETHERLANDS) (1)</b><br>Holding and financial company<br><i>Bergweg 70, 1217 SC Hilversum</i>  |                | 75.00%   | 74.77%           | 0.02            | 2.05            | -                | 0.85          | N/A                   | FC                   | -                           |
| <b>Endemol Nederland, B.V. (NETHERLANDS) (1)</b><br>Radio and television broadcasting and production<br><i>Van Cleeffkade 15, 1431 BA Aalsmeer</i>   |                | 75.00%   | 74.77%           | 0.30            | (1.76)          | -                | 7.93          | N/A                   | FC                   | -                           |

(\*) Companies included in the 2004 consolidated tax statement.

(\*\*) Companies included in the 2005 consolidated tax statement.

## Subsidiaries, Associates and Investees as of 12-31-2005

| (millions of euros)   | % Ownership |          |                  | Capital | Reserves | Interim Dividend | Income (loss) | Gross Carrying Amount | Consolidation Method | Value in Consolidation (10) |
|---|-------------|----------|------------------|---------|----------|------------------|---------------|-----------------------|----------------------|-----------------------------|
|   | Direct      | Indirect | Telefónica Group |         |          |                  |               |                       |                      |                             |
| <b>Endemol International Distribution (NETHERLANDS) (1)</b><br>Sale and operation of audiovisual rights<br><i>Bergweg 70, 1217 SC Hilversum</i>   |             | 75.00%   | 74.77%           | 0.02    | (3.50)   | –                | 0.88          | N/A                   | FC                   | –                           |
| <b>Stokvis &amp; Nieve Produkties B.V. (NETHERLANDS)</b><br>Sale and operation of audiovisual rights<br><i>Laren</i>  |             | 63.75%   | 63.56%           | 0.04    | (0.69)   | –                | 2.99          | N/A                   | FC                   | –                           |
| <b>625 TV Produkties B.V. (NETHERLANDS)</b><br>Sale and operation of audiovisual rights<br><i>Almere</i>  |             | 75.00%   | 74.77%           | 0.02    | 0.43     | –                | 0.30          | N/A                   | FC                   | –                           |
| <b>TVBV B.V. (NETHERLANDS)</b><br>Sale and operation of audiovisual rights<br><i>Almere</i>   |             | 52.50%   | 52.34%           | 0.02    | (0.15)   | –                | 0.65          | N/A                   | FC                   | –                           |
| <b>Endemol International Bookings B.V. (NETHERLANDS)</b><br>Sale and operation of audiovisual rights<br><i>Bergweg 70, 1217 SC Hilversum</i>  |             | 75.00%   | 74.77%           | –       | 0.02     | –                | –             | N/A                   | FC                   | –                           |
| <b>Crossmedia B.V. (NETHERLANDS)</b><br>Sale and operation of mobile games<br><i>Laren</i>  |             | 45.00%   | 44.86%           | 0.02    | 0.01     | –                | 0.15          | N/A                   | FC                   | –                           |
| <b>Endemol Finance B.V. (NETHERLANDS) (1)</b><br>Finance company<br><i>Bergweg 70, 1217 SC Hilversum</i>  |             | 75.00%   | 74.77%           | 9.08    | 75.64    | –                | 8.70          | N/A                   | FC                   | –                           |
| <b>Endemol Argentina S.A. (ARGENTINA) (1)</b><br>Presentation and filming by any audiovisual medium<br><i>Dr. E. Ravignani 1470, C1414 CPJ - Buenos Aires</i>   |             | 48.75%   | 48.60%           | 0.15    | 1.36     | –                | (0.59)        | N/D                   | FC                   | –                           |
| <b>Endemol USA, Inc. (USA) (1)</b><br>All the activities permitted by California law, except for certain activities such as banking<br><i>9255 Sunset Blvd, Suite 1100 - Los Angeles - 90069 California</i> |             | 75.00%   | 74.77%           | –       | 4.17     | –                | 19.73         | N/D                   | FC                   | –                           |
| <b>True Entertainment LLC (USA) (1)</b><br>All the activities permitted by Delaware law<br><i>435 West 19th Street - NY10111 New York</i>   |             | 50.25%   | 50.10%           | –       | (1.08)   | –                | 1.72          | N/D                   | FC                   | –                           |
| <b>Endemol Mexico S.A. de CV (MEXICO) (1)</b><br>Development and production of TV programs and series<br><i>Vasco de Quiroga 2000, Colonia Santa Fé, Delegación Guajimalpa, Mexico D.F. 01210</i>           |             | 37.50%   | 37.39%           | 0.00    | 3.12     | –                | 0.25          | N/D                   | PC                   | –                           |
| <b>Endemol Globo, S.A. (BRAZIL) (1)</b><br>Development, exploitation and distribution of audiovisual formats and programs<br><i>Av. das Americas 700, B2 Sala 301, Rio de Janeiro</i>                       |             | 37.50%   | 37.39%           | 0.18    | (0.40)   | –                | 1.58          | N/D                   | PC                   | –                           |
| <b>Endemol Belgium, N.V. (BELGIUM) (1)</b><br>Television, theater, video, film and other productions<br><i>Schaliënhoevedreef 20E, B-2800 Mechelen</i>  |             | 75.00%   | 74.77%           | 1.56    | (0.98)   | –                | 1.62          | N/D                   | FC                   | –                           |
| <b>Endemol-Neovision S.p.z.o.o. (POLAND) (1)</b><br>Radio- and television-related activities<br><i>Ul. Dominikanska 25A, 02-738 - Warsaw</i>  |             | 75.00%   | 74.77%           | 0.02    | 0.12     | –                | (0.06)        | N/D                   | PC                   | –                           |
| <b>Endemol Produções Televisivas Portugal, Lda. (PORTUGAL) (1)</b><br>Production, exchange and distribution of TV productions<br><i>Rua Tierno Galvan, Torre 3, 8º Piso, sala 801, 1070 Lisbon</i>          |             | 75.00%   | 74.77%           | 0.05    | 1.69     | –                | 1.09          | N/D                   | FC                   | –                           |
| <b>Endemol South Africa (SOUTH AFRICA) (1)</b><br>Production of TV programs<br><i>5 Concourse Crescent, Lonehill, 2021 - Johannesburg</i>   |             | 50.00%   | 49.85%           | 0.13    | (0.00)   | –                | 0.82          | N/D                   | FC                   | –                           |
| <b>Endemol Deutschland, GmbH (GERMANY) (1)</b><br>Cinema, television and theater production<br><i>Am Coloneum 3-7, D-50798 Cologne, Germany</i>   |             | 75.00%   | 74.77%           | 0.03    | (4.27)   | –                | 9.31          | N/D                   | FC                   | –                           |

(\*) Companies included in the 2004 consolidated tax statement.

(\*\*) Companies included in the 2005 consolidated tax statement.

## Subsidiaries, Associates and Investees as of 12-31-2005

| (millions of euros)   | % Ownership   |          |                  | Capital         | Reserves        | Interim Dividend | Income (loss) | Gross Carrying Amount | Consolidation Method | Value in Consolidation (10) |
|---|---------------|----------|------------------|-----------------|-----------------|------------------|---------------|-----------------------|----------------------|-----------------------------|
|   | Direct        | Indirect | Telefónica Group |                 |                 |                  |               |                       |                      |                             |
| <b>Meta GmbH (GERMANY) (1)</b><br>Cinema, television and theater production<br><i>Berlin, Germany</i>   |               | 48.75%   | 48.60%           | 0.05            | 0.55            | –                | (0.05)        | N/D                   | FC                   | –                           |
| <b>Endemol Italia Holding e Servizi, S.P.A. (ITALY) (1)</b><br>Production and exploitation of cinema films and TV films and series<br><i>Via Monte Zebio 32, 00195 - Rome</i> |               | 75.00%   | 74.77%           | 10.36           | –               | –                | (19.39)       | N/D                   | FC                   | –                           |
| <b>Endemol Italia (Holding), S.P.A. (ITALY) (1)</b><br>Production and exploitation of cinema films and TV films and series<br><i>Via Monte Zebio 32, 00195 - Rome</i>         |               | 75.00%   | 74.77%           | 0.11            | 13.89           | –                | 7.35          | N/D                   | FC                   | –                           |
| <b>Palomar, S.p.A. (ITALY) (1)</b><br>Production and exploitation of cinema films and TV films and series<br><i>Via Silvio Pellico 24, 00195 - Rome</i>                       |               | 51.38%   | 51.22%           | 0.58            | 3.16            | –                | 0.24          | N/D                   | FC                   | –                           |
| <b>Endemol UK Holding, Ltd. (UK) (1)</b><br>Holding company<br><i>Shepherds Building Central, Charecroft Way, Shepherds Bush, W14 OEE - London</i>                            |               | 75.00%   | 74.77%           | 21.25           | (3.45)          | –                | 7.88          | N/D                   | FC                   | –                           |
| <b>B&amp;B Endemol (SWITZERLAND) (1)</b><br>TV program and film production<br><i>Carmenstrasse 12, CH 8032 - Zurich</i>   |               | 37.50%   | 37.39%           | 0.07            | 0.06            | –                | 2.79          | N/D                   | PC                   | –                           |
| <b>Endemol Russia Holding B.V. (NETHERLANDS) (1)</b><br>Holding company<br><i>Bergweg 70, 1217 SC Hilversum</i>   |               | 60.00%   | 59.82%           | 0.10            | (0.09)          | –                | (0.01)        | N/D                   | FC                   | –                           |
| <b>Endemol Moscow oooo (RUSSIA) (1)</b><br>TV program production and related activities<br><i>Moscow Russia</i>   |               | 60.00%   | 59.82%           | 0.08            | (0.03)          | –                | (0.07)        | N/D                   | FC                   | –                           |
| <b>Endemol Southern Star Plc Ltd (AUSTRALIA) (1)</b><br>TV program and film production<br><i>Sydney, Australia</i>  |               | 38.25%   | 38.13%           | 0.00            | 0.01            | –                | 6.97          | N/D                   | FC                   | –                           |
| <b>Endemol Chile Holding S.L. (CHILE) (1)</b><br>Holding company<br><i>Santiago de Chile</i>  |               | 75.00%   | 74.77%           | 0.02            | 0.07            | –                | –             | N/D                   | FC                   | –                           |
| <b>Endemol Chile S.A. (CHILE) (1)</b><br>TV program production and related activities<br><i>Santiago de Chile</i>   |               | 48.75%   | 48.60%           | 0.02            | 0.06            | –                | (0.34)        | N/D                   | FC                   | –                           |
| <b>Endemol Andino SA (COLOMBIA)</b><br>TV program production and related activities<br><i>Calle 63F # 32 -15 - Bogotá</i>   |               | 38.25%   | 38.13%           | 0.04            | (0.01)          | –                | (0.23)        | N/D                   | FC                   | –                           |
| <b>Endemol España Holding, S.L. (SPAIN) (1)</b><br>Holding company<br><i>Latorre &amp; Asociados, Velasquez 21, 3o O, 28001 - Madrid</i>                                      |               | 75.00%   | 74.77%           | 0.47            | 28.58           | –                | (3.71)        | N/D                   | FC                   | –                           |
| <b>Gestmusic Endemol, S.A. (SPAIN) (1)</b><br>TV program production and related activities<br><i>Sta. Elionor 3, 08024 - Barcelona</i>  |               | 75.00%   | 74.77%           | 0.06            | 16.62           | –                | 7.14          | N/D                   | FC                   | –                           |
| <b>Zeppelin Televison, S.A. (SPAIN) (1)</b><br>Development and production of audiovisual media<br><i>Avda de Manoteras 18-6a Planta, 28050 - Madrid</i>                       |               | 75.00%   | 74.77%           | 0.07            | 6.66            | –                | 9.09          | N/D                   | FC                   | –                           |
| Other Holdings (1)  |               | N/A      | N/A              | N/A             | N/A             | N/A              | N/A           | N/A                   | EM                   | 15,37                       |
| <b>Cesky Telecom, a.s. (CZECH REPUBLIC) (1) (11)</b><br>Telecommunications service provider<br><i>Olsanska 55/5 - Prague 3, 130 34</i>  | <b>69.41%</b> |          | <b>69.41%</b>    | <b>1,072.54</b> | <b>2,084.18</b> | <b>–</b>         | <b>118.03</b> | <b>3,662.53</b>       | <b>FC</b>            | <b>–</b>                    |
| <b>Eurotel Praha, spol. s.r.o. (CZECH REPUBLIC) (1)</b><br>Mobile telephony and internet services<br><i>Vyskocilova cp. 1442/1b - Prague 4, 140 21</i>                        |               | 100.00%  | 69.41%           | 40.33           | 526.58          | –                | 104.60        | 1,015.38              | FC                   | –                           |
| <b>SPT Telecom Finance, B.V. (NETHERLANDS) (1)</b><br>Financing of other Group entities<br><i>Teleportboulevard 140 - Amsterdam 1043EJ, The Netherlands</i>                   |               | 100.00%  | 69.41%           | 0.02            | N/A             | –                | N/A           | 0.02                  | FC                   | –                           |

(\*) Companies included in the 2004 consolidated tax statement.

(\*\*) Companies included in the 2005 consolidated tax statement.



## Subsidiaries, Associates and Investees as of 12-31-2005

| (millions of euros)  | % Ownership    |          |                  | Capital      | Reserves       | Interim Dividend | Income (loss) | Gross Carrying Amount | Consolidation Method | Value in Consolidation (10) |
|--|----------------|----------|------------------|--------------|----------------|------------------|---------------|-----------------------|----------------------|-----------------------------|
|  | Direct         | Indirect | Telefónica Group |              |                |                  |               |                       |                      |                             |
| Omnicom Praha, spol. s.r.o. (CZECH REPUBLIC) (1)<br>Telecommunications network and consultancy services<br><i>Bryksova 818/48 - Prague 9</i>   |                | 100.00%  | 69.41%           | 0.33         | 0.47           | -                | 0.10          | 1.03                  | FC                   | -                           |
| Czech Telecom Germany GmbH (GERMANY) (1)<br>Data transmission services<br><i>Hanauer Landstrasse 300a, Frankfurt am Main 604 13, Germany</i>   |                | 100.00%  | 69.41%           | 0.03         | 0.88           | -                | (0.01)        | 0.93                  | FC                   | -                           |
| Czech Telecom Austria GmbH (AUSTRIA) (1)<br>Data transmission services<br><i>Shuttleworthstrasse 4-8, Vienna 12310, Austria</i>  |                | 100.00%  | 69.41%           | 0.04         | 0.34           | -                | 0.02          | 0.36                  | FC                   | -                           |
| Czech Telecom Slovakia, s.r.o. (SLOVAK REPUBLIC) (1)<br>Data transmission services<br><i>Kutlikova 17, Bratislava 852 50</i>   |                | 100.00%  | 69.41%           | 0.01         | 0.09           | -                | 0.03          | 0.01                  | FC                   | -                           |
| CenTrade, a.s. (CZECH REPUBLIC) (1)<br>E-Business company providing market place services<br><i>Olsanska 55/5 - Prague 3, 130 34</i>   |                | 86.50%   | 60.04%           | 19.98        | (19.92)        | -                | 0.23          | 33.47                 | FC                   | -                           |
| <b>Terra Lycos Holding, B.V. (NETHERLANDS)</b><br>Sale of software licenses<br><i>Koningslaan, 34. 1075 AD Amsterdam - Netherlands</i>   | <b>100.00%</b> |          | <b>100.00%</b>   | <b>0.02</b>  | <b>-</b>       | <b>-</b>         | <b>-</b>      | <b>0.02</b>           | <b>C</b>             | <b>0.02</b>                 |
| <b>Terra Lycos Intangibles, S.A. (SPAIN) (*) (**)</b><br>Internet service provider<br><i>Vía Dos Castillas, 33 - Comp. Ática Ed. 1, 1ª Plta. Pozuelo de Alarcón - 28224 Madrid</i>   | <b>100.00%</b> |          | <b>100.00%</b>   | <b>0.66</b>  | <b>13.24</b>   | <b>-</b>         | <b>-</b>      | <b>19.29</b>          | <b>FC</b>            | <b>-</b>                    |
| <b>LE Holding Corporation (USA)</b><br>Holding company<br><i>Corporation Trust Center, 1209 Orange Street - Wilmington, Delaware</i>   | <b>100.00%</b> |          | <b>100.00%</b>   | <b>N/D</b>   | <b>N/D</b>     | <b>N/D</b>       | <b>N/D</b>    | <b>N/D</b>            | <b>FC</b>            | <b>-</b>                    |
| Lycos Europe, N.V. (NETHERLANDS) (3) (11)<br>Internet portal<br><i>Richard Holkade 30-34, Haarlem - Netherlands</i>  |                | 32.10%   | 32.10%           | 3.12         | 141.95         | -                | (11.10)       | 47.88                 | EM                   | 40.60                       |
| <b>Centro de Investigación y Experimentación de la Realidad Virtual, S.L. (SPAIN) (*) (**)</b><br>Design of communications products<br><i>Vía de Dos Castillas, 33 - Comp. Ática Ed. 1, 1ª Plta. Pozuelo de Alarcón - 28224 Madrid</i> | <b>100.00%</b> |          | <b>100.00%</b>   | <b>0.01</b>  | <b>N/D</b>     | <b>N/D</b>       | <b>N/D</b>    | <b>10.08</b>          | <b>FC</b>            | <b>-</b>                    |
| Corporation Real Time Team, S.L. (SPAIN)<br>Internet design, advertising and consulting<br><i>Claudio Coello, 32, 1º ext. - Madrid</i>   |                | 100.00%  | 100.00%          | 0.02         | N/D            | N/D              | N/D           | 12.40                 | FC                   | -                           |
| <b>UNO-E Bank, S.A. (SPAIN)</b><br>E-banking<br><i>Julián Camarillo, 4, Edificio C, 28037 - Madrid</i>   | <b>33.00%</b>  |          | <b>33.00%</b>    | <b>80.32</b> | <b>31.15</b>   | <b>N/D</b>       | <b>N/D</b>    | <b>189.83</b>         | <b>C</b>             | <b>189.83</b>               |
| <b>Terra Networks Asociadas, S.L. (SPAIN) (*) (**) (4)</b><br>Holding company<br><i>Vía de Dos Castillas, 33 - Comp. Ática Ed. 1, 1ª Plta. Pozuelo de Alarcón - 28224 Madrid</i>   | <b>100.00%</b> |          | <b>100.00%</b>   | <b>6.11</b>  | <b>(23.79)</b> | <b>-</b>         | <b>(0.47)</b> | <b>61.12</b>          | <b>FC</b>            | <b>-</b>                    |
| <b>Terra Business Travel, S.A. (SPAIN) (*) (**) (4)</b><br>Travel agency<br><i>Vía Dos Castillas, 33 - Comp. Ática Ed. 1, 1ª Plta. Pozuelo de Alarcón - 28224 Madrid</i>   |                | 100.00%  | 100.00%          | 0.56         | (0.01)         | -                | (0.13)        | 0.56                  | FC                   | -                           |
| <b>Maptel Networks, S.A.U. (SPAIN) (*) (**) (4)</b><br>Design, development, roll-out and sale of digital maps<br><i>Plaza Santa María Soledad Torres Acosta, 1- 5º - 28004 Madrid</i>  |                | 100.00%  | 100.00%          | -            | -              | -                | -             | 2.41                  | FC                   | -                           |
| <b>Ifigenia Plus, S.L. (SPAIN) (*) (**) (8)</b><br>Vertical education portal and cultural content developer<br><i>Plaza Santa María Soledad Torres Acosta, 1- 5º - Madrid</i>  |                | 100.00%  | 100.00%          | 0.14         | (2.88)         | -                | (0.10)        | 10.11                 | FC                   | -                           |
| <b>Educaterria, S.L. (SPAIN) (*) (**) (4)</b><br>Vertical e-learning portal<br><i>Paseo de la Castellana 141, Edificio Cuzco IV - 5ª Planta, Madrid.</i>   |                | 100.00%  | 100.00%          | 0.69         | 0.97           | -                | 0.24          | 6.30                  | FC                   | -                           |
| <b>Azeler Automoción, S.A. (SPAIN) (**) (4) (6)</b><br>Motorcycle portal<br><i>Paseo de la Castellana, 141 - Edificio Cuzco IV - Madrid</i>  |                | 100.00%  | 100.00%          | -            | -              | -                | -             | 7.32                  | FC                   | -                           |

(\*) Companies included in the 2004 consolidated tax statement.

(\*\*) Companies included in the 2005 consolidated tax statement.

## Subsidiaries, Associates and Investees as of 12-31-2005

| (millions of euros)  | % Ownership    |              |                  | Capital       | Reserves     | Interim Dividend | Income (loss) | Gross Carrying Amount | Consolidation Method | Value in Consolidation (10) |
|--|----------------|--------------|------------------|---------------|--------------|------------------|---------------|-----------------------|----------------------|-----------------------------|
|  | Direct         | Indirect     | Telefónica Group |               |              |                  |               |                       |                      |                             |
| Red Universal de Marketing y Bookings Online, S.A. (SPAIN) (6)<br>Online travel agency<br><i>Proción 1 y 3 La Florida - 28023 - Madrid</i>   |                | 50.00%       | 50.00%           | 0.90          | (6.71)       | -                | 2.01          | 7.50                  | EM                   | -                           |
| Inversis Networks, S.A. (SPAIN)<br>Telematic and computer systems and applications<br><i>C/ Arrastacia, 13 . Poligono de las Mercedes. Madrid</i>  |                | 5.45%        | 5.45%            | 68.80         | N/D          | N/D              | N/D           | 12.81                 | C                    | 12.81                       |
| <b>Terra Networks Marocs, S.A.R.L. (MOROCCO) (7)</b><br>Inactive company<br><i>332 Boulevard Brahim Roudani, Casablanca</i>  | <b>100.00%</b> |              | <b>100.00%</b>   | <b>0.03</b>   | <b>N/D</b>   | <b>N/D</b>       | <b>N/D</b>    | <b>0.03</b>           | <b>C</b>             | <b>0.03</b>                 |
| <b>Terra Networks Serviços de Acesso a Internet e Trading Ltd. (PORTUGAL) (7)</b><br>Inactive company<br><i>Avda. Arriaga, 73-2º andar, sala 212 - Freguesia de Se, Concelho do Funchal (Madeira)</i>                | <b>100.00%</b> |              | <b>100.00%</b>   | <b>0.01</b>   | <b>N/D</b>   | <b>N/D</b>       | <b>N/D</b>    | <b>0.01</b>           | <b>C</b>             | <b>0.01</b>                 |
| <b>Terra Networks España, S.A. (SPAIN) (1) (*) (**)</b><br>ISP and Portal<br><i>Vía Dos Castillas, 33 - Comp. Ática Ed. 1, 1ª Plta. Pozuelo de Alarcón - 28224 Madrid</i>  | <b>100.00%</b> |              | <b>100.00%</b>   | -             | -            | -                | -             | <b>93.97</b>          | <b>FC</b>            | -                           |
| <b>Telefónica International Wholesale Services, S.L. (SPAIN) (*) (**) (1)</b><br>International services provider<br><i>Gran Vía, 28 - 28013 Madrid</i>   | <b>92.51%</b>  | <b>7.49%</b> | <b>100.00%</b>   | <b>229.89</b> | <b>22.84</b> | -                | <b>(7.04)</b> | <b>212.88</b>         | <b>FC</b>            | -                           |
| Telefónica International Wholesale Services America, S.A. (URUGUAY) (1)<br>Provision of high bandwidth communications services<br><i>Luis A. de Herrera, 1248 Piso 4 - Montevideo</i>                                | 100.00%        | 100.00%      | 100.00%          | 427.68        | (210.94)     | -                | (59.39)       | 499.05                | FC                   | -                           |
| <b>Emergia Argentina, S.A. (ARGENTINA) (1)</b><br>Provision of high bandwidth communications services<br><i>Paraguay, 1345 Piso 6 - Buenos Aires</i>   | 100.00%        | 100.00%      | 100.00%          | 21.27         | (17.97)      | -                | (3.99)        | (0.68)                | FC                   | -                           |
| <b>Emergia Participacoes, Ltd. (BRAZIL) (1)</b><br>Provision of high bandwidth communications services<br><i>Rua Martiniano de Carvalho, n°851, 16º andar, Bela Vista</i>  | 100.00%        | 100.00%      | 100.00%          | 52.96         | 29.31        | -                | (2.48)        | 21.16                 | FC                   | -                           |
| <b>Emergia Brasil, Ltd. (BRAZIL) (1)</b><br>Provision of high bandwidth communications services<br><i>Av. Brigadeiro Faria Lima, 1188 Piso 8º - San Pablo</i>  | 100.00%        | 100.00%      | 100.00%          | -             | -            | -                | -             | N/D                   | FC                   | -                           |
| <b>Telefónica International Wholesale Services Chile, S.A. (CHILE) (1)</b><br>Provision of high bandwidth communications services<br><i>Ricardo Lyon, 222 Piso 14 - Santiago de Chile</i>                            | 100.00%        | 100.00%      | 100.00%          | 30.71         | (13.87)      | -                | (1.98)        | 14.86                 | FC                   | -                           |
| <b>Telefónica International Wholesale Services Perú, S.A.C. (PERU) (1)</b><br>Provision of high bandwidth communications services<br><i>Av. de la Floresta, 497 Piso 5 - San Borja</i>                               | 100.00%        | 100.00%      | 100.00%          | 16.89         | (12.42)      | -                | (3.06)        | 1.42                  | FC                   | -                           |
| <b>Telefónica International Wholesale Services USA, Inc. (USA) (1)</b><br>Provision of high bandwidth communications services<br><i>1221 Brickell Avenue, Piso 6 - 33131 Miami (Florida)</i>                         | 100.00%        | 100.00%      | 100.00%          | 29.26         | (22.38)      | -                | (4.80)        | 2.08                  | FC                   | -                           |
| <b>Telefónica International Wholesale Services Guatemala, S.A. (GUATEMALA) (1)</b><br>Provision of high bandwidth communications services<br><i>Blvd. Los Próceres, 5-56 Piso 11, zona 10 - Ciudad de Guatemala</i>  | 100.00%        | 100.00%      | 100.00%          | 13.51         | (4.02)       | -                | (2.20)        | 7.30                  | FC                   | -                           |
| <b>Telefónica International Wholesale Services Puerto Rico, Inc. (PUERTO RICO) (5)</b><br>Provision of high bandwidth communications services<br><i>Metro Office Park Edificio 17, Calle 2, Suite 600 - Guaynabo</i> | 100.00%        | 100.00%      | 100.00%          | 20.07         | (5.56)       | -                | (2.57)        | 11.94                 | FC                   | -                           |

(\*) Companies included in the 2004 consolidated tax statement.

(\*\*) Companies included in the 2005 consolidated tax statement.

## Subsidiaries, Associates and Investees as of 12-31-2005

| (millions of euros)  | % Ownership |          |                  | Capital  | Reserves | Interim Dividend | Income (loss) | Gross Carrying Amount | Consolidation Method | Value in Consolidation (10) |
|--|-------------|----------|------------------|----------|----------|------------------|---------------|-----------------------|----------------------|-----------------------------|
|  | Direct      | Indirect | Telefónica Group |          |          |                  |               |                       |                      |                             |
| <b>Telefónica Datacorp, S.A.U. (SPAIN) (*) (**) (1)</b><br>Provision and exploitation of telecommunications services<br><i>Gran Vía, 28 - 28013 Madrid</i>   | 100.00%     |          | 100.00%          | 1,226.76 | (525.95) | -                | 18.05         | 1,335.81              | FC                   | -                           |
| Telefónica Empresas Mexico, S.A. De C.V. (MEXICO) (1)  |             | 49.00%   |                  |          |          |                  |               |                       |                      |                             |
| Telefónica Data Mexico Holding (MEXICO) (1)<br>Global telecommunications services<br><i>Mexico</i>   |             | 100.00%  | 100.00%          | 29.10    | (26.38)  | -                | (2.35)        | 42.78                 | FC                   | -                           |
| Telefónica Empresas Mexico, S.A. De C.V. (MEXICO) (1)<br>Global telecommunications services<br><i>Sierra Santa Rosa, 61 - Lomas de Chapultepec - 11.650 Mexico DF</i>                                    |             | 51.00%   | 100.00%          | 50.17    | (44.03)  | -                | (4.94)        | 40.94                 | FC                   | -                           |
| Katalyx Mexico, S.A. de C.V. (MEXICO) (1)<br>Administrative management services<br><i>Boulevard Avila Camacho, 24 - Mexico D.F.</i>  |             | 100.00%  | 100.00%          | 9.44     | (9.97)   | -                | 0.63          | 9.94                  | FC                   | -                           |
| Telefónica Data Colombia, S.A. (COLOMBIA) (1)<br>Global telecommunications services<br><i>Santa Fé de Bogotá</i>   |             | 100.00%  | 65.00%           | 1.00     | 13.25    | -                | (5.63)        | 36.67                 | FC                   | -                           |
| Other shareholdings  |             | N/A      | N/A              | N/D      | N/D      | N/D              | N/D           | -                     | C                    | -                           |
| Telefónica Data do Brasil, Ltda. (BRAZIL) (1)<br>Telecommunications services<br><i>Rua da Consolação, 247 - 6 - Sao Paulo</i>  |             | 100.00%  | 100.00%          | 137.48   | 15.96    | -                | (0.19)        | 249.62                | FC                   | -                           |
| Telefónica Data Brasil Holding (BRAZIL) (1) (11)<br>Ownership of companies providing network and telecommunications services<br><i>Avda. Brig. Faria Lima, 1188 plta. 7ª andar-parte - Sao Paulo</i>     |             | 93.98%   | 93.98%           | 192.62   | 3.20     | -                | 2.55          | N/D                   | FC                   | -                           |
| Telefónica Empresas (BRAZIL) (1)<br>Provision and exploitation of telecommunications services<br><i>Avda. Tamboaré, 341/371 - Barueri - Sao Paulo</i>  |             | 93.98%   | 93.98%           | 85.19    | 15.81    | -                | 8.44          | N/D                   | FC                   | -                           |
| Telefónica Datos de Venezuela, S.A. (VENEZUELA) (1)<br>Telecommunications services<br><i>Avda. Las Palmas, 3º - 1050 Caracas</i>   |             | 100.00%  | 100.00%          | 0.01     | 0.24     | -                | 0.07          | 0.02                  | FC                   | -                           |
| Telefónica Data Canadá, Inc. (CANADA)<br>Telecommunications services<br><i>44 Chipman Hill, 10th Floor - P.O. Box 7289 New Brunswick ESL 456</i>   |             | 100.00%  | 100.00%          | N/D      | N/D      | N/D              | N/D           | -                     | C                    | -                           |
| Telefónica Data Caribe (SPAIN)   |             | 10.00%   |                  |          |          |                  |               |                       |                      |                             |
| Telefónica Data USA Inc. (USA) (1)<br>Telecommunications services<br><i>1221 Brickell Avenue - 33131 Miami - Florida</i>   |             | 100.00%  | 100.00%          | 0.00     | 50.34    | -                | (13.39)       | 141.86                | FC                   | -                           |
| Telefónica Data Caribe (SPAIN) (*) (**) (1)<br>Global telecommunications services<br><i>Beatriz de Bobadilla, 14 - 28040 Madrid</i>  |             | 90.00%   | 100.00%          | 0.06     | (2.02)   | -                | (0.02)        | 0.06                  | FC                   | -                           |
| Ipse - 2000 (ITALY) (1)<br>Exploitation of UMTS license<br><i>Piazza dei Caprettari, 70 - 00186 Roma</i>   |             | 4.08%    |                  |          |          |                  |               |                       |                      |                             |
| Telefónica Empresas Perú, S.A.A. (PERU) (1) (11)<br>Provision and exploitation of telecommunications services<br><i>Jorge Basadre, 592 7º - San Isidro - Lima</i>  |             | 97.07%   | 97.07%           | 22.26    | 4.59     | -                | 4.04          | N/D                   | FC                   | -                           |
| Telefónica Data Argentina, S.A. (ARGENTINA) (1) (9) (11)<br>Provision and exploitation of telecommunications services<br><i>Tucumán, 1 plta. 18º - 1049 Buenos Aires</i>                                 |             | 97.92%   | 97.92%           | 27.71    | 5.86     | -                | 5.41          | 97.49                 | FC                   | -                           |
| Telefónica Soluciones de Informática y Comunicaciones, S.L. (SPAIN) (*) (**) (1)<br>Provision and exploitation of telecommunications services<br><i>Sor Ángela de la Cruz, 3 - Pl. 9º - 28020 Madrid</i> |             | 100.00%  | 100.00%          | 16.60    | (34.19)  | -                | (0.67)        | 16.60                 | FC                   | -                           |
| Telefonica Deutschland, GMBH (GERMANY) (1)<br>Internet and telecommunications services<br><i>Landshuter Allee, 8 - 80637 Munich</i>  |             | 100.00%  | 100.00%          | 2.60     | 502.76   | -                | (165.06)      | 638.54                | FC                   | -                           |

(\*) Companies included in the 2004 consolidated tax statement.

(\*\*) Companies included in the 2005 consolidated tax statement.

## Subsidiaries, Associates and Investees as of 12-31-2005

| (millions of euros)   | % Ownership    |          | Telefónica Group | Capital         | Reserves        | Interim Dividend | Income (loss)   | Gross Carrying Amount | Consolidation Method | Value in Consolidation (10) |
|---|----------------|----------|------------------|-----------------|-----------------|------------------|-----------------|-----------------------|----------------------|-----------------------------|
|   | Direct         | Indirect |                  |                 |                 |                  |                 |                       |                      |                             |
| <b>Telefónica Data Atlas, S.A. (MOROCCO) (8)</b><br>Provision and exploitation of telecommunications services<br><i>Tour Bmce, Rond Point Hassan II - Casablanca</i>  |                | 59.86%   | 59.86%           | 0.03            | N/D             | N/D              | N/D             | 0.02                  | C                    | 0.02                        |
| <b>Katalyx, Inc. (USA) (1)</b><br>Administrative management services<br><i>1221 Brickell Avenue - Miami, Florida</i>  |                | 100.00%  | 100.00%          | 103.17          | (112.98)        | -                | (0.51)          | 5.18                  | FC                   | -                           |
| <b>Adquira Mexico, Ltd. (MEXICO) (5)</b><br>E-commerce<br><i>Boulevard Avila Camacho, 24 - Mexico D.F.</i>  |                | 50.00%   | 50.00%           | 7.69            | (6.13)          | -                | (0.31)          | N/D                   | EM                   | 0.62                        |
| <b>Katalyx Cataloguing Brasil, Ltd. (BRAZIL) (1)</b><br>E-commerce and cataloging<br><i>Rua Joaquim Floriano, 1052 - Sao Paulo</i>  |                | 100.00%  | 100.00%          | 0.33            | (0.33)          | -                | (0.03)          | -                     | FC                   | -                           |
| <b>Mercador, S.A. (BRAZIL) (1)</b><br>E-commerce<br><i>Rua Joaquim Floriano, 1052 - Sao Paulo</i>   |                | 54.00%   | 54.00%           | 10.48           | (8.80)          | -                | (0.05)          | N/D                   | EM                   | 0,88                        |
| <b>Telefónica de España, S.A.U. (SPAIN) (*) (**) (1) (6) (9)</b><br><b>Provision of telecommunications services in Spain</b><br><i>Gran Vía, 28 - 28013 Madrid</i>  | <b>100.00%</b> |          | <b>100.00%</b>   | <b>1,023.68</b> | <b>1,616.91</b> | <b>-</b>         | <b>1,494.28</b> | <b>3,033.86</b>       | <b>FC</b>            | <b>-</b>                    |
| <b>Telefónica S. de Informática y Comunicaciones de España, S.A.U. (SPAIN) (*) (**) (3)</b><br>Telecommunications systems, network and infrastructure engineering<br><i>Sor Ángela de la Cruz, 3 - Pl. 9ª - 28020 Madrid</i>              |                | 100.00%  | 100.00%          | 6.06            | 15.30           | -                | (14.17)         | 29.49                 | FC                   | -                           |
| <b>Telefónica Mobile Solutions Chile, S.A.C. (CHILE) (8)</b><br>Equipment and systems engineering activities<br><i>Avda. Seminario, 15 - Providencia - Santiago de Chile</i>  |                | N/D      | N/D              | 0.19            | (1.36)          | -                | 0.11            | 0.19                  | FC                   | -                           |
| <b>Telefónica Mobile Solutions Argentina, S.A. (ARGENTINA)</b><br>Equipment and systems engineering activities<br><i>Carlos Pellegrini, 1149 10º - Buenos Aires</i>   |                | N/D      | N/D              | 0.22            | (0.18)          | -                | -               | 0.23                  | FC                   | -                           |
| <b>Telefónica Sistemas Ingeniería de Productos Guatemala, S.A. (GUATEMALA) (8)</b><br>Telecommunications equipment and systems engineering<br><i>Guatemala</i>  |                | 98.00%   | 98.00%           | 0.01            | (0.22)          | -                | -               | 0.01                  | FC                   | -                           |
| <b>Telefónica Soluciones de Outsourcing, S.A. (SPAIN) (*) (**) (3)</b><br>Network management and marketing<br><i>Goya, 4 - 28001 Madrid</i>   |                | 100.00%  | 100.00%          | 1.00            | (0.20)          | -                | (0.14)          | 0.56                  | FC                   | -                           |
| <b>Telefónica Soluciones Sectoriales, S.A. (SPAIN) (*) (**) (4)</b><br>Consulting services for companies in the communications and IT industries<br><i>Av. Burgos, 17-10.ª-28036 Madrid</i>   |                | 100.00%  | 100.00%          | 13.73           | (3.14)          | -                | 0.25            | 10.72                 | FC                   | -                           |
| <b>Interdomain, S.A. (SPAIN) (*) (**) (4)</b><br>Operation of Internet resources<br><i>Fernando El Santo, 15 - 28.010 Madrid</i>  |                | 100.00%  | 100.00%          | 0.30            | 0.56            | -                | 0.08            | 0.78                  | FC                   | -                           |
| <b>SODETEL, Comercial de Servicios de Telecomunicaciones, S.A. (SPAIN)</b><br>Provision of consulting services, installation and telecommunications services<br><i>Parque industrial y de servicios de Mairena del Aljarafe - Sevilla</i> |                | 50.00%   | 50.00%           | 0.12            | -               | -                | -               | 0.07                  | EM                   | 0.06                        |
| <b>Portel Servicios Telemáticos, S.A. (SPAIN) (1)</b><br>Systems engineering and telecommunications in port areas<br><i>Avda. de Partenón, 10 Campo de las Naciones - 28042 Madrid</i>  |                | 49.00%   | 49.00%           | 3.01            | 0.25            | -                | -               | 1.35                  | EM                   | 1.59                        |
| <b>Ceuta Innovación Digital, S.L. (SPAIN)</b><br>Installation and maintenance of communication networks   |                | 40.00%   | 40.00%           | -               | -               | -                | -               | 0.02                  | EM                   | 0.02                        |
| <b>Bitel Baleares Innovación Telemática, S.A. (SPAIN)</b><br>Provision of services and systems engineering in the IT and communications fields<br><i>Paseo Marítimo, 38 A - 07005 Palma de Mallorca</i>                                   |                | 0.00%    | 0.00%            | -               | -               | -                | -               | -                     | -                    | -                           |

(\*) Companies included in the 2004 consolidated tax statement.

(\*\*) Companies included in the 2005 consolidated tax statement.

## Subsidiaries, Associates and Investees as of 12-31-2005

| (millions of euros)   | % Ownership |          |                  | Capital | Reserves | Interim Dividend | Income (loss) | Gross Carrying Amount | Consolidation Method | Value in Consolidation (10) |
|---|-------------|----------|------------------|---------|----------|------------------|---------------|-----------------------|----------------------|-----------------------------|
|   | Direct      | Indirect | Telefónica Group |         |          |                  |               |                       |                      |                             |
| <b>Tecn. e Ing. de Sist. y Serv. Avanzados de Telec., S.A. (TISSAT) (SPAIN) (2)</b><br>Systems engineering and marketing of advanced services<br><i>Correos, 1 - 46002 Valencia</i>   |             | 30.77%   | 30.77%           | 0.78    | 2.12     | -                | -             | 0.17                  | EM                   | 0.89                        |
| <b>SEMCA (SPAIN)</b><br>Emergency telephone service in Cantabria<br><i>Casimiro Sainz, 4 - Santander</i>  |             | 16.00%   | 16.00%           | 0.75    | (0.11)   | -                | -             | 0.12                  | C                    | 0.12                        |
| <b>Barcelona Emprend, S.A. (SPAIN)</b><br>Promotion of non-financial companies<br><i>C/ Llacuna, 162 - Barcelona</i>  |             | 6.92%    | 6.92%            | 3.25    | (0.57)   | -                | (0.08)        | 0.42                  | C                    | 0.42                        |
| <b>Barcelona Ventures, S.G.E.C.R. (SPAIN)</b><br>Promotion of non-financial companies<br><i>C/ Llacuna, 162 - Barcelona</i>   |             | 6.92%    | 6.92%            | 3.25    | -        | -                | -             | 0.03                  | C                    | 0.03                        |
| <b>Foment Ciutat Vella, S.A. (SPAIN)</b><br>Urban projects<br><i>C/ Pintor Fortuny, 17-19 - Barcelona</i>   |             | 5.00%    | 5.00%            | 6.01    | 0.80     | -                | -             | 0.30                  | C                    | 0.30                        |
| <b>Euroinfomarket, S.A. (SPAIN) (1)</b>   |             | 5.00%    | 5.00%            | 2.05    | (1.28)   | -                | -             | 0.02                  | C                    | 0.02                        |
| <b>Servicios On Line Para Usuarios Múltiples, S.A. (SPAIN)</b>  |             | 33.33%   | 33.33%           | 0.60    | 1.71     | -                | -             | 0.70                  | EM                   | 0.85                        |
| <b>Teleinformática y Comunicaciones, S.A. (TELYCO) (SPAIN) (*) (**) (1)</b><br>Promotion, marketing and distribution of telephone and telematic equipment and services<br><i>Plaza del Descubridor Diego de Ordás, 3 - 28003 Madrid</i> | 100.00%     | 100.00%  | 100.00%          | 2.77    | 11.16    | -                | 1.48          | 12.47                 | FC                   | -                           |
| <b>Telyco Marruecos, S.A. (MOROCCO) (1)</b><br>Promotion, marketing and distribution of telephone services<br><i>Boulevard Abdelmoumen, 88 - Casablanca</i>   | 54.00%      | 54.00%   | 54.00%           | 0.60    | 0.48     | -                | 1.00          | 0.32                  | FC                   | -                           |
| <b>Telefónica Telecomunicaciones Públicas, S.A. (SPAIN) (*) (**) (1)</b><br>Installation of public telephones<br><i>Plaza de Carlos Trias Bertrán, 7 - 28020 Madrid</i>   | 100.00%     | 100.00%  | 100.00%          | 1.20    | 85.45    | -                | 3.71          | 64.12                 | FC                   | -                           |
| <b>Telefónica Salud, S.A. (SPAIN)</b><br>Mangement and operation of telecommunications and public television services<br><i>Avda. de Pirineos, 9 - Nave Industrial 15 - San Sebastián de los Reyes - Madrid</i>                         | 51.00%      | 51.00%   | 51.00%           | 0.06    | -        | -                | -             | 0.03                  | FC                   | -                           |
| <b>Adquira Spain, S.A. (SPAIN) (2)</b><br>E-commerce<br><i>Goya, 4, 4ª planta - Madrid</i>  | 20.00%      | 20.00%   | 20.00%           | 1.56    | 5.68     | -                | (2.13)        | 7.64                  | EM                   | 0.07                        |
| Other shareholdings   | N/A         | N/A      | N/A              | N/A     | N/A      | N/A              | N/A           | 0.02                  | C                    | 0.02                        |
| <b>Telefónica Data España, S.A.U. (SPAIN) (*) (**) (1)</b><br>Data transmission<br><i>Beatriz de Bobadilla, 18 - 28040 Madrid</i>   | 100.00%     | 100.00%  | 100.00%          | 39.27   | 112.24   | -                | 63.08         | 157.25                | FC                   | -                           |
| <b>Telefónica Cable, S.A. (SPAIN) (*) (**) (7)</b><br>Cable telecommunication services<br><i>Virgilio, 2 - Edificio 2 - Ciudad de la Imagen (*) - 28223 Madrid</i>  | 100.00%     | 100.00%  | 100.00%          | 3.05    | (17.08)  | -                | (6.02)        | 29.58                 | FC                   | -                           |
| <b>Telefónica Cable Menorca, S.A. (SPAIN) (*) (**) (7)</b><br>Cable television systems and value-added services<br><i>Santiago Ramón y Cajal, 13 - Mahón - Menorca</i>  | 100.00%     | 100.00%  | 100.00%          | 0.60    | (0.13)   | -                | 0.01          | 0.56                  | FC                   | -                           |
| <b>Telefónica Cable Galicia, S.A. (SPAIN) (*) (**) (7)</b><br>Cable television systems and value-added services<br><i>Ronda de Outeiro, 1-3 - A Coruña</i>  | 85.00%      | 85.00%   | 85.00%           | 0.60    | 0.11     | -                | 0.01          | 0.53                  | FC                   | -                           |
| <b>Sociedad General de Cablevisión Canarias, S.A. (SPAIN) (*) (**) (7)</b><br>Cable television systems and value-added services<br><i>Alcalde Mandillo Tejera, 8 - 38007 Santa Cruz de Tenerife</i>                                     | 100.00%     | 100.00%  | 100.00%          | 0.06    | 0.01     | -                | -             | 1.17                  | FC                   | -                           |
| <b>Telefónica Media Internacional y de Contenidos USA, Inc. (USA) (8)</b><br>Provision of media services in the USA<br><i>1221 Brickell Av. - Miami</i>   | 100.00%     |          | 100.00%          | -       | (4.25)   | -                | (0.02)        | 0.33                  | C                    | 0.33                        |

(\*) Companies included in the 2004 consolidated tax statement.

(\*\*) Companies included in the 2005 consolidated tax statement.

## Subsidiaries, Associates and Investees as of 12-31-2005

| (millions of euros)  | % Ownership |          |                  | Capital | Reserves | Interim Dividend | Income (loss) | Gross Carrying Amount | Consolidation Method | Value in Consolidation (10) |
|--|-------------|----------|------------------|---------|----------|------------------|---------------|-----------------------|----------------------|-----------------------------|
|  | Direct      | Indirect | Telefónica Group |         |          |                  |               |                       |                      |                             |
| <b>Telefónica (USA) Advisors, Inc. (USA) (8)</b><br>All the activities permitted by Delaware State law<br>1013 Center Road, Wilmington - County of Newcastle - Delaware  | 100.00%     |          | 100.00%          | N/D     | N/D      | N/D              | N/D           | 0.87                  | C                    | 0.87                        |
| <b>Taetel, S.L. (SPAIN) (*) (**)</b><br>Acquisition, holding and disposal of shares and ownership interests in other companies<br>Beatriz de Bobadilla, 3 - 28040 Madrid   | 100.00%     |          | 100.00%          | 28.25   | 5.66     | -                | 0.50          | 28.25                 | FC                   | -                           |
| <b>Lotca Servicios Integrales, S.L. (SPAIN) (*) (**) (4)</b><br>Holding and operation of aircraft and the lease thereof.<br>Gran Vía, 28 - 28013 Madrid  | 100.00%     |          | 100.00%          | 16.93   | -        | -                | (0.52)        | 16.93                 | FC                   | -                           |
| <b>Telefónica Ingeniería de Seguridad, S.A. (SPAIN) (*) (**) (2)</b><br>Security services and systems<br>Condesa de Venadito, 1 - 28027 Madrid   | 100.00%     |          | 100.00%          | 0.90    | (3.39)   | -                | (0.60)        | 3.58                  | FC                   | -                           |
| <b>Telefónica Engenharia de Segurança (BRAZIL) (2)</b><br>Security services and systems<br>Rua Haddock Lobo, 337 2º andar, conjunto 21 - 01414-001 - Sao Paulo   |             | 99.99%   | 99.99%           | 2.97    | (1.85)   | -                | (3.49)        | 3.07                  | FC                   | -                           |
| <b>Telefónica Ingeniería de Seguridad México, S.A. de C.V. (MEXICO) (2)</b><br>Security services and systems<br>Ciudad de México, Distrito Federal   |             | 65.00%   | 65.00%           | 0.72    | (0.80)   | -                | (0.42)        | 0.61                  | FC                   | -                           |
| <b>Telefónica Capital, S.A. (SPAIN) (*) (**) (3)</b><br>Finance company<br>Gran Vía, 28 - 28013 Madrid   | 100.00%     |          | 100.00%          | 7.00    | 44.84    | -                | 5.07          | 18.12                 | FC                   | -                           |
| <b>Fonditel Pensiones, Entidad Gestora de Fondos de Pensiones, S.A. (SPAIN) (3)</b><br>Administration of pension funds<br>Pedro Teixeira nº 8 - 3º P - 28020 Madrid  |             | 70.00%   | 70.00%           | 15.70   | 24.50    | -                | 9.55          | 22.45                 | FC                   | -                           |
| <b>Fonditel Gestión, Sociedad Gestora de Instituciones de Inversión Colectiva, S.A. (SPAIN) (*) (**) (3)</b><br>Administration and representation of collective investment institutions<br>Pedro Teixeira nº 8 - 3º P - 28020 Madrid |             | 100.00%  | 100.00%          | 1.50    | 0.58     | -                | 6.33          | 1.50                  | FC                   | -                           |
| <b>Fonditel Valores, Agencia de Valores, S.A. (SPAIN) (*) (**) (3)</b><br>Investment Services<br>Pedro Teixeira nº 8 - 3º P - 28020 Madrid   |             | 100.00%  | 100.00%          | 3.00    | 0.40     | -                | 0.13          | 3.00                  | FC                   | -                           |
| <b>Tele Pizza, S.A. (SPAIN)</b><br>Pizza restaurant and home delivery<br>Isla Graciosa, nº 7. San Sebastián de los Reyes - Madrid  |             | 4.13%    | 4.13%            | N/D     | N/D      | N/D              | N/D           | N/D                   | C                    | 21.35                       |
| <b>Catalana D'Iniciatives, C.R., S.A. (SPAIN)</b><br>Promotion of non-financial companies<br>Passeig de Gracia, 2 - 2ºB - 08007 Barcelona.   |             | 5.99%    | 5.99%            | 30.86   | 31.24    | -                | (1.85)        | 4.04                  | C                    | 3.73                        |
| <b>Ateseco Comunicación, S.A. (SPAIN) (*) (**) (1)</b><br>Holding company<br>C/ Gran Vía, 28 - 28.013 Madrid   | 100.00%     |          | 100.00%          | 6.12    | 41.70    | -                | 0.70          | 107.57                | FC                   | -                           |
| <b>Atento N.V. (NETHERLANDS) (1) (6)</b><br>Telecommunications service provider<br>Locatellikade, 1 - 1076 AZ Amsterdam  | 91.35%      |          | 91.35%           | 0.12    | 12.82    | (2.16)           | 48.22         | 302.71                | FC                   | -                           |
| <b>Procesos Operativos, S.A. (SPAIN) (1)</b><br>Provision of telematic services (telemarketing, help line and call-center activities in general)<br>Isla Sicilia, 3 - 28034 Madrid   |             | 100.00%  | 91.35%           | 0.06    | 2.10     | (2.74)           | 1.28          | 0.76                  | FC                   | -                           |
| <b>Atento Teleservicios España, S.A. (SPAIN) (1)</b><br>Provision of promotion, marketing and market research services relating to direct marketing<br>Santiago de Compostela, 94 - 7º - 28035 Madrid                                |             | 100.00%  | 91.35%           | 1.38    | 44.46    | (20.00)          | 4.58          | 23.93                 | FC                   | -                           |
| <b>Tempotel, Empresa de Trabajo Temporal, S.A. (SPAIN) (1)</b><br>Temporary employment agency<br>Príncipe de Vergara, 28 Madrid  |             | 100.00%  | 91.35%           | 0.06    | 1.04     | -                | 0.23          | 0.06                  | FC                   | -                           |

(\*) Companies included in the 2004 consolidated tax statement.

(\*\*) Companies included in the 2005 consolidated tax statement.



## Subsidiaries, Associates and Investees as of 12-31-2005

| (millions of euros)   | % Ownership |          |                  | Capital | Reserves | Interim Dividend | Income (loss) | Gross Carrying Amount | Consolidation Method | Value in Consolidation (10) |
|---|-------------|----------|------------------|---------|----------|------------------|---------------|-----------------------|----------------------|-----------------------------|
|   | Direct      | Indirect | Telefónica Group |         |          |                  |               |                       |                      |                             |
| <b>Atento Servicios Técnicos y Consultoría, S.L. (SPAIN) (1)</b><br>Study, development and performance of projects and system-related services<br><i>Santiago de Compostela, 94 - 7ª - 28035 Madrid</i> | 100.00%     |          | 91.35%           | 0.01    | 0.49     | -                | 0.36          | 0.01                  | FC                   | -                           |
| <b>Servicios Integrales de Asistencia y Atención, S.L. (SPAIN) (1)</b><br>Management of specialized employment centers for disabled workers<br><i>Santiago de Compostela, 94 - 7ª - 28035 Madrid</i>    | 100.00%     |          | 91.35%           | 0.01    | -        | (0.04)           | 0.26          | 0.01                  | FC                   | -                           |
| <b>Atento Brasil, S.A. (BRAZIL) (1)</b><br>Provision of call-center services<br><i>Av. Maria Coelho de Aguiar, 215 - Bloco B, 8 - 05804-900 Sao Paulo</i>   | 100.00%     |          | 91.35%           | 249.75  | (158.00) | (3.27)           | 15.24         | 195.88                | FC                   | -                           |
| <b>Atento Puerto Rico, Inc. (PUERTO RICO) (5)</b><br>Provision of call-center services<br><i>Valencia Park calle 2 edificio 17 suite 600, Guaynabo - Puerto Rico 00968</i>                              | 100.00%     |          | 91.35%           | 7.12    | (1.69)   | -                | 2.44          | 8.22                  | FC                   | -                           |
| <b>Atento Colombia, S.A. (COLOMBIA) (5)</b><br>Provision of call-center services<br><i>Santa Fé de Bogotá</i>   | 100.00%     |          | 91.35%           | 1.55    | 4.35     | -                | 2.86          | 7.63                  | FC                   | -                           |
| <b>Atento Maroc, S.A. (MOROCCO) (1)</b><br>Provision of call-center services<br><i>Bd Abdelmoumen, Angle rue Errazi et Charles Lebrun - Casablanca</i>  | 100.00%     |          | 91.35%           | 4.15    | (3.23)   | -                | 0.35          | 3.56                  | FC                   | -                           |
| <b>Atento Venezuela, S.A. (VENEZUELA) (1)</b><br>Provision of call-center services<br><i>Caracas D.F.</i>   | 100.00%     |          | 91.35%           | 11.16   | (7.42)   | -                | 3.86          | 8.78                  | FC                   | -                           |
| <b>Atento Centroamérica, S.A. (GUATEMALA) (1)</b><br>Provision of call-center services<br><i>14 Calle 3-51 Zona 10 Edificio Murano Center 18 Nivel - Departamento de Guatemala</i>                      | 100.00%     |          | 91.35%           | 15.95   | (10.10)  | -                | 0.43          | 12.23                 | FC                   | -                           |
| <b>Atento El Salvador, S.A. de C.V. (EL SALVADOR) (1)</b><br>Provision of call-center services<br><i>Ciudad de San Salvador</i>   |             | 7.41%    | 91.35%           | 4.40    | 2.47     | -                | 1.14          | 0.28                  | FC                   | -                           |
| <b>Atento de Guatemala, S.A. (GUATEMALA) (1)</b><br>Provision of call-center services<br><i>Ciudad de Guatemala</i>   | 100.00%     |          | 91.35%           | 14.76   | (8.22)   | -                | 3.05          | 12.40                 | FC                   | -                           |
| <b>Atento El Salvador, S.A. de C.V. (EL SALVADOR) (1)</b>   |             | 92.59%   |                  |         |          |                  |               |                       |                      |                             |
| <b>Atento Holding Chile, S.A. (CHILE) (1)</b><br>Holding company<br><i>Ciudad y Comuna de Santiago</i>  | 100.00%     |          | 91.35%           | 38.85   | (1.91)   | -                | 4.13          | 30.13                 | FC                   | -                           |
| <b>Atento Argentina, S.A. (ARGENTINA) (1)</b><br>Provision of call-center services<br><i>Avda. de Mayo, 645 P1º - Buenos Aires</i>  | 100.00%     |          | 91.35%           | 18.05   | (21.85)  | -                | 3.39          | 0.22                  | FC                   | -                           |
| <b>Atento Chile, S.A. (CHILE) (1)</b><br>Provision of call-center services<br><i>Diagonal Paraguay, 386 - Santiago de Chile</i>   | 70.00%      |          | 77.60%           | 21.72   | 0.31     | (7.19)           | 8.40          | 12.88                 | FC                   | -                           |
| <b>Nexcom (CHILE) (1)</b><br>Provision of call-center services<br><i>Ciudad de Santiago de Chile</i>  | 100.00%     |          | 77.60%           | 1.73    | (1.06)   | -                | (0.12)        | 1.07                  | FC                   | -                           |
| <b>Atento Educación, Ltda. (CHILE) (1)</b><br>Provision of call-center services<br><i>Ciudad de Santiago de Chile</i>   | 100.00%     |          | 77.60%           | 0.01    | 0.15     | -                | 0.12          | 0.01                  | FC                   | -                           |
| <b>Atento Recursos, Ltda. (CHILE) (1)</b><br>Provision of call-center services<br><i>Ciudad de Santiago de Chile</i>  | 100.00%     |          | 77.60%           | 0.01    | (0.30)   | -                | 0.01          | 0.01                  | FC                   | -                           |
| <b>Atento Perú, S.A.C. (PERU) (1)</b><br>Provision of call-center services<br><i>C/ Jiron Camaná, 654 - 01 Lima</i>   | 70.00%      |          | 93.40%           | 7.15    | (2.41)   | -                | 2.84          | 12.84                 | FC                   | -                           |
| <b>Atento Italia, S.R.L. (ITALY) (8)</b><br>Provision of call-center services<br><i>Via Lamaro, edif. D/2 - Roma</i>  | 100.00%     |          | 91.35%           | 0.01    | (2.34)   | -                | -             | 6.08                  | FC                   | -                           |
| <b>Atento Mexicana, S.A. De C.V. (MEXICO) (1)</b><br>Provision of call-center services<br><i>Ciudad de México</i>   | 100.00%     |          | 91.35%           | 5.36    | 2.26     | (3.08)           | 6.53          | 4.10                  | FC                   | -                           |

(\*) Companies included in the 2004 consolidated tax statement.

(\*\*) Companies included in the 2004 consolidated tax statement.

## Subsidiaries, Associates and Investees as of 12-31-2005

| (millions of euros)   | % Ownership    |              |                  | Capital     | Reserves       | Interim Dividend | Income (loss) | Gross Carrying Amount | Consolidation Method | Value in Consolidation (10) |
|---|----------------|--------------|------------------|-------------|----------------|------------------|---------------|-----------------------|----------------------|-----------------------------|
|   | Direct         | Indirect     | Telefónica Group |             |                |                  |               |                       |                      |                             |
| Atento Atención y Servicios, S.A. De C.V. (MEXICO) (1)<br>Provision and receipt of all manner of administrative, professional and consultation services<br><i>Ciudad de México</i>  |                | 100.00%      | 91.35%           | 0.01        | 0.02           | -                | 0.06          | 0.01                  | FC                   | -                           |
| Atento Servicios, S.A. De C.V. (MEXICO) (1)<br>Provision of call-center services<br><i>Ciudad de México</i>   |                | 100.00%      | 100.00%          | 0.02        | 0.58           | -                | 0.44          | 0.02                  | FC                   | -                           |
| <b>Telefónica Investigación y Desarrollo, S.A. (TIDSA) (SPAIN) (*) (**) (3)</b><br><b>Telecommunications research activities and projects</b><br><b>Emilio Vargas, 6 - 28043 Madrid</b>   | <b>100.00%</b> |              | <b>100.00%</b>   | <b>6.01</b> | <b>60.30</b>   | <b>-</b>         | <b>4.39</b>   | <b>6.01</b>           | <b>FC</b>            | <b>-</b>                    |
| Telefónica Investigación y Desarrollo de Mexico, S.A. de C.V. (MEXICO) (5)<br>Telecommunications research activities and projects<br><i>Prol. Paseo de la Reforma, 1.200 - P5 - 05348 Col. Santa Fe Cruz Manca D.F. Mexico</i>                            |                | 100.00%      | 100.00%          | -           | 0.08           | -                | 0.68          | 0.01                  | FC                   | -                           |
| Telefônica Pesquisa e Desenvolvimento do Brasil (BRAZIL) (4)<br>Telecommunications research activities and projects<br><i>Rua Brigadeiro Galvao, 291 - 7º Anadar - 01151-000 Sao Paulo</i>  |                | 99.99%       | 99.99%           | 0.17        | 0.67           | -                | 1.73          | 0.20                  | FC                   | -                           |
| <b>Comunicapital Inversiones, S.A.U. (SPAIN) (5)</b><br><b>Global telecommunications fund</b><br><b>Gran Vía, 28 - 28013 Madrid</b>   | <b>100.00%</b> |              | <b>100.00%</b>   | <b>6.00</b> | <b>(54.94)</b> | <b>-</b>         | <b>(6.62)</b> | <b>6.00</b>           | <b>C</b>             | <b>6.00</b>                 |
| <b>Compañía Española de Tecnología, S.A. (SPAIN) (*) (**) (3)</b><br><b>Promotion of business initiatives and holding of real estate assets</b><br><b>Villanueva, 2 duplicado planta 1ª Oficina 23 - 28001 Madrid</b>                                     | <b>100.00%</b> |              | <b>100.00%</b>   | <b>4.56</b> | <b>(0.36)</b>  | <b>-</b>         | <b>(0.05)</b> | <b>10.71</b>          | <b>FC</b>            | <b>-</b>                    |
| Cleon, S.A. (SPAIN) (3)<br>Property development<br><i>Villanueva, 2 duplicado planta 1ª Oficina 23 - 28001 Madrid</i>   |                | 50.00%       | 50.00%           | 8.23        | (0.78)         | -                | (0.04)        | 4.12                  | EM                   | 3.71                        |
| <b>Casiopea Reaseguradora, S.A. (LUXEMBOURG) (1)</b><br><b>Reinsurance activities</b><br><b>6D, route de Trèves, L-2633 Senningerberg, Luxembourg</b>   | <b>99.97%</b>  | <b>0.03%</b> | <b>100.00%</b>   | <b>3.60</b> | <b>156.32</b>  | <b>-</b>         | <b>11.26</b>  | <b>2.99</b>           | <b>FC</b>            | <b>-</b>                    |
| Pléyade Peninsular, Correduría de Seguros y Reaseguros del Grupo Telefónica, S.A. (SPAIN) (3)<br>Distribution, promotion or preparation of insurance contracts, operating as a broker<br><i>Avda. General Perón, 38 Master II - 17ª P. - 28020 Madrid</i> | 16.67%         | 83.33%       | 100.00%          | 0.36        | 1.28           | -                | 2.16          | 0.38                  | FC                   | -                           |
| Pléyade Perú Corredores de Seguros, S.A.C. (PERU) (5)<br>Insurance broker<br><i>Ciudad de Lima</i>  |                | 99.93%       | 100.00%          | 0.01        | 0.02           | -                | 0.02          | 0.01                  | FC                   | -                           |
| Pléyade Argentina, S.A. (ARGENTINA) (5)<br>Insurance broker<br><i>Ciudad de Buenos Aires</i>  |                | 99.80%       | 99.80%           | 0.01        | 0.15           | -                | 0.12          | 0.01                  | FC                   | -                           |
| TGP Brasil Corretora de Seguros e Resseguros, Ltda. (BRAZIL) (4)<br>Insurance broker<br><i>Rua do Livramento, 66 - Bloco A, 1º andar - 04008-030 - Sao Paulo</i>  |                | 99.90%       | 99.90%           | 0.01        | 0.04           | -                | 0.17          | 0.02                  | FC                   | -                           |
| Pléyade México, Agente de Seguros y de Fianzas, S.A. de C.V., Ltda. (MEXICO) (5)<br>Insurance broker<br><i>San Pedro Garza García - Nuevo León</i>  |                | 99.50%       | 99.50%           | 0.01        | 0.02           | -                | 0.12          | 0.01                  | FC                   | -                           |
| Pléyade Chile, S.A. (CHILE)<br>Insurance broker<br><i>Santiago de Chile</i>   |                | 99.99%       | 99.99%           | 0.05        | 0.01           | -                | 0.01          | 0.05                  | FC                   | -                           |
| Altair Assurances, S.A. (LUXEMBOURG) (1)<br>Performance of direct insurance transations<br><i>6DRoute de Trèves L-2633 - Senningerberg</i>  |                | 100.00%      | 100.00%          | 6.00        | -              | -                | 0.16          | 6.00                  | FC                   | -                           |
| Seguros de Vida y Pensiones Antares, S.A. (SPAIN) (*) (**) (1)<br>Life insurance, pensions and health insurance<br><i>Avda. General Perón, 38 Master II - 17ª P. - 28020 Madrid</i>   | 94.67%         | 5.33%        | 100.00%          | 204.33      | 17.74          | -                | 14.71         | 215.50                | FC                   | -                           |
| Other shareholdings   | N/A            | N/A          | N/A              | N/A         | N/A            | N/A              | N/A           | 3.13                  | C                    | 3.13                        |

(\*) Companies included in the 2004 consolidated tax statement.

(\*\*) Companies included in the 2004 consolidated tax statement.

## Subsidiaries, Associates and Investees as of 12-31-2005

| (millions of euros)   | % Ownership |          |                  | Capital  | Reserves | Interim Dividend | Income (loss) | Gross Carrying Amount | Consolidation Method | Value in Consolidation (10) |
|---|-------------|----------|------------------|----------|----------|------------------|---------------|-----------------------|----------------------|-----------------------------|
|   | Direct      | Indirect | Telefónica Group |          |          |                  |               |                       |                      |                             |
| <b>Telefónica Finanzas, S.A. (TELFISA) (SPAIN) (*) (**) (1)</b><br>Integrated cash management, counseling and financial support for Group companies<br><i>Gran Vía, 30 - 4ª Pta. - 28013 Madrid</i>   | 100.00%     |          | 100.00%          | 3.01     | 10.89    | -                | 1.70          | 12.61                 | FC                   | -                           |
| <b>Telefónica Finanzas Perú, S.A.C. (PERU) (1)</b><br>Integrated cash management, counseling and financial support for Group companies<br><i>Ciudad de Lima</i>   | 100.00%     |          | 100.00%          | 2.96     | -        | -                | (0.04)        | 2.75                  | FC                   | -                           |
| <b>Fisatel Mexico, S.A. de C.V. (MEXICO) (1)</b><br>Integrated cash management, counseling and financial support for Group companies<br><i>Boulevard Manuel Avila Camacho, 24 - 16ª Pta. - Lomas de Chapultepec - 11000 Mexico D.F.</i>       | 100.00%     |          | 100.00%          | 0.35     | 0.02     | -                | 0.36          | 0.43                  | FC                   | -                           |
| <b>Venturini España, S.A. (SPAIN) (*) (**) (2)</b><br>Printing, graphic arts and direct marketing<br><i>Avda. de la Industria, 17 Tres Cantos - 28760 Madrid</i>  | 100.00%     |          | 100.00%          | 3.01     | 0.22     | -                | 0.67          | 3.60                  | FC                   | -                           |
| <b>Venturini, S.A. (SPAIN) (*) (**) (2)</b><br>Direct marketing<br><i>Vía Augusta, 117, 2º 1ª - 08006 Barcelona</i>   |             | 100.00%  | 100.00%          | 0.18     | 0.05     | -                | -             | 0.21                  | FC                   | -                           |
| <b>Communicapital Gestión, S.A.U. (SPAIN) (*) (**) (1)</b><br>Global telecommunications fund<br><i>Gran Vía, 28 - 28013 Madrid</i>  | 100.00%     |          | 100.00%          | 0.06     | (0.02)   | -                | -             | 0.06                  | FC                   | -                           |
| <b>Telefónica Participaciones, S.A. (SPAIN) (*) (**) (1)</b><br>Issuance of preferred securities and/or other debt financial instruments<br><i>Gran Vía, 28 - 28013 Madrid</i>  | 100.00%     |          | 100.00%          | 0.06     | -        | -                | -             | 0.06                  | FC                   | -                           |
| <b>Telefónica Emisiones, S.A. (SPAIN) (*) (**) (1)</b><br>Issuance of preferred securities and/or other debt financial instruments<br><i>Gran Vía, 28 - 28013 Madrid</i>  | 100.00%     |          | 100.00%          | 0.06     | -        | -                | -             | 0.06                  | FC                   | -                           |
| <b>Telefónica Europe, B.V. (NETHERLANDS) (1)</b><br>Fund raising in capital markets<br><i>Strawinskylaan 1259; tower D; 12th floor 1077 XX - Amsterdam</i>  | 100.00%     |          | 100.00%          | 0.05     | 6.65     | (1.92)           | 1.85          | 0.05                  | FC                   | -                           |
| <b>Telefónica Finance USA, LLC. (USA) (1)</b><br>Financial intermediation<br><i>Corporation Trust Center, 1209 Orange street - Wilmington/New Castle County - Delaware</i>  |             | 0.01%    | 0.01%            | 2,000.00 | 0.02     | (83.68)          | 83.68         | 0.01                  | FC                   | -                           |
| <b>Telefónica Internacional USA Inc. (USA)</b><br><i>1221 Brickell Avenue suite 600 - 33131 Miami - Florida</i>   | 100.00%     |          | 100.00%          | -        | 0.72     | -                | (0.59)        | -                     | FC                   | -                           |
| <b>Telefónica B2B Licencing, Inc. (USA) (1)</b>   | 100.00%     |          | 100.00%          | -        | (11.18)  | -                | 3.56          | -                     | FC                   | -                           |
| <b>Telefónica Gestión de Servicios Compartidos, S.A. (SPAIN) (*) (**) (4) (6) (9)</b><br>Provision of management and administration services<br><i>Gran Vía, 28 - 28013 Madrid</i>  | 100.00%     |          | 100.00%          | 7.70     | 2.78     | -                | 4.46          | 23.81                 | FC                   | -                           |
| <b>Telefónica Gestión de Servicios Compartidos, S.A. (ARGENTINA) (4)</b><br>Provision of management and administration services<br><i>Tucuman 1, Piso 18 Ciudad de Buenos Aires</i>   | 4.99%       | 95.00%   | 99.99%           | -        | -        | -                | 0.30          | 0.04                  | FC                   | -                           |
| <b>Cobros Serviços de Gestao, S.A. (BRAZIL) (4)</b><br>Provision of billing, receivables and financing services<br><i>Rua Do Livramento, 66, Ibirapuera - Sao Paulo</i>   |             | 99.33%   | 99.33%           | -        | 0.01     | -                | 0.01          | -                     | FC                   | -                           |
| <b>Telefónica Servicios Integrales de Distribución, S.A.U. (SPAIN) (*) (**) (3)</b><br>Provision of mail, directories and courier services<br><i>C/ Gran Vía, 28 - 28.013 Madrid</i>  |             | 100.00%  | 100.00%          | 2.38     | 2.62     | -                | 2.72          | 0.82                  | FC                   | -                           |
| <b>Telefónica Gestión de Servicios Compartidos Mexico, S.A. de C.V. (MEXICO) (4) (6)</b><br>Provision of management and administration services<br><i>Blvd. Diaz Ordaz Pte N 123 2º, Col. Santamaria - 6465 Monterrey</i>                     |             | 100.00%  | 100.00%          | 3.19     | 0.37     | -                | (1.79)        | 1.38                  | FC                   | -                           |
| <b>Telefónica Gestión de Servicios Compartidos de El Salvador, S.A. de C.V. (EL SALVADOR) (4)</b><br>Provision of management and administration services<br><i>63 Avda. Sur y Alameda Roosevelt-Ctro F Gigante Torre B n 10, San Salvador</i> |             | 100.00%  | 100.00%          | 0.02     | 0.01     | -                | 0.16          | 0.01                  | FC                   | -                           |

(\*) Companies included in the 2004 consolidated tax statement.

(\*\*) Companies included in the 2005 consolidated tax statement.

## Subsidiaries, Associates and Investees as of 12-31-2005

| (millions of euros)   | % Ownership    |          |                  | Capital         | Reserves        | Interim Dividend | Income (loss)   | Gross Carrying Amount | Consolidation Method | Value in Consolidation (10) |
|---|----------------|----------|------------------|-----------------|-----------------|------------------|-----------------|-----------------------|----------------------|-----------------------------|
|   | Direct         | Indirect | Telefónica Group |                 |                 |                  |                 |                       |                      |                             |
| Telefónica Gestión de Servicios Compartidos de Guatemala, S.A. (GUATEMALA) (4)<br>Provision of management and administration services<br>18 Calle 5-56, Zona 10, Edif. Unicentro Nivel 10, Guatemala      |                | 100.00%  | 100.00%          | -               | -               | -                | (0.07)          | 0.01                  | FC                   | -                           |
| Telefonica Gestao de Serviços Compartilhados do Brasil, Ltda. (BRAZIL) (4)<br>Provision of management and administration services<br>Rua Do Livramento, 66 Bolco Ibirapuera - Sao Paulo                   |                | 99.99%   | 99.99%           | 4.5             | 0.72            | -                | 0.70            | 2.74                  | FC                   | -                           |
| Telefónica Gestión de Servicios Compartidos, S.A.C. (PERU) (4) (6)<br>Provision of management and administration services<br>Shell, 310 - Miraflores - Lima   | 0.00%          | 100.00%  | 100.00%          | 2.55            | 0.28            | -                | 0.64            | 3.74                  | FC                   | -                           |
| Telefónica Centros de Cobro Perú, S.A.C. (PERU) (4)<br>Provision of collection services for the account of third parties<br>Shell, 310 - Miraflores - Lima  |                | 100.00%  | 100.00%          | -               | -               | -                | 0.24            | 1.24                  | FC                   | -                           |
| <b>Telefónica Internacional, S.A. (SPAIN) (*) (**) (1) (6) (9)</b><br><b>Investment in the telecommunications industry abroad</b><br><b>C/ Gran Vía, 28 -28013 Madrid</b>                                 | <b>100.00%</b> |          | <b>100.00%</b>   | <b>2,838.68</b> | <b>3,693.98</b> | <b>-</b>         | <b>1,106.67</b> | <b>8,131.75</b>       | <b>FC</b>            | <b>-</b>                    |
| Sao Paulo Telecomunicações Holding, Ltda. (BRAZIL) (1)<br>Holding company<br>Rua Martiniano de Carvalho, 851 20º andar, parte, Sao Paulo  |                | 100.00%  | 100.00%          | 1,163.59        | 404.74          | (78,69)          | 70,00           | 2,723,53              | FC                   | -                           |
| Telecomunicações de Sao Paulo, S.A. - TELESP (BRAZIL) (1) (11)<br>Wireline telephony operator in Sao Paulo<br>Sao Paulo   |                | 87.49%   | 87.49%           | 1,622.09        | 2,313.90        | (1,143,71)       | 881,57          | 1,540,02              | FC                   | -                           |
| Telefónica Finance Limited (ISLE OF MAN)<br>Financial   |                | 100.00%  | 100.00%          | 0.01            | 45,94           | -                | -               | 0,01                  | FC                   | -                           |
| Telefónica Perú Holding, S.A.C. (PERU) (1) (5)<br>Holding company   |                | 100.00%  | 100.00%          | 1,106.30        | (102,25)        | -                | 30,23           | 1,458,98              | FC                   | -                           |
| Telefónica del Perú, S.A.A. (PERU) (1) (11)<br>Operator of local, long distance and international telephony services in Peru<br>Avda. Arequipa, 1155 Santa Beatriz - Lima                                 | 0.14%          | 98.05%   | 98.19%           | 414.08          | (12,39)         | -                | 76,10           | 753,55                | FC                   | -                           |
| Atento Perú, S.A.C. (PERU)  |                | 30.00%   |                  |                 |                 |                  |                 |                       |                      |                             |
| Telefonica International Holding, B.V. (NETHERLANDS) (1)<br>Holding company   |                | 100.00%  | 100.00%          | 434.20          | 351.47          | -                | 51.40           | 417.16                | FC                   | -                           |
| Telefónica Chile Holding, B.V. (NETHERLANDS) (1)<br>Holding company   |                | 100.00%  | 100.00%          | 0.04            | 32.98           | -                | (0.01)          | 135.39                | FC                   | -                           |
| Telefónica Internacional de Chile, S.A. (CHILE) (1)<br>Holding company  |                | 100.00%  | 100.00%          | 11.57           | 1,075.96        | -                | 31.67           | 32.92                 | FC                   | -                           |
| Compañía de Telecomunicaciones de Chile, S.A. (C.T.C.), (CHILE) (1) (11)<br>Provision of telecommunications services in Chile<br>Avenida Providencia, 111 piso 29 Santiago de Chile                       |                | 44.89%   | 44.89%           | 1,178.65        | (240.31)        | (38.62)          | 42.68           | 685.66                | FC                   | -                           |
| Telefónica Mundo, S.A. (CHILE) (1) (11)<br>Operator of local, long distance and international telephony services in Chile.<br>Avenida Providencia, 127-A Santiago de Chile                                |                | 99.16%   | 99.16%           | 65.51           | 128.47          | -                | 2.56            | 196.92                | FC                   | -                           |
| Telefónica Gestión de Servicios Compartidos Chile, S.A. (CHILE) (1)<br>Provision of management and administration services<br>Avda. Providencia, 111-piso 22.<br>Comuna de Providencia. Santiago de Chile |                | 99.90%   | 44.85%           | 1.36            | 0.23            | -                | 0.78            | 0.92                  | FC                   | -                           |
| Atento Chile, S.A. (CHILE) (1) (6)  |                | 30.00%   |                  |                 |                 |                  |                 |                       |                      |                             |
| Compañía Internacional de Telecomunicaciones, S.A. (ARGENTINA) (1)<br>Holding company<br>Av. Ingeniero Huergo, 723, PB - Buenos Aires   |                | 99.98%   | 99.98%           | 237.73          | (764.00)        | -                | 265.93          | N/D                   | FC                   | -                           |
| Telefónica Holding de Argentina, S.A. (ARGENTINA) (1) (11)<br>Holding company<br>Tucumán, 1 P-17 Buenos Aires   |                | 99.96%   | 99.96%           | 570.45          | (797.58)        | -                | 152.54          | N/D                   | FC                   | -                           |

(\*) Companies included in the 2004 consolidated tax statement.

(\*\*) Companies included in the 2005 consolidated tax statement.

## Subsidiaries, Associates and Investees as of 12-31-2005

| (millions of euros)   | % Ownership |          |                  | Capital | Reserves | Interim Dividend | Income (loss) | Gross Carrying Amount | Consolidation Method | Value in Consolidation (10) |
|---|-------------|----------|------------------|---------|----------|------------------|---------------|-----------------------|----------------------|-----------------------------|
|   | Direct      | Indirect | Telefónica Group |         |          |                  |               |                       |                      |                             |
| <b>Telefónica de Argentina, S.A. (ARGENTINA) (1) (11)</b><br>Telecommunications service provider<br><i>Av. Ingeniero Huergo, 723, PB - Buenos Aires</i>   |             | 98.03%   | 98.03%           | 493.16  | (716.09) | -                | 505.83        | 866.22                | FC                   | -                           |
| <b>Telefónica Venezuela Holding, B.V. (NETHERLANDS) (1)</b><br>Holding company  |             | 100.00%  | 100.00%          | 0.04    | 32.98    | -                | (0.01)        | 66.63                 | FC                   | -                           |
| <b>Compañía Anónima Nacional de Teléfonos de Venezuela, C.A. (CANTV) (VENEZUELA) (1) (11)</b><br>Telecommunications service provider<br><i>Avenida Libertador, Centro Nacional de Telecomunicaciones, Piso 1 - 1226 Caracas</i> |             | 6.92%    | 6.92%            | N/D     | N/D      | N/D              | N/D           | N/D                   | C                    | 94.22                       |
| <b>Telefónica Larga Distancia de Puerto Rico, INC. (PUERTO RICO) (1)</b><br>Telecommunications service operator<br><i>Calle 1, Edificio n° 8. Metro Office Park. Sector de Buchanan. Guaynabo - Puerto Rico</i>                 |             | 98.00%   | 98.00%           | 88.54   | (49.17)  | -                | (0.72)        | N/D                   | FC                   | -                           |
| <b>Telefónica Móviles, S.A. (SPAIN) (*) (**) (1)</b>  |             | 21.53%   |                  |         |          |                  |               |                       |                      |                             |
| <b>China Netcom Group Corporation (Hong Kong) Limited (CHINA) (11)</b><br>Telecommunications service operator   |             | 5.00%    | 5.00%            | N/D     | N/D      | N/D              | N/D           | 452.31                | C                    | 452.31                      |
| Other shareholdings   |             | N/A      | N/A              | N/A     | N/A      | N/A              | N/A           | N/A                   | EM                   | 0.18                        |
| Other shareholdings   |             | N/A      | N/A              | N/A     | N/A      | N/A              | N/A           | N/A                   | C                    | 20.02                       |
| <b>Terra Networks Venezuela, S.A. (VENEZUELA) (1)</b><br>ISP and portal<br><i>Avda. Francisco de Miranda, Centro Plaza, Torre A, Piso 11, Los Palos Grandes, Caracas</i>  |             | 100.00%  | 100.00%          | 0.39    | (2.16)   | -                | (0.88)        | -                     | FC                   | -                           |
| <b>Terra Networks Perú, S.A. (PERU) (1)</b><br>ISP and Portal<br><i>Los Sauces, 374 - Torre Roja - San Borja - Lima</i>   |             | 99.99%   | 99.99%           | 2.15    | (0.75)   | -                | (0.17)        | -                     | FC                   | -                           |
| <b>Terra Networks Mexico Holding, S.A. De C.V. (MEXICO) (1) (6)</b><br>Holding company<br><i>Blvd. Díaz Ordaz Pte. N° 123, Col. Santa María, Monterrey, Nuevo León, México</i>  |             | 100.00%  | 100.00%          | 63.92   | (65.80)  | -                | 3.67          | 11.85                 | FC                   | -                           |
| <b>Terra Networks Mexico, S.A. De C.V. (MEXICO) (1) (6)</b><br>ISP and portal and real-time financial information<br><i>Blvd. Díaz Ordaz Pte. N° 123, Col. Santa María, Monterrey, Nuevo León, México</i>                       |             | 99.99%   | 99.99%           | 0.77    | (18.90)  | -                | (1.50)        | 2.86                  | FC                   | -                           |
| <b>Telefónica Interactiva Brasil, Ltda. (BRAZIL) (1) (6)</b><br>Holding company<br><i>Rua Martiniano de Carvalho, 851 20º andar, parte, Sao Paulo</i>   |             | 100.00%  | 100.00%          | 368.17  | (295.64) | -                | (1.42)        | 67.58                 | FC                   | -                           |
| <b>Terra Networks Brasil, S.A. and subsidiaries (BRAZIL) (1) (6)</b><br>ISP and Portal<br><i>Rua General Joao Manoel, 90 - Porto Alegre - Rio Grande do Sul</i>   |             | 100.00%  | 100.00%          | 325.59  | (313.51) | -                | (1.41)        | 26.81                 | FC                   | -                           |
| <b>Terra Networks Chile Holding Limitada (CHILE) (1) (6)</b><br>Holding company<br><i>Avda. Vitacura, 2736. Las Condes - Santiago de Chile</i>  |             | 99.99%   | 99.99%           | 75.17   | (49.44)  | -                | 1.65          | 41.03                 | FC                   | -                           |
| <b>Terra Networks Chile, S.A. (CHILE) (1)</b><br>ISP and Portal<br><i>Avda. Vitacura, 2736. Las Condes - Santiago de Chile</i>  |             | 100.00%  | 99.99%           | 48.48   | (49.67)  | -                | 1.64          | 88.88                 | FC                   | -                           |
| <b>Terra Networks Guatemala, S.A. (GUATEMALA) (1) (6)</b><br>ISP and Portal<br><i>C/ Diagonal, 6 Edificio Las Margaritas II - Ciudad de Guatemala</i>   |             | 100.00%  | 100.00%          | 11.35   | (12.37)  | -                | (1.18)        | 0.66                  | FC                   | -                           |
| <b>Terra Networks El Salvador, S.A. (EL SALVADOR) (1)</b><br>ISP and portal<br><i>63 Ave. Sur y Alameda Roosevelt, Centro Fin. Gigante Torre de San Salvador</i>  |             | 99.99%   | 99.99%           | 1.85    | (1.85)   | -                | (0.06)        | 1/3                   | FC                   | -                           |
| <b>Terra Networks Honduras, S.A. (HONDURAS)</b><br>ISP and portal<br><i>Honduras</i>  |             | 99.99%   | 99.98%           | 0.03    | (0.06)   | -                | -             | N/D                   | FC                   | -                           |
| <b>Terra Networks Costa Rica, S.A. (COSTA RICA) (1)</b><br>ISP and portal<br><i>Curridabat, Edificio Domus Plaza, 2ª Planta Oficina 2 - San José</i>  |             | 99.99%   | 99.97%           | 0.22    | (0.12)   | -                | (0.05)        | N/D                   | FC                   | -                           |

(\*) Companies included in the 2004 consolidated tax statement.

(\*\*) Companies included in the 2005 consolidated tax statement.

## Subsidiaries, Associates and Investees as of 12-31-2005

| (millions of euros)   | % Ownership   |               |                  | Capital         | Reserves        | Interim Dividend | Income (loss)   | Gross Carrying Amount | Consolidation Method | Value in Consolidation (10) |
|---|---------------|---------------|------------------|-----------------|-----------------|------------------|-----------------|-----------------------|----------------------|-----------------------------|
|   | Direct        | Indirect      | Telefónica Group |                 |                 |                  |                 |                       |                      |                             |
| <b>Terra Networks Nicaragua, S.A. (NICARAGUA)</b><br>Internet portal<br><i>Nicaragua</i>  |               | 99.99%        | 99.96%           | –               | –               | –                | –               | N/D                   | FC                   | –                           |
| <b>Terra Networks Panamá, S.A. (PANAMA) (1)</b><br>Internet portal<br><i>Harry Eno y Piloto, Posada Edificio El Educador - Coopeduc - Bethania</i>                                      |               | 99.99%        | 99.95%           | –               | (2.45)          | –                | (0.22)          | N/D                   | FC                   | –                           |
| <b>Terra Networks USA, Inc. y Filiales. (USA) (1) (6)</b><br>Internet portal<br><i>1201 Brickell Avenue, Suite 700, Miami - Florida 33131</i>   |               | 100.00%       | 100.00%          | –               | 3.57            | –                | (1.78)          | 15.65                 | FC                   | –                           |
| <b>Terra Networks Argentina, S.A. (ARGENTINA) (1)</b><br>ISP and Portal<br><i>Ingeniero Huergo, 723 Piso 17 - Ciudad de Buenos Aires</i>  |               | 100.00%       | 100.00%          | 0.03            | (0.32)          | –                | (0.17)          | –                     | FC                   | –                           |
| <b>Terra Networks Colombia Holding, S.A. (COLOMBIA) (1) (6)</b><br>Holding company<br><i>Diagonal 97, N° 17-60, Oficina 402. Bogotá D.C., Colombia</i>                                  |               | 100.00%       | 100.00%          | 0.09            | (0.89)          | –                | (0.66)          | 0.75                  | FC                   | –                           |
| <b>Terra Networks Colombia, S.A. (La Ciudad.com) (COLOMBIA) (1)</b><br>ISP and portal<br><i>Diagonal 97, N° 17-60, Oficina 402. Bogotá D.C., Colombia</i>                               |               | 99.99%        | 99.99%           | 0.01            | 0.86            | –                | (0.50)          | 3.32                  | FC                   | –                           |
| <b>Telefónica Móviles, S.A. (SPAIN) (*) (**) (1) (6) (11)</b><br>Holding company<br><i>Goya, 24 - 28001 Madrid</i>  | <b>71.38%</b> | <b>21.53%</b> | <b>92.91%</b>    | <b>2,165.28</b> | <b>1,661.87</b> | <b>–</b>         | <b>1,918.91</b> | <b>3,051.91</b>       | <b>FC</b>            | <b>–</b>                    |
| <b>Brascel, N.V. (NETHERLANDS) (5)</b><br>Joint Venture<br><i>Strawinskylaan 3105 - 1077ZX - Amsterdam</i>  |               | 50.00%        | 46.46%           | 0.13            | 5,829.45        | –                | 20.43           | 2,179.38              | PC                   | –                           |
| <b>VIVO Brasil Comunic. (BRAZIL) (5)</b><br>Holding company<br><i>Rua da Consolação, 247 - 6° andar / sala 57-F São Paulo - SP</i>  |               | 50.00%        | 46.46%           | 0.02            | –               | –                | (19.04)         | –                     | PC                   | –                           |
| <b>Tagilo Participações, Ltda. (BRAZIL) (5)</b><br>Ownership of intellectual and industrial property<br><i>Rua Martiniano de Carvalho, 851, 20 andar, Parte, Bela Vista, São Paulo.</i> |               | 50.00%        | 46.45%           | 127.57          | 6.72            | –                | (0.03)          | –                     | PC                   | –                           |
| <b>Sudestecel Participações, S.A. (BRAZIL) (5)</b><br>Holding company<br><i>Rua Martiniano de Carvalho, 851, 20 andar, Parte, Bela Vista, São Paulo</i>                                 |               | 50.00%        | 46.46%           | 698.70          | (25.91)         | –                | (14.55)         | –                     | PC                   | –                           |
| <b>Avista Participações, Ltda. (BRAZIL) (5)</b><br>Holding company<br><i>Rua da Consolação, 247 - 6° andar / sala 57-F São Paulo - SP</i>   |               | 50.00%        | 46.45%           | 223.08          | (2.75)          | –                | (11.96)         | –                     | PC                   | –                           |
| <b>Tele Sudeste Celular Participações, S.A. (BRAZIL) (5) (11)</b><br>Holding company<br><i>Prai de Botafogo 501, 20 andar, parte bela Vista, São Paulo</i>                              |               | 45.51%        | 42.28%           | 752.03          | 269.06          | –                | 200.60          | –                     | PC                   | –                           |
| <b>Telerj Celular, S.A. (BRAZIL) (5)</b><br>Provision of wireless communications services<br><i>Praia de Botafogo, 501-5° a 8° Andares, Botafogo - Rio de Janeiro</i>                   |               | 45.51%        | 42.28%           | 602.18          | 61.38           | –                | 40.90           | –                     | PC                   | –                           |
| <b>Telest Celular, S.A. (BRAZIL) (5)</b><br>Provision of wireless communications services<br><i>Avda. Nossa Senhora da Penha, 275 - Praia de Santa Elena, Vitoria - Espiritu Santo</i>  |               | 45.51%        | 42.28%           | 130.51          | 43.99           | –                | 11.34           | –                     | PC                   | –                           |
| <b>Telefónica Brasil Sul Celular Participações, S.A. (BRAZIL) (5)</b><br>Holding company<br><i>Avda. Martiniano de Carvalho, 851, 20 andar, parte São Paulo, São Paulo</i>              |               | 49.25%        | 45.76%           | 211.93          | 17.89           | –                | 9.09            | 0.53                  | PC                   | –                           |
| <b>Celular CRT Participações, S.A. (BRAZIL) (5) (11)</b><br>Holding company<br><i>Rua José Bonifácio, 245, Bon Fim, Porto Alegre - Rio Grande Do Sul</i>                                |               | 33.50%        | 31.13%           | 118.61          | 285.47          | –                | 43.40           | –                     | PC                   | –                           |
| <b>Celular CRT, S.A. (BRAZIL) (5)</b><br>Provision of wireless communications services<br><i>Rua José Bonifácio, 245, Bon Fim, Porto Alegre - Rio Grande Do Sul</i>                     |               | 33.50%        | 31.13%           | 206.59          | (13.28)         | –                | –               | –                     | PC                   | –                           |

(\*) Companies included in the 2004 consolidated tax statement.

(\*\*) Companies included in the 2005 consolidated tax statement.



## Subsidiaries, Associates and Investees as of 12-31-2005

| (millions of euros)  | % Ownership |          |                  | Capital  | Reserves | Interim Dividend | Income (loss) | Gross Carrying Amount | Consolidation Method | Value in Consolidation (10) |
|--|-------------|----------|------------------|----------|----------|------------------|---------------|-----------------------|----------------------|-----------------------------|
|  | Direct      | Indirect | Telefónica Group |          |          |                  |               |                       |                      |                             |
| <b>Tele Leste Celular Participações, S.A. (BRAZIL) (5) (11)</b><br>Holding company<br><i>Rua Silveria Martins, n 1036, Cabula, Salvador- Bahia</i>   |             | 25.33%   | 23.54%           | 130.51   | 43.99    | -                | 11.34         | -                     | PC                   | -                           |
| <b>Telebahia Celular, S.A. (BRAZIL) (5)</b><br>Provision of wireless communications services<br><i>Rua Silveria Martins, n 1036, Cabula, Salvador- Bahia</i>   |             | 25.33%   | 23.54%           | 129.58   | (22.31)  | -                | (33.46)       | -                     | PC                   | -                           |
| <b>Telegipe Celular, S.A. (BRAZIL) (5)</b><br>Provision of wireless communications services<br><i>Avda. Francisco Porto, 686, 13 de julho - Aracaju, Sergipe</i>   |             | 25.33%   | 23.54%           | 111.12   | 16.07    | -                | (27.50)       | -                     | PC                   | -                           |
| <b>Ptelecom Brasil, S.A. (BRAZIL) (5)</b><br>Holding company<br><i>Rua Cubatao, 320, 4 andar, Sao Paulo, Sao Paulo</i>   |             | 49.99%   | 46.44%           | 956.47   | (550.12) | -                | (8.03)        | -                     | PC                   | -                           |
| <b>Portelcom Participações, S.A. (BRAZIL) (5)</b><br>Holding company<br><i>Av Brigadeiro Faria Lima, 2277, 15º andar, Conj1503, Jardim Paulistano, Sao Paulo</i>   |             | 49.99%   | 46.45%           | 1,282.42 | (262.21) | -                | (21.98)       | -                     | PC                   | -                           |
| <b>Telesp Celular Participações, S.A. (BRAZIL) (5) (11)</b><br>Holding company<br><i>Av. Roque Petroni Júnior, nº 1464, 6 andar-parte, bloco B, Morumbi, Sao Paulo, Sao Paulo</i>  |             | 33.04%   | 30.70%           | 2,415.60 | (638.39) | -                | (289.18)      | -                     | PC                   | -                           |
| <b>Telesp Celular, S.A. (BRAZIL) (5)</b><br>Holding company<br><i>Av. Roque Petroni Júnior, nº 1464, 6 andar-parte, bloco B, Morumbi, Sao Paulo, Sao Paulo</i>   |             | 33.04%   | 30.70%           | 788.15   | 269.81   | -                | 55.57         | -                     | PC                   | -                           |
| <b>Global Telcom Telecom, S.A. (BRAZIL) (5)</b><br>Wireless operator<br><i>Av. Higienópolis, nº 1635, Curitiba, Parana</i>   |             | 33.04%   | 30.70%           | 1,465.75 | (992.04) | -                | (85.47)       | -                     | PC                   | -                           |
| <b>Tele Centro Oeste Celular Participações, S.A. (BRAZIL) (5) (11)</b><br>Holding company and telecommunications operator<br><i>Sector Comercial Sul, Quadra 2, Bloco C, nº 226, Edif Telebrasil Celular, 7 andar, Brasilia DF</i> |             | 17.34%   | 16.11%           | 370.02   | 523.00   | -                | 106.44        | -                     | PC                   | -                           |
| <b>Telegoiás Celular, S.A. (BRAZIL) (5)</b><br>Wireless operator<br><i>Rua 136-C, Quadra F-44, nº 150, Setor Sul Goiania, Goias</i>  |             | 17.34%   | 16.11%           | 94.08    | 154.42   | -                | 50.74         | -                     | PC                   | -                           |
| <b>Telemat Celular, S.A. (BRAZIL) (5)</b><br>Wireless operator<br><i>Av. Getúlio Vargas, nº 1,300, Centro, Cuiabá, Matogrosso</i>  |             | 17.34%   | 16.11%           | 55.06    | 95.57    | -                | 35.19         | -                     | PC                   | -                           |
| <b>Telems Celular, S.A. (BRAZIL) (5)</b><br>Wireless operator<br><i>Av. Alfonso Pena, nº 2,386, Ed Dolor de Andrade, Campo Grande, Matogrosso Do Sul</i>   |             | 17.34%   | 16.11%           | 42.80    | 66.46    | -                | 21.65         | -                     | PC                   | -                           |
| <b>Teleron Celular, S.A. (BRAZIL) (5)</b><br>Wireless operator<br><i>Av. Getúlio Vargas, 1941, Porto Velho, Rondonia</i>   |             | 17.34%   | 16.11%           | 13.50    | 21.41    | -                | 4.24          | -                     | PC                   | -                           |
| <b>Teacre Celular, S.A. (BRAZIL) (5)</b><br>Wireless operator<br><i>Rua Minas Gerais, nº 64, Ivete Vargas, Rio Branco-Acre</i>   |             | 17.34%   | 16.11%           | 7.18     | 11.19    | -                | 0.58          | -                     | PC                   | -                           |
| <b>Norte Brasil Telecom, S.A. (BRAZIL) (5)</b><br>Wireless operator<br><i>Travessa Padre Eutiquio, nº 1,226, Barrio Batista Campos, Belém, Para</i>  |             | 17.34%   | 16.11%           | 65.19    | 14.11    | -                | 5.30          | -                     | PC                   | -                           |
| <b>Tele Centro Oeste IP, S.A. (BRAZIL) (5)</b><br>Wireless operator<br><i>AC/ Sul Quadra 02, Bloco C, nº 256, 3º Pavimento, Ed Toufic, Plano Piloto, Brasilia, DF</i>  |             | 17.34%   | 16.11%           | 4.15     | (3.97)   | -                | (0.10)        | -                     | PC                   | -                           |
| <b>Telefónica Móviles El Salvador Holding, S.A. de C.V. (EL SALVADOR) (1)</b><br>Holding company<br><i>Alameda Roosevelt y Avenida Sur. Torre Telefónica nivel 10 - San Salvador</i>   | 100.00%     |          | 92.91%           | 158.55   | (63.95)  | -                | (0.34)        | 160.83                | FC                   | -                           |

(\*) Companies included in the 2004 consolidated tax statement.

(\*\*) Companies included in the 2005 consolidated tax statement.

## Subsidiaries, Associates and Investees as of 12-31-2005

| (millions of euros)  | % Ownership |          | Telefónica Group | Capital | Reserves   | Interim Dividend | Income (loss) | Gross Carrying Amount | Consolidation Method | Value in Consolidation (10) |
|--|-------------|----------|------------------|---------|------------|------------------|---------------|-----------------------|----------------------|-----------------------------|
|  | Direct      | Indirect |                  |         |            |                  |               |                       |                      |                             |
| <b>Telefónica Móviles El Salvador, S.A. de C.V. (EL SALVADOR) (1)</b><br>Provision of wireless and international long distance communications services<br><i>Alameda Roosevelt y Avenida Sur. Torre Telefónica nivel 10 - San Salvador</i> |             | 99.03%   | 92.01%           | 59.35   | (41.12)    | -                | (5.82)        | -                     | FC                   | -                           |
| <b>Telefónica Multiservicios, S.A. de C.V. (EL SALVADOR) (1)</b><br>Cable modem system operator<br><i>Alameda Roosevelt y Avenida Sur. Torre Telefónica nivel 10 - San Salvador</i>  |             | 76.75%   | 71.31%           | 7.53    | (1.66)     | -                | (1.10)        | -                     | FC                   | -                           |
| <b>Telefónica Móviles Centroamérica, S.A. de C.V. (EL SALVADOR) (3)</b><br>Operative company<br><i>Alameda Roosevelt y Avenida Sur. Torre Telefónica nivel 10 - San Salvador</i>   |             | 99.03%   | 92.01%           | 1.21    | (0.06)     | -                | 0.21          | -                     | FC                   | -                           |
| <b>Telefónica El Salvador, S.A. de C.V. (EL SALVADOR) (3)</b><br>Operative company<br><i>Alameda Roosevelt y Avenida Sur. Torre Telefónica nivel 10 - San Salvador</i>   |             | 99.03%   | 92.01%           | 0.02    | (0.03)     | -                | (0.02)        | -                     | FC                   | -                           |
| <b>TCG Holdings, S.A. (GUATEMALA) (1)</b><br>Holding company<br><i>Bulevar Los Próceres 5-56 Zona 10, Unicentro nivel 10 - Ciudad de Guatemala</i>   |             | 100.00%  | 92.91%           | 351.16  | (1.45)     | -                | 0.18          | 238.54                | FC                   | -                           |
| <b>Telefónica Móviles Guatemala, S.A. (GUATEMALA) (1)</b><br>Provision of wireless, wireline and radio paging communications services<br><i>Bulevar Los Próceres 5-56 Zona 10, Unicentro nivel 11 - Ciudad de Guatemala</i>                |             | 100.00%  | 92.91%           | 248.89  | (148.30)   | -                | (2.01)        | -                     | FC                   | -                           |
| <b>Tele Escucha, S.A. (GUATEMALA) (5)</b><br>Telecommunications and paging service provider<br><i>Bulevar Los Próceres 5-56 Zona 10, Unicentro nivel 11 - Ciudad de Guatemala</i>  |             | 100.00%  | 92.91%           | 3.92    | (2.30)     | -                | (0.59)        | -                     | FC                   | -                           |
| <b>Infraestructura Internacional, S.A. (GUATEMALA)</b><br>Telecommunications and paging service provider<br><i>5ª Avenida 7-76, Zona 10 - Ciudad de Guatemala</i>  |             | 70.00%   | 65.04%           | 0.48    | (0.17)     | -                | (0.05)        | -                     | FC                   | -                           |
| <b>PageMart de Centroamérica</b><br>Operative company<br><i>Bulevar Los Próceres 5-56 Zona 10, Unicentro nivel 11 - Ciudad de Guatemala</i>  |             | 30.00%   | 27.87%           | -       | -          | -                | -             | -                     | C                    | -                           |
| <b>Telefónica Móviles España, S.A.U. (SPAIN) (*) (**) (1)</b><br>Provision of wireless communications services<br><i>Plaza de la Independencia, 6 - Pta. 5 - 28001 Madrid</i>  |             | 100.00%  | 92.91%           | 476.51  | 393.36     | 700.00           | 2,104.85      | 933.21                | FC                   | -                           |
| <b>Spiral Investments, B.V. (NETHERLANDS) (1)</b><br>Holding company<br><i>Strawinskylaan 3105 - 1077ZX - Amsterdam</i>  |             | 100.00%  | 92.91%           | 38.54   | (135.71)   | -                | (3.19)        | -                     | FC                   | -                           |
| <b>3G Mobile AG (SWITZERLAND) (9)</b><br>Wireless telephony operator<br><i>Bahnhofplatz 4, 8001 Zurich</i>   |             | 100.00%  | 92.91%           | 35.43   | (77.45)    | -                | (2.63)        | -                     | FC                   | -                           |
| <b>Mobipay España, S.A. (SPAIN)</b><br>Provision of payment services through wireless telephony<br><i>Avda. Europa, 20 - Alcobendas - Madrid</i>   |             | 13.36%   | 12.41%           | 16.05   | 7.96       | -                | (4.79)        | -                     | P/E                  | 0.42                        |
| <b>Solivella Investment, B.V. (NETHERLANDS) (1)</b><br>Holding company<br><i>Strawinskylaan 3105 - 1077ZX - Amsterdam</i>  |             | 100.00%  | 92.91%           | 880.70  | (1,412.28) | -                | (90.04)       | -                     | FC                   | -                           |
| <b>Ipse 2000, S.p.A. (ITALY)</b><br>Installation and operation of third-generation wireless communications systems<br><i>Piazza dei Capprettari, 70 - Roma</i>   |             | 45.59%   | 46.44%           | 150.50  | 81.56      | -                | (1,223.39)    | -                     | P/E                  | -                           |
| <b>Group 3G UMTS Holding, GmbH (GERMANY) (1)</b><br>Network development and provision of third-generation telecommunications services<br><i>Alois-Wolfmüller-Str. 8 80939 Munich</i>   |             | 57.20%   | 53.14%           | 250.03  | (965.51)   | -                | (32.84)       | -                     | FC                   | -                           |
| <b>Quam, GmbH (GERMANY) (1)</b><br>Provider of UMTS services<br><i>Alois-Wolfmüller-Str. 8 80939 Munich</i>  |             | 57.20%   | 53.14%           | 250.03  | 9,001.11   | -                | (7.32)        | -                     | FC                   | -                           |

(\*) Companies included in the 2004 consolidated tax statement.

(\*\*) Companies included in the 2005 consolidated tax statement.

## Subsidiaries, Associates and Investees as of 12-31-2005

| (millions of euros)   | % Ownership |          |                  | Capital | Reserves | Interim Dividend | Income (loss) | Gross Carrying Amount | Consolidation Method | Value in Consolidation (10) |
|---|-------------|----------|------------------|---------|----------|------------------|---------------|-----------------------|----------------------|-----------------------------|
|   | Direct      | Indirect | Telefónica Group |         |          |                  |               |                       |                      |                             |
| <b>Opco Mobile Services GmbH (GERMANY) (1)</b><br>Provider of UMTS services<br><i>Alois-Wolfmüller-Str.8 80939 Munich</i>   |             | 57.20%   | 53.14%           | 0.05    | –        | –                | –             | –                     | FC                   | –                           |
| <b>Médi Telecom, S.A. (MOROCCO) (1)</b><br>Provision of wireless communications services<br><i>Twin Center, Tour A. Angle Bd Zertouni et El Massira El Kadra Casablanca</i>                         |             | 32.18%   | 29.90%           | 427.94  | (320.94) | –                | 11.27         | –                     | P/E                  | 52.64                       |
| <b>Terra Mobile Brasil, Ltd. (BRAZIL) (7)</b><br>Inactive company<br><i>22º ANDAR 17 - Bairro ou Distrito FLAMENGO, Rio de Janeiro</i>  |             | 100.00%  | 92.91%           | 5.65    | (5.63)   | –                | –             | –                     | FC                   | –                           |
| <b>Gruppo 3G, SRL (ITALY)</b><br>Holding company<br><i>Via Lepetit, 4 - Milan</i>   |             | 100.00%  | 92.91%           | 0.07    | –        | –                | –             | 0.10                  | C                    | 0.10                        |
| <b>Tempos 21 Innovación en Aplicaciones Móviles, S.A. (SPAIN)</b><br>Research, development and commercial operation of wireless services and applications<br><i>Avda. Diagonal, 640 - Barcelona</i> |             | 38.50%   | 35.77%           | 4.64    | –        | –                | (3.33)        | –                     | EM                   | 0.50                        |
| <b>Simpay, Ltd. (UK)</b><br>Payment services through wireless telephony<br><i>62-65 Chandos Place, London WC2N 4LP</i>  |             | 25.00%   | 23.23%           | –       | –        | –                | –             | –                     | C                    | –                           |
| <b>Omicron Ceti, S.L. (SPAIN) (8)</b><br>Holding company<br><i>José Abascal - Madrid</i>  |             | 100.00%  | 92.91%           | –       | –        | –                | –             | –                     | C                    | –                           |
| <b>Telefónica Móviles Puerto Rico, Inc. (PUERTO RICO)</b><br>Ownership of wireless operators in Puerto Rico<br><i>Metro Office Park Calle Edificio #17, Suite 600 - 00968 Guaynabo</i>              |             | 100.00%  | 92.91%           | 83.59   | (73.14)  | –                | (1.90)        | 62.92                 | FC                   | –                           |
| <b>Newcomm Wireless Services, Inc. (PUERTO RICO)</b><br>Wireless operator   |             | 49.30%   | 45.80%           | –       | –        | –                | –             | 53.84                 | C                    | 53.84                       |
| <b>OMTP Limited (Open Mobile Terminal Platform) (UK)</b>  |             | 2.04%    | 1.90%            | –       | –        | –                | –             | –                     | C                    | –                           |
| <b>MobiPay Internacional, S.A. (SPAIN)</b><br>Provision of payment services through wireless telephony<br><i>Avenida de Europa 20, Alcobendas, Madrid</i>   |             | 50.00%   | 46.46%           | 11.82   | (3.58)   | –                | (2.42)        | 5,212.00              | PC                   | –                           |
| <b>Telefónica Móviles Perú Holding, S.A.A. (PERU) (1) (11)</b><br>Holding company<br><i>Avda. Arequipa, 1155 Lima, 01</i>   |             | 97.97%   | 91.02%           | 180.71  | 31.93    | –                | (4.33)        | 254.46                | FC                   | –                           |
| <b>Telefónica Móviles Perú, S.A.C. (PERU) (1) (11)</b><br>Provision of wireless communications services<br><i>Avda. Arequipa, 1155 Lima, 01</i>   |             | 98.03%   | 91.08%           | 38.52   | 183.43   | –                | (4.70)        | 0.17                  | FC                   | –                           |
| <b>Inmuebles Aries, S.A.C. (PERU)</b>   |             | 98.03%   | 91.08%           | –       | –        | –                | –             | –                     | FC                   | –                           |
| <b>Billing &amp; Management System, S.A.C. (PERU)</b>   |             | 98.03%   | 91.08%           | –       | –        | –                | –             | –                     | FC                   | –                           |
| <b>Telefónica Móviles Argentina, S.A. (ARGENTINA) (1)</b><br>Holding company<br><i>Ing Huergo 723, piso 17 - Capital Federal</i>  |             | 100.00%  | 92.91%           | 450.63  | (732.51) | –                | (138.25)      | 789.72                | FC                   | –                           |
| <b>Telefónica Comunicaciones Personales, S.A. (ARGENTINA) (1)</b><br>Provision of wireless communications services<br><i>Ing Huergo 723, piso 17 - Capital Federal</i>                              |             | 100.00%  | 92.91%           | 344.66  | (625.98) | –                | (1.86)        | –                     | FC                   | –                           |
| <b>Radio Servicios, S.A. (ARGENTINA) (7)</b><br>Inactive company<br><i>Ing Huergo 723, piso 17 - Capital Federal</i>  |             | 100.00%  | 92.91%           | 0.01    | (0.34)   | –                | (0.02)        | –                     | P/E                  | –                           |
| <b>Telefónica de Centroamérica, S.L. (SPAIN) (7)</b><br>Inactive company<br><i>Gran Vía, nº 28, Madrid</i>  |             | 100.00%  | 92.91%           | 0.50    | 0.01     | –                | (0.13)        | 1.33                  | C                    | 1.33                        |
| <b>Telefónica Móviles Holding Uruguay, S.A. (URUGUAY) (7)</b><br>Inactive company<br><i>Plza de la Independencia 8, planta baja, Montevideo</i>   |             | 100.00%  | 92.91%           | 30.33   | –        | –                | (0.30)        | 25.80                 | FC                   | –                           |
| <b>Telefónica Móviles Uruguay, S.A. (URUGUAY) (7)</b><br>Inactive company<br><i>Plza de la Independencia 8, planta baja, Montevideo</i>   |             | 100.00%  | 92.91%           | 24.01   | –        | –                | (0.09)        | –                     | FC                   | –                           |

(\*) Companies included in the 2004 consolidated tax statement.

(\*\*) Companies included in the 2005 consolidated tax statement.

## Subsidiaries, Associates and Investees as of 12-31-2005

| (millions of euros)   | % Ownership |          |                  | Capital    | Reserves | Interim Dividend | Income (loss) | Gross Carrying Amount | Consolidation Method | Value in Consolidation (10) |
|---|-------------|----------|------------------|------------|----------|------------------|---------------|-----------------------|----------------------|-----------------------------|
|   | Direct      | Indirect | Telefónica Group |            |          |                  |               |                       |                      |                             |
| <b>Wireless Network Ventures (BRITISH VIRGIN ISLANDS)</b><br>Holding company<br><i>Palm Grove House, PO Box 438, tortola, BVI</i>   | 100.00%     | 92.91%   | –                | –          | –        | –                | –             | –                     | FC                   | –                           |
| <b>Paging de Centroamérica, S.A. (GUATEMALA)</b><br>Telecommunications and paging service provider<br><i>Bulevar Los Próceres 5-56 Zona 10, Unicentro nivel 11 - Ciudad de Guatemala</i>  | 100.00%     | 92.91%   | –                | –          | –        | –                | –             | –                     | C                    | –                           |
| <b>Telefónica Soporte y Tecnología, S.A. (GUATEMALA)</b><br>Telecommunications and paging service provider<br><i>Bulevar Los Próceres 5-56 Zona 10, Unicentro nivel 11 - Ciudad de Guatemala</i>  | 100.00%     | 92.91%   | –                | –          | –        | –                | –             | –                     | C                    | –                           |
| <b>Telefónica Móviles México, S.A. de C.V. (MEXICO) (1)</b><br>Holding company<br><i>Paseo de los Tamarindos No. 400-A, piso 4, Col. Bosques de las Lomas, México, D.F. 05120</i>   | 100.00%     | 92.91%   | 1,772.13         | (1,468.50) | –        | (405.94)         | 1,176.27      | –                     | FC                   | –                           |
| <b>Telefónica Finanzas México, S.A. de C.V. (MEXICO) (1)</b><br>Promotion, formation, organization, exploitation, operation and ownership of companies' capital stock.<br><i>Paseo de los Tamarindos No. 400-A, piso 4, Col. Bosques de las Lomas, México, D.F. 05120</i> | 100.00%     | 92.91%   | –                | 1.15       | –        | 1.84             | –             | –                     | FC                   | –                           |
| <b>Baja Celular Mexicana, S.A. de C.V. (MEXICO) (1)</b><br>Provision of wireless local loop services<br><i>Paseo de los Tamarindos No. 400-A, piso 4, Col. Bosques de las Lomas, México, D.F. 05120</i>   | 100.00%     | 92.91%   | 119.19           | (55.31)    | –        | 2.07             | –             | –                     | FC                   | –                           |
| <b>Movitel de Noroeste, S.A. de C.V. (MEXICO) (1)</b><br>Provision of wireless local loop services<br><i>Paseo de los Tamarindos No. 400-A, piso 4, Col. Bosques de las Lomas, México, D.F. 05120</i>   | 90.00%      | 83.62%   | 17.27            | (19.75)    | –        | (3.72)           | –             | –                     | FC                   | –                           |
| <b>Moviservicios, S.A. de C.V. (MEXICO) (1)</b><br>Technical, administrative, consultancy, advisory and supervision services.<br><i>Paseo de los Tamarindos No. 400-A, piso 4, Col. Bosques de las Lomas, México, D.F. 05120</i>  | 99.99%      | 92.90%   | 2.22             | 0.74       | –        | 0.01             | –             | –                     | FC                   | –                           |
| <b>Telefonia Celular del Norte, S.A. de C.V. (MEXICO) (1)</b><br>Provision of wireless local loop services<br><i>Paseo de los Tamarindos No. 400-A, piso 4, Col. Bosques de las Lomas, México, D.F. 05120</i>   | 100.00%     | 92.91%   | 36.82            | (107.69)   | –        | 2.54             | –             | –                     | FC                   | –                           |
| <b>Celular de Telefonía, S.A. de C.V. (MEXICO) (1)</b><br>Provision of wireless local loop services<br><i>Paseo de los Tamarindos No. 400-A, piso 4, Col. Bosques de las Lomas, México, D.F. 05120</i>  | 100.00%     | 92.91%   | 29.49            | (144.93)   | –        | (17.88)          | –             | –                     | FC                   | –                           |
| <b>Enlaces del Norte, S.A. de C.V. (MEXICO) (1)</b><br>Acquisition, disposal and custodianship of securities<br><i>Paseo de los Tamarindos No. 400-A, piso 4, Col. Bosques de las Lomas, México, D.F. 05120</i>   | 94.90%      | 88.17%   | 0.04             | (10.59)    | –        | 12.15            | –             | –                     | FC                   | –                           |
| <b>Grupo de Telecomunicaciones Mexicanas, S.A. de C.V. (MEXICO) (1)</b><br>Provision of wireless local loop services<br><i>Paseo de los Tamarindos No. 400-A, piso 4, Col. Bosques de las Lomas, México, D.F. 05120</i>   | 97.40%      | 90.49%   | 0.70             | (9.07)     | –        | 25.51            | –             | –                     | FC                   | –                           |
| <b>Pegaso Telecomunicaciones, S.A. de C.V. (MEXICO) (1)</b><br>Installation, maintenance and operation of public or private telecommunications networks<br><i>Paseo de los Tamarindos No. 400-A, piso 4, Col. Bosques de las Lomas, México, D.F. 05120</i>                | 100.00%     | 92.91%   | 888.51           | (1,924.45) | –        | (387.05)         | –             | –                     | FC                   | –                           |
| <b>Pegaso Comunicaciones y Sistemas, S.A. de C.V. (MEXICO) (1)</b><br>Provision of wireless local loop services<br><i>Paseo de los Tamarindos No. 400-A, piso 4, Col. Bosques de las Lomas, México, D.F. 05120</i>  | 100.00%     | 92.91%   | 704.14           | (1,380.70) | –        | 85.76            | –             | –                     | FC                   | –                           |
| <b>Pegaso PCS, S.A. de C.V. (MEXICO) (1)</b><br>Provision of wireless local loop services<br><i>Paseo de los Tamarindos No. 400-A, piso 4, Col. Bosques de las Lomas, México, D.F. 05120</i>  | 100.00%     | 92.91%   | 12.63            | (388.64)   | –        | (521.99)         | –             | –                     | FC                   | –                           |

(\*) Companies included in the 2004 consolidated tax statement.

(\*\*) Companies included in the 2005 consolidated tax statement.

## Subsidiaries, Associates and Investees as of 12-31-2005

| (millions of euros)   | % Ownership |          |                  | Capital  | Reserves | Interim Dividend | Income (loss) | Gross Carrying Amount | Consolidation Method | Value in Consolidation (10) |
|---|-------------|----------|------------------|----------|----------|------------------|---------------|-----------------------|----------------------|-----------------------------|
|   | Direct      | Indirect | Telefónica Group |          |          |                  |               |                       |                      |                             |
| <b>Pegaso Recursos Humanos, S.A. de C.V. (MEXICO) (1)</b><br>Technical professional services for the development of public telecommunications networks<br><i>Paseo de los Tamarindos No. 400-A, piso 4, Col. Bosques de las Lomas, México, D.F. 05120</i> | 100.00%     | 92.91%   |                  | 2.78     | 0.95     | -                | (1.84)        | -                     | FC                   | -                           |
| <b>Activos Para Telecomunicación, S.A. de C.V. (MEXICO) (1)</b><br>Provision of handsfree wireless telecommunications services<br><i>Paseo de los Tamarindos No. 400-A, piso 4, Col. Bosques de las Lomas, México, D.F. 05120</i>                         | 100.00%     | 92.91%   |                  | 0.00     | (100.30) | -                | 74.73         | -                     | FC                   | -                           |
| <b>Telecomunicaciones Punto a Punto México, S.A. de C.V. (MEXICO) (1)</b><br>Provision of handsfree wireless telecommunications services<br><i>Paseo de los Tamarindos No. 400-A, piso 4, Col. Bosques de las Lomas, México, D.F. 05120</i>               | 100.00%     | 92.91%   |                  | -        | (38.78)  | -                | (0.70)        | -                     | FC                   | -                           |
| <b>Telefónica Telecomunicaciones México (MEXICO) (1)</b><br>Holding company<br><i>Rio Duero 31, México DF 06500</i>   | 94.90%      | 88.17%   |                  | -        | -        | -                | -             | -                     | FC                   | -                           |
| <b>Telefónica Móviles Soluciones y Aplicaciones, S.A. (CHILE) (1)</b><br>Provision of computer and communications services<br><i>Avenida del Cóndor N°720, piso 4, comuna de Huechuraba, de la Ciudad de Santiago de Chile</i>                            | 100.00%     | 92.91%   |                  | 13.96    | (6.09)   | -                | (3.02)        | 10.84                 | FC                   | -                           |
| <b>Inversiones Telefónica Móviles Holding Limitada (CHILE) (1)</b><br>Holding company<br><i>Miraflores 130, piso 12, Santiago e Chile</i>   | 100.00%     | 92.91%   |                  | 428.23   | 264.21   | -                | (32.40)       | 423.89                | FC                   | -                           |
| <b>TEM Inversiones Chile Limitada (CHILE) (1)</b><br>Holding company<br><i>Miraflores 130, piso 12, Santiago e Chile</i>  | 100.00%     | 92.91%   |                  | 1,119.98 | 12.48    | -                | (25.20)       | -                     | FC                   | -                           |
| <b>T. Moviles Chile Distribucion S.A.</b><br>Wireless telephony operator<br><i>Fidel Oteiza 1953, Oficina 201, Providencia, Santiago de Chile</i>   | 99.99%      | 92.90%   |                  | 0.02     | -        | -                | (0.04)        | -                     | FC                   | -                           |
| <b>Telefónica Móviles Soluciones, S.A. (CHILE) (1)</b><br>Sociedad de servicios<br><i>Miraflores 130, piso 12, Santiago e Chile</i>   | 100.00%     | 92.91%   |                  | 13.96    | (6.09)   | -                | (3.02)        | -                     | FC                   | -                           |
| <b>Telefónica Móviles eServices Latin America, Inc. (USA)</b><br>Provider of computer services<br><i>Mellon Financial Center 1111 Brickell ave. Suite 1000, Miami, Florida 33131</i>  | 100.00%     | 92.91%   |                  | 12.13    | (1.79)   | -                | 4.62          | 3.25                  | FC                   | -                           |
| <b>Ecuador Cellular Holdings, B.V. (NETHERLANDS) (1)</b><br>Holding company<br><i>Strawinskylaan 3105, Atium 7th, Amsterdam</i>   | 100.00%     | 92.91%   |                  | 0.02     | 640.17   | -                | 0.13          | 658.31                | FC                   | -                           |
| <b>BS Ecuador Holdings, Ltd. (BRITISH VIRGIN ISLANDS)</b><br>Holding company<br><i>Palm Grove House, PO Box 438, tortola, BVI</i>   | 100.00%     | 92.91%   |                  | -        | -        | -                | -             | -                     | FC                   | -                           |
| <b>Otecel, S.A. (ECUADOR) (1)</b><br>Provision of wireless communications services<br><i>Avda. de la República y la Pradera esq. Casilla, Quito</i>   | 100.00%     | 92.91%   |                  | 93.75    | 62.91    | -                | 2.56          | -                     | FC                   | -                           |
| <b>Cellular Holdings (Central America), Inc. (BRITISH VIRGIN ISLANDS)</b><br>Holding company<br><i>Palm Grove House, PO Box 438, tortola, BVI</i>   | 100.00%     | 92.91%   |                  | -        | -        | -                | -             | 37.93                 | FC                   | -                           |
| <b>Guatemala Cellular Holdings, B.V. (NETHERLANDS) (1)</b><br>Holding company<br><i>Strawinskylaan 3105, Atium 7th, Amsterdam</i>   | 100.00%     | 92.91%   |                  | 0.02     | 27.71    | -                | (0.01)        | 29.40                 | FC                   | -                           |
| <b>TMG (BVI) Holdings, Ltd. (BRITISH VIRGIN ISLANDS)</b><br>Holding company<br><i>Palm Grove House, PO Box 438, tortola, BVI</i>  | 100.00%     | 92.91%   |                  | -        | -        | -                | -             | -                     | FC                   | -                           |
| <b>Centram Communications, LP (BRITISH VIRGIN ISLANDS)</b><br>Holding company<br><i>Palm Grove House, PO Box 438, tortola, BVI</i>  | 100.00%     | 92.91%   |                  | -        | -        | -                | -             | -                     | FC                   | -                           |

(\*) Companies included in the 2004 consolidated tax statement.

(\*\*) Companies included in the 2005 consolidated tax statement.

## Subsidiaries, Associates and Investees as of 12-31-2005

| (millions of euros)   | % Ownership |          |                  | Capital  | Reserves | Interim Dividend | Income (loss) | Gross Carrying Amount | Consolidation Method | Value in Consolidation (10) |
|---|-------------|----------|------------------|----------|----------|------------------|---------------|-----------------------|----------------------|-----------------------------|
|   | Direct      | Indirect | Telefónica Group |          |          |                  |               |                       |                      |                             |
| <b>TEM Guatemala Ltd. (BRITISH VIRGIN ISLANDS)</b><br>Holding company<br><i>Palm Grove House, PO Box 438, tortola, BVI</i>  | 100.00%     | 92.91%   | –                | –        | –        | –                | –             | –                     | FC                   | –                           |
| <b>Central America Services Holding, Ltd. (BRITISH VIRGIN ISLANDS) (7)</b><br>Inactive company<br><i>Palm Grove House, PO Box 438, tortola, BVI</i>                         | 100.00%     | 92.91%   | –                | –        | –        | –                | –             | –                     | FC                   | –                           |
| <b>Multi Holding Corporation (PANAMA) (11)</b><br>Holding company<br><i>Edificio HSBC, Piso 11, Avd Samuel Lewis - Panamá</i>   | 99.96%      | 92.87%   | –                | –        | –        | –                | –             | 300.91                | FC                   | –                           |
| <b>Panamá Cellular Holdings, B.V. (NETHERLANDS)</b><br>Holding company<br><i>Strawinskylaan 3105, Atium 7th, Amsterdam</i>  | 100.00%     | 92.91%   | 0.02             | 242.37   | –        | (7.40)           | 238.25        | –                     | FC                   | –                           |
| <b>BellSouth Panamá, Ltd. (CAYMAN ISLANDS) (1)</b><br>Holding company<br><i>Cayman Islands</i>  | 100.00%     | 92.91%   | –                | –        | –        | –                | –             | –                     | FC                   | –                           |
| <b>Panamá Cellular Holdings, LLC (USA) (1)</b><br>Holding company<br><i>Delaware</i>  | 100.00%     | 92.91%   | –                | –        | –        | –                | –             | –                     | FC                   | –                           |
| <b>BSC de Panama Holdings, SRL (PANAMA)</b><br>Holding company<br><i>Avda Samuel Lewis y Calle 54, Edificio Afra, Panamá</i>  | 100.00%     | 92.91%   | –                | 100.65   | –        | 2.08             | –             | –                     | FC                   | –                           |
| <b>BSC Cayman (CAYMAN ISLANDS)</b><br>General Partnership<br><i>Cayman Islands</i>  | 99.98%      | 92.89%   | –                | –        | –        | –                | –             | –                     | FC                   | –                           |
| <b>Telefónica Móviles Panamá, S.A. (PANAMA) (1)</b><br>Wireless telephony operator<br><i>Edificio Magna Corp. Calle 51 Este y Avda Manuel Maria Icaza, Ciudad de Panamá</i> | 100.00%     | 92.91%   | 78.10            | 110.29   | –        | 41.64            | –             | –                     | FC                   | –                           |
| <b>Panamá Cellular Investments, LLC (USA)</b><br>Services company<br><i>Delaware</i>  | 69.51%      | 64.58%   | –                | –        | –        | –                | –             | –                     | FC                   | –                           |
| <b>Latin American Cellular Holdings, B.V. (NETHERLANDS) (1)</b><br>Holding company<br><i>Strawinskylaan 3105, Atium 7th, Amsterdam</i>                                      | 100.00%     | 92.91%   | 0.02             | 1,251.41 | –        | (17.21)          | 1,226.80      | –                     | FC                   | –                           |
| <b>Abilitur, S.A. (URUGUAY)</b><br>Holding company<br><i>Constituyente 1467 Piso 23, Montevideo 11200</i>   | 100.00%     | 92.91%   | 44.80            | (10.62)  | –        | 8.77             | –             | –                     | FC                   | –                           |
| <b>Redanil, S.A. (URUGUAY)</b><br>Holding company<br><i>Constituyente 1467 Piso 23, Montevideo 11200</i>  | 100.00%     | 92.91%   | 6.32             | 21.09    | –        | 1.20             | 8.33          | –                     | FC                   | –                           |
| <b>Abiatar, S.A. (URUGUAY) (1)</b><br>Wireless operator and services<br><i>Constituyente 1467 Piso 23, Montevideo 11200</i>   | 100.00%     | 92.91%   | 6.88             | 24.99    | –        | 0.66             | –             | –                     | FC                   | –                           |
| <b>Telefónica Móviles Nicaragua, S.A. (NICARAGUA)</b><br>Holding company<br><i>Managua</i>  | 100.00%     | 92.91%   | –                | –        | –        | –                | –             | –                     | FC                   | –                           |
| <b>Pisani Resources y Cía, Ltd. (NICARAGUA)</b><br>Holding company<br><i>Managua</i>  | 100.00%     | 92.91%   | –                | –        | –        | –                | –             | –                     | FC                   | –                           |
| <b>Doric Holding y Cía, Ltd. (NICARAGUA)</b><br>Holding company<br><i>Managua</i>   | 100.00%     | 92.91%   | –                | –        | –        | –                | –             | –                     | FC                   | –                           |
| <b>Kalamai Holdings, Ltd. (BRITISH VIRGIN ISLANDS)</b><br>Holding company<br><i>Palm Grove House, PO Box 438, tortola, BVI</i>  | 100.00%     | 92.91%   | –                | –        | –        | –                | –             | –                     | FC                   | –                           |
| <b>Kalamai Hold. Y Cía, Ltd. (NICARAGUA)</b><br>Holding company<br><i>Managua</i>   | 100.00%     | 92.91%   | –                | –        | –        | –                | –             | –                     | FC                   | –                           |
| <b>Telefonía Celular de Nicaragua, S.A. (NICARAGUA) (1)</b><br>Wireless telephony operator<br><i>Carretera Mazalla, Managua</i>   | 100.00%     | 92.91%   | 12.33            | 35.32    | –        | (6.96)           | –             | –                     | FC                   | –                           |
| <b>Comtel Comunicaciones Telefónicas, S.A. (VENEZUELA) (1)</b><br>Holding company<br><i>Av. Francisco de Miranda, Edif Parque Cristal, Caracas 1060, Venezuela</i>          | 65.14%      | 60.52%   | 0.67             | 104.19   | –        | (107.42)         | 0.15          | –                     | FC                   | –                           |

(\*) Companies included in the 2004 consolidated tax statement.

(\*\*) Companies included in the 2005 consolidated tax statement.



## Subsidiaries, Associates and Investees as of 12-31-2005

| (millions of euros)  | % Ownership |          |                  | Capital | Reserves | Interim Dividend | Income (loss) | Gross Carrying Amount | Consolidation Method | Value in Consolidation (10) |
|--|-------------|----------|------------------|---------|----------|------------------|---------------|-----------------------|----------------------|-----------------------------|
|  | Direct      | Indirect | Telefónica Group |         |          |                  |               |                       |                      |                             |
| Telcel, C.A. (VENEZUELA) (1)<br>Wireless telephony operator<br>Av. Francisco de Miranda, Edif Parque Cristal, Caracas 1060                                     | 100.00%     | 92.91%   | 26.20            | 430.24  | –        | 187.98           | 134.43        | FC                    | –                    |                             |
| Sistemas Timetrak, C.A. (VENEZUELA) (1)<br>Fleet locating services<br>Calle Pantin, Edificio Grupo Secusat. Piso 3. Caracas, Venezuela                         | 75.00%      | 69.68%   | 1.68             | 9.60    | –        | –                | N/D           | FC                    | –                    |                             |
| Servicios Telcel, C.A. (VENEZUELA) (1)<br>Telecommunication services and customer services<br>Av. Francisco de Miranda, Edif Parque Cristal, Caracas 1060      | 100.00%     | 92.91%   | –                | –       | –        | –                | –             | FC                    | –                    |                             |
| Telcel International, Ltd. (CAYMAN ISLANDS)<br>Holding Company<br>Cayman Islands   | 100.00%     | 92.91%   | –                | –       | –        | –                | –             | FC                    | –                    |                             |
| Corporación 271191, C.A. (VENEZUELA)<br>Sale and purchase of real estate<br>Av. Francisco de Miranda, Edif Parque Cristal, Caracas 1060                        | 100.00%     | 92.91%   | –                | –       | –        | –                | –             | FC                    | –                    |                             |
| Promociones 4222, C.A. (VENEZUELA)<br>Sale and purchase of real estate<br>Av. Francisco de Miranda, Edif Parque Cristal, Caracas 1060                          | 100.00%     | 92.91%   | –                | –       | –        | –                | –             | FC                    | –                    |                             |
| S.T. Mérida, C.A. (VENEZUELA)<br>Telecommunication services and customer services<br>Av. Francisco de Miranda, Edif Parque Cristal, Caracas 1060               | 100.00%     | 92.91%   | –                | –       | –        | –                | –             | FC                    | –                    |                             |
| S.T. Ciudad Ojeda, C.A. (VENEZUELA)<br>Telecommunication services and customer services<br>Av. Francisco de Miranda, Edif Parque Cristal, Caracas 1060         | 100.00%     | 92.91%   | –                | –       | –        | –                | –             | FC                    | –                    |                             |
| S.T. San Cristóbal (VENEZUELA)<br>Telecommunication services and customer services<br>Av. Francisco de Miranda, Edif Parque Cristal, Caracas 1060              | 100.00%     | 92.91%   | –                | –       | –        | –                | –             | FC                    | –                    |                             |
| S.T. Maracaibo, C.A. (VENEZUELA)<br>Telecommunication services and customer services<br>Av. Francisco de Miranda, Edif Parque Cristal, Caracas 1060            | 100.00%     | 92.91%   | –                | –       | –        | –                | –             | FC                    | –                    |                             |
| S.T. Punto Fijo, C.A. (VENEZUELA)<br>Telecommunication services and customer services<br>Av. Francisco de Miranda, Edif Parque Cristal, Caracas 1060           | 100.00%     | 92.91%   | –                | –       | –        | –                | –             | FC                    | –                    |                             |
| S.T. Valera, C.A. (VENEZUELA)<br>Telecommunication services and customer services<br>Av. Francisco de Miranda, Edif Parque Cristal, Caracas 1060               | 100.00%     | 92.91%   | –                | –       | –        | –                | –             | FC                    | –                    |                             |
| S.T. Valencia, C.A. (VENEZUELA)<br>Telecommunication services and customer services<br>Av. Francisco de Miranda, Edif Parque Cristal, Caracas 1060             | 100.00%     | 92.91%   | –                | –       | –        | –                | –             | FC                    | –                    |                             |
| SyRed, T.E.I., C.A. (VENEZUELA)<br>Telecommunication services and customer services<br>Av. Francisco de Miranda, Edif Parque Cristal, Caracas 1060             | 100.00%     | 92.91%   | –                | –       | –        | –                | –             | FC                    | –                    |                             |
| Servicios Telcel Acarigua, C.A. (VENEZUELA)<br>Telecommunication services and customer services<br>Av. Francisco de Miranda, Edif Parque Cristal, Caracas 1060 | 100.00%     | 92.91%   | –                | –       | –        | –                | –             | FC                    | –                    |                             |

(\*) Companies included in the 2004 consolidated tax statement.

(\*\*) Companies included in the 2005 consolidated tax statement.

## Subsidiaries, Associates and Investees as of 12-31-2005

| (millions of euros)  | % Ownership |          |                  | Capital  | Reserves | Interim Dividend | Income (loss) | Gross Carrying Amount | Consolidation Method | Value in Consolidation (10) |
|--|-------------|----------|------------------|----------|----------|------------------|---------------|-----------------------|----------------------|-----------------------------|
|  | Direct      | Indirect | Telefónica Group |          |          |                  |               |                       |                      |                             |
| <b>Servicios Telcel Barquisimeto, C.A. (VENEZUELA)</b><br>Telecommunication services and customer services<br><i>Av. Francisco de Miranda, Edif Parque Cristal, Caracas 1060</i> | 100.00%     | 92.91%   | –                | –        | –        | –                | –             | –                     | FC                   | –                           |
| <b>Servicios Telcel Charallave (VENEZUELA)</b><br>Telecommunication services and customer services<br><i>Av. Francisco de Miranda, Edif Parque Cristal, Caracas 1060</i>         | 100.00%     | 92.91%   | –                | –        | –        | –                | –             | –                     | FC                   | –                           |
| <b>S.T. Cumana, C.A. (VENEZUELA)</b><br>Telecommunication services and customer services<br><i>Av. Francisco de Miranda, Edif Parque Cristal, Caracas 1060</i>                   | 100.00%     | 92.91%   | –                | –        | –        | –                | –             | –                     | FC                   | –                           |
| <b>S.T. Guarenas, C.A. (VENEZUELA)</b><br>Telecommunication services and customer services<br><i>Av. Francisco de Miranda, Edif Parque Cristal, Caracas 1060</i>                 | 100.00%     | 92.91%   | –                | –        | –        | –                | –             | –                     | FC                   | –                           |
| <b>S.T. Los Teques, C.A. (VENEZUELA)</b><br>Telecommunication services and customer services<br><i>Av. Francisco de Miranda, Edif Parque Cristal, Caracas 1060</i>               | 100.00%     | 92.91%   | –                | –        | –        | –                | –             | –                     | FC                   | –                           |
| <b>S.T. Maracay, C.A. (VENEZUELA)</b><br>Telecommunication services and customer services<br><i>Av. Francisco de Miranda, Edif Parque Cristal, Caracas 1060</i>                  | 100.00%     | 92.91%   | –                | –        | –        | –                | –             | –                     | FC                   | –                           |
| <b>S.T. Margarita, C.A. (VENEZUELA)</b><br>Telecommunication services and customer services<br><i>Av. Francisco de Miranda, Edif Parque Cristal, Caracas 1060</i>                | 100.00%     | 92.91%   | –                | –        | –        | –                | –             | –                     | FC                   | –                           |
| <b>S.T. Maturín, C.A. (VENEZUELA)</b><br>Telecommunication services and customer services<br><i>Av. Francisco de Miranda, Edif Parque Cristal, Caracas 1060</i>                  | 100.00%     | 92.91%   | –                | –        | –        | –                | –             | –                     | FC                   | –                           |
| <b>S.T. Puerto Ordaz, C.A. (VENEZUELA)</b><br>Telecommunication services and customer services<br><i>Av. Francisco de Miranda, Edif Parque Cristal, Caracas 1060</i>             | 100.00%     | 92.91%   | –                | –        | –        | –                | –             | –                     | FC                   | –                           |
| <b>S.T. Puerto la Cruz, CA (VENEZUELA)</b><br>Telecommunication services and customer services<br><i>Av. Francisco de Miranda, Edif Parque Cristal, Caracas 1060, Venezuela</i>  | 100.00%     | 92.91%   | –                | –        | –        | –                | –             | –                     | FC                   | –                           |
| <b>S.T. La Guaira, C.A. (VENEZUELA)</b><br>Telecommunication services and customer services<br><i>Av. Francisco de Miranda, Edif Parque Cristal, Caracas 1060, Venezuela</i>     | 100.00%     | 92.91%   | –                | –        | –        | –                | –             | –                     | FC                   | –                           |
| <b>Olympic, Ltda. (COLOMBIA) (1)</b><br>Holding company<br><i>Av. 82 N° 10-62, piso 6</i>  | 100.00%     | 92.91%   | 0.03             | 935.73   | –        | (18.13)          | –             | –                     | FC                   | –                           |
| <b>Telefónica Móviles Colombia, S.A. (COLOMBIA) (1)</b><br>Wireless operator<br><i>Calle 100, N° 7-33, Piso 15, Bogotá, Colombia</i>   | 100.00%     | 92.91%   | 0.35             | 1,113.63 | –        | 1.57             | 116.35        | –                     | FC                   | –                           |
| <b>Bautzen, Inc. (PANAMÁ)</b><br>Financial management<br><i>Ciudad de Panamá</i>   | 100.00%     | 92.91%   | 0.26             | (0.24)   | –        | –                | –             | –                     | FC                   | –                           |
| <b>Comoviles, S.A. (COLOMBIA)</b><br>Telecommunications services<br><i>Calle 100 N° 7-33, piso 17, Bogotá</i>  | 99.97%      | 92.88%   | –                | 0.21     | –        | (0.01)           | –             | –                     | FC                   | –                           |

(\*) Companies included in the 2004 consolidated tax statement.

(\*\*) Companies included in the 2005 consolidated tax statement.

## Subsidiaries, Associates and Investees as of 12-31-2005

| (millions of euros)   | % Ownership |          |                  | Capital | Reserves | Interim Dividend | Income (loss) | Gross Carrying Amount | Consolidation Method | Value in Consolidation (10) |
|---|-------------|----------|------------------|---------|----------|------------------|---------------|-----------------------|----------------------|-----------------------------|
|   | Direct      | Indirect | Telefónica Group |         |          |                  |               |                       |                      |                             |
| <b>Comunicaciones Trunking, S.A. (COLOMBIA)</b><br>Provision of trunking services<br><i>Calle 100 N° 7-33, piso 16, Bogotá</i>  |             | 99.95%   | 92.87%           | 0.02    | 0.08     | -                | (0.01)        | -                     | FC                   | -                           |
| <b>Paracomunicar, S.A. (COLOMBIA)</b><br>Telecommunications services<br><i>Calle 100 N° 7-33, piso 17, Bogotá</i>   |             | 99.31%   | 92.27%           | -       | -        | -                | -             | -                     | FC                   | -                           |
| <b>Kobrocom Electrónica, Ltd. (COLOMBIA)</b><br>Telecommunications services<br><i>Calle 100 N° 7-33, piso 15, Bogotá</i>  |             | 99.95%   | 92.87%           | 0.05    | (0.02)   | -                | -             | -                     | FC                   | -                           |
| <b>Telefónica Móviles Chile Inversiones. S.A. (CHILE)</b><br>Holding company<br><i>Avda. El Bosque Sur 090 - Las Condes - Santiago de Chile</i>   |             | 100.00%  | 92.91%           | 31.72   | (44.66)  | -                | (1.79)        | 9.76                  | FC                   | -                           |
| <b>Telefónica Móviles Chile larga Distancia, S.A. (CHILE)</b><br>Wireless operator<br><i>Avda. El Bosque Sur 090 - Las Condes - Santiago de Chile</i>   |             | 100.00%  | 92.91%           | 31.75   | (45.29)  | -                | (0.58)        | -                     | FC                   | -                           |
| <b>Telefónica Móviles Chile, S.A. (CHILE)</b><br>Wireless operator<br><i>Avda. El Bosque Sur 090 - Las Condes - Santiago de Chile</i>   |             | 100.00%  | 92.91%           | 341.62  | 8.80     | -                | 10.62         | 307.80                | FC                   | -                           |
| <b>Intertel, S.A. (CHILE)</b><br>Wireless operator<br><i>Avda. El Bosque Sur 090 - Las Condes - Santiago de Chile</i>   |             | 100.00%  | 92.91%           | -       | 0.02     | -                | -             | -                     | FC                   | -                           |
| <b>Telefónica Móviles Inversora, S.A. (ARGENTINA)</b><br>Holding company<br><i>Av. Libertador 602, Piso 20 - Buenos Aires</i>   |             | 100.00%  | 92.91%           | 0.02    | 0.42     | -                | (0.17)        | -                     | FC                   | -                           |
| <b>B.A. Celular Inversora.S.A. (ARGENTINA)</b><br>Holding company<br><i>Av. Libertador 602, Piso 4 - Buenos Aires</i>   |             | 100.00%  | 92.91%           | 0.02    | 0.41     | -                | (0.17)        | 370.17                | FC                   | -                           |
| <b>Compañía Radiocomunicaciones Móviles, S.A. (ARGENTINA)</b><br>Wireless telephony operator<br><i>Ingeniero Butty 240, Piso 4, Buenos Aires.</i>   |             | 100.00%  | 92.91%           | 7.76    | 112.57   | -                | (42.51)       | 141.68                | FC                   | -                           |
| <b>Compañía de Teléfonos del Plata (ARGENTINA)</b><br>Wireless telephony operator<br><i>Av. Libertador 602, Piso 4, Buenos Aires</i>  |             | 100.00%  | 92.91%           | 0.01    | 0.86     | -                | (0.03)        | -                     | FC                   | -                           |
| <b>TLD Top Level Domain Ltd.</b>  |             | N/D      | N/D              | N/D     | N/D      | N/D              | N/D           | 0.72                  | C                    | 0.72                        |
| Other shareholdings   |             | N/A      | N/A              | -       | -        | -                | -             | 5.38                  | C                    | 5.38                        |
| <b>Telefónica Factoring Do Brasil, Ltd. (BRAZIL) (5)</b><br>Factoring<br><i>Avda. Paulista, 1106</i>  | 40.00%      | 10.00%   | 50.00%           | 1.37    | 0.69     | (0.19)           | 1.66          | 1.44                  | EM                   | 1.49                        |
| <b>Telefónica Factoring Establecimiento Financiero de Crédito, S.A. (SPAIN) (5)</b><br>Loans and credits (consumer and mortgage loans and commercial transactions)<br><i>Pedro Teixeira, 8 - 28020 Madrid</i> | 50.00%      |          | 50.00%           | 5.11    | 1.74     | -                | 2.76          | 2.64                  | EM                   | 5.00                        |
| <b>Aliança Atlântica Holding B.V. (NETHERLANDS)</b><br>Holder of 5,225,000 Portugal Telecom, S.A. shares<br><i>Strawinskylaan 1725, 1077 XX Amsterdam</i>   | 50.00%      | 43.76%   | 93.76%           | 40.00   | 1.83     | (3.33)           | 1.66          | 21.97                 | FC                   | -                           |
| <b>Torre de Colçerola, S.A. (SPAIN) (2)</b><br>Operation of a telecommunications mast and technical assistance and consulting services<br><i>Ctra. Vallvidrera-Tibidabo, s/nº - 08017 Barcelona</i>           | 30.40%      |          | 30.40%           | 12.02   | 0.56     | -                | -             | 2.45                  | EM                   | 3.83                        |
| <b>Telefónica Publicidad e Información, S.A. (SPAIN) (1), (6) (11)</b><br>Publishing of directories and advertising in all types of media<br><i>Avda. de Manoteras, 12 - 28050 Madrid</i>                     | 59.90%      |          | 59.90%           | 18.05   | 99.80    | -                | 125.30        | 3.98                  | FC                   | -                           |
| <b>Telinver, S.A. (ARGENTINA) (1)</b><br>Publication and sale of telephone directories<br><i>Av. Ingeniero Huergo, 723 - Buenos Aires</i>   |             | 100.00%  | 59.90%           | 35.00   | (0.19)   | -                | (19.51)       | 57.54                 | FC                   | -                           |
| Other shareholdings   |             |          |                  |         |          |                  |               |                       |                      |                             |

(\*) Companies included in the 2004 consolidated tax statement.

(\*\*) Companies included in the 2005 consolidated tax statement.

## Subsidiaries, Associates and Investees as of 12-31-2005

| (millions of euros)  | % Ownership |          |                  | Capital  | Reserves | Interim Dividend | Income (loss) | Gross Carrying Amount | Consolidation Method | Value in Consolidation (10) |
|--|-------------|----------|------------------|----------|----------|------------------|---------------|-----------------------|----------------------|-----------------------------|
|  | Direct      | Indirect | Telefónica Group |          |          |                  |               |                       |                      |                             |
| <b>Telefónica Publicidad e Información Direct, S.L. (SPAIN) (2)</b><br>Direct marketing related activities<br><i>Avda. de Manoteras, 12 - 28050 Madrid</i>   | 100.00%     |          | 59.90%           | 0.06     | 0.52     | –                | (1.00)        | 0.64                  | FC                   | –                           |
| <b>Telefónica Publicidad e Información Edita, S.A.U. (SPAIN) (1)</b><br>Publishing of technical and professional directories in various industries<br><i>Fuerteventura, 21- San Sebastián de los Reyes. Madrid</i> | 100.00%     |          | 59.90%           | 0.66     | 9.35     | –                | (4.17)        | 11.02                 | FC                   | –                           |
| <b>Edinet Europa, S.A.U. (SPAIN) (2)</b><br>Publishing<br><i>Avda. de Manoteras, 12 - 28050 Madrid</i>   | 100.00%     |          | 59.90%           | 0.06     | –        | –                | 0.73          | 0.35                  | FC                   | –                           |
| <b>Adquira Spain, S.A. (SPAIN) (2)</b><br>E-commerce<br><i>Goya, 4, 4ª planta - Madrid</i>   | 20.00%      |          | 11.98%           | 1.56     | 30.75    | –                | (0.33)        | 3.17                  | EM                   | 1.01                        |
| <b>Telefónica Publicidad e Información Internacional, S.A.U. (SPAIN) (1)</b><br>Holding company<br><i>Avda. de Manoteras, 12 - 28050 Madrid</i>  | 100.00%     |          | 59.90%           | 48.83    | 1.00     | –                | 3.37          | 49.34                 | FC                   | –                           |
| <b>Directories Holding, B.V. (NETHERLANDS)</b><br>Holding company<br><i>Drentestraat 24 BG 1083 HK - Amsterdam</i>   | 100.00%     |          | 59.90%           | 0.02     | 13.10    | –                | 0.77          | 47.58                 | FC                   | –                           |
| <b>Publiguías Holding, S.A. (CHILE) (1)</b><br>Holding company<br><i>Avda. Santa María 0792 - Providencia - Santiago de Chile</i>  | 100.00%     |          | 59.90%           | 13.73    | (3.73)   | –                | 2.28          | 13.20                 | FC                   | –                           |
| <b>Edinet América, S.A. (CHILE) (2)</b><br>Publishing<br><i>Avda. Santa María 0792 - Providencia - Santiago de Chile</i>   | 100.00%     |          | 59.90%           | 0.38     | 0.03     | –                | (0.28)        | 0.36                  | FC                   | –                           |
| <b>Impresora y Comercial Publiguías, S.A. (CHILE) (1)</b><br>Publication and sale of telephone directories<br><i>Avda. Santa María 0792 - Providencia - Santiago de Chile</i>                                      | 100.00%     |          | 59.90%           | 2.96     | 0.66     | –                | 54.04         | 47.31                 | FC                   | –                           |
| Other shareholdings  | N/A         |          | N/A              | N/A      | N/A      | –                | N/A           | 0.21                  | C                    | 0.21                        |
| <b>Telefónica Publicidad e Información Perú, S.A.C. (PERU) (1)</b><br>Publishing of market directories in Peru<br><i>Paseo República, 3755 San Isidro, Lima</i>  | 100.00%     |          | 59.90%           | 0.25     | (0.14)   | –                | 4.90          | 18.25                 | FC                   | –                           |
| <b>Telefónica Publicidade e Informação, Ltda. (BRAZIL) (1)</b><br>Publishing of directories and advertising.<br><i>Rua Gomes de Carvalho, 1507 Vila Olímpia, Sao Paulo - Brasil</i>                                | 100.00%     |          | 59.90%           | 71.40    | 11.98    | –                | (76.19)       | 80.88                 | FC                   | –                           |
| <b>11888 Servicio Consulta Telefónica, S.A. (SPAIN) (1)</b><br>Provision of wireline public telephone and directory enquiry service<br><i>Avda. de Manoteras, 12 - 28050 Madrid</i>                                | 100.00%     |          | 59.90%           | 0.06     | 0.01     | –                | 6.02          | 0.06                  | FC                   | –                           |
| <b>Services de Renseignements Telephoniques, S.A.S. (FRANCE)</b><br>Provision of wireline public telephone and directory enquiry service<br><i>Alac Etile 003, Rue du Colonel Moll - 75017 Paris</i>               | 100.00%     |          | 59.90%           | 0.04     | –        | –                | (0.04)        | 0.04                  | FC                   | –                           |
| <b>Servizio Di Consultazione Telefonica, S.R.L. (ITALY) (1)</b><br>Provision of wireline public telephone and directory enquiry service<br><i>Via Boschetti, 4 - Milan</i>   | 100.00%     |          | 59.90%           | 0.01     | –        | –                | (5.56)        | 0.01                  | FC                   | –                           |
| <b>Guia Local Network, S.A. (BRAZIL)</b><br>City guide Internet portal<br><i>Avda. Das Americas, 500 Bl. 6A - Rio de Janeiro</i>   | 20.00%      |          | 11.98%           | 3.70     | –        | –                | (2.93)        | 1.57                  | C                    | 1.57                        |
| <b>Euredit, S.A. (FRANCE)</b><br>Publication of European yearbooks<br><i>Avda. Friedland, 9 - 75008 Paris (*)</i>  | 5.00%       |          | 2.99%            | 2.80     | 2.08     | –                | 2.64          | 0.23                  | C                    | 0.23                        |
| <b>Sistemas Técnicos de Loterías del Estado, S.A. (SPAIN) (2)</b><br>Operation of a gaming terminal system for the Spanish State Gaming Organization<br><i>Manuel Tovar, 9 - 28034 Madrid</i>                      | 31.75%      |          | 31.75%           | 12.02    | 56.77    | –                | 6.38          | 3.82                  | EM                   | 23.07                       |
| <b>Portugal Telecom, S.G.P.S., S.A. (PORTUGAL) (5) (11)</b><br>Holding company<br><i>Avda. Fontes Pereira de Melo, 40 - 1089 Lisboa</i>  | 8.78%       | 1.06%    | 9.84%            | 1,128.86 | 1,423.42 | –                | 355.30        | 831.60                | EM                   | 796.06                      |

(\*) Companies included in the 2004 consolidated tax statement.

(\*\*) Companies included in the 2005 consolidated tax statement.

## Subsidiaries, Associates and Investees as of 12-31-2005

| (millions of euros)   | % Ownership |          |                  | Capital  | Reserves  | Interim Dividend | Income (loss) | Gross Carrying Amount | Consolidation Method | Value in Consolidation (10) |
|---|-------------|----------|------------------|----------|-----------|------------------|---------------|-----------------------|----------------------|-----------------------------|
|   | Direct      | Indirect | Telefónica Group |          |           |                  |               |                       |                      |                             |
| <b>Banco Bilbao Vizcaya Argentaria, S.A. (SPAIN) (5) (6) (11)</b><br>Banking<br><i>Plaza de San Nicolás, 4 - 48005 Bilbao (Vizcaya)</i>   | 1.07%       |          | 1.07%            | 1,662.00 | 8,831.00  | (1,167.00)       | 3,806.00      | 555.62                | C                    | 546.13                      |
| <b>Oz plc (UK) (2) (6) (11)</b><br>Wireless services provider in Europe.<br><i>Wellington Street - Slough - Berkshire SL1 1YP</i>   | 4.97%       |          | 4.97%            | 13.13    | 14,848.97 | -                | 153.22        | 1,265.83              | C                    | 1,255.62                    |
| <b>Amper, S.A. (SPAIN) (5) (6) (11)</b><br>Development, manufacture and repair of telecommunications systems and equipment and related components<br><i>Marconi, 3 - 28760 Tres Cantos - Madrid</i> | 6.10%       |          | 6.10%            | 27.91    | 17.95     | -                | 4.90          | 11.82                 | C                    | 11.89                       |
| <b>I-CO Global Communications (HOLDINGS) Limited (UK)</b>   | N/D         |          | N/D              | N/D      | N/D       |                  | N/D           | 6.02                  | C                    | 6.02                        |
| <b>Other investments</b>  | N/A         | N/A      | N/A              | N/A      | N/A       |                  | N/A           | 8.41                  | C                    | 8.41                        |
| <b>TOTAL CONSOLIDATED VALUE OF ASSOCIATES (Note 9)</b>  |             |          |                  |          |           |                  |               |                       |                      | <b>1,664.35</b>             |
| <b>TOTAL CONSOLIDATED VALUE OF SUBSIDIARIES (Note 8)</b>  |             |          |                  |          |           |                  |               |                       |                      | <b>2,717.95</b>             |

(1) Company audited by Ernst &amp; Young, S.L.

(2) Company audited by PriceWaterhouseCoopers.

(3) Company audited by K.P.M.G. Peat Marwick.

(4) Company audited by B.D.O Audiberia.

(5) Company audited by Deloitte &amp; Touche. In Spain Deloitte &amp; Touche España, S.L.

(6) Consolidated figures.

(7) Inactive company

(8) Company in liquidation.

(9) Pro-forma figures.

(10) This value relates to the contribution to the Telefónica Group and not to the subgroups to which the contributing companies belong.

(11) Companies listed on international stock exchanges at December 31 2005.

FC Fully consolidated companies.

PC Proportionally consolidated companies.

EM Companies accounted for by the equity method.

C Investees.

N/D No data.

N/A Not available.

Provisional figures for associates and investees.

(\*) Companies included in the 2004 consolidated tax statement.

(\*\*) Companies included in the 2005 consolidated tax statement.

## Appendix II

Changes to the 2005 consolidation scope are described in the following sections.

### Telefónica

In 2005, Telefónica acquired 1,155 shares in Dutch company Endemol Holding, N.V. (Endemol) for a total outlay of 0.03 million euros. These acquisitions took the Telefónica Group's total holding in Endemol's share capital to 99.704%.

In 2005, Endemol Investment B.V., a 99.7% owned subsidiary of Telefónica, S.A. held a public offering of Endemol, N.V. shares. The offering price was 9 euros per share and the total number of shares sold amounted to 31,250,000 ordinary shares, representing 25% of the company's share capital. The sale generated a profit of 55.58 million euros, which was recognized in the Telefónica Group's income statement under "Gain on disposal of assets" under "Other income" (see Note 19).

The shares placed in the offering trade on the AEX Eurnet Amsterdam index of the Amsterdam Stock Exchange since November 22, 2005.

Endemol is still fully consolidated in the Telefónica Group.

Telefónica, S.A. also sold IN 2005, 611,824 shares of Portugal Telecom, S.G.P.S., S.A. (P.T.) for a total of 5.13 million euros. On December 21, P.T. cancelled a total of 37,628,550 treasury shares equivalent to 3.23% of its current share capital. On conclusion of the share cancellation, the Telefónica Group's holding in the Portuguese telecoms operator stood at 9.84% (9.96% in nominal terms). P.T. is still accounted for in the Telefónica Group's consolidated financial statements by the equity method.

Spanish company Telefónica Procesos y Tecnología de la Información, S.A. was absorbed by Telefónica Gestión de Servicios Compartidos, S.A. in February this year. Telefónica Procesos y Tecnología de la Información, S.A., which was fully consolidated in the consolidated financial statements of the Telefónica Group, was therefore removed from the consolidation scope.

On April 19, 2005 Telefónica Wholesale Services, S.L. (TIWS), a Spanish subsidiary of Telefónica Datacorp, S.A., concluded a 212.68 million euro capital increase that was fully subscribed by Telefónica, S.A. and paid for via the non-monetary contribution of Uruguyaun company International Wholesale Services America, S.A. On conclusion of the transaction, Telefónica, S.A. owned 92.513% of the share capital of TIWS, which continues to be fully consolidated in the statements of the Telefónica Group, which now owns 100% of its equity.

On June 10, the European Commission authorized Telefónica's bid to take over Czech operator Cesky Telecom a.s. by acquiring 51.1% of its share capital. The acquisition was concluded on June 16 at a price of 502 Czech crowns per share. Telefónica then launched a tender offer for the remaining 48.9% of Cesky Telecom then in the hands of minority shareholders. The tender offer closed on September 19, with Telefónica acquiring 58,985,703 shares at a price of 456 Czech crowns per share. In all, Telefónica paid 3,662.53 million euros to increase its interest in the Czech operator. After these acquisitions, Telefónica's total shareholding in the company

is equivalent to 69.41%. Cesky Telecom is now fully consolidated in the Telefónica Group.

The carrying amounts and fair values of the assets and liabilities acquired, the acquisition cost and the goodwill arising from the acquisition of Cesky Telecom at the acquisition date are as follows:

| Millions of euros                 | Carrying amount | Fair value |
|-----------------------------------|-----------------|------------|
| <b>Cesky Telecom, a.s.</b>        |                 |            |
| Intangible assets                 | 350.70          | 1,532.57   |
| Goodwill                          | 443.56          | 443.56     |
| Property, plant and equipment     | 3,091.15        | 3,087.08   |
| Non-current financial assets      | 10.54           | 10.54      |
| Other current assets              | 375.83          | 378.82     |
| Non-current trade payables        | (437.50)        | (516.87)   |
| Deferred tax liabilities          | (202.29)        | (473.95)   |
| Current liabilities               | (584.97)        | (542.04)   |
| Change in equity June - September | –               | 41.87      |
| Net asset value                   | 3,047.16        | 3,961.59   |
| Minority interests                | 932.02          | 1,211.71   |
| Acquisition cost                  |                 | 3,662.53   |
| Goodwill                          |                 | 912.66     |

In June 2005 Telefónica S.A. sold 4,300,000 shares in its subsidiary Telefónica Publicidad e Información, S.A. The sale generated a capital gain of 27.36 million euros recognized under "Gain on disposal of assets" under "Other income" in the Telefónica Group income statement. On conclusion of the sale, the Telefónica Group's holding in TPI stood at 59.90%. TPI is still fully consolidated in the Telefónica Group.

In March the Telefónica Group bought the 50% interest in Azeler Automoción, S.A., then owned by Banco Bilbao Vizcaya Argentaria, S.A. (BBVA). The transaction gave Telefónica control of Azeler's entire share capital. Azeler was previously accounted for in the Telefónica Group's consolidated financial statements by the equity method, but will now be fully consolidated.

In parallel with the aforementioned transaction, the Telefónica Group sold to BBVA its 50% interest in Spanish company Iniciativas Residenciales en Internet, S.A. (ATREA). As a result of the sale, ATREA, which was accounted for in the consolidated financial statements of the Telefónica Group by equity method, was removed from the consolidation scope.

The combined transaction meant a total outlay for Telefónica of 1.84 million euros and generated goodwill of 1.54 million euros.

On April 14, 2005 Telefónica concluded an agreement to sell its 54.15% interest in Onetravel.com, Inc. at a price of 26.4 million US dollars. Proceeds from the sale amounted to 3 million euros. The company, which was fully consolidated in the consolidated financial statements of the Telefónica Group, was therefore eliminated from the consolidation scope.

Fully consolidated Spanish company Terra Networks Latam, S.L. and Dominican company Terra Networks Caribe, S.A. were wound up in June 2005 and therefore eliminated from the consolidation scope.



In July, Telefónica, S.A. took over and merged Terra Networks, S.A., with economic effects from January 1, 2005. Terra Networks, S.A. was dissolved and all of its assets and liabilities were transferred to Telefónica, S.A. by means of a share swap consisting of two Telefónica, S.A. treasury shares for every nine Terra shares. The company, which was fully consolidated in the financial statements of the Telefónica Group, was therefore eliminated from the consolidation scope.

### *T.P.I. Group*

In 2005 the 100%-owned Spanish subsidiary of Telefónica Publicidad e Información, S.A. (TPI), 11888 Servicio Consulta Telefónica, S.A., established French company Services de Renseignements Telephoniques, S.A.S., subscribing and paying 0.04 million euros for its entire share capital. The new company is fully consolidated in the Telefónica Group.

Also in 2005, 11888 Servicio Consulta Telefónica, S.A. created the Italian company Di Consultazioni Telefónica, S.R.L. subscribing and paying 0.01 million euros for all shares comprising its share capital. The company is now fully consolidated in the consolidated financial statements of the Telefónica Group.

On November 11 Telefónica Group companies Telefónica Publicidad e Información, S.A. (the dominant shareholder) and Telefónica Publicidad e Información Internacional, S.A.U. bought from Telefónica de Argentina, S.A. 95% and 5%, respectively, of the share capital of Argentine company Telinver, S.A. for a total outlay of 57.0 million euros (66.72 million US dollars). The operation was financed by Telefónica Argentina, S.A. by debt maturing in 2008. Telinver continues to be fully consolidated in the Telefónica Group.

### *Telefónica de España Group*

Soluciones Tecnológicas para la Alimentación, S.L., a Spanish company in which Telefónica Soluciones de Informática y Comunicaciones de España, S.A.U. had a 45% shareholding, was sold in February 2005. The company, which was reported by equity method, therefore no longer appears in the Telefónica Group consolidated financial statements.

In March Telefónica de España S.A.U. sold its 0.73% interest in INTELSAT for 17.77 million euros, generating a capital gain of 17.58 million euros. The company was reported under "Other investments" in "Non-current financial assets" on the Telefónica Group's consolidated balance sheet.

In May Telefónica Soluciones Sectoriales, S.A.'s finalized its withdrawal from IT7 (formerly Incatel), Instituto Canario de Telecomunicaciones S.A., by returning to the other shareholders the 31% interest it held in the company at December 31, 2004. The company was therefore excluded from the Telefónica consolidated financial statements, where it was previously accounted for by the equity method.

In June the Spanish company Segurvirtual MVS, S.A., 49%-owned by Telefónica Data España, S.A. was liquidated. The company was therefore excluded from the Telefónica consolidated financial statements, where it was previously accounted for by the equity method.

June also saw the liquidation of Telefónica Sistemas el Salvador, S.A. de C.V, a Salvadorean company 99.5%-owned by Soluciones Informáticas y Comunicaciones de España, S.A.U. The company, which was previously fully consolidated, was therefore excluded from the consolidation scope.

Telefónica Telecomunicaciones Públicas took part in the incorporation of a new Spanish company, Telefónica Salud, S.A, subscribing and paying 0.06 million euros for 51% of the company's initial share capital. Telefónica Salud, S.A. is now fully consolidated in the Telefónica Group.

Telefónica Soluciones Sectoriales, S.A., meanwhile, was involved in the incorporation of another new Spanish company, Ceuta Innovación Digital, S.L., subscribing for and paying up 40% of the company's initial share capital. The Telefónica Group accounts for this investment by the equity method.

August marked the sale of Spanish company Bitel Baleares Innovación Telemática, S.A. for 0.75 million euros and a capital gain of 0.25 million euros which is recognized in the Telefónica Group income statement as "Gain on disposal of consolidated companies" under "Other income." The company was accounted for in the consolidated financial statements of the Telefónica Group by equity method but has now been excluded from the consolidation scope.

On September 1, 2005 Spanish company Agencia de Certificación Electrónica, S.A. was absorbed by its sole shareholder Telefónica Data España, S.A., on the latter's decision. Agencia de Certificación Electrónica, S.A. was fully consolidated in the consolidated financial statements of the Telefónica Group but has now been removed from the consolidation scope.

### *Telefónica Móviles Group*

The acquisitions of 100% of the Chilean and Argentine operators owned by BellSouth were concluded on January 7 and January 11, 2005, respectively, thereby completing the purchase of the Latin American cellular operators from BellSouth.

The total acquisition cost for Telefónica Móviles, adjusted for the outstanding net debt at these two operators, was 519.39 million euros for Radiocomunicaciones Móviles, S.A. (Argentina) and 317.56 million euros for Telefónica Móviles Chile, S.A.

The net carrying amounts of the assets and liabilities acquired from BellSouth operators in Chile and Argentina and the goodwill generated, after the purchase price allocation to the fair value recognition of all assets and liabilities assumed in the acquisition, are as follows:

| Millions of euros<br>2005     | Carrying<br>amount | Fair<br>value |
|-------------------------------|--------------------|---------------|
| <b>Assets</b>                 |                    |               |
| Intangible assets             | 127                | 212           |
| Property, plant and equipment | 322                | 155           |
| Non-current financial assets  | 3                  | 3             |
| Deferred tax assets           | 128                | 128           |
| Current assets                | 330                | 287           |
| <b>Liabilities</b>            |                    |               |
| Non-current trade payables    | (110)              | (110)         |
| Deferred tax liabilities      | (121)              | (112)         |
| Current trade payables        | (421)              | (421)         |
| Current provisions            | (71)               | (71)          |
| <b>Net asset value</b>        | <b>187</b>         | <b>71</b>     |
| <b>Acquisition cost</b>       |                    | <b>837</b>    |
| <b>Goodwill</b>               |                    | <b>766</b>    |

The capital increase for approximately 2.054 million Brazilian reais carried out by Telesp Celular Participações, S.A. on January 4, 2005 was fully subscribed. Brasilcel, N.V. now owns 65.70% of Telesp Celular Participações, S.A.

On April 20, 2005, Telefónica Móviles, through its subsidiary TEM Puerto Rico, Inc., converted the promissory notes representing 49.9% of the share capital of Puerto Rican company Newcomm Wireless Services, thereby acquiring a 49.9% shareholding.

Also in April 2005 Telcel, C.A increased its capital by 26.791 thousand US dollars. The new shares were subscribed for in full by Telefónica Móviles, S.A., thus bringing its stake in Telcel to 91.63%. The company is still fully consolidated in the Telefónica Group.

Also in 2005, 100%-owned Telefónica Móviles, S.A. subsidiary TES Holding, S.A. acquired an additional interest in Telefónica Móviles El Salvador, S.A. This acquisition raised TES Holding, S.A.'s stake in Telefónica Móviles El Salvador, S.A. to 99.03%. The company is still fully consolidated in the Telefónica Group.

April 2005 marked the conclusion of Telefónica Móviles, S.A.'s bid to acquire the minority interests in Peruvian subsidiary Comunicaciones Móviles de Perú, S.A. At the close of the operation, Telefónica Móviles, S.A. owned 99.89% of its Peruvian subsidiary. Subsequently, on June 1, 2005, Comunicaciones Móviles Perú, S.A. was merged with Telefónica Móviles Perú, S.A.C. Directly and indirectly, the Telefónica Móviles Group controls 98.03% of the new company Telefónica Móviles Perú, S.A., which is fully consolidated in the Telefónica Group's financial statements.

In June 2005 the Group acquired an additional 0.38% of Telefónica Móviles Panamá for 2.19 million euros. Following this and subsequent acquisitions, Telefónica Móviles controls 99.98% of the company.

Also in June, Spanish company Tempos 21 Innovación en Aplicaciones Móviles, S.A was included in the Telefónica consolidated group by the equity method, effective retroactively at January 1, 2005.

In July 2005, certain assets of companies comprising the Brasilcel Group were capitalized. The Group's new holding in these companies is as follows:

| <b>Brasilcel, N.V.</b>                   | <b>Shareholding</b> |
|--|---------------------|
| Tele Sudeste Celular Participações, S.A. | 91.03%              |
| Tele Leste Celular Participações, S.A.   | 50.67%              |
| Celular CRT Participações, S.A.          | 66.36%              |
| Telesp Celular Participações, S.A.       | 66.09%              |
| Tele Centro Oeste Participações, S.A.    | 34.68%              |

Newcomm Wireless Services carried out a capital increase in August 2005 to which the Group decided not to subscribe. As a result its holding in this company was reduced to 49.3%.

In September 2005 Telefónica Móviles approved the merger by absorption of Telefónica Móviles Interacciona, S.A., a company in which it was the sole shareholder. The company is still fully consolidated in the Telefónica Group.

In October 2005, the Venezuelan companies Telcel, C.A., Servicios Telcel, C.A. and Telecomunicaciones BBS, C.A. merged, giving rise to Telcel, C.A. The company is still fully consolidated in the Telefónica Group.

In November 2005 Telefónica Móviles, S.A. bought the remaining 2.08% of Telefónica Móviles Argentina, S.A. for 1.99 million euros, giving it 100% control of this subsidiary. The company is still fully consolidated in the Telefónica Group.

In December 2005, Telefónica Móviles, S.A. reached an agreement to buy 8% of Telefónica Móviles México, S.A. de C.V. in exchange for shares in Telefónica, S.A. The sale entailed an outlay of 177.27 million euros and gave Telefónica Móviles 100% control of the subsidiary, which is still fully consolidated in the Telefónica Group.

December 2005 also saw the merger by absorption of TEM Guatemala y Cia. S.C.A. (the absorbing company) and Telefónica Móviles Guatemala, S.A. (absorbed company) and Tele-Escucha, S.A. (absorbed company). The company arising from the merger has taken the name Telefónica Móviles Guatemala, and continues to be fully consolidated in the Telefónica Group.

### *Telefónica Internacional Group*

On July 27, 2005, Telefónica Internacional, S.A. acquired 100% of Telefónica, S.A.'s holdings in Terra México Holding, Terra Colombia Holding, Terra Guatemala, Terra Venezuela, Terra Argentina, Terra USA and Terra Brasil Group. Also on this date, Telefónica Internacional, S.A. assumed 100% of the net debt owed by the aforementioned Terra Group companies to Telefónica, S.A.

In August, Telefónica Internacional sold US company, Communication Technology, Inc. (CTI), in which it was the sole shareholder, realizing a capital loss of 3.71 million euros which is recorded on the Telefónica Group's income statement in "Losses on disposal of consolidated companies" under "Other expenses." The company, which was fully

consolidated in the financial statements of the Telefónica group, was therefore removed from the consolidation scope.

Colombian company Telefónica Data Colombia, S.A. carried out a capital increase in September that was subscribed for in full by Spanish company Telefónica DataCorp, S.A. The operation gave the Spanish company, which previously owned 65% of Telefónica Data Colombia, S.A, 100% control. The company is still fully consolidated in the Telefónica Group's consolidated financial statements.

### *Telefónica de Contenidos Group*

In the first quarter of 2005 the Telefónica de Contenidos Group sold all the shares it owned in LS4 Radio Continental, S.A. and Radio Estéreo, S.A., realizing capital gains on disposal of 7.22 and 0.20 million euros, respectively. The companies were fully consolidated in the financial statements of the Telefónica Group but have now been removed from the consolidation scope.

In the course of 2005 Sogecable, S.A. increased its share capital by 7,560,261 shares with a par value of 2 euros each and bearing an issue premium of 22.47 euros. The Telefónica Group subscribed 1,801,689 of these shares, paying a total of approximately 44.10 million euros. As a result, the Group's shareholding in Sogecable is unchanged, at 23.83% of its total share capital. Sogecable, S.A. is still accounted for in the Telefónica Group consolidated financial statements by the equity method.

### *Atento Group*

On July 29, 2005 Atento Brasil, S.A. acquired 100% of the share capital of Brazilian company Beans Administradora de Cartões de Crédito, Ltda. In August, it was merged with the parent Atento Brasil, S.A. Beans was fully consolidated in the financial statements of the Telefónica Group but was therefore removed from the consolidation scope.

### *Telefónica Gestión de Servicios Compartidos Group*

Spanish company Telefónica Gestión de Servicios Compartidos, S.A. has acquired the entire share capital of Mexican subsidiary Telefónica Gestión de Servicios Compartidos México, S.A. de C.V. and Brazilian company Telefónica Gestao de Serviços Compartilhados do Brasil, Ltda. from its parent Telefónica, S.A. at a price of 2.83 million and 2.74 million euros, respectively. Both companies are still fully consolidated in the Telefónica Group.

Telefónica Gestión de Servicios Compartidos, S.A. has also bought from its parent Telefónica, S.A. 11,400 shares representing 95% of the capital of Argentine company Telefónica Gestión de Servicios Compartidos Argentina, S.A. for 0.04 million euros. The company is still fully consolidated in the Telefónica Group.

As reported in the section on Telefónica, S.A. above, in the first quarter of 2005 Telefónica Gestión de Servicios Compartidos, S.A. absorbed the Spanish company Telefónica Procesos y Tecnología de la Información, S.A. (T.P.T.I.), thereby acquiring all property, rights and obligations pertaining to the now-extinct T.P.T.I. has therefore been removed from the consolidated financial statements of the Telefónica Group, within which it was fully consolidated.

In November Spanish company Telefónica Gestión de Servicios Compartidos, S.A. acquired the entire 10,238,949 shares 99.99% of total capital in Peruvian subsidiary Telefónica Gestión de Servicios Compartidos Perú S.A.C. formerly belonging to its parent Telefónica, S.A. for 3.74 million euros. The company is still fully consolidated in the Telefónica Group.

## 2004

The changes in the consolidation scope in the year ended December 31, 2004 were as follows:

### *Telefónica*

In 2004 Telefónica acquired 71,693 shares of the Dutch company Endemol Entertainment Holding, N.V. (Endemol) for 1.79 million euros. These acquisitions took the Telefónica Group's total holding in Endemol's share capital to 99.70%.

Telefónica, S.A. acquired 52,820,862 shares of Portugal Telecom, S.G.P.S., S.A. for 475.14 million euros, giving rise to consolidation goodwill of 344.52 million euros. In addition, on December 29, 2004, Portugal Telecom reduced capital by canceling 87,799,950 treasury shares, representing 7% of share capital. Following these transactions, Telefónica increased its direct holding in this company to 8.55%. The direct and indirect effective ownership interest by the Telefónica Group was 9.58%. After these acquisitions, this company was consolidated in Telefónica Group's consolidated financial statements by the equity method.

The Spanish subsidiary Inmobiliaria Telefónica, S.L.U. was dissolved without liquidation through the overall transfer of its assets and liabilities to its sole shareholder, Telefónica, S.A. and the subsequent extinction of the company. This company, which had been fully consolidated in the consolidated financial statements of the Telefónica Group, was excluded from the consolidation scope.

The U.S. companies Telefónica B2B, Inc. and Telefónica USA, Inc., which were fully consolidated in the consolidated financial statements of the Telefónica Group, were excluded from the consolidation scope following their liquidation and dissolution and the transfer of their assets and liabilities to their sole shareholder, Telefónica, SA.

Zeleris Soluciones Integrales, S.L.U. was merged into Telefónica Gestión de Servicios Compartidos España, S.A. (a wholly owned subsidiary of Telefónica, S.A.), which increased share capital by 5.47 million euros and received as a consideration all the shares comprising Zeleris' share capital. As a result of the merger, Zeleris España, S.A.U., a wholly-owned subsidiary of Zeleris Soluciones Integrales, S.A., became a wholly-owned subsidiary of Telefónica Gestión de Servicios Compartidos España, S.A. The company is still fully consolidated in the consolidated financial statements of the Telefónica Group.

In October Telefónica Gestión de Servicios Compartidos España, S.A., acquired a 99.33% holding in the Brazilian company Cobros Serviços de Gestão, S.A., currently Cobros Serviços de Gestão, S.L. As a result of the acquisition, the Brazilian company became a fully consolidated Telefónica Group subsidiary.

In 2004, Telefónica Investigación y Desarrollo, S.A. incorporated the Mexican company Telefónica Investigación y Desarrollo México, S.A. and subscribed and paid all its share capital, consisting of 50,000 shares of MXP 1 par value each. The company is fully consolidated in the Telefónica Group.

Telefónica, S.A. sold 464 shares in Torre de Collçerola, S.A. for 1.47 million euros. This reduced its shareholding to 30.4%. The Telefónica Group still accounts for this company by the equity method.

In November, the Spanish companies Telefónica Participaciones, S.A.U. and Telefónica Emisiones, S.A.U. were incorporated, both with share capital comprising 62,000 shares with a par value of 1 euro each, subscribed and fully paid by sole shareholder Telefónica, S.A.

In December, Luxemburg company Altair Assurances, S.A. was incorporated, with start-up capital of 6 million euros. The wholly-owned Telefónica Group subsidiaries Casiopea Reaseguradora, S.A. of Luxemburg and Seguros de Vida y Pensiones Antares, S.A. of Spain subscribed and paid the full amount of the company's share capital in the proportion of 95% and 5%, respectively.

In December, Peruvian company Telfisa Perú, S.A.C. was incorporated, with start-up capital of 12 million new Peruvian soles. The Telefónica Group subscribed and paid the full amount of the start-up capital.

Spanish company Cleon, S.A., a 50%-owned subsidiary of Compañía Española de Tecnología, S.A., in which Telefónica, S.A. is the sole shareholder, was included in the Telefónica Group consolidated annual accounts by the equity method on the basis of management criteria. This company was fully consolidated in the Telefónica Group's consolidated financial statements the year before.

### *T.P.I. Group*

In 2004 Telefónica Publicidad e Información, S.A., the parent company of the group, acquired the remaining 49% holding in its Chilean subsidiary Impresora y Comercial Publiguías, S.A. for 65.6 million euros, thereby increasing its ownership interest to 100%. In this purchase, a 9% holding was acquired from Chilean company Compañía de Telecomunicaciones de Chile, S.A., a Telefónica Group subsidiary. The company is still fully consolidated in the Telefónica Group.

On August 13, 2004, the Chilean company Edinet América, S.A. (formerly Urge Chile, S.A.) increased capital by 218.81 Chilean pesos (0.29 million euros). This capital increase was fully subscribed and paid by Publiguías Holding, S.A. As a result of this transaction, the TPI group increased its holding in Edinet América, S.A. from 99.90% to 99.978%. In November the Chilean company Impresora y Comercial Publiguías, S.A. acquired a 0.022% holding in Edinet América, S.A.'s share capital. Following this transaction, the Telefónica Publicidad e Información Group increased its holding in the Chilean company to 100%. The company is still fully consolidated in the Telefónica Group.

### *Telefónica de España Group*

Telefónica Cable, S.A., a wholly-owned subsidiary of Telefónica de España, S.A., continued its corporate group restructuring process and merged the following local operators: Telefónica Cable Asturias, S.A., Telefónica Cable Valencia, S.A., Telefónica Cable Extremadura, S.A. and Telefónica Cable Balears, S.A. All these companies, which had been fully consolidated in the Telefónica Group in 2004, were excluded from the consolidation scope.

Telefónica de España, S.A.'s 2.13% holding in the French company Eutelsat, S.A. was sold for 44.83 million euros, giving rise to net capital gains of 21.43 million euros. In addition, Telefónica de España S.A. sold its 0.75% holding in the Dutch company New Skies Satellites, B.V. for 6.02 million euros, recording 5.95 million euros of capital gains.

Telefónica Mobile Solutions, S.A.U. was taken over by its parent company Telefónica Soluciones de Informática y Comunicaciones de España, S.A.U. This company, which had been fully consolidated in the consolidated financial statements of the Telefónica Group in 2003, was excluded from consolidation in 2004.

### *Terra Group (merged in 2005 with Telefónica, S.A. – see Note 2)*

Emplaza, S.A., a 20%-owned subsidiary of the Terra Lycos Group that had not been included in the consolidation since June 2003 because it was dormant, was dissolved and liquidated in January 2004.

Lycos, Inc. sold its holdings in Wit Capital and GSI Global Sports in March 2004.

In 2004 Lycos, Inc. sold all its minority interests in Amazon, Interland, Cross Media, Easy Link, Fast, Autobytel and Total Sports, recording a loss of 5.32 million euros.

All the shares of the Mexican company Tecnología y S.V.A., S.A. de C.V. were sold in June 2004, producing a capital gain of 10.77 million euros. This company, which had been fully consolidated in the Telefónica Group, was excluded from consolidation in 2004.

In 2004 Terra Networks Asociadas, S.L. increased capital at Inversis Networks, S.A. by 1.60 million euros, thereby increasing its ownership interest in this company to 10.68%.

On September 2, 2004, Terra Networks Asociadas, S.L. sold its holding in A Tu Hora, S.L., an idle company, to Telepizza, which until then owned a 50% ownership interest in this company. This investee had been accounted for by the equity method but was excluded from the Telefónica Group's consolidation scope in 2004.

On October 5, 2004, Terra Networks, S.A. and Daum Communications, Corp. reached an agreement for the sale of Lycos, Inc. after obtaining the required administrative authorizations and approval from the US antitrust authorities. The sale price was set at 108 million dollars, giving rise to a gain of 39.62 million euros. On September 30, 2004, i.e. before the sale of Lycos, Inc., and as part of the agreement for this transaction, Lycos, Inc. transferred assets amounting to 332.9 million euros to Terra Networks, S.A.

In November 2004, a capital increase of 0.3 million euros was carried out at subsidiary Terra Networks Colombia, S.A. for the purpose of offsetting losses. The local partners did not subscribe for this capital increase. Following this transaction, the ownership interest of minorities decreased from 32% to 5%. The company is still fully consolidated in the Telefónica Group's consolidated financial statements.

The merger of the wholly-owned subsidiary Ordenamiento de Links Especializados, S.L. (OLÉ) into Terra Networks España, S.A. was completed in December 2004. OLÉ was excluded from the consolidation scope.

### Atento Group

All the shares of Atento Guatemala Comercial, S.A. were sold in March 2004. This company, which had been fully consolidated in the Telefónica Group in 2003, was excluded from the consolidation scope in 2004.

Atento USA, Inc. was dissolved and all its assets and liabilities were transferred to its parent company Atento Holding Inc. effective January 1, 2004. This company was excluded from the consolidation scope in 2004.

US company Atento Holding Inc. was dissolved on April 30, 2004, and all its assets and liabilities were transferred to the Dutch parent company Atento N.V. The company, which had been fully consolidated in the consolidated financial statements of the Telefónica Group through that date, was subsequently excluded from the consolidation scope.

Leader Line, S.A., a wholly-owned subsidiary of Atento Teleservicios España, S.A., was merged into the latter on July 16, 2004. The company, which had been fully consolidated in the consolidated financial statements of the Telefónica Group through that date, was subsequently excluded from the consolidation scope.

Mexican company Atento Atención y Servicios, S.A. de C.V. was incorporated on September 1, 2004. Of its start-up share capital, 49,999 Mexican pesos were fully subscribed and paid by Atento Mexicana, S.A. de C.V. and 1 peso by the Mexican company Atento Servicios, S.A. de C.V. The company was fully consolidated in the Telefónica Group.

Atento Uruguay, S.A. was dissolved and liquidated on September 30, 2004, and all its assets and liabilities were transferred to its parent company Atento Argentina, S.A. The company, which had been fully consolidated in the consolidated financial statements of the Telefónica Group through that date, was subsequently excluded from the consolidation scope.

### Telefónica Móviles Group

On June 10, 2004, the Company acquired an additional 13.95% in Mobipay Internacional, bringing its shareholding to 50%. As a result, this company was no longer consolidated under the equity method and is now proportionally consolidated.

In August 2004, Brasilcel N.V. and Telesp Celular Participações, S.A. (TCP) announced their intention to launch friendly tender offers for Tele Sudeste Celular Participações, S.A., Tele Leste Celular Participações, S.A., Celular CRT Participações, S.A. and Tele Centro Oeste Celular Participações, S.A. (TCO). These tender offers finalized in October 2004, resulting in the following shareholdings:

|                  | Pre-offer<br>shareholding | Post-offer<br>shareholding |
|------------------|---------------------------|----------------------------|
| <b>Brasilcel</b> |                           |                            |
| Tele Sudeste     | 86.7%                     | 90.9%                      |
| Tele Leste       | 27.9%                     | 50.6%                      |
| CRT              | 51.5%                     | 67.0%                      |

|            | Pre-offer<br>shareholding | Post-offer<br>shareholding |
|------------|---------------------------|----------------------------|
| <b>TCP</b> |                           |                            |
| TCO        | 18.8%                     | 32.9%                      |

These tender offers gave rise to a cash payment of approximately 607 million reais for Brasilcel, N.V. and of 902 million reais for TCP.

At the end of June 2004, Brasilcel N.V. effectively acquired from NTT DoCoMo, Inc. and Itochu Corporation their ownership interests in Sudestecel Participações, S.A., a holding company controlling a bloc of shares in operator Tele Sudeste Celular Participações, S.A. representing 10.5% of its share capital, for 20.84 million euros. As a result of this transaction, Brasilcel increased its interest in Sudestecel Participações, S.A. to 100%. This company continues to be fully consolidated in the Brasilcel Group financial statements, while Brasilcel Group is proportionally consolidated in the Telefónica Group consolidated financial statements.

On July 23, 2004, a 100% holding in the Chilean company Telefónica Móvil de Chile, S.A. was acquired from the Chilean company Compañía de Telecomunicaciones de Chile, S.A., a subsidiary of Telefónica Internacional, S.A., for a total of 870 million euros. As a result of this transaction, the Telefónica Group increased its effective ownership interest in the company's share capital from 44.89% to 92.46%. The company is still fully consolidated in the consolidated financial statements of the Telefónica Group.

The mergers of the following Mexican companies were effective on September 25, 2004: Movicelular, S.A. de C.V. was merged into Movitel del Noroeste, S.A. de C.V. the remaining company after the merger was Movitel del Noroeste, S.A. de C.V.- and Tamcel, S.A. de C.V. was merged into Baja Celular Mexicana, S.A. de C.V. -the remaining company after the merger was Baja Celular Mexicana, S.A. de C.V. Both companies are still fully consolidated in the Telefónica Group.

On October 8, 2004, Teles Celulares Participações, S.A. approved a capital increase of approximately 2,054 million reais. This capital increase was fully subscribed and concluded on January 4, 2005. Brasilcel, N.V.'s shareholding in the company increased from 65.12% to 65.70% as a result.

On March 5, 2004, Telefónica Móviles, S.A. reached an agreement with BellSouth Corporation ("BellSouth") to acquire 100% of its holdings in its cellular operators in Argentina, Chile, Peru, Venezuela, Colombia, Ecuador, Uruguay, Guatemala, Nicaragua and Panama.



The effective transfer of the shares of these companies was conditional, inter alia, upon obtaining the required regulatory authorizations in each country and on any necessary approvals from minority shareholders. The effective transfer of the shares of these operators was made in 2004 and in January 2005. All the holdings of BellSouth in the operators located in Ecuador, Guatemala and Panama were transferred on October 14, 2004; those in the operators located in Colombia, Nicaragua, Peru, Uruguay and Venezuela were transferred on October 28, 2004, that in the operator in Chile was transferred on January 7, 2005, and the holding in the Argentinean operator was transferred on January 11, 2005.

This agreement valued 100% of the assets of these operators at 4,330 million dollars (5,850 million dollars if we include the Argentine and Chilean acquisitions completed in January 2005). The total acquisition cost for Telefónica Móviles, adjusted by the net debt of all the companies, amounted to 3,252.54 million euros (excluding Chile and Argentina).

Following are the values assigned to each transaction and the acquisition cost for Telefónica Móviles:

- Acquisition of 100% of Otecel, S.A. (Ecuador) for a total enterprise value of 833 million dollars. The acquisition cost for Telefónica Móviles, adjusted for outstanding net debt, was 663.43 million euros.
- Acquisition of 100% of Telefónica Móviles y Compañía, S.C.A. for a total enterprise value of 175 million dollars. The acquisition cost for Telefónica Móviles, adjusted for outstanding net debt, was 92.54 million euros.
- Acquisition of 99.57% of BellSouth Panamá, S.A. for a total enterprise value of 657 million dollars. The acquisition cost for Telefónica Móviles, adjusted for outstanding net debt, was 549.28 million euros.
- Acquisition of 100% of Telcel, S.A. (Venezuela) for a total enterprise value of 1,195 million dollars. The acquisition cost for Telefónica Móviles, adjusted for outstanding net debt, was 1,223.98 million euros.
- Acquisition of 100% of Telefónica Móviles Colombia, S.A. for a total enterprise value of 1,050 million dollars. The acquisition cost for Telefónica Móviles, adjusted for outstanding net debt, was 517.46 million euros.
- Acquisition of 99.85% of Comunicaciones Móviles del Perú, S.A. for a total enterprise value of 210 million dollars. The acquisition cost for Telefónica Móviles, adjusted for outstanding net debt, was 7.70 million euros.
- Acquisition of 100% of Telefonía Celular de Nicaragua, S.A. for a total enterprise value of 150 million dollars. The acquisition cost for Telefónica Móviles, adjusted for outstanding net debt, was 148.74 million euros.
- Acquisition of 100% of Abiatar, S.A. for a total enterprise value of 60 million dollars. The acquisition cost for Telefónica Móviles, adjusted for outstanding net debt, was 49.42 million euros.

The net carrying amounts of the assets and liabilities acquired from BellSouth and the goodwill generated, after the purchase price allocation to the fair value recognition of all assets assumed in the acquisition of these operators, are as follows:

| Millions of euros<br>October 2004 | Carrying amount | Fair value   |
|-----------------------------------|-----------------|--------------|
| <b>Assets</b>                     |                 |              |
| Intangible assets                 | 246             | 1,105        |
| Goodwill                          | 719             | 719          |
| Property, plant and equipment     | 818             | 701          |
| Non-current financial assets      | 32              | 32           |
| Current assets                    | 962             | 926          |
| <b>Liabilities</b>                |                 |              |
| Non-current trade payables        | (390)           | (390)        |
| Deferred tax liabilities          | -               | (299)        |
| Current trade payables            | (739)           | (739)        |
| <b>Net asset value</b>            | <b>1,648</b>    | <b>2,055</b> |
| <b>Acquisition cost</b>           |                 | <b>3,252</b> |
| <b>Goodwill</b>                   |                 | <b>1,197</b> |

### *Telefónica Internacional Group*

The Brazilian company Aix Participações, which in 2003 was accounted for by the equity method in the consolidated financial statements of the Telefónica Group, was proportionally consolidated in 2004.

US company Katalyx, Inc. took over the US companies Adquira, Inc. and Katalyx Transportation, LLC. Both companies were excluded from the consolidation scope.

Peruvian company Telefónica Empresas Perú, S.A.A. took over Peruvian company Telefónica Servicios Financieros, S.A.C., which was excluded from the consolidation scope.

On July 8, 2004, Telefónica Internacional Chile S.A. acquired 3 million ADRs of Compañía de Telecomunicaciones de Chile S.A. (CTC), representing 12 million series A shares, equal to a 1.25% holding in this company, thereby increasing the Telefónica Group's total ownership interest to 44.89%. The price paid was 37.07 million dollars. The company is still fully consolidated in the Telefónica Group.

On April 26, 2004, CTC sold to Telefónica Publicidad e Información, S.A. its (9%) holding in Chilean company Impresora y Comercial Publiciñas S.A.

Following approval by the Board of Directors of the Chilean company CTC on May 18 and subsequent ratification at the Shareholders' Meeting on July 15, 2004, the aforementioned sale of a 100% holding in subsidiary Telefónica Móviles Chile, S.A. to Telefónica Móviles, S.A. was carried out.

Under a share buyback program, the subsidiary Telefónica del Perú, S.A.A. acquired own shares in the market for 21.90 million new soles (approximately 5.3 million euros), increasing the Telefónica Group's



effective percentage of ownership from 97.21% to 98.19%. The company is still fully consolidated in the Telefónica Group.

In November Telefónica del Perú S.A.A. acquired a 99.99% holding in Antena 3 Producciones S.A. for 3.85 million dollars (approximately 2.9 million euros). This company was fully consolidated in the consolidated financial statements of the Telefónica Group.

Telefónica del Perú, S.A.A. sold all the shares it owned in the Dutch company New Skies Satellites, B.V., representing approximately 0.83% of this company's share capital, for 7.84 million dollars (approximately 5.9 million euros). The company was recorded under "Other investments – Non-current Financial Assets" in the Telefónica Group's consolidated balance sheet.

As for the Katalyx Group, the Mexican subsidiaries Katalyx Construction Mexico, S.R.L., Katalyx Health Mexico, S.R.L., Katalyx Cataloguing Mexico, S.R.L. de C.V., Katalyx Food Service Mexico, S.R.L. de C.V. and Katalyx Transportation Mexico, LLC. and the Argentine companies Katalyx Transportation Argentina, S.R.L., Katalyx Construction Argentina, Katalyx Food Service Argentina, S.R.L., Katalyx Cataloguing Argentina, S.R.L. and Katalyx Argentina, S.A. were dissolved or are in the process of liquidation. All of them were excluded from the consolidation scope.

Argentine company Adquira Argentina, S.L. was taken over by Telefónica Data Argentina, S.A. and excluded from the consolidation scope.

In December, Brazilian company Telecomunicações de São Paulo, S.A. (TELESP) entered into an agreement for the purchase of all the shares (*quotas*) of Santa Genovense Participações Ltd., a holding company owning all the *quotas* of Atrium Telecomunicações, for 113.44 million Brazilian reais (approximately 31 million euros), giving rise to goodwill of 23.75 million euros. This company was fully consolidated in the consolidated financial statements of the Telefónica Group.

### *Telefónica de Contenidos Group*

In July 2004, a 70% holding in the Spanish company Lola Films, S.A. was sold to its minority shareholder.

The group parent company took over its Spanish subsidiaries Telefónica Medios de Comunicación, S.A., Telefónica Media Internacional y de Contenidos, S.A., Producciones Multitemáticas, S.A. and Gestora de Medios Audiovisuales de Fútbol, S.L. Spanish company Corporación Admira Media, S.A. was dissolved and liquidated in June 2004. All these companies had been fully consolidated in the Telefónica Group in 2003, but were excluded from the consolidation scope in 2004.

In October 2004, Telefónica de Contenidos, S.A. sold its holdings in Lideres Entertainment Group, Inc and Fieldy BV. These companies, which had been accounted for by the equity method in the consolidated financial statements of the Telefónica Group in 2003, were excluded from the consolidation scope in 2004.

Telefónica de Contenidos's 20% holding in Argentine company Torneos y Competencias, S.A. was classified in the Telefónica Group's consolidated financial statements as an available-for-sale investment on the basis of management criteria.

## Appendix III

### Goodwill

The detail of the movements in “Goodwill” at December 31, 2005 and 2004 is as follows:

| Goodwill  | Balance at<br>12-31-04 | Additions       | Disposals/<br>Impairment | Exclusion of<br>companies | Transfers       | Translation<br>differences | Balance<br>12-31-05 |
|---|------------------------|-----------------|--------------------------|---------------------------|-----------------|----------------------------|---------------------|
| C.T.C. (Chile)  | 36.92                  | –               | –                        | –                         | –               | 7.86                       | 44.78               |
| T. Peru Holding (Peru)                                    | 78.03                  | –               | –                        | –                         | (0.03)          | 10.42                      | 88.42               |
| Telefónica del Perú, S.A.A. (Peru)                        | 123.55                 | –               | –                        | –                         | –               | 12.81                      | 136.36              |
| Telefónica Móvil de Chile, S.A (Chile)                    | 341.41                 | 77.77           | –                        | –                         | (0.01)          | 85.35                      | 504.52              |
| Telesp Participações (Brazil)                             | 71.37                  | –               | –                        | –                         | –               | 22.08                      | 93.45               |
| T. Holding de Argentina and subsidiaries<br>(Argentina)   | 113.87                 | –               | –                        | –                         | –               | 15.31                      | 129.18              |
| Cointel (Argentina)                                       | 78.51                  | –               | –                        | –                         | –               | 10.56                      | 89.07               |
| TPI Edita (Spain)   | 4.70                   | –               | (0.21)                   | –                         | –               | –                          | 4.49                |
| Impresora y Comercial Publiguías, S.A. (Chile)            | 37.33                  | –               | –                        | –                         | –               | 9.33                       | 46.66               |
| Telefonica Internacional (Spain)                          | 195.17                 | –               | –                        | –                         | –               | –                          | 195.17              |
| Telefonica Móviles (Spain)                                | 117.72                 | –               | –                        | –                         | –               | –                          | 117.72              |
| T. Data España (Spain)                                    | 41.75                  | –               | –                        | –                         | –               | –                          | 41.75               |
| T. Data Brasil (Brazil)                                   | 87.01                  | –               | –                        | –                         | –               | 26.92                      | 113.93              |
| Cesky Telecom, a.s (Czech Republic)                       | –                      | 912.66          | –                        | –                         | –               | 32.70                      | 945.36              |
| Eurotel Praha, spol. s.r.o. (Czech Republic)              | –                      | 443.56          | –                        | –                         | –               | 15.72                      | 459.28              |
| T. Deutchland Gmbh and subsidiaries (Germany)             | 431.48                 | –               | –                        | –                         | –               | –                          | 431.48              |
| Endemol (Netherlands)                                     | 708.86                 | 0.02            | –                        | (177.22)                  | –               | –                          | 531.66              |
| Endemol Holding, N.V. subsidiaries                        | 480.65                 | 50.27           | (1.84)                   | –                         | 2.64            | 1.63                       | 533.35              |
| Atlántida Comunicaciones, S.A. (Argentina)                | 48.48                  | –               | –                        | –                         | –               | 6.52                       | 55.00               |
| Atlántida Comunicaciones, S.A. subsidiaries               | 5.21                   | –               | –                        | –                         | –               | 0.70                       | 5.91                |
| Atento Perú, S.A.C. (Peru)                                | 3.60                   | –               | –                        | –                         | –               | 0.37                       | 3.97                |
| Atento Brasil (Brazil)                                    | 55.86                  | –               | –                        | –                         | –               | 17.28                      | 73.14               |
| Terra Networks Brasil, S.A. and subsidiaries<br>(Brazil)  | 48.24                  | –               | –                        | –                         | 0.49            | 14.92                      | 63.65               |
| Terra Networks Chile, S.A. (Chile)                        | 8.98                   | –               | –                        | –                         | 1.71            | 2.51                       | 13.20               |
| Terra Networks, S.A. (Spain)                              | 62.37                  | –               | –                        | –                         | (10.10)         | –                          | 52.27               |
| Emergia Holding, N.V (Netherlands)                        | 2.01                   | –               | –                        | –                         | (2.01)          | –                          | –                   |
| Comunicaciones Móviles de Perú, S.A. (Peru)               | 11.30                  | –               | –                        | –                         | (9.58)          | 0.12                       | 1.84                |
| Latin American Cellular Holdings, B.V.<br>(Netherlands)   | –                      | 1.99            | –                        | –                         | –               | –                          | 1.99                |
| Telefónica Comunicaciones Personales, S.A.<br>(Argentina) | –                      | 14.53           | –                        | –                         | –               | (0.35)                     | 14.18               |
| Terra Bussiness Travel, S.A. (Spain)                      | –                      | 3.00            | –                        | –                         | –               | –                          | 3.00                |
| Telefónica Data Colombia, S.A. (Colombia)                 | –                      | 1.02            | –                        | –                         | –               | 0.02                       | 1.04                |
| Azeler Automoción, S.A. (Spain)                           | –                      | 1.53            | –                        | –                         | 0.14            | –                          | 1.67                |
| T.Centroamerica Guatemala and subsidiaries<br>(Guatemala) | 30.86                  | –               | –                        | –                         | –               | 5.49                       | 36.35               |
| Telefónica El Salvador (El Salvador)                      | 47.08                  | 5.66            | –                        | –                         | –               | 7.66                       | 60.40               |
| Telefónica Móviles Chile Inversiones (Chile)              | –                      | 219.44          | –                        | –                         | –               | 44.39                      | 263.83              |
| Radiocomunicaciones Móviles, S.A. (Argentina)             | –                      | 547.22          | –                        | –                         | –               | 55.08                      | 602.30              |
| Brasilcel and subsidiaries (Brazil)                       | 522.56                 | 11.55           | –                        | –                         | (115.39)        | 140.53                     | 559.25              |
| Telefónica Móviles México and subsidiaries<br>(Mexico)    | 330.15                 | 90.95           | –                        | –                         | –               | 42.44                      | 463.54              |
| Telefonía Celular de Nicaragua, S.A.                      | 71.48                  | 7.81            | –                        | –                         | –               | (0.67)                     | 78.62               |
| Telcel (Venezuela)  | 481.36                 | –               | –                        | –                         | (4.86)          | 15.03                      | 491.53              |
| Otecel, S.A. (Ecuador)                                    | 403.87                 | 0.06            | –                        | –                         | (7.40)          | 62.20                      | 458.73              |
| Olympic, Ltda. (Colombia)                                 | 541.31                 | –               | –                        | –                         | (5.12)          | 111.04                     | 647.23              |
| Telefónica Móviles Panamá (Panama)                        | 272.85                 | 2.82            | –                        | –                         | (0.06)          | 42.31                      | 317.92              |
| Atento N.V. (Netherlands)                                 | –                      | 61.04           | –                        | –                         | –               | –                          | 61.04               |
| Telefónica Móviles Guatemala y Cía, S.C.A.<br>(Guatemala) | 27.48                  | 0.01            | –                        | –                         | –               | 4.88                       | 32.37               |
| T. Uruguay S.A. (Uruguay)                                 | 10.30                  | –               | –                        | –                         | (0.11)          | 2.67                       | 12.86               |
| Other   | 15.76                  | –               | (0.01)                   | –                         | 9.37            | 1.65                       | 26.77               |
| <b>Total</b>  | <b>5,949.44</b>        | <b>2,452.91</b> | <b>(2.06)</b>            | <b>(177.22)</b>           | <b>(140.32)</b> | <b>827.48</b>              | <b>8,910.23</b>     |

| Goodwill  | Balance at<br>01-01-04 | Additions       | Disposals/<br>Impairment | Exclusion of<br>companies | Transfers      | Translation<br>differences | Balance<br>12-31-04 |
|---|------------------------|-----------------|--------------------------|---------------------------|----------------|----------------------------|---------------------|
| C.T.C. (Chile)  | 30.55                  | 7.38            | -                        | -                         | -              | (1.01)                     | 36.92               |
| T. Peru Holding (Peru)                                    | 79.70                  | -               | -                        | -                         | -              | (1.67)                     | 78.03               |
| Telefónica del Perú, S.A.A. (Peru)                        | 126.21                 | -               | -                        | -                         | -              | (2.66)                     | 123.55              |
| Telefónica Móvil de Chile, S.A (Chile)                    | 183.18                 | 150.52          | -                        | -                         | -              | 7.71                       | 341.41              |
| Telesp Participações (Brazil)                             | 46.96                  | 23.75           | -                        | -                         | -              | 0.66                       | 71.37               |
| T. Holding de Argentina and subsidiaries<br>(Argentina)   | 124.86                 | -               | -                        | -                         | -              | (10.99)                    | 113.87              |
| Cointel (Argentina)                                       | 86.09                  | -               | -                        | -                         | -              | (7.58)                     | 78.51               |
| TPI Editá (Spain)   | 6.81                   | -               | (2.11)                   | -                         | -              | -                          | 4.70                |
| Impresora y Comercial Publiguías, S.A. (Chile)            | -                      | 37.82           | -                        | -                         | -              | (0.49)                     | 37.33               |
| Telefonica Internacional (Spain)                          | 195.17                 | -               | -                        | -                         | -              | -                          | 195.17              |
| Telefonica Móviles (Spain)                                | 111.62                 | 6.10            | -                        | -                         | -              | -                          | 117.72              |
| T. Data España (Spain)                                    | 41.75                  | -               | -                        | -                         | -              | -                          | 41.75               |
| T. Data Brasil (Brazil)                                   | 86.22                  | -               | -                        | -                         | (0.01)         | 0.80                       | 87.01               |
| T. Deutchland Gmbh and subsidiaries<br>(Germany)          | 540.95                 | -               | (109.51)                 | -                         | -              | 0.04                       | 431.48              |
| Endemol (Netherlands)                                     | 698.58                 | 10.28           | -                        | -                         | -              | -                          | 708.86              |
| Endemol Holding, N.V. subsidiaries                        | 443.41                 | 44.63           | -                        | -                         | (7.88)         | 0.49                       | 480.65              |
| Atlántida Comunicaciones, S.A. (Argentina)                | 53.16                  | -               | -                        | -                         | -              | (4.68)                     | 48.48               |
| Atlántida Comunicaciones, S.A. subsidiaries               | 5.71                   | -               | -                        | -                         | -              | (0.50)                     | 5.21                |
| Atento Perú, S.A.C. (Peru)                                | 3.68                   | -               | -                        | -                         | -              | (0.08)                     | 3.60                |
| Atento Brasil (Brazil)                                    | 55.35                  | -               | -                        | -                         | -              | 0.51                       | 55.86               |
| Terra Networks Brasil, S.A. (Brazil)<br>and subsidiaries  | 47.78                  | -               | -                        | -                         | -              | 0.46                       | 48.24               |
| Terra Networks Chile (Chile)                              | 9.05                   | -               | -                        | -                         | -              | (0.07)                     | 8.98                |
| Lycos, Inc (USA)  | 31.54                  | -               | -                        | (32.10)                   | -              | 0.56                       | 0.00                |
| Lycos, Inc subsidiaries (USA)                             | 23.27                  | -               | -                        | (23.69)                   | -              | 0.42                       | 0.00                |
| One Travel.com, Inc. (USA)                                | 14.80                  | -               | (8.89)                   | -                         | (5.91)         | -                          | 0.00                |
| Terra Networks, S.A. (Spain)                              | 60.56                  | 1.81            | -                        | -                         | -              | -                          | 62.37               |
| Emergia Holding, N.V (Netherlands)                        | 2.01                   | -               | -                        | -                         | -              | -                          | 2.01                |
| T.Centroamerica Guatemala and subsidiaries<br>(Guatemala) | 32.16                  | -               | -                        | -                         | -              | (1.30)                     | 30.86               |
| Telefónica El Salvador (El Salvador)                      | 50.78                  | -               | -                        | -                         | -              | (3.70)                     | 47.08               |
| Brasilcel and subsidiaries (Brazil)                       | 474.30                 | 43.53           | -                        | -                         | -              | 4.73                       | 522.56              |
| Telefónica Móviles México and subsidiaries<br>(Mexico)    | 299.30                 | 47.56           | -                        | -                         | -              | (16.71)                    | 330.15              |
| Telefonía Celular de Nicaragua, S.A.                      | -                      | 76.65           | -                        | -                         | -              | (5.17)                     | 71.48               |
| Telcel (Venezuela)  | -                      | 491.12          | -                        | -                         | -              | (9.76)                     | 481.36              |
| Otecel, S.A. (Ecuador)                                    | -                      | 451.37          | -                        | -                         | -              | (47.50)                    | 403.87              |
| Olympic, Ltda. (Colombia)                                 | -                      | 536.09          | -                        | -                         | -              | 5.22                       | 541.31              |
| Telefónica Móviles Panamá (Panama)                        | -                      | 305.15          | -                        | -                         | -              | (32.30)                    | 272.85              |
| Comunicaciones Móviles de Perú, S.A. (Peru)               | -                      | 12.08           | -                        | -                         | -              | (0.78)                     | 11.30               |
| Telefónica Móviles Guatemala y Cía, S.C.A.<br>(Guatemala) | -                      | 32.15           | -                        | -                         | -              | (4.67)                     | 27.48               |
| T. Móviles Uruguay S.A. (Uruguay)                         | -                      | 10.83           | -                        | -                         | -              | (0.53)                     | 10.30               |
| Other   | 16.26                  | -               | (0.16)                   | -                         | -              | (0.34)                     | 15.76               |
| <b>Total</b>  | <b>3,981.77</b>        | <b>2,288.82</b> | <b>(120.67)</b>          | <b>(55.79)</b>            | <b>(13.80)</b> | <b>(130.89)</b>            | <b>5,949.44</b>     |

## Appendix IV

### Minority interests

The balance at December 31, 2005 comprised the holdings of minority shareholders in the following companies:

| Millions of euros                                     |             |                 |               |                         |                     |
|---|-------------|-----------------|---------------|-------------------------|---------------------|
| Company   | % ownership | Equity          | Income (loss) | Translation differences | Balance at 31-12-05 |
| Cesky Telecom A.s.                                    | 30.59%      | 1,197.80        | 45.81         | 29.55                   | 1,273.16            |
| Endemol, N.V.   | 25.00%      | 31.10           | 4.08          | (0.01)                  | 35.17               |
| C.T. Chile, S.A.                                      | 55.11%      | 406.75          | 27.47         | 113.28                  | 547.50              |
| Fonditel Entidad Gestora de Fondos de Pensiones, S.A. | 30.00%      | 12.06           | 2.86          | –                       | 14.92               |
| Telefónica del Perú, S.A.                             | 1.95%       | 6.22            | 1.69          | 0.79                    | 8.70                |
| Telefónica Publicidad e Información, S.A.             | 40.10%      | 39.65           | 53.90         | 5.86                    | 99.41               |
| Telesp Participações, S.A.                            | 12.51%      | 220.17          | 110.29        | 129.14                  | 459.60              |
| Telefónica Móviles, S.A.                              | 7.09%       | 190.77          | 136.20        | 64.33                   | 391.30              |
| Telefónica Móviles México, S.A. and subsidiaries      | 0.00%       | 33.05           | (34.20)       | 2.12                    | 0.97                |
| Brasilcel (Holdings)                                  | –           | 410.39          | (1.21)        | 83.46                   | 492.64              |
| Other   | –           | 53.53           | 34.32         | 13.92                   | 101.77              |
| <b>Total</b>  |             | <b>2,601.49</b> | <b>381.21</b> | <b>442.44</b>           | <b>3,425.14</b>     |

The balance at December 31, 2004 comprised the holdings of minority shareholders in the following companies:

| Millions of euros                                     |             |                 |               |                         |                     |
|---|-------------|-----------------|---------------|-------------------------|---------------------|
| Company   | % ownership | Equity          | Income (loss) | Translation differences | Balance at 31-12-04 |
| C.T. Chile, S.A.                                      | 55.11%      | 517.82          | 17.29         | (0.99)                  | 534.12              |
| Terra Networks, S.A.                                  | 22.25%      | 246.08          | 46.74         | (0.08)                  | 292.74              |
| Fonditel Entidad Gestora de Fondos de Pensiones, S.A. | 30.00%      | 10.55           | 2.49          | –                       | 13.04               |
| Telefónica del Perú, S.A.                             | 1.95%       | 11.58           | 0.07          | (0.25)                  | 11.40               |
| Telefónica Publicidad e Información, S.A.             | 38.90%      | 55.91           | 46.63         | (1.16)                  | 101.38              |
| Telesp Participações, S.A.                            | 12.51%      | 314.26          | 76.88         | 1.90                    | 393.04              |
| Telefónica Móviles, S.A.                              | 7.05%       | 129.42          | 119.96        | (13.76)                 | 235.62              |
| Telefónica Móviles México, S.A. and subsidiaries      | 8.00%       | 53.49           | (55.12)       | 2.31                    | 0.68                |
| Brasilcel (Holdings)                                  | –           | 231.48          | 43.10         | 4.79                    | 279.37              |
| Other   |             | 30.17           | 11.88         | (0.73)                  | 41.32               |
| <b>Total</b>  |             | <b>1,600.76</b> | <b>309.92</b> | <b>(7.97)</b>           | <b>1,902.71</b>     |

## Appendix V

### Debentures and bonds

The detail and main features of outstanding debentures and bonds at December 31, 2005 are as follows (in millions of euros):

| Telefónica and special purpose vehicles | Currency | % Interest rate  | Maturity (Nominal) |        |        |        |          | Subsequent years | Total    |
|---|----------|------------------|--------------------|--------|--------|--------|----------|------------------|----------|
|   |          |                  | 2006               | 2007   | 2008   | 2009   | 2010     |                  |          |
| Debentures and bonds:                   |          |                  |                    |        |        |        |          |                  |          |
| FEBRUARY 1990 SERIES C                  | Euros    | 12.60            | –                  | –      | –      | –      | 3.76     | –                | 3.76     |
| FEBRUARY 1990 SERIES F                  | Euros    | 12.58            | –                  | –      | –      | –      | 9.09     | –                | 9.09     |
| APRIL 1999                              | Euros    | 4.50             | –                  | –      | –      | 500.00 | –        | –                | 500.00   |
| JUNE 1999                               | Euros    | 2.70             | –                  | –      | –      | 300.00 | –        | –                | 300.00   |
| JULY 1999 zero-coupon                   | Euros    | 6.37             | –                  | –      | –      | –      | –        | 44.47            | 44.47    |
| MARCH 2000                              | Euros    | 5.137 (*)        | –                  | –      | –      | –      | –        | 50.00            | 50.00    |
| APRIL 2000                              | Euros    | 5.63             | –                  | 500.00 | –      | –      | –        | –                | 500.00   |
| Debentures subtotal:                    |          |                  | –                  | 500.00 | –      | 800.00 | 12.85    | 94.47            | 1,407.32 |
| MARCH 1998                              | Euros    | 4.84             | –                  | –      | 420.71 | –      | –        | –                | 420.71   |
| GLOBAL BOND                             | USD      | 7.75             | –                  | –      | –      | –      | 2,119.18 | –                | 2,119.18 |
| GLOBAL BOND                             | USD      | 8.25             | –                  | –      | –      | –      | –        | 1,059.59         | 1,059.59 |
| EMTN ISSUE                              | Euros    | 5.13             | 1,000.00           | –      | –      | –      | –        | –                | 1,000.00 |
| EMTN ISSUE (A Tranche)                  | Euros    | 5.13             | –                  | –      | –      | –      | –        | 1,500.00         | 1,500.00 |
| EMTN ISSUE (B Tranche)                  | Euros    | 5.88             | –                  | –      | –      | –      | –        | 500.00           | 500.00   |
| EMTN ISSUE                              | Euros    | 3M EURIBOR +0,18 | 100.00             | –      | –      | –      | –        | –                | 100.00   |
| EMTN ISSUE                              | Euros    | 3M EURIBOR +0,18 | 200.00             | –      | –      | –      | –        | –                | 200.00   |
| Bonds subtotal:                         |          |                  | 1,300.00           | –      | 420.71 | –      | 2,119.18 | 3,059.59         | 6,899.48 |
| Total issues:                           |          |                  | 1,300.00           | 500.00 | 420.71 | 800.00 | 2,132.03 | 3,154.06         | 8,306.80 |

(\*) Interest rate used (floating and set annually) is that of a 10Y pound sterling interest rate swap multiplied by 1.0225.

| Foreign operators<br>Debentures and bonds                   | Currency   | % Interest<br>rate | Maturity (Nominal) |                 |               |               |                 | Subsequent<br>years | Total            |
|---|------------|--------------------|--------------------|-----------------|---------------|---------------|-----------------|---------------------|------------------|
|   |            |                    | 2006               | 2007            | 2008          | 2009          | 2010            |                     |                  |
| Yankee Bonds  | USD        | 7.63               | 42.05              | –               | –             | –             | –               | –                   | 42.05            |
| Yankee Bonds  | USD        | 8.38               | 132.61             | –               | –             | –             | –               | –                   | 132.61           |
| Series F  | UF         | 6.00               | 2.12               | 2.12            | 2.12          | 2.12          | 2.12            | 13.82               | 24.42            |
| <b>CTC CHILE:</b>   |            |                    | <b>176.78</b>      | <b>2.12</b>     | <b>2.12</b>   | <b>2.12</b>   | <b>2.12</b>     | <b>13.82</b>        | <b>199.08</b>    |
| T. Peru 1 <sup>st</sup> Program (1 <sup>st</sup> )          | PEN        | VAC+6.94           | 28.21              | –               | –             | –             | –               | –                   | 28.21            |
| T. Peru 1 <sup>st</sup> Program (2 <sup>nd</sup> )          | PEN        | VAC+7.00           | –                  | –               | –             | 12.27         | –               | –                   | 12.27            |
| T. Peru 2 <sup>nd</sup> Program (3 <sup>rd</sup> )          | PEN        | VAC+6.19           | 26.75              | –               | –             | –             | –               | –                   | 26.75            |
| T. Peru 2 <sup>nd</sup> Program (5 <sup>th</sup> )          | PEN        | VAC+6.25           | –                  | 3.25            | –             | –             | –               | –                   | 3.25             |
| T. Peru 3 <sup>rd</sup> Program (1 <sup>st</sup> )          | PEN        | VAC+5.00           | –                  | –               | –             | –             | 13.01           | –                   | 13.01            |
| T. Peru 3 <sup>rd</sup> Program (2 <sup>nd</sup> Series A)  | PEN        | 5.31               | –                  | 7.41            | –             | –             | –               | –                   | 7.41             |
| T. Peru 3 <sup>rd</sup> Program (3 <sup>rd</sup> )          | PEN        | 8.13               | –                  | 7.41            | –             | –             | –               | –                   | 7.41             |
| T. Peru 3 <sup>rd</sup> Program (5 <sup>th</sup> -Series A) | PEN        | 5.50               | –                  | 16.85           | –             | –             | –               | –                   | 16.85            |
| T. Peru 3 <sup>rd</sup> Program (6 <sup>th</sup> )          | PEN        | 5.19               | 24.69              | –               | –             | –             | –               | –                   | 24.69            |
| T. Peru 3 <sup>rd</sup> Program (7 <sup>th</sup> )          | PEN        | 5.50               | 17.28              | –               | –             | –             | –               | –                   | 17.28            |
| T. Peru Senior Notes  | PEN        | 8.00               | –                  | –               | –             | –             | –               | 186.16              | 186.16           |
| 7 <sup>th</sup> issue T. Peru bonds                         | PEN        | 7.94               | –                  | –               | 15.60         | –             | –               | –                   | 15.60            |
| 8 <sup>th</sup> issue T. Peru bonds                         | USD        | 3.81               | –                  | –               | –             | 14.28         | –               | –                   | 14.28            |
| 9 <sup>th</sup> issue T. Peru bonds                         | USD        | 3.13               | –                  | 16.95           | –             | –             | –               | –                   | 16.95            |
| <b>Telefónica del Perú:</b>                                 |            |                    | <b>96.93</b>       | <b>51.87</b>    | <b>15.60</b>  | <b>26.55</b>  | <b>13.01</b>    | <b>186.16</b>       | <b>390.13</b>    |
| Marketable debentures                                       | USD        | 9.13               | –                  | –               | 106.50        | –             | –               | –                   | 106.50           |
| Marketable debentures                                       | USD        | 9.88               | 60.50              | –               | –             | –             | –               | –                   | 60.50            |
| Marketable debentures                                       | USD        | 11.88              | –                  | 160.81          | –             | –             | –               | –                   | 160.81           |
| Marketable debentures                                       | USD        | 9.13               | –                  | –               | –             | –             | 180.16          | –                   | 180.16           |
| Marketable debentures                                       | ARS        | 10.38              | –                  | –               | –             | –             | –               | 0.06                | 0.06             |
| Marketable debentures                                       | USD        | 8.85               | –                  | –               | –             | –             | –               | 114.13              | 114.13           |
| Marketable debentures                                       | ARS        | BADLAR+2.4 (*)     | 18.21              | –               | –             | –             | –               | –                   | 18.21            |
| Marketable debentures                                       | ARS        | 8.00               | 29.05              | –               | –             | –             | –               | –                   | 29.05            |
| Marketable debentures                                       | ARS        | SURVEY+2.5 (*)     | –                  | 13.98           | –             | –             | –               | –                   | 13.98            |
| <b>TASA</b>   |            |                    | <b>107.76</b>      | <b>174.79</b>   | <b>106.50</b> | <b>–</b>      | <b>180.16</b>   | <b>114.19</b>       | <b>683.40</b>    |
| Marketable debentures                                       | USD        | 9.75               | –                  | 6.40            | –             | –             | –               | –                   | 6.40             |
| <b>Telefónica Holding Argentina</b>                         |            |                    | <b>–</b>           | <b>6.40</b>     | <b>–</b>      | <b>–</b>      | <b>–</b>        | <b>–</b>            | <b>6.40</b>      |
| Peso bonds  | MXN        | 91-day CETES+0.61  | –                  | –               | –             | –             | 275.28          | –                   | 275.28           |
| Peso bonds  | MXN        | 9.25               | –                  | –               | –             | –             | –               | 117.98              | 117.98           |
| <b>Telefónica Finanzas México</b>                           |            |                    | <b>–</b>           | <b>–</b>        | <b>–</b>      | <b>–</b>      | <b>275.28</b>   | <b>117.98</b>       | <b>393.26</b>    |
| Nonconvertible bonds  | BRL        | 103.5% CDI         | –                  | 543.22          | –             | –             | –               | –                   | 543.22           |
| <b>TELESP</b>   |            |                    | <b>–</b>           | <b>543.22</b>   | <b>–</b>      | <b>–</b>      | <b>–</b>        | <b>–</b>            | <b>543.22</b>    |
| Nonconvertible bonds  | BRL        | 104.4% CDI         | –                  | 90.54           | –             | –             | –               | –                   | 90.54            |
| Nonconvertible bonds  | BRL        | 104.2% CDI         | –                  | –               | –             | –             | 144.86          | –                   | 144.86           |
| Nonconvertible bonds  | BRL        | 103.3% CDI         | –                  | –               | –             | 36.21         | –               | –                   | 36.21            |
| <b>Brasilcel</b>  |            |                    | <b>–</b>           | <b>90.54</b>    | <b>–</b>      | <b>36.21</b>  | <b>144.86</b>   | <b>–</b>            | <b>271.61</b>    |
| <b>3.5% 2008 bond</b>                                       | <b>CZK</b> | <b>3.50</b>        | <b>–</b>           | <b>–</b>        | <b>206.86</b> | <b>–</b>      | <b>–</b>        | <b>–</b>            | <b>206.86</b>    |
| <b>Cesky Telecom</b>  |            |                    | <b>–</b>           | <b>–</b>        | <b>206.86</b> | <b>–</b>      | <b>–</b>        | <b>–</b>            | <b>206.86</b>    |
| <b>Total issues:</b>  |            |                    | <b>381.47</b>      | <b>868.94</b>   | <b>331.08</b> | <b>64.89</b>  | <b>615.42</b>   | <b>432.14</b>       | <b>2,693.94</b>  |
| Consolidation adjustments                                   |            |                    | –                  | –               | –             | –             | –               | –                   | –                |
| <b>Total Group issues:</b>                                  |            |                    | <b>1,681.47</b>    | <b>1,368.94</b> | <b>751.80</b> | <b>864.88</b> | <b>2,747.46</b> | <b>3,586.21</b>     | <b>11,000.75</b> |



The detail and main features of outstanding debentures and bonds at December 31, 2004 are as follows (in millions of euros):

| Telefónica and special purpose vehicles | Currency | % Interest rate   | Maturity (Nominal) |          |        |        |        | Subsequent years | Total     |
|---|----------|-------------------|--------------------|----------|--------|--------|--------|------------------|-----------|
|   |          |                   | 2005               | 2006     | 2007   | 2008   | 2009   |                  |           |
| Debentures and bonds:                   |          |                   |                    |          |        |        |        |                  |           |
| FEBRUARY 1990 SERIES B                  | Euros    | 12.60             | 8.22               | –        | –      | –      | –      | –                | 8.22      |
| FEBRUARY 1990 SERIES C                  | Euros    | 12.60             | –                  | –        | –      | –      | –      | 3.76             | 3.76      |
| FEBRUARY 1990 SERIES E                  | Euros    | 12.85             | 75.39              | –        | –      | –      | –      | –                | 75.39     |
| FEBRUARY 1990 SERIES F                  | Euros    | 12.58             | –                  | –        | –      | –      | –      | 8.15             | 8.15      |
| DECEMBER 1990                           | Euros    | 13.58             | 715.45             | –        | –      | –      | –      | –                | 715.45    |
| APRIL 1999                              | Euros    | 4.50              | –                  | –        | –      | –      | 500.00 | –                | 500.00    |
| JUNE 1999                               | Euros    | 3.02              | –                  | –        | –      | –      | 300.00 | –                | 300.00    |
| JULY 1999 zero-coupon                   | Euros    | 6.37              | –                  | –        | –      | –      | –      | 42.00            | 42.00     |
| MARCH 2000                              | Euros    | 5.19(*)           | –                  | –        | –      | –      | –      | 50.00            | 50.00     |
| APRIL 2000                              | Euros    | 5.63              | –                  | –        | 500.00 | –      | –      | –                | 500.00    |
| Debentures subtotal:                    |          |                   | 799.06             | –        | 500.00 | –      | 800.00 | 103.91           | 2,202.97  |
| MARCH 1998                              | Euros    | 4.84              | –                  | –        | –      | 420.71 | –      | –                | 420.71    |
| GLOBAL BOND                             | USD      | 7.35              | 917.70             | –        | –      | –      | –      | –                | 917.70    |
| GLOBAL BOND                             | USD      | 7.75              | –                  | –        | –      | –      | –      | 1,835.40         | 1,835.40  |
| GLOBAL BOND                             | USD      | 8.25              | –                  | –        | –      | –      | –      | 917.70           | 917.70    |
| GLOBAL BOND                             | Euros    | 6.13              | 1,000.00           | –        | –      | –      | –      | –                | 1,000.00  |
| EMTN ISSUE                              | Euros    | 5.13              | –                  | 1,000.00 | –      | –      | –      | –                | 1,000.00  |
| EMTN ISSUE                              | Euros    | 0.15              | 50.00              | –        | –      | –      | –      | –                | 50.00     |
| EMTN ISSUE                              | Euros    | Eonia+0.47        | 100.00             | –        | –      | –      | –      | –                | 100.00    |
| EMTN ISSUE (A Tranche)                  | Euros    | 5.13              | –                  | –        | –      | –      | –      | 1,500.00         | 1,500.00  |
| EMTN ISSUE (B Tranche)                  | Euros    | 5.88              | –                  | –        | –      | –      | –      | 500.00           | 500.00    |
| EMTN ISSUE                              | Euros    | BNPEONIA01+0.23   | 100.00             | –        | –      | –      | –      | –                | 100.00    |
| EMTN ISSUE                              | Euros    | 3m Euribor + 0.14 | 100.00             | –        | –      | –      | –      | –                | 100.00    |
| EMTN ISSUE                              | Euros    | Eonia OIS+ 0.17   | 50.00              | –        | –      | –      | –      | –                | 50.00     |
| EMTN ISSUE                              | Euros    | 3m Euribor 0.18   | –                  | 100.00   | –      | –      | –      | –                | 100.00    |
| EMTN ISSUE                              | Euros    | 3m Euribor 0.18   | –                  | 200.00   | –      | –      | –      | –                | 200.00    |
| Bonds subtotal:                         |          |                   | 2,317.70           | 1,300.00 | –      | 420.71 | –      | 4,753.10         | 8,791.51  |
| Total issues:                           |          |                   | 3,116.76           | 1,300.00 | 500.00 | 420.71 | 800.00 | 4,857.01         | 10,994.48 |

(\*) Interest rate used (floating and set annually) is that of a 10Y pound sterling interest rate swap multiplied by 1.0225.

| Foreign operators<br>Debentures and bonds                   | Currency | % Interest<br>rate | Maturity (Nominal) |                 |               |                 | Subsequent    |                 | Total            |
|---|----------|--------------------|--------------------|-----------------|---------------|-----------------|---------------|-----------------|------------------|
|   |          |                    | 2005               | 2006            | 2007          | 2008            | 2009          | years           |                  |
| Yankee Bonds  | USD      | 7.63               | –                  | 36.42           | –             | –               | –             | –               | 36.42            |
| Yankee Bonds  | USD      | 8.38               | –                  | 114.84          | –             | –               | –             | –               | 114.84           |
| Series F  | UF       | 6.00               | 1.63               | 1.63            | 1.63          | 1.63            | 1.63          | 10.96           | 19.11            |
| Series K 1998   | UF       | 6.75               | 91.26              | –               | –             | –               | –             | –               | 91.26            |
| <b>CTC CHILE:</b>   |          |                    | <b>92.89</b>       | <b>152.89</b>   | <b>1.63</b>   | <b>1.63</b>     | <b>1.63</b>   | <b>10.96</b>    | <b>261.63</b>    |
| T. Peru 1 <sup>st</sup> Program (1 <sup>st</sup> )          | PEN      | VAC+6.94           | –                  | 25.29           | –             | –               | –             | –               | 25.29            |
| T. Peru 1 <sup>st</sup> Program (2 <sup>nd</sup> )          | PEN      | VAC+7.00           | –                  | –               | –             | –               | 11.00         | –               | 11.00            |
| T. Peru 2 <sup>nd</sup> Program (3 <sup>rd</sup> )          | PEN      | VAC+6.19           | –                  | 23.99           | –             | –               | –             | –               | 23.99            |
| T. Peru 2 <sup>nd</sup> Program (5 <sup>th</sup> )          | PEN      | VAC+6.25           | –                  | –               | 2.92          | –               | –             | –               | 2.92             |
| T. Peru 2 <sup>nd</sup> Program (7 <sup>th</sup> -Series A) | USD      | 4.38               | 28.64              | –               | –             | –               | –             | –               | 28.64            |
| T. Peru 2 <sup>nd</sup> Program (7 <sup>th</sup> -Series B) | USD      | 4.00               | 8.03               | –               | –             | –               | –             | –               | 8.03             |
| T. Peru 2 <sup>nd</sup> Program (8 <sup>th</sup> -Series A) | PEN      | 6.50               | 16.78              | –               | –             | –               | –             | –               | 16.78            |
| T. Peru 2 <sup>nd</sup> Program (8 <sup>th</sup> -Series B) | PEN      | 6.19               | 3.36               | –               | –             | –               | –             | –               | 3.36             |
| T. Peru 2 <sup>nd</sup> Program (9 <sup>th</sup> )          | USD      | 2.44               | 16.67              | –               | –             | –               | –             | –               | 16.67            |
| T. Peru 3 <sup>rd</sup> Program (1 <sup>st</sup> )          | PEN      | VAC+5.00           | –                  | –               | –             | –               | –             | 11.66           | 11.66            |
| T. Peru 3 <sup>rd</sup> Program (2 <sup>nd</sup> -Series A) | PEN      | 5.31               | –                  | –               | 6.71          | –               | –             | –               | 6.71             |
| T. Peru 3 <sup>rd</sup> Program (3 <sup>rd</sup> )          | PEN      | 8.13               | –                  | –               | 6.71          | –               | –             | –               | 6.71             |
| 6 <sup>th</sup> issue T. Peru bonds                         | PEN      | 5.19               | 15.66              | –               | –             | –               | –             | –               | 15.66            |
| 7 <sup>th</sup> issue T. Peru bonds                         | PEN      | 7.94               | –                  | –               | –             | 14.14           | –             | –               | 14.14            |
| 8 <sup>th</sup> issue T. Peru bonds                         | USD      | 3.81               | –                  | –               | –             | –               | 12.37         | –               | 12.37            |
| 9 <sup>th</sup> issue T. Peru bonds                         | USD      | 3.13               | –                  | –               | 15.52         | –               | –             | –               | 15.52            |
| <b>Telefónica del Perú:</b>                                 |          |                    | <b>89.14</b>       | <b>49.28</b>    | <b>31.86</b>  | <b>14.14</b>    | <b>23.37</b>  | <b>11.66</b>    | <b>219.45</b>    |
| Marketable debentures                                       | USD      | 9.13               | –                  | –               | –             | 92.24           | –             | –               | 92.24            |
| Marketable debentures                                       | USD      | 9.88               | –                  | 52.40           | –             | –               | –             | –               | 52.40            |
| Marketable debentures                                       | USD      | 11.88              | –                  | –               | 136.96        | 2.32            | –             | –               | 139.28           |
| Marketable debentures                                       | USD      | 9.13               | –                  | –               | –             | –               | –             | 156.03          | 156.03           |
| Marketable debentures                                       | ARS      | 10.38              | –                  | –               | –             | –               | –             | 0.02            | 0.02             |
| Marketable debentures                                       | USD      | 8.85               | –                  | –               | –             | –               | –             | 98.85           | 98.85            |
| Marketable debentures                                       | ARS      | 8.05               | 38.60              | –               | –             | –               | –             | –               | 38.60            |
| Marketable debentures                                       | ARS      | 8.25               | 31.88              | –               | –             | –               | –             | –               | 31.88            |
| Marketable debentures                                       | ARS      | BADLAR+2.4 (*)     | –                  | 16.06           | –             | –               | –             | –               | 16.06            |
| <b>TASA</b>   |          |                    | <b>70.48</b>       | <b>68.46</b>    | <b>136.96</b> | <b>94.56</b>    | –             | <b>254.90</b>   | <b>625.36</b>    |
| Marketable debentures                                       | USD      | 9.75               | –                  | –               | 5.54          | –               | –             | –               | 5.54             |
| <b>Telefónica Holding Argentina</b>                         |          |                    | –                  | –               | 5.54          | –               | –             | –               | 5.54             |
| Nonconvertible bonds  | BRL      | 103.5% CDI         | –                  | –               | –             | 414.87          | –             | –               | 414.87           |
| <b>TELESP</b>   |          |                    | –                  | –               | –             | <b>414.87</b>   | –             | –               | <b>414.87</b>    |
| Nonconvertible bonds  | BRL      | 104.4% CDI         | –                  | –               | –             | 69.14           | –             | –               | 69.14            |
| <b>Brasilcel</b>  |          |                    | –                  | –               | –             | <b>69.14</b>    | –             | –               | <b>69.14</b>     |
| <b>Total issues:</b>  |          |                    | <b>252.51</b>      | <b>270.63</b>   | <b>175.99</b> | <b>594.34</b>   | <b>25.00</b>  | <b>277.52</b>   | <b>1,595.99</b>  |
| <b>Consolidation adjustments</b>                            |          |                    | <b>(18.32)</b>     | –               | –             | –               | –             | –               | <b>(18.32)</b>   |
| <b>Total Group issues:</b>                                  |          |                    | <b>3,350.95</b>    | <b>1,570.63</b> | <b>675.99</b> | <b>1,015.05</b> | <b>825.00</b> | <b>5,134.53</b> | <b>12,572.15</b> |

## Appendix VI

The detail of the type of financial instruments arranged by the Group as of December by currency and interest rates at December 31, 2005 is as follows:

| Millions of euros                | 2006           | 2007         | 2008         | 2009         | 2010         | Subsequent<br>years | Total          |
|----------------------------------|----------------|--------------|--------------|--------------|--------------|---------------------|----------------|
| <b>EURO</b>                      | <b>10,299</b>  | <b>577</b>   | <b>331</b>   | <b>2,123</b> | <b>2,041</b> | <b>10,235</b>       | <b>25,606</b>  |
| Floating rate                    | 6,313          | (286)        | (426)        | 398          | (338)        | 2,035               | 7,696          |
| Spread - Ref Euribor             | 0.03%          | (0.05)%      | 0.61%        | 1.27%        | (1.25)%      | 0.54%               | 0.26%          |
| Fixed rate                       | 3,979          | 855          | 750          | 325          | 2,154        | 7,000               | 15,063         |
| Interest rate                    | 3.03%          | 5.10%        | 4.18%        | 5.73%        | 7.06%        | 3.91%               | 4.25%          |
| Rate cap                         | 8              | 8            | 8            | 1,400        | 224          | 1,200               | 2,848          |
| <b>OTHER EUROPEAN CURRENCIES</b> | <b>(6,103)</b> | <b>-</b>     | <b>308</b>   | <b>515</b>   | <b>567</b>   | <b>-</b>            | <b>(4,713)</b> |
| <b>Instruments in CZK</b>        | <b>651</b>     | <b>-</b>     | <b>308</b>   | <b>515</b>   | <b>567</b>   | <b>-</b>            | <b>2,041</b>   |
| Floating rate                    | 717            | -            | -            | 0            | 361          | -                   | 1,078          |
| Spread                           | -              | -            | -            | 0.05%        | 0.02%        | -                   | 0.01%          |
| Fixed rate                       | (66)           | -            | 308          | 515          | 206          | -                   | 963            |
| Interest rate                    | 1.90%          | -            | 3.39%        | 3.15%        | 3.17%        | -                   | 3.32%          |
| <b>Instruments in GBP</b>        | <b>(6,755)</b> | <b>-</b>     | <b>-</b>     | <b>-</b>     | <b>-</b>     | <b>-</b>            | <b>(6,755)</b> |
| Floating rate                    | (6,755)        | -            | -            | -            | -            | -                   | (6,755)        |
| Spread                           | -              | -            | -            | -            | -            | -                   | -              |
| Fixed rate                       | -              | -            | -            | -            | -            | -                   | -              |
| Interest rate                    | -              | -            | -            | -            | -            | -                   | -              |
| <b>NORTH AND SOUTH AMERICA</b>   | <b>859</b>     | <b>1,777</b> | <b>1,245</b> | <b>1,450</b> | <b>919</b>   | <b>2,166</b>        | <b>8,416</b>   |
| <b>Instruments in USD</b>        | <b>(980)</b>   | <b>183</b>   | <b>515</b>   | <b>973</b>   | <b>361</b>   | <b>1,748</b>        | <b>2,800</b>   |
| Floating rate                    | (615)          | (136)        | 288          | 44           | -            | 223                 | (196)          |
| Spread                           | (0.57)%        | (0.65)%      | 0.22%        | (4.30)%      | -            | 0.59%               | (2.25)%        |
| Fixed rate                       | (365)          | 319          | 215          | 70           | 180          | 1,454               | 1,873          |
| Interest rate                    | 1.02%          | 8.92%        | 7.10%        | 5.02%        | 9.93%        | 7.68%               | 9.23%          |
| Rate cap                         | -              | -            | 12           | 859          | 181          | 71                  | 1,123          |
| <b>Instruments in ARS</b>        | <b>438</b>     | <b>93</b>    | <b>-</b>     | <b>-</b>     | <b>-</b>     | <b>-</b>            | <b>531</b>     |
| Floating rate                    | 136            | -            | -            | -            | -            | -                   | 136            |
| Spread                           | -              | -            | -            | -            | -            | -                   | 0              |
| Fixed rate                       | 285            | 79           | -            | -            | -            | 0                   | 364            |
| Interest rate                    | 7.88%          | 8.77%        | -            | -            | -            | 10.38%              | 8.08%          |
| Rate cap                         | 18             | 14           | -            | -            | -            | -                   | 32             |
| <b>Instruments in BRL</b>        | <b>370</b>     | <b>1,047</b> | <b>213</b>   | <b>100</b>   | <b>148</b>   | <b>25</b>           | <b>1,903</b>   |
| Floating rate                    | 203            | 1,047        | 213          | 100          | 148          | 25                  | 1,736          |
| Spread                           | (1.43)%        | (0.30)%      | (1.69)%      | (3.62)%      | -            | 2.69                | (0.72)%        |
| Fixed rate                       | 167            | -            | -            | -            | -            | -                   | 167            |
| Interest rate                    | 10.38%         | -            | -            | -            | -            | -                   | 10.38%         |
| <b>Instruments in CLP</b>        | <b>441</b>     | <b>100</b>   | <b>217</b>   | <b>79</b>    | <b>-</b>     | <b>-</b>            | <b>837</b>     |
| Floating rate                    | 300            | -            | 20           | 18           | -            | -                   | 338            |
| Spread                           | -              | -            | (0.28)%      | (0.33)%      | -            | -                   | (0.03)%        |
| Fixed rate                       | 142            | 100          | 197          | 62           | -            | -                   | 501            |
| Interest rate                    | 4.28%          | 4.45%        | 4.80%        | 5.07%        | -            | -                   | 4.62%          |
| <b>Instruments in UFC</b>        | <b>73</b>      | <b>3</b>     | <b>150</b>   | <b>194</b>   | <b>109</b>   | <b>75</b>           | <b>604</b>     |
| Floating rate                    | 70             | -            | -            | -            | 106          | -                   | 176            |
| Spread                           | 0.08%          | -            | -            | -            | 0.45%        | -                   | 0.30%          |
| Fixed rate                       | 3              | 3            | 150          | 194          | 3            | 75                  | 428            |
| Interest rate                    | 6.49%          | 6.49%        | 2.57%        | 3.51%        | 6.49%        | 4.74%               | 3.45%          |
| <b>Instruments in PEN</b>        | <b>261</b>     | <b>214</b>   | <b>16</b>    | <b>11</b>    | <b>23</b>    | <b>196</b>          | <b>721</b>     |
| Floating rate                    | 43             | 25           | -            | -            | -            | -                   | 68             |
| Spread                           | -              | -            | -            | -            | -            | -                   | -              |
| Fixed rate                       | 219            | 190          | 16           | 11           | 23           | 196                 | 655            |
| Interest rate                    | 6.10%          | 5.80%        | 7.94%        | 7.00%        | 6.07%        | 7.99%               | 6.64%          |
| <b>Instruments in COP</b>        | <b>242</b>     | <b>58</b>    | <b>128</b>   | <b>-</b>     | <b>-</b>     | <b>5</b>            | <b>433</b>     |
| Floating rate                    | 97             | -            | 0            | -            | -            | 0                   | 97             |
| Spread                           | 0.00%          | -            | 6.50%        | -            | -            | 6.50%               | 0.00%          |
| Fixed rate                       | 146            | 58           | 128          | -            | -            | 5                   | 337            |
| Interest rate                    | 9.51%          | 8.79%        | 8.04%        | -            | -            | 9.50%               | 8.83%          |

| Millions of euros          | 2006         | 2007         | 2008         | 2009         | 2010         | Subsequent<br>years | Total         |
|----------------------------|--------------|--------------|--------------|--------------|--------------|---------------------|---------------|
| <b>Instruments in VEB</b>  | <b>(639)</b> | <b>-</b>     | <b>-</b>     | <b>-</b>     | <b>-</b>     | <b>-</b>            | <b>(639)</b>  |
| Floating rate              | -            | -            | -            | -            | -            | -                   | -             |
| Spread                     | -            | -            | -            | -            | -            | -                   | -             |
| Fixed rate                 | (639)        | -            | -            | -            | -            | -                   | (639)         |
| Interest rate              | 8.91%        | -            | -            | -            | -            | -                   | 8.91%         |
| <b>Instruments in MXN</b>  | <b>647</b>   | <b>80</b>    | <b>7</b>     | <b>92</b>    | <b>279</b>   | <b>118</b>          | <b>1,223</b>  |
| Floating rate              | 702          | 13           | 3            | 88           | 277          | -                   | 1,083         |
| Spread                     | (0.01)%      | (0.66)%      | (0.52)%      | 2.59%        | 0.60%        | -                   | 0.35%         |
| Fixed rate                 | (56)         | 67           | 3            | 3            | 2            | 118                 | 137           |
| Interest rate              | 2.61%        | 7.93%        | 8.83%        | 8.83%        | 8.83%        | 9.25%               | 11.27%        |
| <b>Instruments in GTQ</b>  | <b>5</b>     | <b>-</b>     | <b>-</b>     | <b>-</b>     | <b>-</b>     | <b>-</b>            | <b>5</b>      |
| Floating rate              | 15           | -            | -            | -            | -            | -                   | 15            |
| Spread                     | -            | -            | -            | -            | -            | -                   | -             |
| Fixed rate                 | (10)         | -            | -            | -            | -            | -                   | (10)          |
| Interest rate              | 2.00%        | -            | -            | -            | -            | -                   | 2.00%         |
| <b>ASIA</b>                | <b>1</b>     | <b>(1)</b>   | <b>0</b>     | <b>0</b>     | <b>-</b>     | <b>1</b>            | <b>1</b>      |
| <b>Instruments in JPY</b>  | <b>1</b>     | <b>(1)</b>   | <b>0</b>     | <b>0</b>     | <b>-</b>     | <b>1</b>            | <b>1</b>      |
| Floating rate              | 1            | 0            | 0            | 0            | -            | 1                   | 2             |
| Spread                     | 3.79%        | 3.79%        | 3.79%        | 1.25%        | -            | 3.79%               | 3.79%         |
| Fixed rate                 | -            | (1)          | -            | -            | -            | -                   | (1)           |
| Interest rate              | (1.64)%      | 2.16%        | -            | -            | -            | 2.30%               | 3.76%         |
| <b>AFRICA</b>              | <b>-</b>     | <b>-</b>     | <b>-</b>     | <b>-</b>     | <b>-</b>     | <b>91</b>           | <b>91</b>     |
| <b>Instruments in MAD</b>  | <b>-</b>     | <b>-</b>     | <b>-</b>     | <b>-</b>     | <b>-</b>     | <b>91</b>           | <b>91</b>     |
| Floating rate              | -            | -            | -            | -            | -            | -                   | -             |
| Spread                     | -            | -            | -            | -            | -            | -                   | -             |
| Fixed rate                 | -            | -            | -            | -            | -            | 91                  | 91            |
| Interest rate              | -            | -            | -            | -            | -            | 4.54%               | 4.54%         |
| <b>TOTAL</b>               | <b>5,056</b> | <b>2,353</b> | <b>1,884</b> | <b>4,088</b> | <b>3,527</b> | <b>12,493</b>       | <b>29,401</b> |
| <b>Total floating rate</b> | <b>1,226</b> | <b>662</b>   | <b>98</b>    | <b>648</b>   | <b>554</b>   | <b>2,283</b>        | <b>5,471</b>  |
| <b>Total fixed rate</b>    | <b>3,804</b> | <b>1,669</b> | <b>1,767</b> | <b>1,179</b> | <b>2,568</b> | <b>8,939</b>        | <b>19,926</b> |
| <b>Total rate cap</b>      | <b>26</b>    | <b>21</b>    | <b>19</b>    | <b>2,259</b> | <b>406</b>   | <b>1,271</b>        | <b>4,002</b>  |
| <b>Currency options</b>    | <b>(15)</b>  | <b>-</b>     | <b>-</b>     | <b>-</b>     | <b>-</b>     | <b>-</b>            | <b>(15)</b>   |
| <b>Other</b>               |              |              |              |              |              |                     | <b>502</b>    |

| (Euros)                |           | Maturities |            |               |             |               |
|------------------------|-----------|------------|------------|---------------|-------------|---------------|
| Interest Rate Options  | 2006      | 2007       | 2008       | 2009          | 2010        | 2011+         |
| <b>Collars</b>         |           |            |            |               |             |               |
| Notional amount bought | 7,512,651 | 7,512,651  | 19,285,889 | 2,259,446,375 | 11,773,238  | 70,639,428    |
| Strike Cap             | 5.520%    | 5.520%     | 4.745%     | 3.725%        | 4.250%      | 4.250%        |
| Strike Floor           | 5.415%    | 5.415%     | 3.941%     | 2.740%        | 3.000%      | 3.000%        |
| Notional amount sold   | -         | -          | -          | -             | -           | 1,500,000,000 |
| Strike Cap             | -         | -          | -          | -             | -           | 6.823%        |
| Strike Floor           | -         | -          | -          | -             | -           | 4.184%        |
| <b>Caps</b>            |           |            |            |               |             |               |
| Notional amount sold   | 7,512,651 | 7,512,651  | 19,285,889 | 2,559,446,375 | 11,773,238  | 70,639,428    |
| Strike                 | 7.000%    | 7.000%     | 6.237%     | 3.796%        | 5.750%      | 5.750%        |
| <b>Floors</b>          |           |            |            |               |             |               |
| Notional amount bought | -         | -          | -          | 2,247,673,137 | -           | -             |
| Strike                 | -         | -          | -          | 0.010%        | -           | -             |
| Notional amount sold   | -         | -          | -          | -             | 393,800,158 | 700,000,000   |
| Strike                 | -         | -          | -          | -             | 4.431%      | 2.146%        |

| (Euros)                           |               | Maturities |      |      |      |       |
|-----------------------------------|---------------|------------|------|------|------|-------|
| Currency Options                  | 2006          | 2007       | 2008 | 2009 | 2010 | 2011+ |
| <b>Call USD / Put ARS</b>         |               |            |      |      |      |       |
| Notional amount of options bought | 212,919,154   | -          | -    | -    | -    | -     |
| Strike                            | 2.9645        | -          | -    | -    | -    | -     |
| Notional amount of options sold   | 312,081,925   | -          | -    | -    | -    | -     |
| Strike                            | 3.1168        | -          | -    | -    | -    | -     |
| <b>Put USD / Call ARS</b>         |               |            |      |      |      |       |
| Notional amount of options sold   | 46,201,302    | -          | -    | -    | -    | -     |
| Strike                            | 2.7200        | -          | -    | -    | -    | -     |
| <b>Call USD / Put MXN</b>         |               |            |      |      |      |       |
| Notional amount of options bought | 77,731,627    | -          | -    | -    | -    | -     |
| Strike                            | 11.4550       | -          | -    | -    | -    | -     |
| Notional amount of options sold   | 77,731,627    | -          | -    | -    | -    | -     |
| Strike                            | 12.4550       | -          | -    | -    | -    | -     |
| <b>Put USD / Call EUR</b>         |               |            |      |      |      |       |
| Notional amount of options bought | 1,380,494,535 | -          | -    | -    | -    | -     |
| Strike                            | 1.2108        | -          | -    | -    | -    | -     |
| Notional amount of options sold   | 1,122,785,454 | -          | -    | -    | -    | -     |
| Strike                            | 1.2644        | -          | -    | -    | -    | -     |

The detail of the type of financial instruments arranged by the Group (notional amount) by currency and interest rates at December 31, 2004 is as follows:

| Millions of euros                | 2005           | 2006         | 2007       | 2008         | 2009         | Subsequent<br>years | Total          |
|----------------------------------|----------------|--------------|------------|--------------|--------------|---------------------|----------------|
| <b>EURO</b>                      | <b>5,755</b>   | <b>2,125</b> | <b>534</b> | <b>774</b>   | <b>1,286</b> | <b>4,960</b>        | <b>15,434</b>  |
| Floating rate                    | (3)            | 6            | (286)      | (47)         | (2)          | 137                 | (195)          |
| Spread - Ref Euribor             | (776.70)%      | 34.24%       | (0.05)%    | 5.36%        | (72.67)%     | 3.12%               | (12.95)%       |
| Fixed rate                       | 5,309          | 2,111        | 812        | 814          | 788          | 4,599               | 14,433         |
| Interest rate                    | 4.58%          | 3.97%        | 5.27%      | 4.16%        | 4.24%        | 6.07%               | 4.96%          |
| Rate cap                         | 448            | 8            | 8          | 8            | 500          | 224                 | 1,196          |
| <b>OTHER EUROPEAN CURRENCIES</b> | <b>-</b>       | <b>-</b>     | <b>-</b>   | <b>-</b>     | <b>-</b>     | <b>-</b>            | <b>-</b>       |
| <b>Instruments in GBP</b>        | <b>-</b>       | <b>-</b>     | <b>-</b>   | <b>-</b>     | <b>-</b>     | <b>-</b>            | <b>-</b>       |
| Floating rate                    | -              | -            | -          | -            | -            | -                   | -              |
| Spread                           | -              | -            | -          | -            | -            | -                   | -              |
| Fixed rate                       | -              | -            | -          | -            | -            | -                   | -              |
| Interest rate                    | -              | -            | -          | -            | -            | -                   | -              |
| <b>Instruments in CHF</b>        | <b>-</b>       | <b>-</b>     | <b>-</b>   | <b>-</b>     | <b>-</b>     | <b>-</b>            | <b>-</b>       |
| Floating rate                    | -              | -            | -          | -            | -            | -                   | -              |
| Spread                           | -              | -            | -          | -            | -            | -                   | -              |
| Fixed rate                       | -              | -            | -          | -            | -            | -                   | -              |
| Interest rate                    | -              | -            | -          | -            | -            | -                   | -              |
| <b>NORTH AND SOUTH AMERICA</b>   | <b>200</b>     | <b>739</b>   | <b>740</b> | <b>1,054</b> | <b>907</b>   | <b>1,635</b>        | <b>5,275</b>   |
| <b>Instruments in USD</b>        | <b>(1,776)</b> | <b>23</b>    | <b>316</b> | <b>235</b>   | <b>629</b>   | <b>1,600</b>        | <b>(1,027)</b> |
| Floating rate                    | (699)          | (155)        | 45         | 73           | -            | (5)                 | (741)          |
| Spread                           | (0.33)%        | (0.66)%      | 3.81%      | 1.20%        | -            | (10.38)%            | (0.87)%        |
| Fixed rate                       | (428)          | 179          | 271        | 152          | 61           | 1,387               | (1,622)        |
| Interest rate                    | 7.34%          | 9.77%        | 9.43%      | 7.24%        | 5.02%        | 7.89%               | 8.33%          |
| Rate cap                         | (650)          | -            | -          | 10           | 568          | 218                 | 146            |
| <b>Instruments in CAD</b>        | <b>-</b>       | <b>-</b>     | <b>-</b>   | <b>-</b>     | <b>-</b>     | <b>-</b>            | <b>-</b>       |
| Floating rate                    | -              | -            | -          | -            | -            | -                   | -              |
| Spread                           | -              | -            | -          | -            | -            | -                   | -              |
| Fixed rate                       | -              | -            | -          | -            | -            | -                   | -              |
| Interest rate                    | 3.00%          | -            | -          | -            | -            | -                   | 3.00%          |
| <b>Instruments in ARS</b>        | <b>133</b>     | <b>59</b>    | <b>54</b>  | <b>-</b>     | <b>-</b>     | <b>-</b>            | <b>246</b>     |
| Floating rate                    | 66             | 16           | 1          | -            | -            | -                   | 83             |
| Spread                           | -              | 2.40%        | -          | -            | -            | -                   | 0.47%          |
| Fixed rate                       | 68             | 43           | 54         | -            | -            | -                   | 165            |
| Interest rate                    | 8.83%          | 8.64%        | 9.27%      | -            | -            | 10.38%              | 8.92%          |
| <b>Instruments in BRL</b>        | <b>493</b>     | <b>307</b>   | <b>117</b> | <b>544</b>   | <b>49</b>    | <b>9</b>            | <b>1,519</b>   |
| Floating rate                    | 15             | 260          | 117        | 544          | 49           | 9                   | 994            |
| Spread                           | (7.68)%        | (0.95)%      | (2.06)%    | (0.50)%      | (5.59)%      | -                   | (1.16)%        |
| Fixed rate                       | 478            | 48           | -          | -            | -            | -                   | 526            |
| Interest rate                    | 15.68%         | -            | -          | -            | -            | -                   | 14.26%         |
| <b>Instruments in CLP</b>        | <b>241</b>     | <b>11</b>    | <b>80</b>  | <b>173</b>   | <b>63</b>    | <b>-</b>            | <b>568</b>     |
| Floating rate                    | 368            | -            | -          | 16           | 14           | -                   | 398            |
| Spread                           | -              | -            | -          | (0.28)%      | (0.33)%      | -                   | (0.02)%        |
| Fixed rate                       | (127)          | 11           | 80         | 157          | 49           | -                   | 170            |
| Interest rate                    | 3.42%          | 3.30%        | 4.45%      | 4.80%        | 5.07%        | -                   | 5.66%          |
| <b>Instruments in UFC</b>        | <b>390</b>     | <b>27</b>    | <b>2</b>   | <b>83</b>    | <b>151</b>   | <b>12</b>           | <b>665</b>     |
| Floating rate                    | 300            | 25           | -          | 81           | -            | -                   | 406            |
| Spread                           | 0.03%          | 0.33%        | -          | 0.95%        | -            | -                   | 0.23%          |
| Fixed rate                       | 91             | 2            | 2          | 2            | 151          | 12                  | 260            |
| Interest rate                    | 6.74%          | 6.49%        | 6.49%      | 6.49%        | 3.50%        | 6.17%               | 4.83%          |
| <b>Instruments in PEN</b>        | <b>393</b>     | <b>119</b>   | <b>75</b>  | <b>14</b>    | <b>10</b>    | <b>12</b>           | <b>623</b>     |
| Floating rate                    | 137            | 2            | -          | -            | -            | -                   | 139            |
| Spread                           | -              | -            | -          | -            | -            | -                   | -              |
| Fixed rate                       | 256            | 117          | 75         | 14           | 10           | 12                  | 484            |
| Interest rate                    | 5.08%          | 6.06%        | 6.33%      | 7.94%        | 7.00%        | 5.00%               | 5.63%          |



| Millions of euros          | 2005         | 2006         | 2007         | 2008         | 2009         | Subsequent<br>years | Total         |
|----------------------------|--------------|--------------|--------------|--------------|--------------|---------------------|---------------|
| <b>Instruments in COP</b>  | <b>132</b>   | <b>101</b>   | <b>30</b>    | <b>-</b>     | <b>-</b>     | <b>-</b>            | <b>263</b>    |
| Floating rate              | 129          | 5            | -            | -            | -            | -                   | 134           |
| Spread                     | 0.35%        | 4.00%        | -            | -            | -            | -                   | 0.50%         |
| Fixed rate                 | 4            | 96           | 30           | -            | -            | -                   | 130           |
| Interest rate              | 15.00%       | 9.65%        | 10.55%       | -            | -            | -                   | 10.01%        |
| <b>Instruments in VEB</b>  | <b>-</b>     | <b>-</b>     | <b>-</b>     | <b>-</b>     | <b>-</b>     | <b>-</b>            | <b>-</b>      |
| Floating rate              | -            | -            | -            | -            | -            | -                   | -             |
| Spread                     | -            | -            | -            | -            | -            | -                   | -             |
| Fixed rate                 | -            | -            | -            | -            | -            | -                   | -             |
| Interest rate              | -            | -            | -            | -            | -            | -                   | -             |
| <b>Instruments in MXN</b>  | <b>192</b>   | <b>92</b>    | <b>66</b>    | <b>5</b>     | <b>5</b>     | <b>3</b>            | <b>363</b>    |
| Floating rate              | 88           | 3            | 11           | 3            | 3            | 1                   | 109           |
| Spread                     | (0.37)%      | (0.52)%      | (0.66)%      | (0.52)%      | (0.52)%      | (0.52)%             | (0.41)%       |
| Fixed rate                 | 104          | 89           | 55           | 3            | 3            | 1                   | 255           |
| Interest rate              | 8.09%        | 7.75%        | 7.93%        | 8.83%        | 8.83%        | 8.83%               | 7.96%         |
| <b>Instruments in GTQ</b>  | <b>1</b>     | <b>-</b>     | <b>-</b>     | <b>-</b>     | <b>-</b>     | <b>-</b>            | <b>1</b>      |
| Floating rate              | -            | -            | -            | -            | -            | -                   | -             |
| Spread                     | -            | -            | -            | -            | -            | -                   | -             |
| Fixed rate                 | 1            | -            | -            | -            | -            | -                   | 1             |
| Interest rate              | 10.50%       | -            | -            | -            | -            | -                   | 10.50%        |
| <b>ASIA</b>                | <b>(1)</b>   | <b>0</b>     | <b>1</b>     | <b>-</b>     | <b>-</b>     | <b>-</b>            | <b>0</b>      |
| <b>Instruments in JPY</b>  | <b>(1)</b>   | <b>0</b>     | <b>1</b>     | <b>-</b>     | <b>-</b>     | <b>-</b>            | <b>0</b>      |
| Floating rate              | 0            | 0            | 1            | -            | -            | -                   | 1             |
| Spread                     | 3.79%        | 3.79%        | 3.79%        | -            | -            | -                   | 3.79%         |
| Fixed rate                 | (2)          | -            | -            | -            | -            | -                   | (2)           |
| Interest rate              | -            | -            | -            | -            | -            | -                   | -             |
| <b>AFRICA</b>              | <b>31</b>    | <b>-</b>     | <b>-</b>     | <b>-</b>     | <b>-</b>     | <b>-</b>            | <b>31</b>     |
| <b>Instruments in MAD</b>  | <b>31</b>    | <b>-</b>     | <b>-</b>     | <b>-</b>     | <b>-</b>     | <b>-</b>            | <b>31</b>     |
| Floating rate              | -            | -            | -            | -            | -            | -                   | -             |
| Spread                     | -            | -            | -            | -            | -            | -                   | -             |
| Fixed rate                 | 31           | -            | -            | -            | -            | -                   | 31            |
| Interest rate              | 4.23%        | -            | -            | -            | -            | -                   | 4.23%         |
| <b>TOTAL</b>               | <b>5,985</b> | <b>2,864</b> | <b>1,275</b> | <b>1,828</b> | <b>2,193</b> | <b>6,595</b>        | <b>20,740</b> |
| <b>Total floating rate</b> | <b>400</b>   | <b>162</b>   | <b>(113)</b> | <b>669</b>   | <b>63</b>    | <b>142</b>          | <b>1,323</b>  |
| <b>Total fixed rate</b>    | <b>5,786</b> | <b>2,695</b> | <b>1,379</b> | <b>1,141</b> | <b>1,062</b> | <b>6,011</b>        | <b>18,074</b> |
| <b>Total rate cap</b>      | <b>(202)</b> | <b>8</b>     | <b>8</b>     | <b>18</b>    | <b>1,068</b> | <b>442</b>          | <b>1,342</b>  |
| <b>Currency options</b>    | <b>(25)</b>  | <b>-</b>     | <b>-</b>     | <b>-</b>     | <b>-</b>     | <b>-</b>            | <b>(25)</b>   |
| <b>Other</b>               |              |              |              |              |              |                     | <b>268</b>    |
| <b>Net</b>                 |              |              |              |              |              |                     | <b>20,982</b> |

| (Euros)                | Maturities    |      |      |            |               |               |
|------------------------|---------------|------|------|------------|---------------|---------------|
| Interest RATE OPTIONS  | 2005          | 2006 | 2007 | 2008       | 2009          | 2010+         |
| <b>Collars</b>         |               |      |      |            |               |               |
| Notional amount bought | 3,385,015,018 | –    | –    | 60,101,210 | 2,134,160,487 | 1,591,770,061 |
| Strike Cap             | 2.483%        | –    | –    | 5.520%     | 3.694%        | 6.675%        |
| Strike Floor           | 2.259%        | –    | –    | 5.415%     | 2.740%        | 4.416%        |
| <b>Caps</b>            |               |      |      |            |               |               |
| Notional amount sold   | 3,385,015,018 | –    | –    | 60,101,210 | 2,434,160,487 | 91,770,061    |
| Strike                 | 2.941%        | –    | –    | 7.000%     | 4.628%        | 5.750%        |
| <b>Floors</b>          |               |      |      |            |               |               |
| Notional amount sold   | 1,400,000,000 | –    | –    | –          | –             | 1,071,097,628 |
| Strike                 | 2.400%        | –    | –    | –          | –             | 2.914%        |
| Notional amount bought | 400,000,000   | –    | –    | –          | –             | –             |
| Strike                 | 2.125%        | –    | –    | –          | –             | –             |

| (Euros)                           | Maturities    |      |      |      |      |       |
|-----------------------------------|---------------|------|------|------|------|-------|
| Currency Options                  | 2005          | 2006 | 2007 | 2008 | 2009 | 2010+ |
| <b>Call USD / Put ARS</b>         |               |      |      |      |      |       |
| Notional amount of options bought | 199,397,988   | –    | –    | –    | –    | –     |
| Strike                            | 3.0726        | –    | –    | –    | –    | –     |
| Notional amount of options sold   | 176,973,309   | –    | –    | –    | –    | –     |
| Strike                            | 3.5036        | –    | –    | –    | –    | –     |
| <b>Put USD / Call ARS</b>         |               |      |      |      |      |       |
| Notional amount of options bought | –             | –    | –    | –    | –    | –     |
| Strike                            | –             | –    | –    | –    | –    | –     |
| Notional amount of options sold   | 209,102,840   | –    | –    | –    | –    | –     |
| Strike                            | 2.8914        | –    | –    | –    | –    | –     |
| <b>Call USD / Put EUR</b>         |               |      |      |      |      |       |
| Notional amount of options bought | 181,337,640   | –    | –    | –    | –    | –     |
| Strike                            | 1.3315        | –    | –    | –    | –    | –     |
| Notional amount of options sold   | 40,378,827    | –    | –    | –    | –    | –     |
| Strike                            | 1.3354        | –    | –    | –    | –    | –     |
| <b>Put USD / Call EUR</b>         |               |      |      |      |      |       |
| Notional amount of options bought | 1,054,254,460 | –    | –    | –    | –    | –     |
| Strike                            | 1.3255        | –    | –    | –    | –    | –     |
| Notional amount of options sold   | 671,756,846   | –    | –    | –    | –    | –     |
| Strike                            | 1.3588        | –    | –    | –    | –    | –     |

## CONSOLIDATED MANAGEMENT REPORT OF THE TELEFÓNICA GROUP 2005

In 2005, the Telefónica Group continued to pursue its international expansion strategy, gaining a global dimension and becoming the benchmark telecommunications operator. During the year, Telefónica completed the integration of BellSouth's 10 Latin American cellular operators, acquired Czech operator Cesky Telecom and initiated the purchase of UK operator O2, which was completed successfully in January 2006. It also made a strategic investment in China Netcom. With these acquisitions, Telefónica has strengthened its position in Europe, where its presence was smaller. This new global dimension will enable Telefónica to serve its customers better and more efficiently, while giving rise to substantial synergies in the day-to-day running of the business.

In addition, Telefónica increased its customer base by 24% in an increasingly competitive market, which required a substantial commercial effort to defend our position. At year end 2005, Telefónica had a total customer base of over 150 million, of which 98 million were cellular customers, 41 wireline customers and 13 million data and internet customers.

Telefónica Group delivered an excellent earnings performance in 2005, driven by the international expansion of its customer base, enhanced operating efficiency and innovation efforts, making Telefónica one of the industry's major players and confirming its strategy of becoming the telecommunications operator that offers its shareholders the best combination of profitability and growth.

Net revenues rose 25.1%, driven by the addition of Cesky and the ten BellSouth operators. Organic growth; i.e. stripping out the impact of the change in the consolidated group and exchange rate fluctuations, was 9.3%. The performance of operating expenses<sup>1</sup> reflected the Group's concerted commercial efforts to broaden and consolidate both the wireless and broadband customer bases in Spain and Latin America. These efforts led to higher revenues and a larger customer base, which fed through to a 25% increase in OIBDA (operating income before depreciation and amortization) to 15,276.4 million euros (organic growth of 9.9%). Better operating and financial results enabled Telefónica to post net income for the full year of 4,445.8 million euros, an increase of 40.0%.

Investment in PP&E and intangible assets (capex) totaled 5,468.6 million euros, 45.1% more than in 2004, mainly reflecting the acquisition of Cesky and the ten BellSouth operators. Investment highlights included the deployment of ADSL in both Spain and Latin America; the investment in wireless operators for the roll-out of the new GSM networks and to boost coverage and capacity of existing networks; the upgrading of Latin American wireline operating systems; and the construction of the Telefónica Group's new corporate headquarters in Madrid (District C). The capex/revenues ratio was 14.4%, reflecting the shift towards heavier investment while abiding by strict profitability criteria and maximizing shareholder returns.

The Telefónica Group had to manage its businesses in an increasingly tough environment, characterized by the strong

commercial pressure by competitors, the globalization of business, rapid technological development and the need to anticipate changes to meet customers' needs. Accordingly, the Group focused on the main market drivers: new products associated with broadband, mobility, solutions and multimedia. To do so, Telefónica has transformed its business model to become a clearly customer-oriented Group and, consequently, it has anticipated industry changes and now manages its business with greater operating efficiency.

The year's good results and the success of its strategy will enable Telefónica to maintain its shareholder remuneration policy. In April 2005, the Company announced its decision to renew its current share buyback program, saying it was planning on buying back up to a total of 6,000 million euros worth of its own shares and extending the program until 2007.

Going forward, the Telefónica Group plans to continue with its strategy of making the customer the cornerstone of the Group by focusing on operating excellence, innovation as a competitive edge and personnel motivation. This new global dimension poses a challenge for Telefónica to maximize the synergies derived from the inclusion of new companies so it can leverage economies of scale and offer customers a higher quality service.

### *Organization by business line*

In 2005 Telefónica maintained the organizational model by business line established in 2004, with the aim of ensuring a stronger management focus on the core businesses and achieving a leaner asset and cost structure.

The main organizational changes in the year were as follows:

- The completion of the acquisition of 100% of BellSouth Chile and BellSouth Argentina (Movicom) in January. This marked the last step in the integration of the BellSouth operators into the wireless business begun in 2004. In those countries where Telefónica was already present (Argentina, Chile, Guatemala and Peru), the two companies merged.
- Approval in February of the takeover of Terra Networks by Telefónica, S.A. This merger signals a return to the model based on the operational integration of the telephony and internet businesses, reflecting broader market trends –growth of broadband has increasingly blurred the line distinguishing these two businesses. Results in 2005 reflect the integration of the Terra Networks companies into the wireline telephony operators as of July 2005.
- The purchase of Cesky Telecom, approved in June, and its inclusion in the Group's consolidation scope in July 2005. Telefónica can use Cesky Telecom, the leading wireline and wireless operator in the Czech Republic, as a springboard for its profitable growth strategy.

Management comments in this report refer to the financial performance of the Telefónica Group based on this organizational structure. The assumptions underlying the comments by Business Line do not in any way alter the overall results obtained by the Telefónica Group.

Finally, at the end of December 2005 Telefónica adapted its organizational structure to its new multinational dimension and to

<sup>1</sup> Includes supplies, personnel, capitalized work on PP&E and tax under new IAS criteria.

its corporate integration and cultural change objectives. This new strategy aims to: maximize synergy benefits, continue to transform Telefónica into a customer-oriented group that emphasizes operating excellence, innovation and talent management, and anticipate market trends in order to offer integrated solutions to each customer segment.

In this respect, the Telefónica Group is organized around four Business Lines: Telefónica de España, Telefónica Móviles, Telefónica Latinoamérica and O2, which includes the businesses of Cesky Telecom, Telefónica Deutschland and O2. The businesses of TPI, Endemol, Atento, Telefónica Servicios Audiovisuales, Telefé and subsidiaries and investees are now managed by the Investees and Subsidiaries Division. This new organizational structure will come into effect as of 2006.

## Customers

The Telefónica Group's customer base ended 2005 at 154 million (including wireline telephony, data and internet access, cellular access and pay TV), 24% more than the year before. Cesky Telecom contributed 8.3 million access users (4.7 million cellular, 2.9 million wireline and 0.7 million data and internet access users) to the Group total.

Telefónica Móviles' managed customer base rose from 74.4 million to 94.4 million in the year, cementing its position as one of the world's largest wireless operators. The sharp 27% increase was mainly driven by the incorporation of BellSouth customers in Chile and Argentina, the strong commercial efforts and the international launch of the Movistar brand.

In Spain Telefónica Móviles is defending its leadership position in what is now a mature market, with a customer base edging the twenty million mark by December 2005, 5% more than in 2004. Latin America saw rapid growth in practically all markets, with the region's access customers increasing by 17.8 million to 70.5 million.

In the wireline business, Telefónica de España managed 16.1 million wireline access customers and Telefónica Latinoamérica 21.6 million at the end of the year, 1% fewer and 1.5% more, respectively, compared to 2004.

In the broadband market, ADSL connections totaled 5.9 million in 2005, up from 3.9 million in 2004, largely driven by Spain, where net adds reached record figures thanks to the good acceptance of the "Duo" (ADSL+voice) and "Trio" (a combination of ADSL+voice+Imagenio TV) products launched in the last quarter of the year. The Telefónica Group remains strongly committed to this business, the pillar of future growth for wireline telephony operators. Accordingly, it has assigned considerable commercial efforts and a significant portion of investments to its development, for which new services and content associated with solutions and the multimedia environment are being designed. In 2005, once again the access speed of all the ADSL connections of Telefónica de España was doubled at no additional cost to users. Notable, too, was the marketing of Imagenio through more intense sales drives and the deployment of ADSL2+ technology, allowing the Group to close the year with more than 200,000 customers. In Latin America the ADSL business also recorded strong growth, primarily in Brazil and Argentina, fueled by the marketing and promotional campaigns carried out.

Finally, in broadband products we would highlight the T. Deutschland connections under the retail resale system, with over half a million users at the end of 2005.

To conclude, we point out that the Group also has 479,000 more pay TV customers, mostly from Cable Mágico in Peru.

## International expansion

In the pursuit of its growth strategy, the Telefónica Group has geared investment efforts towards the selective acquisition of leading wireline and/or wireless operators in their respective markets in order to obtain economies of scale so it can become even more competitive and profitable. Within this framework it completed the integration of the BellSouth wireless operators and the acquisition of Czech operator Cesky Telecom.

In January 2005 Telefónica Móviles concluded its purchase of all the BellSouth operators in Latin America with the acquisition of Movicom in Argentina and BellSouth Chile. In this way Telefónica Móviles has positioned itself as the only wireless operator in all the key markets in the region, leaving in better placed to capture the considerable growth potential of Latin America.

Among the key transactions of 2005 were the purchases in June and September of 69.4% of Czech operator Cesky Telecom with a view to boosting Telefónica's European presence. Cesky Telecom is the Czech Republic's leading wireline and wireless operator.

As part of its international expansion, we would highlight Telefónica's acquisition in June 2005 of 5% of telecommunications company China Netcom, securing access to a favorable framework for the joint acquisition of technology and infrastructure, the exchange of technical, operating and management know-how and cooperation between the two areas.

Finally, in October 2005 Telefónica announced the purchase of the UK wireless operator O2. This acquisition marks a major leap forward in Europe for the Group by consolidating its presence in Europe's two largest cellular markets, the UK and Germany, and significantly enlarging its customer base, which at December 2005 surpassed 180 million. It also provides considerable strategic benefits: with O2, Telefónica becomes the world's fourth largest wireless operator and Europe's fastest-growing operator.

## Regulatory environment

In Europe, 2005 marked a transition year on the regulatory front. The highlight was the official start of debate on the reform of the regulatory framework and the list of markets subject to regulation, two issues with major implications for levels of investment and innovation in the years ahead.

In Spain the publication of the regulations on universal service and user protection stands out. Here we would point out the public consultation aimed at learning the interest of other operators in providing universal service as of January 2008, when Telefónica de España's current obligation expires.

In wireline, the price-cap system allowed for a 2% increase in line rental and a 1% reduction in service charges as a whole. In addition, call/termination rates in the Telefónica Móviles España network declined by 10.6%. In wireless, social and regulatory pressure led Telefónica Móviles España to launch a type of contract with billing per second.

In broadband, the telecommunications regulator, the CMT, approved several of Telefónica de España's proposals for the sale of voice-data and voice-data-TV packages, as well as ADSL 2+ products, albeit limited to exchanges where local loop is unbundled.

In addition, the Ministry for Industry, Tourism and Commerce assigned the radio spectrum led by the Moviline service and the cellular access rural telephony system (TRAC) to Amena and Telefónica Móviles España.

Telefónica concluded the integration BellSouth's cellular operators in Latin America and, consequently, in some countries the company resulting from the merger will have to dispose of part of its radio spectrum.

In Argentina, the Economic Emergency Law has been extended to December 2006, and the period for renegotiating contracts with the government has also been extended to that date.

In Brazil, Telesp's concession was extended for a further twenty years in January 2006. Tariffs were also rebalanced, in accordance the contract's provisions, leading to increases in call-termination charges in wireless networks, connection charges and monthly line rental, DLD and public phone rates and to disposals in international calls and interconnection prices.

In Chile, the tariff reduction came into effect at the beginning of 2005 –with retroactive effect from May 2004– with most of the operators have appealing the decree.

In Peru tariffs were adjusted, leading to a reduction in the monthly charge, the local rate of some packages offering unlimited use and the local rate for prepaid cards.

Finally, in Mexico Pegaso was authorized to provide SMS and MMS (multimedia messaging) services.

### Share price performance

Telefónica's share price fell by 8.3% in 2005 to 12.7 euros. This came amid a negative overall environment for the European telecommunications industry, with the sector as a whole ending the year down 1.8% and several of Telefónica's peers sustaining even larger losses (Telecom Italia -18.3%, Deutsche Telekom -15.4%, France Telecom -13.5%, British Telecom +9.7%). The sector's underperformance in Europe was due to the higher perception of risk (e.g. M&A, technological, business, regulatory and market) and a more propitious macroeconomic setting for other industries.

Despite Telefónica's poor performance, partly caused by uncertainty surrounding its acquisitions policy, the market highlighted its above-average growth vis-à-vis the industry, the high quality of its assets, solid execution of its business decisions, the integrated management of its operations, strong cash flow, a generous

shareholder remuneration policy (dividend plus share buyback), attractive valuation and the good macroeconomic trends in the emerging countries where it has exposure.

Telefónica's market cap at December 31, 2005 stood at 74,113 million US dollars, ranking sixth in the world among telecommunications operators. Vodafone led the ranking with a market cap of 133,240 million US dollars, followed by AT&T (95,836 million US dollar), China Mobile (93,805 million US dollars), Verizon (83,281 million US dollars) and NTTDoCoMo (74,477 million US dollars).

## Information on the Business Lines

### *Telefónica de España*

Since July 2005, the Telefónica de España Group includes Terra Networks' business in Spain in its consolidation scope.

Telefónica de España Group posted a 4.8% increase in operating revenues to 11,739.5 million euros. The growth, one of the highest of recent years, reflects the success of the company's increasing focus on broadband. The year saw increases in both retail and wholesale broadband services (40.2%), a good performance by data services (5.4%) and the development of IT services (38.9%). Driving the growth of broadband services was an increase in the total ADSL base, with net adds of nearly one million lines in the year. The increase in data services reflects higher revenues from circuit leasing and sale of capacity to other operators. And, finally, the positive performance of IT services is associated with the development of job outsourcing and systems integration. The good results of these services offset the decline in revenues from traditional voice and narrowband internet services.

Operating expenses for the Telefónica de España Group were 5% higher in 2005, at 7,213.7 million euros. This was due mainly to the growth in supplies and external services deriving from the strong commercial effort. Personnel expenses fell 0.8% owing to lower staff restructuring expenses vs. 2004 associated with the Labor Force Reduction Plans, which affected 1,877 employees of Telefónica de España and 68 of Telefónica Data España, S.A. in 2005. The Telefónica de España parent company ended the year with 33,279 employees, 1,766 fewer than in 2004. The productivity ratio was 623.5 equivalent lines per employee, an increase of 57.5 lines/employee.

OIBDA rose 4.5% to 4,766.8 million euros, leaving an OIBDA margin of 40.6%.

Capex totaled 1,406.6 million euros, an increase of 16.5%, prompted by higher demand for both ADSL and broadband services, the development of solutions services and maintenance capex in the traditional business.

The company had a total of 22 million access users (wireline telephony and data, internet and pay TV services), 2.8% more than the year before. The number of wireline telephony access users fell 1.2% to 16.2 million. The wireline business sustained a net loss in the customer base, but similar to that of 2004 owing to the positive impact of the free-of-charge sign-up campaigns carried out in April and September, which produced 210,000 gross adds. Telefónica de España had 3.4 million broadband access and 2.7 million retail ADSL accesses, signaling increases of 38.1% and 68.5%, respectively. Also noteworthy on the broadband side was the significant advance in

the number of leased loops, which climbed to 435 thousand. Of these, 156 thousand corresponded to fully unbundled lines and 279 thousand to shared lines. Finally, in pay TV the company closed 2005 with over 200,000 Imagenio customers.

The total estimated cumulative traffic volume of Telefónica de España declined by 10.4% to 110,207 million minutes in December 2005. Outgoing voice traffic fell by 7.2% and the number of minutes in outgoing internet traffic decreased by 27.8% owing to cannibalization by broadband ADSL services. Incoming traffic fell 6.4% to 50,789 million minutes as domestic traffic was spread out to other operators. Pre-assigned lines presented a positive balance, with a 4.0% drop vis-à-vis 2004 to 2.3 million lines.

Commercially and operationally, 2005 was marked by the success of the Group's pay TV service (Imagenio) and the broadband commercial effort. In the course of the year the Group undertook substantial efforts to deploy its Imagenio service and managed to give coverage to 33% of Spanish households, up from 11% at the start of the year. It also worked hard to improve and expand Imagenio's content by increasing its number of TV and audio channels and doubling video-on-demand.

In broadband services the Group enlarged the ADSL product range to include more flexible contracts based on time or volume. Again in 2005 it increased line speed twofold at no additional cost to customers in order to promote the expansion of the value-added services associated with this technology.

Finally, it is worth noting that in September the Group launched a range of packaged products that combine digital TV, ADSL and voice services under the of "Trios" trademark (a package comprising all three services) and "Duos" (a packages allowing customers to choose two of the three services). In just four months more than a million packages were sold, leading to record net adds of both ADSL lines and Imagenio customers in the year's last quarter.

Finally, the data and solutions business saw technology to IP-ADSL services migration, the deployment of systems outsourcing services and growth in integrated solutions products.

### *Telefónica Latinoamérica*

In Latin America, 2005 featured positive trends in all currencies vis-à-vis the dollar and a stable dollar against the euro, which had a positive impact on the income statement of this business line. In addition, Terra's business in Latin America was integrated in the region, with results consolidated from July.

Revenues rose 22.5% to 8,265.5 million euros. Stripping out the positive exchange rate effect and the impact of Terra Latam's inclusion, revenues were still up 6.2%, reflecting the good performance of all operators, particularly Telesp and TASA. Though smaller contributors, Telefónica Empresas and TIWS also grew notably, while growth at CTC and Telefónica del Perú was more muted due to stiff competition in Chile and the application of the productivity factor in Peru.

OIBDA from Latin America advanced 14.1% to 3,758.3 million euros, or 0.4% excluding the impact of exchange rates and the inclusion of Terra Latam. These growth rates were affected by the sale in 2004 of

the wireless unit in Chile for 425.9 million euros, and in 2005 of Infonet and Telinver in Argentina 1Q05 and 4Q05, respectively for a total of 128.4 million euros. Excluding these effects, OIBDA rose 26.5% (10.9% without the effects of exchange rates and the inclusion of Terra Latam).

Capex totaled 1,061.2 million euros, equivalent to 12.8% of revenues, with the bulk going to cover the rapid expansion of broadband services at all operators.

At the end of the year, Telefónica Latinoamérica's managed customer base stood at 28.2 million (wireline and data, internet and TV access), 7.0% more than in 2004, due mainly to the 86.4% growth of broadband access to 2.2 million lines and Terra Latam's inclusion. Wireline access users reached 21.6 million, up 1.5% on 2004, primarily driven by robust growth at TASA (4.8%) and Telefónica del Perú (9.8%).

Telefónica Latinoamérica had 28,856 permanent employees at the end of 2005, 10.6% more than the year before, due mainly to the acquisition of Atrium in Brazil (214 employees), the inclusion of Terra Latam (around 1,000 employees) and the in-sourcing of jobs, mostly at Telesp and TASA.

Highlights of the operation are as follows<sup>2</sup>:

**Telesp** remained committed to broadband services, recording a 46.0% increase in its customer base to 1.2 million despite tougher competition, particularly as of the last quarter of the year. Traditional lines in service virtually unchanged at 12.3 million, with a greater weight of usage-controlled products aimed at lower-income segments. The company's local market share rose significantly, to nearly 61%, while its shares of DLD and international traffic held stable at around 87% and 53%, respectively.

Telesp had 7,770 permanent employees at the end of the year, 9.1% more than in 2004, thanks to the inclusion of Atrium's employees and the in-sourcing of jobs associated with various specific systems and security activities.

The operator recorded a 7.9% increase in net revenues, largely owing to the growth of its portfolio of ADSL customers, the tariff hike and the good performance of public telephony and new value-added services. By contrast, operating expenses remained under tight control, driving a 9.5% increase in OIBDA.

**TASA's** traditional lines performed well, increasing by 4.8% to 4.5 million, driven by higher demand. Voice traffic also recorded strong growth of 6.9%, fuelled by the increase in the number of users and the large volume of traffic generated by the rapid growth of wireless telephony. Internet traffic, however, fell sharply owing to the negative impact of the migration of the best narrowband users to broadband services. The broadband business expanded significantly, with a 59.6% increase in the number of users to 303,500 at year end, giving the operator a 72% market share in its area of influence. We should also highlight the rise in TASA's productivity, with lines per employee increasing by 4.7% to 585.

In all, TASA achieved a 9.3% increase in revenues despite the tariff freeze in force since January 2002. Revenue growth was accompanied by higher commercial expenses, and the operator had to adapt the

<sup>2</sup> Year-on-year growth in local currency.



rest of its costs to the indexing applied by the majority of Argentine industries. As a result, expenses rose were higher than in 2004 despite the improvement in bad debts, which remained tightly controlled owing to the good performance of customer payments and the recovery of delinquent balances. OIBDA increased 17.0%, reflecting not only the good performance of revenues, but also the effect of the sale of Telinver in the year's last quarter.

**CTC** recorded 1.1% growth in net revenues, driven primarily by the growth of broadband business and, within its traditional business, traffic with wireless telephones; Chile's cellular market continues to expand rapidly. Despite the boom in the wireless market, the company managed to eke out an increase in the number of lines in service, to 2.4 million (up to 0.7%) thanks to per-minute contracts and flexible prepaid products, which together represent over 700,000 customers. The company also was firmly committed to broadband, with 314,200 customers at the end of the year, an increase of 56.5%, despite strong competitive pressure, primarily from cable operators.

Expenses were higher due mainly to the intense activity in network installations and maintenance, sales campaigns and customer service. OIBDA totaled 362.4 million euros, a fall of 57.2% on 2004. These figures, however, are not comparable because CTC's accounts reflect the sale in July 2004 of its wireless telephony subsidiary to Telefónica Móviles, generating a capital gain of 425 million euros. Finally, we would highlight the 11.4% improvement in productivity, with a productivity ratio of 968 lines per employee.

**Telefónica del Perú** continued marketing the tariff plans launched in 2003, increasing the number of lines in service considerably to 2.4 million, which help offset the decline in traditional business - this was hurt by the productivity factor, which prompted a fall in prices. Voice traffic grew by 2.2%, largely driven by local traffic and incoming international and wireless calls, while DLD traffic fell by 2.2% owing to strong competition. The broadband business was the year's star performer, with 65.7% growth in the number of users to 340,000.

Despite the negative impact of the productivity factor, broadband products drove a 1.6% increase in net revenues. Operating expenses were lower, mainly as a result of the better performance of bad debts and lower labor and tax contingencies. Underpinning a 15.1% increase in OIBDA.

**Telefónica Empresas América (TEA)** operates in the corporate segment in Brazil, Argentina, Chile, Peru, Colombia, Mexico and the US. Net revenues in 2005 amounted to 620.9 million euros, an 8.3% increase on 2004 excluding the positive exchange rate effect. OIBDA grew 62.1% to 102.2 million euros.

**TIWS** continues to achieve higher growth in both revenues and income. Net revenues rose 19.4% to 188.0 million euros, while OIBDA advanced 30.1% to 58.3 million euros.

### *Telefónica Móviles*

At the beginning of January, Telefónica Móviles finalized the acquisition of BellSouth cellular assets in Argentina and Chile. By the end of 2005, it was present in 15 countries, representing a total population of almost 500 million. Its operators in these countries all enjoy solid competitive positions (ranking first or second in the main markets).

The year featured the integration of the operators purchased from BellSouth, which led to significant savings, particularly in those countries where Telefónica Móviles was already present (Argentina, Chile, Guatemala and Peru), and to the unification of the product image under the Movistar brand. The company also embarked on a regionalization process to integrate the management of operations in Latin America around four regions: the northern region (Mexico, Guatemala, El Salvador, Nicaragua and Panama), Brazil, the Andean region (Colombia, Ecuador, Peru and Venezuela) and the Southern Cone (Argentina, Chile and Uruguay). This produced significant savings thanks to the joint development of various projects, most notably centralized infrastructure and handset management.

The strong growth of the penetration rate in Latin America produced a large increase in commercial activity in the main markets, in line with the Telefónica Móviles' commitment to expanding in the region's high potential markets, amid a fiercely competitive backdrop.

The year was also marked by the integration of the BellSouth operators, technological migration in six countries and strong competitive pressure, with the managed customer base reaching 94.4 million compared to 74.4 million in 2004, strengthening Telefónica Móviles' position as one of the world largest operators.

The wireless business generated net revenues of 16,513.5 million euros, a 38.1% increase from 2004. Organic growth (i.e. stripping out the change in consolidation scope and the exchange rate effect) was 14.2%, primarily reflecting the expansion of its customer base.

By geographical area, operating revenues of Telefónica Móviles España increased by 7.6%, driven by traffic growth, which was partly offset by cuts in service prices and lower interconnection tariffs. Data ARPU rose 7.7% to 4.4 euros. Operating revenues in Latin America grew by 104.9%, or 23.5% in organic terms, due mainly to the strong increase in the lines in service in Colombia, Argentina and Venezuela.

Operating expenses amounted to 10,634.2 million euros, up 45.0% on 2004. At Telefónica Móviles España, particularly notable was the growth in expenses in supplies (increase in commercial initiatives and interconnection costs, due mainly to the growth of outgoing traffic) and external services (stronger commercial efforts, leading to an increase in SACs, SRCs and advertising expenses, mostly associated with the launch of the Movistar brand in April 2005). Similarly, Latin America saw an increase in expenses in supplies and external services due to changes in the consolidation scope and stronger commercial activity.

OIBDA advanced 25.4% to 5,817 million euros, with organic growth of 7.4%. Operations in Spain accounted for 71% of OIBDA, down a slight 0.7% from the year before. OIBDA in Latin America rose 27.9% in organic terms, owing to strong growth in Venezuela, Chile and Argentina.

Capex amounted to 2,330 million euros, 39.6% higher than in 2004 mostly as result of the changes in the consolidation scope. Notable developments included the deployment of new GSM networks in Colombia, Ecuador, Nicaragua, Panama, Peru and Uruguay and the upgrading of the coverage and capacity of GSM networks in Argentina, Chile, Guatemala, El Salvador and Mexico.

The wireless business' headcount stood at 23,511 in 2005, an increase of 15.9% driven mainly by the incorporation of BellSouth's operators acquired at the beginning of the year.

In Spain, the wireless telephony business saw strong competitive pressure, which led to estimated market growth of over 10% with respect to 2004 and an estimated penetration rate of 96.6%. In this setting, Telefónica Móviles España (TME) achieved net adds of nearly one million lines, with its customer base edging 20 million, representing a 5% increase on 2004 year-end. The year's strong commercial effort stands out in particular: including adds, migrations and handset exchanges, TME carried out 10.7 million commercial initiatives in the year, the highest in its history. Noteworthy was the substantial growth in gross contract adds (up 30%), which, coupled with ongoing efforts aimed at prepaid-to-contract migration (nearly one million in 2005), increase this segment's weight on TME's total customer base to 54% (5 percentage points above the 2004 figure). TME also launched a series of commercial initiatives, which not only provided an important tool for enhancing customer loyalty and stimulating usage, but also curbed the churn rate despite competitors' aggressive commercial activity, while at the same time boosting traffic volume.

TME continued to deploy its high quality UMTS network, reaching over 5,000 base stations in 2005 (vs. 3,800 at 2004 year-end). It was also the first Spanish operator to carry out demonstrations of HSDPA (high speed downlink packet access) technology in a real environment, and it was awarded a 4 Mhz bloc in the GSM 900 brand to complete the coverage and capacity of its GSM network, thereby improving the quality of its service.

In 2005 Brazil witnessed robust market growth and much stronger commercial efforts by competitors, particularly in the higher value segments. The estimated penetration rate in Vivo's areas of operation rose to 50%. In this environment, Vivo focused its commercial efforts on acquiring and retaining higher value customers, enlarging its customer base by 12% to 29.8 million.

At the same time, Vivo launched the first wireless handset services in Brazil based on its CDMA2000 1xEV-DO (evolution-data optimized) network. This technology provides internet access speed of up to 2.4Mb/second, much higher than the domestic broadband speed.

In Argentina the growth of the market accelerated sharply in 2005, driven by the country's healthy macroeconomic setting and a pick-up in the competitive environment. The estimated penetration rate reached 55.1%, more than 20 percentage points more than in 2004. Telefónica Móviles Argentina's customer base grew sharply to 8.3 million, with net adds of 2.6 million in the year to a total of 8.3 million (2.4 million from BellSouth), 45% more than the year before. GSM customers now account for 52% of the total.

In Mexico, particularly from the second half of the year, Telefónica Móviles has geared its efforts towards developing a quality distribution network and upgrading its processes, enhancing customer service and service quality. The Company also reinforced its commercial strategy to reduce the churn rate, by adjusting the pace of its commercial activity and improving its credit risk analysis systems. Its customer base at December 2005 year-end stood at 6.4 million, up 13% on 2004. GSM customers represented 88% of the total (72% in 2004).

The Colombian cellular market also grew enormously in 2005, with an increase in the estimated penetration rate of more than 24 percentage points to over 47% at year end. After the commercial launch of GSM in July, Telefónica Móviles Colombia again stepped up the pace of commercial activity, enlarging its customer base to over 6 million at December 2005 year-end, 83% more than in 2004. The success of the Christmas campaign, aimed at attracting GSM customers, generated a high percentage of gross adds in this technology and only 5 months after its launch GSM customers accounted for over 27% of the total customer base.

Venezuela's wireless telephony market also grew substantially in 2005, reaching an estimated penetration rate of 47.6%, more than 15 percentage points higher than in 2004. Telefónica Móviles Venezuela ended the year with more than 6 million customers, a 39% increase. Particularly notable was the launch in December of services based on EV-DO technology, with a network that provides coverage to the main 26 urban areas in Venezuela, which represent 80% of the total population.

In Chile, the market remained robust, with an increase of 10 percentage points in the estimated penetration rate to over 71%. Telefónica Móviles Chile ended 2005 with 5.3 million customers, with net adds of 525,000 in the year as a whole. GSM customers accounted for 51% of the total customer base.

### Cesky Telecom

The Cesky Telecom Group<sup>3</sup> was included in the Telefónica Group's consolidation scope as of July 2005. It contributed 1,035.2 million euros in revenues and 456.7 million euros to OIBDA.

In a year marked by the company's privatization process, particularly in the first half of the year, the Cesky Telecom Group sustained a 4.8% decline in OIBDA excluding the exchange rate effect owing to flat revenues, but higher operating expenses.

Revenues were unchanged because the growth of wireless business offset the fall in revenues from wireline telephony caused by the decline in the number of traditional lines in service. The OIBDA margin<sup>4</sup> was 44.1%, among the highest in the industry.

In wireline telephony, Cesky Telecom continued to advance towards a growth model based on broadband products and data revenues, partially easing the impact of the fall in the volume of its traditional service. The slide in revenues from voice and internet traffic and monthly line rental was not offset by higher revenues from broadband and data services.

At operating level, traditional lines in service decreased by 7.2% in 2005 to 3.1 million lines, down 6.1% vs. 2004. Noteworthy was the Company's stronger commercial focus, mainly reflected in the growth of ADSL lines, which grew 170.5% in the year to 273,741. The launch of the new portfolio of ADSL products in the spring, combined with commercial promotions carried out, fuelled higher growth in the lines in service in the second half of the year, with net adds of 109,570 vs. 62,969 in the year's first half.

<sup>3</sup> Financial results refer to 2H05.

<sup>4</sup> Operating income before depreciation and amortization over revenues.

In the wireless business, Eurotel's revenues rose by 1.9% primarily owing to the 6.4% increase in the number of customers to 4.7 million. The increase in the weight of contract customers on the total from 24% to 33%, along with the 137.8% increase in internet customers to 70,342, led to a higher contribution by SMS, MMS and internet revenues to the total. After a good performance in the second half of the year, Eurotel remains the wireless operator with the largest number of customers in the Czech Republic. Finally, we would highlight the launch of the UMTS business on December 1, 2005.

Capex rose 5.5% in the year as a result of higher investment by Eurotel in the roll-out of its UMTS network. The capex/revenues ratio remained very low in 2005, at 9.9%, compared to 9.3% in 2004.

### Directories

In 2005 the TPI Group confirmed its strategic commitment to international expansion by acquiring Telinver, leader in Argentina's directories market.

Revenues amounted to 660.5 million euros, up 7.1% on 2004. This increase primarily reflects performance in Europe, where both the traditional paper and internet products and telephone traffic fared extremely well. This, coupled with control over costs, enabled OBIDA to advance 7.4% to 220 million euros.

Advertising revenues contributed 83% of total revenues. The Internet business remained robust, representing 7.4% of the Group's advertising revenues.

Telephone traffic revenues were 39.3% higher than in 2004. The positive performance of telephone traffic business reflects the growth in the number of calls and average revenues per call to the 11888 number in Spain, as well as the launch of the directory assistance (DA) business in Italy via the subsidiary 1288 Servizio di Consultazione Telefonica, S.r.l. as of October 2005.

In Spain, new directories of existing products were launched in 2005, such as pocket editions of the Yellow Pages, as well as new products that complement Yellow Pages products, such as local directories.

We would highlight the consolidation of the vertical directories for construction and hotel & restaurants as well as higher turnover from specialized magazines and direct marketing initiatives.

The companies Edinet Europa and Edinet América have also helped to streamline the Group's productive systems by pooling their publishing activities in just two centers, one in Spain and the other in Latin America.

### Call Centers

2005 featured sustained growth for the Atento Group, driven by stronger commercial activity with current customers and the addition of new customers.

Revenues rose 41.2% to 856.5 million euros (31.2% excluding the impact of exchange rates). The performance in different markets where Atento is present was favorable in all operations, with the exception of

Atento Marruecos, led by Atento Brasil, with a 52.7% increase in revenues. Revenues from Atento Brasil in euros totaled 304.5 million euros, making it the Atento Group's largest operation, accounting for 35.5% of total revenues. Atento España (Spain) posted revenues to 293.0 million euros, 34.2% of the total and 22.2% higher than in 2004.

We would also highlight Atento's operations in Argentina, Central America, Colombia, Mexico and Venezuela, where revenues grew over 50%, and in Puerto Rico, with revenue growth of over 40%.

In addition, there was a notable increase in the contribution of revenues from the customers of the Multisector Market (outside the Telefónica Group) from 50% to 52% in 2005<sup>5</sup>.

In line with its strategy, the Atento Group remains committed to the diversification of its customer portfolio by consolidating its leadership positions in the financial sector, major consumer goods, energy and public institutions.

Operating expenses rose 42% on the back of higher maintenance costs and occupancy levels at centers and higher expenses in equipment leases (for covering the growth of business in 2005), the increase in personnel and higher spending on training.

As a result, OIBDA rose 36.7% to 116.4 million euros (24.0% excluding the impact of exchange rates), with an OIBDA margin of 13.6%. Atento Brasil contributed 49 million euros or 42.1% of the Atento Group's total income. Atento España contributed 13.8 million euros, Mexico 12.6 million euros and Chile 12.2 million euros, each accounting for over 10% of Group OIBDA.

The Atento Group ended the year with 39,705 service points, an increase of nearly 30%. At the same time, the Atento Group posted its highest ever productivity, with a 78% ratio, a 3 percentage point advance on 2004.

Finally, the Atento Group continued its growth strategy, creating jobs in most of the markets where it is present and increasing its headcount by 28% to 96,000 employees.

### Media and Content

In 2005, in a process that began in 2003, this line of business concluded its disposal of non-core assets. In March it sold its Radio Continental shares in March 2005 and in May, after meeting the conditions agreed in late 2004, it finalized the sale of its stake in Torneos y Competencias.

In April, approval was given at the Sogecable's Shareholders' Meeting to increase capital by up to 185 million euros, with the proceeds going to the early repayment of the participating loans granted by the main partners (PRISA, Telefónica de Contenidos and Vivendi Universal), in which Telefónica participated in an amount corresponding to its shareholding.

In June the merger of Telefónica Sport (previously the owner of various soccer rights and now specialized in consulting services in matters of sports rights for the rest of the Group's companies) and

<sup>5</sup> Revenues from vivo (customer of Atento Brasil) are considered part of the Multisector Market.

Telefónica de Contenidos was registered at the Mercantile Register, in which the former was dissolved but not liquidated.

On November 22, 2005, the Endemol Group placed on the Amsterdam Stock Exchange (Euronext) 25% of the share capital of its subsidiary Endemol N.V., formed by all the company's operating activities worldwide except for France.

The business units encompassed in this line obtained consolidated operating revenues of 1,269.1 million euros, a 4.1% increase on 2004. OIBDA was 45.5% higher, at 269.2 million euros. This increase was largely driven by the proceeds from the flotation of 25% of Endemol N.V., the sale of the ATCO radio business and the healthy earnings performances by business lines.

a) The company, which was recently listed on the Amsterdam stock exchange, reported revenue growth of 5.8% in 2005 to 900.1 million euros. Of this figure, revenues from new acquisitions totaled 10.5 million euros, and the remainder derived from organic growth. Revenues grew in all countries in which Endemol NV operates with the Spanish, UK and RoW businesses showing the most outstanding performance, making the group's revenues more diversified. We also note the higher contribution of revenues from formats other than non-scripted (i.e. scripted and digital), which accounted for 23.3% of total group revenues vs. 21.4% in 2004.

b) Endemol NV recorded OIBDA of 152.8 million euros, an increase of 15.4% on 2004 with an OIBDA margin of 17%, 1.4% higher than the previous year. The company's positive operating performance was due to significant revenue growth and the strong performance of production costs in the US, following the syndication of four series of Fear Factor, and offsetting the weaker operating performance in some of its RoW markets where the company had grown the most proportionally.

Meanwhile, ATCO's earnings also improved with respect to 2004. Revenues rose 7% to 97 million pesos, thanks to the overall growth of the advertising market in the capital and greater Buenos Aires, as well as the good audience ratings obtained by Telefé, which raised its cumulative market share to 41.2%. OIBDA climbed 16% to 19.8 million pesos, driven not only by the growth in revenues, but also by the gains from the sale of Radio Continental and Radio Estéreo.

## Earnings

### Consolidated income

Growth rates for the year are affected by changes in the consolidation scope, the most significant of which were as follows: in 2004, the exclusion of Lola Films (effective as of August 2004) and Telefónica UK (effective as of January 2004) and the inclusion of the eight BellSouth wireless operators (effective as of November 2004), and in 2005 the inclusion of the two other BellSouth wireless operators (Argentina and Chile), Atrium (from January 2005) and the Czech operator Cesky Telecom (from July 2005).

The Telefónica Group's operating revenues amounted to 37,882.2 million euros in 2005, an increase of 25.1%. Organic growth; i.e. stripping out the impact of exchange rates and changes in the consolidation scope, was 9.3%. This growth reflects the solid performance of operations and the sustained increase in its customer base that resulted from the internationalization of its business and the intensification of sales drives

in all lines of activity. The increase in revenues offset the higher growth of operating expenses associated with commercial efforts, allowing for a 25% increase in OIBDA to 15,276.4 million euros (9.9% organic growth).

Operating income amounted to 8,558.8 million euros, up 30.6% on 2004 (21.7% organic growth), owing to the positive performance of OIBDA, which offset the growth in depreciation and amortization. The share of losses in companies consolidated by the equity method amounted to 128.2 million euros, which was far higher than 2004 owing to the larger write-down at IPSE, which was partially offset by the better results of Sogecable, Medi Telecom and Lycos Europa.

Net finance costs in the year totaled 1,634.3 million euros, similar to 2004. As later indicated, the higher interest expenses associated with the increase in the Group's average debt and the rise in interest rates were offset by the positive exchange rate effect.

Better performance both at operating and non-operating level underpinned a 40% increase in net income, to 4,445.8 million euros.

The Telefónica Group's EPS was 0.913 euros.

### Revenues

Revenues rose 25.1% in 2005 to 37,882.2 million euros, reflecting the significant effects of changes in the consolidation scope and the impact of exchange rates. Excluding these two effects, organic growth would be 9.3%.

The biggest contributors to Group revenues were the wireless business (40%), the Telefónica de España Group (29%) and Telefónica Latinoamérica (21%).

Revenues from the wireless business were 16,513.5 million euros, up 38.1% or 14.2% in organic terms, mainly driven by the growth of the customer base. Spain contributed 53% of the revenues generated by wireless business and Latin America 47%.

Revenues for the Telefónica de España Group amounted to 11,739.5 million euros, up 4.8% on 2004, driven by solid growth in both retail and wholesale broadband services and the increase in the monthly line rental, which, in turn, offset the decline in voice traffic revenues.

Telefónica Latinoamérica post a 22.5% increase in revenues to 8,265.5 million euros, with organic growth of 5.9%. This growth is mainly explained by the development of broadband services, the tariff increase, the good performance of public telephony revenues and Telesp's new value added businesses, alongside a pickup in consumption and the improvement of TASA's operating indicators despite the tariff freeze. While the weight is smaller, Telefónica Empresas América and TIWS also contributed positive to revenue growth, while consolidating their market positions.

### Expenses

Operating expenses<sup>6</sup> rose 26.7% to 23,219.3 million euros, with organic growth of 10.2%. This increase was due mainly to the

<sup>6</sup> Includes supplies, personnel, capitalized work on PP&E.

wireless business, marked by intense commercial activity in 2005 and the launch of the Movistar brand in April 2005.

Supply costs were 31.8% higher, amounting to 10,065.0 million euros. This increase primarily derives from the inclusion in 2005 of Cesky and the 10 BellSouth wireless operators. Stripping out these inclusions, the increase would be explained by the larger volume of handset purchases, higher wireline and wireless operator interconnection costs, increased purchases of equipment for the deployment of ADSL services and the expenses associated with the adaptation of exchanges for the unbundling of the local loop to new operators.

External service expenses amounted to 6,715.3 million euros, a 32.4% increase on the year before, also affected by the changes in the consolidation scope and exchange rates. Commercial activity in all the Group's business lines was intense during the year. This was particularly notable in the wireless business, where its expenses grew substantially owing to the resources invested for subscriber acquisition and retention and the international launch of the Movistar brand. In wireline operators, the rise in expenses largely derives from greater commercial efforts linked to the deployment of ADSL and the higher plant maintenance costs.

The Group's personnel expenses rose 11% to 5,656.4 million euros, reflecting the inclusion of Cesky and the BellSouth operators and the increase in Atento's headcount. This item also reflects the personnel restructuring expense under Telefónica de España's Labor Force Reduction Plan (2003-2007), which affected 1,877 employees in 2005. At December 31, 2005 Telefónica Group had 207,641 employees, compared with 173,554 in 2004.

Other operating expenses include the amount assigned to the impairment of receivables, considerably higher in 2005 owing to the larger provisions in the wireless business derived from the inclusion of the BellSouth operators and increased provisions in Mexico and Brazil. Here we should also highlight the capital gains on the sale of Infonet and Endemol's IPO, and the benefits of Telefónica de España's real estate efficiency plan.

### *OIBDA and operating income*

OIBDA rose 25% to 15,276.4 million euros in 2005, with organic growth of 9.9%.

Operating income rose by 30.5% (21.7% organic growth) to 8,558.8 million euros. Behind the sharp growth was the increase in OIBDA, as the depreciation and amortization charge was 18.6% higher because of the newly acquired operators. In organic terms, depreciation and amortization expense fell by 2.5%, underscoring the Telefónica Group's policy of scaling back capex.

### *Investment activity*

In 2005 the Telefónica Group recorded additions to intangible assets and property, plant and equipment of 5,468.65 million euros, 45.1% more than in 2004. This increase reflects the inclusion of Cesky and the BellSouth wireless operators. Stripping out these inclusions, additions also reflect the stronger investment efforts of Telefónica Latinoamérica and Telefónica de España and investment on the

construction of the Group's new corporate headquarters in Madrid (Telecommunications City District C).

All operators of Telefónica Latinoamérica stepped up capex, most notably on systems to enhance customer management and the deployment of broadband services.

Telefónica de España proceeded with its broadband expansion policy, speeding up the rollout of ADSL technology and betting heavily on the development of new multimedia businesses (Imagenio) without overlooking the needs of its traditional business.

At Telefónica Móviles, notable developments included the deployment of new GSM networks in Colombia, Ecuador, Nicaragua, Panama, Peru and Uruguay and the upgrading of the coverage and capacity of GSM networks in Argentina, Chile, Guatemala, El Salvador and Mexico.

Investment in property, plant and equipment totaled 4,391.3 million euros, up 38.4% from 2004, while investment in intangible assets stood at 1,077.3 million euros, down 81.3% on the year before.

Financial investments amounted to 6,839.8 million euros, led by the acquisitions of the BellSouth operators in Chile and Argentina, Cesky Telecom and O2 shares.

### *Innovation and R&D*

The Telefónica Group considers innovation to be one of the cornerstones of its future transformation. This strategy underscores the importance of innovation as a basic means for obtaining sustainable competitive advantages, such as the anticipation of market trends and product differentiation through the addition of new technologies via the development of new products and services and the inclusion of ICT (information and communications technologies) in business processes. Here its goal is to become a more effective, efficient and flexible integrated group focused on the customer.

In 2005 Telefónica rolled out the new Technological Innovation model defined in 2004, articulated by Telefónica Investigación y Desarrollo (Telefónica I+D), which pave the way for an even greater alignment of technological innovation with the Group's strategy. It also promotes collaboration with other agents (customers, public authorities, suppliers, business allies, etc.) who will become "technological allies."

Telefónica spent 2,950 million euros in 2005 on items related to technological innovation, 23% more than in 2004. Every year, as part of its investment streamlining policy, Telefónica has increased the percentage of investment earmarked for new businesses.

As for how it obtains innovative solutions, Telefónica still considers that differentiating itself to peers and being more widely accepted by the market does not depend solely on an acquired technology. It must promote its own R&D activities to guarantee this differentiation and to drive forward other innovation initiatives. In 2005 Telefónica invested 544 million euros, or 1.4% of revenues, in R&D activities. According to figures published by the European Commission corresponding to financial year 2004, Telefónica invested more in R&D than any other Spanish company.



Most of the R&D activities are carried out by Telefónica Investigación y Desarrollo, a wholly-owned subsidiary, which works principally for Telefónica's businesses. In the performance of this function, it also collaborates with other companies and universities. Telefónica I+D is the driving force behind the Group's innovation, playing a dual role as the developer of the ICT solutions Telefónica needs and as the identifier of emerging technological options that could have a significant impact on business.

Telefónica I+D worked on over 1,800 projects during the year, including the development of products, services and processes, and applied research initiatives aimed at anticipating new technologies that could affect Telefónica's business.

The development of products, services and processes has produced results that can be applied in the short term by Telefónica's businesses (either by enlarging the product range with a better position in the market or by introducing systems and processes that help its commercial development, make it more efficient and enhance quality levels). These projects play an important role in Telefónica's strategy of creating value through broadband communications and services and in the deployment of new networks and services at companies recently integrated in the Telefónica Group.

Last year Telefónica I+D continued to consolidate its network of Centers of Excellence. Internationally, it has considerably increased the percentage of activity developed at its centers in Mexico City and Sao Paulo in Brazil, which share the mission of providing support for technological innovation at the Group's companies in Latin America. Within the framework of the strategy introduced several years ago to ensure the geographical distribution of the Group's technological innovation capacity, in Andalusia Telefónica I+D launched a new center in Granada, which complements the activities already under way at the rest of its centers in Barcelona, Huesca, Madrid and Valladolid. The center in Barcelona has undergone a decisive upgrading under a new organizational structure, with a threefold increase in human resources and a new technological strategy for the development of its projects. With these initiatives Telefónica I+D is building an extensive network of technological innovation in Spain and abroad.

As indicated, in 2005 it also undertook activities relating to applied research aimed more at the medium and long term, in order to detect, understand, develop and apply—through consulting work, strategic studies, technological surveillance and experimental tests—any aspects, singular features, opportunities and particularly technologies that will affect the performance of Telefónica's business lines. These activities have mainly been developed within the corporate framework of Telefónica, complementing projects carried out in the sphere of the European union's R&D programs, the general government of Spain and the Spanish regions where Telefónica I+D has centers. Telefónica I+D's response to the general government's CENIT program merits special mention. The company has contributed 11 project proposals, leading five of them, which should be decided on at the beginning of the year.

The new model also provided for the creation of a Telefónica I+D Scientific Assessment Council, comprising leading academic personalities from around the world, with the mission of orienting Telefónica from a scientific and university vantage.

Throughout 2005 Telefónica, via Telefónica I+D, carried ahead with its intense pace of intangible and non-lucrative initiatives with a view to promoting the Group's technological image through its presence at universities and scientific institutions and numerous technical contributions such as articles, lectures at conferences, books and other publications. In addition, through Telefónica I+D, Telefónica continued to expand the Group's portfolio of technological property considerably.

### *Financial income (expenses)*

Net financial expenses in 2005 totaled 1.634,3 million euros, a decrease of 0.3% (4.8 million euros) compared to 2004 (1.639,1 million euros). Interest expenses decreased by 334.3 million euros, of which 261.3 million euros derived from the 18.6% increase in average net debt vs. 2004. Exchange rate differences rose by 339.1 million euros on 2004, highlighting the contribution of the USD/EUR position, which accounted for 43% of the improvement.

The free cash flow generated by the Telefónica Group in 2005 amounted to 7,108.1 million euros, of which 4,476.1 million euros were used by Telefónica S.A. to pay dividends and buy back treasury shares, 5,839.9 million euros were earmarked for financial investments (net of real estate divestments) and 692.8 million euros were used to settle commitments acquired by the Group, derived mainly from the labor force reduction plans. Consequently, the free cash flow after dividends, which to a large extent explains the increase in net financial debt, amounted to 3,900.7 million euros.

### *Financing*

The Telefónica Group's net debt amounted to 30,067,0 million at 2005 year-end. The increase of 6,372.6 million euros with respect to the consolidated debt at 2004 year-end (23,694.4 million euros) is largely attributable to the free cash flow after dividends (-3,900.7 million euros). In addition, debt increased by 1,075.8 million euros due to changes in the consolidation scope and other impacts on financial accounts and by 1,396.1 million euros due to the effect of exchange rates on debt not taken out in euros.

The principal financing transactions carried out in 2005 were as follows:

- Telefónica Emisiones, S.A.U., a subsidiary of Telefónica, S.A., launched a program for the issuance of debt instruments ("the program") for up to a total of 15,000 million euros. It was registered at the UK Listing Authority on July 8, 2005. On February 4, 2005 the documents entitled *Dealership Agreement, Issue and Paying Agency Agreement, Deed of Covenant, Deed of Guarantee and Master Global Notes* were formalized. This program, which is guaranteed by Telefónica, S.A., substitutes the previous similar program dated February 4, 2005.
- On May 4, 2005 Compañía de Telecomunicaciones de Chile concluded the renegotiation of the 180 US dollar million syndicated loan signed in 1998, with a current amount of 150 million dollars, which enabled it to extend the maturity from April 2007 to December 2008. Subsequently, on October 28, it also renegotiated the syndicated loan initially signed in 1996 for 225 million dollars, with an outstanding amount of 150 million

dollars, extending maturity from April 2008 to June 2011 and adjusting the spread to market conditions.

- In May 2005, Telefónica Europe, B.V. updated its ECP (euro commercial paper) program. In 2005 Telefónica Europe continued its issuance activity under the aforementioned program, underwritten by Telefónica, S.A., with short-term issues maturing between one week and 364 days. At December 31, 2005, the final balance of outstanding commercial paper totaled 1,133.29 million euros (at the initial issue price).
- On June 28, 2005 Telefónica, S.A. arranged a syndicated loan with 40 national and international financial institutions for 6,000 million euros, maturing on June 28, 2011. The loan is denominated in euros and can be drawn either in this currency or in US dollars, sterling, yen, Swiss francs or any other currency subject to prior agreement by the banking institutions. The interest rate for each term or period of interest will be the EURIBOR/LIBOR for each period plus a spread that will be based on the long-term credit rating assigned by the rating agencies Moody's and Standard and Poor's. At current levels, Baa1/BBB+, the spread would be 0.225% per annum.
- On September 29, Telefónica Finanzas México, a Telefónica Móviles subsidiary, held two issues for a combined value of 5,000 million pesos under its current *certificados bursátiles* (peso bonds) program that has a maximum issuance of 12,000 million pesos. The first issue was for 3,500 million pesos, with a 5-year maturity and paying quarterly interest at the annualized rate of 91-day Cetes (Mexican government treasury notes) plus 61 basis points. The second 1,500 million peso issue, matures in 7 years and pays a fixed 9.25% half-yearly. This program was authorized by the Comisión Nacional Bancaria y de Valores (Mexican banking and securities regulator) on December 30, 2004, underwritten by an unconditional and irrevocable guarantee by Telefónica S.A. Issues can be made under the program for four years from this date.
- On October 11, 2005, Telefónica del Perú launched a bond issue on the international market for 754 million new Peruvian soles at a fixed interest rate of 8%. The bonds mature on April 11, 2016.
- On October 31, 2005 Telefónica Europe, B.V. arranged a syndicated loan, underwritten by Telefónica, S.A., for 18,500 million sterling, subsequently reduced to 18,000 million under a modification of December 14, 2005, for the purpose of financing or refinancing the acquisition of the shares relating to the purchase of O2 and the associated costs. The loan consists of two tranches, A and B, for 12,000 million and 6,000 million, for a period of 364 days, which can be extended for two periods, the first by 365 days and the second by 180 days, for the A tranche and 3 years for the B tranche. Lastly, the annual interest rate for each period or interest rate will be EURIBOR/LIBOR for the period plus a spread based on the long-term credit rating assigned to Telefónica, S.A. by the rating agencies Moody's and Standard and Poor's. At current levels, Baa1/BBB+, the spread would be 0.325% per annum for tranche A and 0.375% per annum for tranche B, although the spread could be reduced by 0.05% per annum in both tranches if the amount drawn is the same as or less than 50% of the total amount.

O2, limiting the downgrade to one notch, i.e. to Baa1 and A-, respectively, once the acquisition is completed. On the same date Standard and Poor's cut our credit rating from A to A- and placed it on creditwatch for a possible further downgrade, limiting further falls to one notch once the acquisition concludes, i.e. BBB+. On December 22, 2005, Moody's finally lowered its long-term credit rating assigned to Telefónica to Baa1, but affirmed its short-term P-2 rating.

After 2005 year-end, on January 11, 2006 Fitch lowered its long-term credit rating for Telefónica to A- with a stable outlook and its short-term credit rating from F-1 to F-2. On the same day Standard and Poor's also lowered its long-term credit rating to BBB+ with a stable outlook and affirmed its short-term credit rating of A-2. This concluded all actions announced by the rating agencies with respect to Telefónica's takeover bid for O2 Plc.

### Treasury shares

At the start of 2005 Telefónica had treasury shares of 4.18179%, made up of 207,245,179 shares with a book value of 11.833 euros per share, a balance of 2,452.31 million euros and a nominal value of 207.25 million euros.

During 2005 the Company acquired 230,038,870 its own shares for a total of 2,741.47 million euros and sold 48,503,517 shares for a total price of 647.45 million euros.

In addition it used 29,274,686 shares for the share exchange in the takeover of Terra Networks S.A., 34,760,964 shares to reduce capital and 188,096,296 treasury shares for the return of the share premium to shareholders through the delivery of treasury shares. Lastly, 1,525 treasury shares were delivered as part of the share option plan for Endemol employees (EN-SOP).

As a result of the above, the number of treasury shares in 2005 rose to 136,647,061 (2.77674%) acquired at an average price of 12.996 euros per share.

### Rating agencies

On October 31, 2005, Moody's and Fitch Ratings, respectively, placed our credit ratings under review for possible downgrade after the announcement of the takeover bid for 100% of the share capital of





# Annual Financial Statements and Management Report Telefónica, S.A.

02

|         |  |     |
|---------|--|-----|
| 02   01 | Auditor's Letter   | 145 |
| 02   02 | Annual Financial Statements and<br>Management Report, Telefónica, S.A. | 146 |



**INFORME DE AUDITORÍA DE CUENTAS ANUALES**

A los Accionistas de  
Telefónica, S.A.

1. Hemos auditado las cuentas anuales de Telefónica, S.A., que comprenden el balance de situación al 31 de diciembre de 2005 y la cuenta de pérdidas y ganancias y la memoria correspondientes al ejercicio anual terminado en dicha fecha, cuya formulación es responsabilidad de los Administradores de la Sociedad. Nuestra responsabilidad es expresar una opinión sobre las citadas cuentas anuales en su conjunto, basada en el trabajo realizado de acuerdo con las normas de auditoría generalmente aceptadas, que requieren el examen, mediante la realización de pruebas selectivas, de la evidencia justificativa de las cuentas anuales y la evaluación de su presentación, de los principios contables aplicados y de las estimaciones realizadas.

2. De acuerdo con la legislación mercantil, los Administradores presentan, a efectos comparativos, con cada una de las partidas del balance de situación, de la cuenta de pérdidas y ganancias y del cuadro de financiación, además de las cifras del ejercicio 2005, las correspondientes al ejercicio anterior. Nuestra opinión se refiere exclusivamente a las cuentas anuales del ejercicio 2005. Con fecha 4 de marzo de 2005 otros auditores emitieron su informe de auditoría acerca de las cuentas anuales del ejercicio 2004 en el que expresaron una opinión favorable.

3. En nuestra opinión, las cuentas anuales del ejercicio 2005 adjuntas expresan, en todos los aspectos significativos, la imagen fiel del patrimonio y de la situación financiera de Telefónica, S.A. al 31 de diciembre de 2005 y de los resultados de sus operaciones y de los recursos obtenidos y aplicados durante el ejercicio anual terminado en dicha fecha y contienen la información necesaria y suficiente para su interpretación y comprensión adecuada, de conformidad con principios y normas contables generalmente aceptados, que guardan uniformidad con los aplicados en el ejercicio anterior.

4. El informe de gestión adjunto del ejercicio 2005 contiene las explicaciones que los Administradores consideran oportunas sobre la situación de Telefónica, S.A., la evolución de sus negocios y sobre otros asuntos y no forma parte integrante de las cuentas anuales. Hemos verificado que la información contable que contiene el citado informe de gestión concuerda con la de las cuentas anuales del ejercicio 2005. Nuestro trabajo como auditores se limita a la verificación del informe de gestión con el alcance mencionado en este mismo párrafo y no incluye la revisión de información distinta de la obtenida a partir de los registros contables de la Sociedad.

INSTITUTO DE  
CENSORES JURADOS  
DE CUENTAS DE ESPAÑA

Miembro ejerciente:  
ERNST & YOUNG, S.L.

año 2006 nº A1-003640

IMPORTE COLEGIAL: 67 €

Este informe está sujeto a la tasa  
aplicable establecida en la  
Ley 44/2002 de 22 de noviembre.

ERNST & YOUNG, S.L.

(Inscrita en el Registro Oficial de Auditores  
de Cuentas con el N° S0530)



José Miguel Andrés Torrecillas

1 de marzo de 2006

## Telefónica, S.A.

### Balance Sheet at December 31

Millions of euros

| Assets   | 2005             | 2004             |
|--|------------------|------------------|
| <b>A) Fixed and Other non Current Assets</b>                 | <b>40,392.56</b> | <b>43,715.40</b> |
| I. Start-up expenses   | 0.51             | 12.19            |
| II. Intangible assets (Note 5)                               | 84.99            | 40.08            |
| Computer software  | 153.51           | 95.90            |
| Intellectual Property  | 20.38            | 8.88             |
| Other intangible assets                                      | 61.63            | 1.65             |
| Accumulated amortization                                     | (150.53)         | (66.35)          |
| III. Property, plant and equipment (Note 6)                  | 529.63           | 261.59           |
| Land and buildings   | 213.61           | 220.21           |
| Furniture, tools and other items                             | 39.43            | 23.73            |
| Property, plant and equipment under construction             | 356.31           | 79.88            |
| Accumulated depreciation and provisions                      | (79.72)          | (62.23)          |
| IV. Long-term investments (Note 7)                           | 39,777.43        | 43,401.54        |
| Investments in Group companies                               | 23,127.69        | 22,415.48        |
| Investments in associated companies                          | 1,098.16         | 1,479.16         |
| Other investments  | 1,847.70         | 14.42            |
| Loans to Group and associated companies                      | 14,004.66        | 20,531.41        |
| Other loans  | 0.59             | 55.17            |
| Long-term deposits and guarantees given                      | 6.41             | 35.05            |
| Tax receivables (Note 14.2)                                  | 3,255.69         | 4,343.19         |
| Provisions   | (3,563.47)       | (5,472.34)       |
| <b>B) Deferred Charges (Note 8)</b>                          | <b>265.04</b>    | <b>266.22</b>    |
| <b>C) Current Assets</b>                                     | <b>10,277.34</b> | <b>7,515.63</b>  |
| I. Accounts receivable                                       | 219.53           | 109.93           |
| Trade receivables  | 15.85            | 7.86             |
| Receivable from Group companies                              | 143.09           | 71.04            |
| Receivable from associated companies                         | 0.43             | 0.15             |
| Sundry accounts receivable                                   | 7.98             | 6.73             |
| Employee receivables   | 0.75             | 0.78             |
| Tax receivables (Note 14.2)                                  | 61.60            | 27.89            |
| Provision for bad debts                                      | (10.17)          | (4.52)           |
| II. Short-term investments                                   | 9,651.57         | 6,447.97         |
| Loans to Group companies and associated companies (Note 7.6) | 9,614.15         | 6,184.36         |
| Short-term investment securities (Note 7.7)                  | 37.42            | 263.61           |
| III. Short-term treasury stock (Note 9)                      | 348.48           | 690.18           |
| IV. Cash   | 22.29            | 255.72           |
| V. Prepayments and accrued income                            | 35.47            | 11.83            |
| <b>Total Assets</b>  | <b>50,934.94</b> | <b>51,497.25</b> |

The accompanying Notes 1 to 20 and Appendix I are an integral part of the balance sheet.



# Telefónica, S.A.

## Balance Sheet at December 31

Millions of euros

| Liabilities   | 2005             | 2004             |
|---|------------------|------------------|
| <b>A) Shareholders' Equity (Note 9)</b>                             | <b>10,989.20</b> | <b>14,399.38</b> |
| I. Capital stock  | 4,921.13         | 4,955.89         |
| II. Share premium   | 1,670.83         | 5,287.68         |
| III. Revaluation reserves   | 1,368.89         | 1,368.89         |
| IV. Reserves  | 1,273.96         | 1,485.52         |
| Legal reserve   | 920.08           | 789.94           |
| Reserve for treasury stock  | 348.48           | 690.18           |
| Other reserves  | 5.40             | 5.40             |
| V. Income for the year  | 1,754.39         | 1,301.40         |
| <b>B) Provisions for Liabilities and Charges (Note 16.6)</b>        | <b>444.41</b>    | <b>139.30</b>    |
| <b>C) Long-Term Liabilities</b>                                     | <b>23,601.51</b> | <b>20,770.55</b> |
| I. Debentures, bonds and other marketable debt securities (Note 10) | 1,914.65         | 1,917.52         |
| Non-convertible debentures and bonds                                | 1,828.32         | 1,824.62         |
| Other marketable debt securities                                    | 86.33            | 92.90            |
| II. Payable to credit institutions (Note 11)                        | 9,864.60         | 2,950.56         |
| III. Payable to Group and associated companies (Note 12)            | 11,622.28        | 15,697.40        |
| IV. Other payables  | 11.83            | 13.02            |
| V. Taxes payable (Note 14.2)  | 43.02            | 46.92            |
| VI. Unpaid portion of investments in Group and associated companies | 145.13           | 145.13           |
| Group companies   | 145.13           | 145.13           |
| <b>D) Current Liabilities</b>                                       | <b>15,899.82</b> | <b>16,188.02</b> |
| I. Debentures, bonds and other marketable debt securities (Note 10) | 1,297.21         | 1,814.65         |
| Non-convertible debentures and bonds                                | –                | 799.06           |
| Other marketable debt securities                                    | 1,246.87         | 963.84           |
| Interest on debentures and other securities                         | 50.34            | 51.75            |
| II. Payable to credit institutions                                  | 3,236.71         | 2,619.35         |
| Loans and other accounts payable (Note 11)                          | 3,130.91         | 2,607.85         |
| Accrued interest payable  | 105.80           | 11.50            |
| III. Payable to Group and associated companies (Note 12)            | 10,977.97        | 11,551.42        |
| IV. Trade accounts payable  | 61.72            | 53.87            |
| V. Other non-trade payables   | 326.21           | 148.73           |
| Taxes payable (Note 14.2)   | 26.23            | 17.31            |
| Other non-trade payables (Note 15)                                  | 299.98           | 131.42           |
| <b>Total Shareholders' Equity and Liabilities</b>                   | <b>50,934.94</b> | <b>51,497.25</b> |

The accompanying Notes 1 to 20 and Appendix I are an integral part of the balance sheet.

## Telefónica, S.A.

### Income Statement for the Years Ended December 31

Millions of euros

| Debit   | 2005     | 2004     |
|---|----------|----------|
| <b>A) Expenses</b>  |          |          |
| Personnel expenses (Note 16.2)                                | 106.46   | 94.94    |
| Depreciation and amortization expense                         | 47.02    | 49.89    |
| Property, plant and equipment (Note 6)                        | 4.68     | 4.62     |
| Intangible assets (Note 5)                                    | 30.66    | 23.75    |
| Deferred expenses   | 11.68    | 21.52    |
| Other operating expenses                                      | 309.46   | 250.52   |
| External services provided by Group companies (Note 16.8)     | 72.12    | 51.49    |
| External services   | 223.62   | 186.93   |
| Taxes other than income tax                                   | 13.38    | 7.09     |
| Other current operating expenses                              | 0.34     | 5.01     |
| <b>I. Operating Profit</b>                                    | –        | –        |
| Financial and similar expenses                                |          |          |
| From liabilities with Group companies (Notes 16.4 and 16.8)   | 873.92   | 891.56   |
| From other liabilities (Note 16.4)                            | 513.55   | 324.96   |
| Changes in provisions for writedown of short-term investments | 10.71    | 0.26     |
| Amortization of deferred charges                              | 30.17    | 34.31    |
| Exchange losses (Note 16.5)                                   | 1,300.05 | 651.78   |
| <b>II. Financial Profit</b>                                   | 1,276.47 | 726.45   |
| <b>III. Income from Ordinary Activities</b>                   | 947.39   | 456.48   |
| Changes in provisions for securities investments (Note 7.1)   | (313.45) | (761.77) |
| Extraordinary expenses and losses (Note 16.7)                 | 86.22    | 69.70    |
| <b>IV. Extraordinary Income</b>                               | 704.62   | 708.84   |
| <b>V. Profit Before Taxes</b>                                 | 1,652.01 | 1,165.32 |
| Corporate income tax in Spain (Note 14)                       | (107.45) | (139.99) |
| Foreign taxes (Note 14)                                       | 5.07     | 3.91     |
| <b>VI. Profit for the Year</b>                                | 1,754.39 | 1,301.40 |

The accompanying Notes 1 to 20 and Appendix I are an integral part of the income statement.

## Telefónica, S.A.

### Income Statement for the Years Ended December 31

Millions of euros

| Credit  | 2005     | 2004     |
|---|----------|----------|
| <b>B) Revenues</b>  |          |          |
| Net sales to Group companies (Note 16.1)                                    | 40.63    | 26.04    |
| Other operating revenues  | 93.23    | 99.34    |
| Non-core and other current operating revenues – Group companies (Note 16.1) | 72.96    | 87.24    |
| Non-core and other current operating revenues – Non-Group companies         | 20.27    | 12.10    |
| I. Operating LOSS   | 329.08   | 269.97   |
| Revenues from securities investments  | 1,749.52 | 823.30   |
| Group companies (Note 16.8)   | 1,692.90 | 795.41   |
| Associated companies  | 39.53    | 13.26    |
| Non-Group companies   | 17.09    | 14.63    |
| Revenues from other financial investments and loans (Note 16.4)             | 1,021.18 | 1,100.84 |
| Group companies (Note 16.8)   | 1,016.25 | 968.32   |
| Other companies   | 4.93     | 132.52   |
| Exchange gains (Note 16.5)  | 1,234.17 | 705.18   |
| II. Financial Loss  | –        | –        |
| III. Loss on Ordinary Activities  | –        | –        |
| Gains on fixed asset disposals (Note 16.6)                                  | 82.89    | 16.26    |
| Extraordinary revenues (Note 16.6)  | 394.50   | 0.51     |
| IV. Extraordinary Loss  | –        | –        |
| V. Loss Before Taxes  | –        | –        |
| VI. Loss for the Year   | –        | –        |

The accompanying Notes 1 to 20 and Appendix I are an integral part of the income statement.

## Telefónica, S.A.

### Notes to the Financial Statement for the Year Ended December 31, 2005

#### (1) Introduction and General Information

Telefónica, S.A. ("Telefónica" or "the Company") is a public limited company incorporated for an indefinite period on April 19, 1924, under the corporate name of Compañía Telefónica Nacional de España, S.A. It adopted its present name in April 1998.

The Company's registered office is at Gran Vía 28, Madrid (Spain), and its Employer Identification Number (CIF) is A-28/015865.

Telefónica's corporate purpose, pursuant to Article 4 of its bylaws, is the provision and operation of all manner of telecommunications services (including ancillary or supplementary telecommunications services or related services); research and development, the promotion and application of all manner of telecommunications components, equipment and systems; manufacturing, production and, in general, all other types of industrial activity relating to telecommunications; and the acquisition, sale and, in general, all other types of commercial activity relating to telecommunications.

As also stipulated in Article 4 of its bylaws, all business activities that constitute the corporate purpose described above may be performed either in Spain or abroad and may be carried out either wholly or partially by the Company, or through shareholdings or equity interests in other companies or legal entities with an identical or a similar corporate purpose.

In keeping with the above, Telefónica is currently the parent company of a group that operates mainly in the telecommunications, media and entertainment industries, providing a wide range of services on the international stage.

The Company is taxed under the general tax regime established by the Spanish State, the Spanish Autonomous Communities and local governments, and files consolidated tax returns with most of the Spanish subsidiaries of its Group under the consolidated tax regime applicable to corporate groups.

#### *Merger of Telefónica, S.A. and Terra Networks, S.A.*

On June 2, 2005, after the merger agreement was approved at Telefónica, S.A.'s General Shareholders' Meeting, approval was given at Terra's General Shareholders' Meeting for the takeover by Telefónica, S.A. of Terra Networks, S.A., implying the dissolution of Terra Networks, S.A. and block transfer of all its assets and liabilities to Telefónica, S.A., which thereby assumed, through the overall transfer, all of Terra's rights and obligations.

Pursuant to this agreement, Telefónica transferred shares from treasury stock to Terra shareholders at an exchange ratio of two Telefónica shares with a par value of one euro each for every nine Terra shares with a par value of two euros. No additional cash payment was involved and no new shares were issued. The merger

was registered in the Madrid Mercantile Register on July 16, 2005, effective for accounting purposes from January 1, 2005.

#### *Dissolution of Terra Networks Latam ETVE, S.L.*

The dissolution without liquidation of Terra Networks Latam ETVE, S.L. through the overall transfer of its assets and liabilities to Telefónica, S.A., which via the above merger became owner of all shares constituting its capital stock, was ratified by public deed on June 9, 2005.

#### (2) Basis of Presentation

##### *True and fair view*

The accompanying financial statements were prepared from Telefónica's accounting records by the Company's directors in accordance with the accounting principles and standards contained in the Commercial Code, as implemented by the Spanish Chart of Accounts and, accordingly, give a true and fair view of the Company's net assets, financial position, results of operations and of the funds obtained and applied in 2005.

The financial statements for 2005 will be submitted for approval at the General Shareholders' Meeting, and it is expected that they will be approved without any changes. The financial statements for 2004 were approved at the Shareholders' Meeting held on May 31, 2005.

##### *Comparative information*

There were no changes in the structure of the balance sheet or income statement with respect to the previous year. In addition, no material changes were made to accounting criteria with respect to 2004.

The takeover of Terra Networks, S.A. by Telefónica, S.A. was concluded in 2005, effective for accounting purposes from January 1, 2005. The dissolution without liquidation of Terra Networks Latam ETVE, S.L. via the overall transfer of its assets and liabilities to Telefónica, S.A., was also concluded in 2005.

In 2004 Inmobiliaria Telefónica, S.L.U., a wholly owned subsidiary of Telefónica, S.A., was dissolved without liquidation through the overall transfer of its assets and liabilities to its sole shareholder and its subsequent extinction. The financial impact of the transfer was considered effective for accounting purposes as of January 1, 2004.

These notes to the financial statements disclose the main effects of these transfers to facilitate comparison between the 2005 and 2004 figures.

No additional significant events took place that prevent comparison of the figures for 2005 with those of 2004.

The figures in these financial statements and in the management report are expressed in millions of euros unless otherwise indicated.

### (3) Proposed Distribution of Profit

Telefónica, S.A. obtained income of 1,754.39 million euros in 2005.

The Company's Board of Directors will submit the following proposed distribution of income for approval at the Shareholders' Meeting: a) to appropriate 64.15 million euros of the income for the year to the legal reserve; which would then represent 20% of share capital, b) to pay a fixed dividend of 0.25 euros gross per share on the Company's outstanding shares carrying dividend rights; and c) to appropriate the remainder to voluntary reserves.

|  | Millions of euros |
|--|-------------------|
| Total distributable income   | 1,754.39          |
| Distribution to:   |                   |
| Legal reserve  | 64.15             |
| Dividend (maximum distributable amount of 0.25 euros/share for all shares into which the Company's capital stock is divided (4,921,130,397 shares) | 1,230.28          |
| To voluntary reserves (minimum)  | 459.96            |
| <b>Total</b>   | <b>1,754.39</b>   |

It is hereby stated that at their meeting held on February 28, 2006, the Company's Board of Directors agreed to distribute a fixed interim dividend out of 2005 income of a gross 0.25 euros per share for each of the Company's outstanding shares carrying dividend rights, up to a maximum total amount of 1,230.28 million euros. This interim dividend will be paid on May 12, 2006. Consequently, the proposed dividend to be paid out of 2005 income will be fully settled through payment of this interim dividend.

### (4) Accounting Policies

The main valuation criteria used in preparing the 2005 financial statements were as follows:

#### a) Start-up expenses

"Start-up expenses," which comprise capital increase costs are amortized on a straight-line basis over five years.

#### b) Intangible assets

"Intangible assets" include mainly the following:

1. Computer software licenses, which are recorded at cost and amortized on a straight-line basis over three years.
2. Intellectual property, which are recorded at the amounts paid to acquire ownership of or rights to use patents and trademarks and are amortized on a straight-line basis over a period of three to ten years, depending on the estimated useful life of the patent or trademark.
3. The goodwill arising from the merger of Terra Networks España, S.A. and Maptel Networks, S.A.U. and Azeler Automoción, S.A. (companies in which indirect interests was held via Terra Networks Asociadas, S.L.). This goodwill was

included within Telefónica's investment in Terra Networks, S.A. at December 31, 2004. In the 2005 financial statements it has been reclassified due to the merger of Telefónica, S.A. and Terra Networks, S.A.

This goodwill is estimated to have a useful life of ten years and is included in "Other intangible assets."

#### c) Property, plant and equipment

Property, plant and equipment are stated at cost.

The costs of expansion, modernization or improvements leading to increased productivity, capacity or efficiency or to a lengthening of the useful lives of assets are capitalized.

The interest and other financial expenses incurred during the construction of property, plant and equipment are also capitalized.

Upkeep and maintenance expenses are expensed currently.

Property, plant and equipment are depreciated by the straight-line method at annual rates based on the following estimated useful lives:

|   | Years of estimated useful life |
|---|--------------------------------|
| Buildings   | 33-40                          |
| Plant and machinery   | 12                             |
| Furniture, office equipment and other tangible fixed assets | 4-10                           |

#### d) Long-term investments

Investments in marketable securities are recorded as follows:

1. Listed securities (excluding shares in Group or associated companies).

At the lower of cost or market value. The market value is taken to be the lower of the average market price in the last quarter or market price at year end.

2. Investments in Group and associated companies.

At the lower of acquisition cost or underlying book value of the holdings, adjusted by the amount of the unrealized gains existing at the time of the acquisition which still remain at the date of the subsequent valuation.

3. Other unlisted securities.

At cost, net, where appropriate, of the writedown provisions required to reduce them to their underlying book value, adjusted, where appropriate, for the amount of the unrealized gains existing at the time of the acquisition which still remain at the date of the subsequent valuation.

Unrealized losses (i.e. where cost is higher than market value) are recorded under "Provisions" (see Note 7). However, an additional provision is recorded with debit (or credit in the case of reversal) to "Extraordinary income or losses" to cover possible third-party liabilities arising from the negative net assets of investees. This

provision is included in "Provisions for contingencies and expenses" (see Note 16.6).

Dividends are recorded as revenues as soon as their distribution is approved, and gains or losses on the sale of holdings are recorded as revenues or expenses in the year in which they are realized.

As required under prevailing legislation the Company has prepared separate consolidated financial statements, which have been drawn up in accordance with International Financial Reporting Standards (IFRS). The balances of the main headings of the Telefónica Group consolidated financial statements for 2005 are as follows:

| Caption                                      | Millions of euros |
|--|-------------------|
| Total assets                                 | 73,173.77         |
| Equity                                       |                   |
| Attributable to equity holders of the parent | 12,733.29         |
| Attributable to minority interests           | 3,425.14          |
| Revenues                                     | 39,300.42         |
| Profit for the year                          |                   |
| Attributable to equity holders of the parent | 4,445.85          |
| Attributable to minority interests           | 381.21            |

#### e) *Deferred charges*

This heading basically includes the following items:

- Interest on long-term promissory notes.  
This relates to the difference between the face value and the effective value of the promissory notes issued to mature over more than one year. This interest is charged to profit or loss based on financial criteria.
- Debt arrangement expenses.  
These relate to long-term debt arrangement expenses and issues premiums on debentures and bonds, and are amortized using financial criteria on the basis of the principal amounts outstanding.
- Prepayments.  
These relate to payments made on the purchase of services not yet received at year end.

#### f) *Treasury stock*

Treasury stock is valued at the lower of average cost, comprising the total amount paid for the shares, or market value. Since the shares were acquired without any prior resolution having been adopted at the Shareholders' Meeting to use them to reduce capital, it is considered that they can be used for subsequent sale or, alternatively, for a capital reduction. Accordingly, the market value is taken to be the lowest of the average official market price in the last quarter of the year, the year-end market price or the related underlying book value. The corresponding provision is recorded against the income statement for the difference between the acquisition cost and the lower of the year-end market price or the average market price in the last quarter, and against reserves for the difference between said value and the related underlying book value.

#### g) *Foreign currency transactions*

Fixed-income securities and receivables and payables denominated in foreign currencies are translated to euros at the exchange rates ruling at the transaction date, and are adjusted at year end to the exchange rates then prevailing.

Exchange differences arising on adjustment of foreign currency fixed-income securities and receivables and payables to year-end exchange rates are classified by currency and due date, and for this purpose all currencies that, although different, are officially convertible are grouped together.

The positive net differences in each group of currencies are recorded under "Deferred income" on the liability side of the balance sheet, unless exchange losses for the group have been charged to profit and loss in prior years, in which case the positive net differences are credited to period income up to the limit of the negative net differences charged to income in prior years.

The positive differences deferred in prior years are credited to income in the year in which the related accounts receivable and payable fall due or are repaid early, or as each homogenous group records exchange losses for the same or a higher amount.

#### h) *Pension and other commitments to employees*

Telefónica has entered into an agreement with its employees, the main terms of which are as follows:

- Occupational Pension Plan pursuant to Legislative Royal Decree 1/2002, November 29 approving the revised Pension Plans and Funds Law.
- Defined contribution of 4.51% of the participating employees' base salary. The defined contributions of employees transferred to Telefónica from other Group companies with different defined contributions (e.g. 6.87% in the case of Telefónica de España) will be maintained.
- Obligatory contribution by the participant of a minimum of 2.2% of his/her base salary.
- Individual and financial capitalization systems.

This fund was outsourced to Telefónica subsidiary Fonditel Entidad Gestora de Fondos de Pensiones, S.A., which has added the pension fund assets to its Fonditel B fund.

At December 31, 2005 and 2004 respectively, 650 and 632 employees were members of the plan. The cost for the Company amounted to 2.73 million euros and 2.30 million euros in 2005 and 2004, respectively (see Note 16.2).

#### i) *Accounts payable*

Accounts payable are recorded at repayment value, except in the case of zero-coupon debenture and bond issues, which are recorded in the balance sheet at issue value plus the related accrued interest (see Note 10.3).

---

#### *j) Derivatives*

Transactions whose purpose and effect are to eliminate or significantly reduce exchange, interest rate or market risks on asset and liability positions or on other transactions are treated as hedging transactions. The gains or losses arising during the life of these derivatives are taken to income using the same timing of recognition method as that used to recognize the gains or losses on the underlying hedged item or transaction.

Transactions that, exceptionally, are not assigned to cover risks are not treated as hedging transactions. In transactions of this kind, which can arise because of risk hedges at Group companies, the differences in market price are booked when the transactions are cancelled or finally settled. However, if, at year end, potential losses are anticipated at year end, the related provision is recorded against the income statement.

#### *k) Corporate income tax*

The corporate income tax expense for each year is calculated on the basis of book profit before taxes, increased or decreased, as appropriate, by the permanent differences from taxable income. Tax relief and tax deductions from gross tax payable, excluding tax withholdings and prepayments, are deducted from the corporate income tax charge in the year in which they are definitively taken. The difference between the accrued expense and the tax paid is due to the abovementioned deferral and to revenue and expense recognition timing differences giving rise to deferred tax assets and liabilities (see Note 14).

#### *l) Recognition of revenues and expenses*

Revenues and expenses are recognized on an accrual basis, i.e. when the actual flow of the related goods and services occurs, irrespective of when the resulting monetary or financial flow arises.

In keeping with accounting principle of prudence, only realized income is recorded at year end, whereas foreseeable contingencies and losses, including possible losses, are recorded as soon as they become known (see Note 16).

#### *m) Provisions for contingencies and expenses*

The Company records provisions for contingencies and expenses based on its best estimate in order to cover quantifiable probable or certain third-party liability arising from litigation in progress, indemnity payments and obligations or from expenses of undetermined amount, and collateral and other similar guarantees provided by the Company.



## (5) Intangible Assets

The detail of the movements in intangible asset accounts and the related accumulated amortization in 2005 and 2004 is as follows:

| Millions of euros   | Computer software | Intellectual Property | Other intangible assets | Total         |
|---|-------------------|-----------------------|-------------------------|---------------|
| <b>Cost:</b>  |                   |                       |                         |               |
| <b>Balance at 12-31-03</b>                                | <b>71.72</b>      | <b>8.61</b>           | <b>2.76</b>             | <b>83.09</b>  |
| Incorporation of Inmobiliaria Telefónica, S.A.U. (Note 2) | 1.02              | –                     | –                       | 1.02          |
| Additions   | 14.63             | 0.36                  | 1.02                    | 16.01         |
| Retirements   | –                 | –                     | (2.13)                  | (2.13)        |
| Transfers   | 8.53              | (0.09)                | –                       | 8.44          |
| <b>Balance at 12-31-04</b>                                | <b>95.90</b>      | <b>8.88</b>           | <b>1.65</b>             | <b>106.43</b> |
| Merger with Terra Networks, S.A. (Note 2)                 | 43.10             | 11.03                 | 54.35                   | 108.48        |
| Additions   | 10.93             | 0.47                  | 5.63                    | 17.03         |
| Transfers   | 3.58              | –                     | –                       | 3.58          |
| <b>Balance at 12-31-05</b>                                | <b>153.51</b>     | <b>20.38</b>          | <b>61.63</b>            | <b>235.52</b> |
| <b>Accumulated amortization:</b>                          |                   |                       |                         |               |
| <b>Balance at 12-31-03</b>                                | <b>38.70</b>      | <b>3.60</b>           | <b>0.14</b>             | <b>42.44</b>  |
| Incorporation of Inmobiliaria Telefónica, S.A.U. (Note 2) | 0.16              | –                     | –                       | 0.16          |
| Additions   | 22.52             | 1.12                  | 0.11                    | 23.75         |
| Transfers   | 0.09              | (0.09)                | –                       | –             |
| <b>Balance at 12-31-04</b>                                | <b>61.47</b>      | <b>4.63</b>           | <b>0.25</b>             | <b>66.35</b>  |
| Merger with Terra Networks, S.A. (Note 2)                 | 41.37             | 9.60                  | 0.14                    | 51.11         |
| Additions   | 22.06             | 1.73                  | 6.87                    | 30.66         |
| <b>Balance at 12-31-05</b>                                | <b>124.90</b>     | <b>15.96</b>          | <b>7.26</b>             | <b>148.12</b> |
| <b>Impairment provisions</b>                              |                   |                       |                         |               |
| <b>Balance at 12-31-04</b>                                | <b>–</b>          | <b>–</b>              | <b>–</b>                | <b>–</b>      |
| Additions   | 1.44              | 0.93                  | 0.04                    | 2.41          |
| <b>Balance at 12-31-05</b>                                | <b>1.44</b>       | <b>0.93</b>           | <b>0.04</b>             | <b>2.41</b>   |
| <b>Intangible assets, net</b>                             | <b>27.17</b>      | <b>3.49</b>           | <b>54.33</b>            | <b>84.99</b>  |

The detail of goodwill included in “Other intangible assets” (see Note 4.b) is as follows:

| Millions of euros           | Initial allocation in the merger | Goodwill amortized in the year | Net balance at 12-31-05 |
|-----------------------------|----------------------------------|--------------------------------|-------------------------|
| Terra Networks España, S.A. | 52.27                            | 6.53                           | 45.74                   |
| Maptel Networks, S.A.U.     | 1.76                             | 0.22                           | 1.54                    |
| Azeler Automoción, S.A.     | 0.13                             | 0.02                           | 0.11                    |
| <b>Total</b>                | <b>54.16</b>                     | <b>6.77</b>                    | <b>47.39</b>            |

## (6) Property, plant and equipment

The detail of the movements in this heading and the related accumulated depreciation in 2005 is as follows:

| Millions of euros                                 | Balance at<br>12-31-04 | Merger<br>with Terra<br>Networks, S.A. | Additions     | Retirements   | Transfers     | Balance at<br>12-31-05 |
|---|------------------------|--|---------------|---------------|---------------|------------------------|
| <b>Cost:</b>                                      |                        |  |               |               |               |                        |
| Land and buildings                                | 220.21                 | –                                      | –             | (6.60)        | –             | 213.61                 |
| Furniture, tools and other items                  | 23.73                  | 15.12                                  | 0.53          | (0.06)        | 0.11          | 39.43                  |
| Property, plant and equipment under constructions | 79.88                  | –                                      | 279.62        | –             | (3.19)        | 356.31                 |
| Property, plant and equipment, gross              | 323.82                 | 15.12                                  | 280.15        | (6.66)        | (3.08)        | 609.35                 |
| <b>Accumulated depreciation:</b>                  |                        |  |               |               |               |                        |
| Land and buildings                                | 52.68                  | –                                      | 2.76          | (1.84)        | –             | 53.60                  |
| Furniture, tools and other items                  | 6.60                   | 13.49                                  | 1.92          | (0.03)        | –             | 21.98                  |
| <b>Total accumulated depreciation</b>             | <b>59.28</b>           | <b>13.49</b>                           | <b>4.68</b>   | <b>(1.87)</b> | <b>–</b>      | <b>75.58</b>           |
| <b>Impairment provision</b>                       | <b>2.95</b>            | <b>–</b>                               | <b>1.19</b>   | <b>–</b>      | <b>–</b>      | <b>4.14</b>            |
| <b>Property, plant and equipment, net</b>         | <b>261.59</b>          | <b>1.63</b>                            | <b>274.28</b> | <b>(4.79)</b> | <b>(3.08)</b> | <b>529.63</b>          |

The detail of the movements in this heading and the related accumulated depreciation in 2004 are as follows:

| Millions of euros                                 | Balance at<br>12-31-03 | Inclusion of<br>Inmobiliaria<br>Telefónica,<br>S.A.U. | Additions    | Retirements   | Transfers     | Balance at<br>12-31-04 |
|---|------------------------|---|--------------|---------------|---------------|------------------------|
| <b>Cost:</b>                                      |                        |   |              |               |               |                        |
| Land and buildings                                | 0.81                   | 137.57  | 10.72        | –             | 71.11         | 220.21                 |
| Furniture, tools and other items                  | 22.47                  | 0.56  | 0.59         | (0.69)        | 0.80          | 23.73                  |
| Property, plant and equipment under constructions | 9.23                   | 88.21   | 63.18        | (0.39)        | (80.35)       | 79.88                  |
| <b>Property, plant and equipment, gross</b>       | <b>32.51</b>           | <b>226.34</b>   | <b>74.49</b> | <b>(1.08)</b> | <b>(8.44)</b> | <b>323.82</b>          |
| <b>Accumulated depreciation:</b>                  |                        |   |              |               |               |                        |
| Land and buildings                                | 0.18                   | 49.87   | 2.79         | (0.16)        | –             | 52.68                  |
| Furniture, tools and other items                  | 4.27                   | 0.50  | 1.83         | –             | –             | 6.60                   |
| <b>Total accumulated depreciation</b>             | <b>4.45</b>            | <b>50.37</b>  | <b>4.62</b>  | <b>(0.16)</b> | <b>–</b>      | <b>59.28</b>           |
| <b>Impairment provisions</b>                      | <b>–</b>               | <b>2.57</b>   | <b>0.38</b>  | <b>–</b>      | <b>–</b>      | <b>2.95</b>            |
| <b>Property, plant and equipment, net</b>         | <b>28.06</b>           | <b>173.40</b>   | <b>69.49</b> | <b>(0.92)</b> | <b>(8.44)</b> | <b>261.59</b>          |

Most of the additions recorded in 2005 relate to costs associated with the construction of the new Telefónica Group central offices (named “District C”) in a business park development in Las Tablas (Madrid). “Land and buildings” includes 80.33 million euros corresponding to the value of the land. All other costs incurred are classified under “Property, plant and equipment under constructions” until the assets in question are available for use. Phase one of the new central office development is scheduled to be completed in the second half of 2006.

At December 31, 2005 the total value of firm commitments to acquire property, plant and equipment related to the construction of District C was 170.45 million euros.

Capitalized interest and other financial expenses incurred in the construction of property, plant and equipment in 2005 came to 8.79 million euros (up from 1.72 million euros in 2004).

The Company has leased buildings with a total area of 41,187 square meters to various Telefónica Group companies, which is equivalent to an occupancy rate of 95.70% of total property available for lease. Revenues from property leases amounted to 7.30 million euros in 2005 (see Note 16.1), compared with 6.32 million euros in 2004.

In 2005 the Company recorded a capital gain on the disposal of property of 5.26 million euros, compared with 6.09 million euros in 2004 (see Note 16.6).

At December 31, 2005, the Company's fully depreciated property, plant and equipment amounted to 16.54 million euros.

Telefónica, S.A. has taken out insurance policies with appropriate limits to cover the possible risks to which its property, plant and equipment are exposed.

## (7) Long-Term Investments

**7.1.** The detail of the movements in long-term investments and the related investment writedown provisions in 2005 is the following:

### a) Changes in long-term investments:

| Millions of euros                       | Balance at<br>12-31-04 | Merger<br>with Terra<br>Networks,<br>S.A. | Dissolution<br>Terra<br>Networks<br>Latam, S.L. | Additions       | Retirements       | Transfers<br>and other | Balance at<br>12-31-05 |
|---|------------------------|---|---|-----------------|-------------------|------------------------|------------------------|
| Investments in Group companies          | 22,415.48              | (2,097.72)                                | 628.02  | 3,667.76        | (1,199.48)        | (286.37)               | 23,127.69              |
| Investments in associated companies     | 1,479.16               | 189.83                                    | -   | 2.97            | (6.35)            | (567.45)               | 1,098.16               |
| Other investments                       | 14.42                  | -   | -   | 1,265.83        | -                 | 567.45                 | 1,847.70               |
| Loans to Group and associated companies | 20,531.41              | 438.57                                    | -   | 3,827.71        | (4,260.97)        | (6,532.06)             | 14,004.66              |
| Other loans                             | 55.17                  | -   | -   | 693.41          | (747.99)          | -                      | 0.59                   |
| Deposits and guarantees                 | 35.05                  | 0.62                                      | -   | 278.75          | (308.01)          | -                      | 6.41                   |
| Tax receivables (Note 14.2)             | 4,343.19               | 116.35                                    | -   | 103.77          | (1,307.62)        | -                      | 3,255.69               |
| <b>Total</b>                            | <b>48,873.88</b>       | <b>(1,352.35)</b>                         | <b>628.02</b>                                   | <b>9,840.20</b> | <b>(7,830.42)</b> | <b>(6,818.43)</b>      | <b>43,340.90</b>       |

| Millions of euros                       | Balance at<br>12-31-03 | Additions       | Retirements       | Transfers<br>and other | Balance at<br>12-31-04 |
|---|------------------------|-----------------|-------------------|------------------------|------------------------|
| Investments in Group companies          | 23,374.86              | 22.80           | (877.71)          | (104.47)               | 22,415.48              |
| Investments in associated companies     | 1,005.42               | 475.14          | (1.40)            | -                      | 1,479.16               |
| Other investments                       | 6.82                   | 0.49            | (0.01)            | 7.12                   | 14.42                  |
| Loans to Group and associated companies | 19,729.71              | 3,381.79        | (1,673.61)        | (906.48)               | 20,531.41              |
| Other loans                             | 70.26                  | -               | (1.89)            | (13.20)                | 55.17                  |
| Deposits and guarantees                 | 3.22                   | 29.32           | -                 | 2.51                   | 35.05                  |
| Tax receivables (Note 14.2)             | 5,000.10               | 139.99          | -                 | (796.90)               | 4,343.19               |
| <b>Total</b>                            | <b>49,190.39</b>       | <b>4,049.53</b> | <b>(2,554.62)</b> | <b>(1,811.42)</b>      | <b>48,873.88</b>       |

**b) Changes in the long-term investment writedown provisions:**

| Millions of euros                           | Balance at<br>12-31-04 | Merger<br>Terra<br>Networks,<br>S.A. | Dissolution<br>Terra<br>Networks<br>Latam, S.L. | Change in<br>provisions | Retirements       | Transfers<br>and other | Balance at<br>12-31-05 |
|---|------------------------|--------------------------------------|---|-------------------------|-------------------|------------------------|------------------------|
| Investments in Group companies              | 5,313.55               | (946.23)                             | 612.83  | (224.32)                | (1,034.46)        | (281.31)               | 3,440.06               |
| Investments in associated companies         | 153.22                 | 41.33                                | –   | (64.94)                 | (0.62)            | (43.09)                | 85.90                  |
| Other investments                           | 5.57                   | –                                    | –   | (24.19)                 | –                 | 56.13                  | 37.51                  |
| <b>Total investment writedown provision</b> | <b>5,472.34</b>        | <b>(904.90)</b>                      | <b>612.83</b>                                   | <b>(313.45)</b>         | <b>(1,035.08)</b> | <b>(268.27)</b>        | <b>3,563.47</b>        |

| Millions of euros                           | Balance at<br>12-31-03 | Change in<br>provisions | Retirements   | Transfers<br>and other | Balance at<br>12-31-04 |
|---|------------------------|-------------------------|---------------|------------------------|------------------------|
| Investments in Group companies              | 6,121.08               | (801.55)                | (2.85)        | (3.13)                 | 5,313.55               |
| Investments in associated companies         | 113.44                 | 39.78                   | –             | –                      | 153.22                 |
| Other investments                           | 5.57                   | –                       | –             | –                      | 5.57                   |
| <b>Total investment writedown provision</b> | <b>6,240.09</b>        | <b>(761.77)</b>         | <b>(2.85)</b> | <b>(3.13)</b>          | <b>5,472.34</b>        |

Most of the subsidiaries for which the Company had established provisions at the end of 2004 enjoyed further improvements in their net worth in 2005 (principally Telefónica Internacional Group, for which a reversion of 301.03 million euros was made at the end of 2005). A provision for Atento, N.V. (35.78 million euros) was also released. Provisions were also recorded at the year end, mainly on account of the Telefónica de Contenidos Group (105.60 million euros) and Telefónica Datacorp Group (56.74 million euros).

The main change in provisions for associated companies was a 67.31 million euro reversion of a provision for Telefónica's investment in Portugal Telecom, S.G.P.S., S.A.

The Company had already recorded a sizeable reversal of the investment writedown provision in 2004, again mainly for its investment in the Telefónica Internacional Group (1,056.87 million euros). The main additions related to investments in the Telefónica International Wholesale Services (TIWS) Group (61.73 million euros), the Telefónica de Contenidos Group (296.83 million euro) and Telefónica DataCorp Group (47.14 million euros).

Retirements recorded in 2005 and 2004 correspond to investments sold, liquidated or transferred in the course of the year (see 7.5 of this Note).

The transfer from "Investments in associated companies" to "Other investments" recorded in 2005 relates to the Company's holdings in Banco Bilbao Vizcaya Argentaria, S.A. and Amper, S.A. (see Appendix I)

**7.2.** The detail of subsidiaries, associated companies and investees is provided in Appendix I.

### 7.3. Impact on long-term investments of the merger of Telefónica, S.A. and Terra Networks, S.A.

The proposed takeover of Terra Networks, S.A. by Telefónica, S.A. was approved at the General Shareholders' Meetings of Telefónica, S.A. and Terra Networks, S.A. held on May 31, 2005 and June 2, 2005 respectively. This takeover merger was registered in the Madrid Mercantile Register on July 16, 2005, effective for accounting purposes from January 1, 2005 (see Note 1).

The detail of Terra Networks, S.A.'s contributions on January 1, 2005 to "Investments in Group companies", "Investments in associated companies" and the corresponding investment writedown provisions shown in the financial statements of Telefónica, S.A., is as follows:

| Millions of euros                          | Acquisition cost | Investment writedown provisions | Additional provision for negative net book value of the investment (see Note 4.d) |
|--|------------------|---------------------------------|---|
| <b>Investments in Group companies</b>      |                  |                                 |   |
| Terra Networks España, S.A.U.              | 93.97            | (93.97)                         | (374.09)  |
| Terra Intangibles, S.A.                    | 19.29            | (5.41)                          | –   |
| Terra Business Travel, S.A.                | 0.56             | –                               | –   |
| Le Holding Corporation                     | 47.88            | (1.31)                          | –   |
| Terra Networks, USA, Inc                   | 7.76             | (0.79)                          | –   |
| CIERV, S.L.                                | 10.08            | (10.08)                         | –   |
| CRTT, S.L.                                 | 12.40            | (12.40)                         | (8.04)  |
| Terra Lycos Holding, B.V                   | 0.02             | (0.02)                          | –   |
| Terra Networks Asociadas, S.L.             | 61.12            | (61.12)                         | (17.67)   |
| Terra Networks Colombia Holding, S.A.      | 6.50             | (6.50)                          | (0.55)  |
| Terra Networks Latam ETVE, S.L             | 540.69           | (450.14)                        | –   |
| <b>Total Group companies</b>               | <b>800.27</b>    | <b>(641.74)</b>                 | <b>(400.35)</b>   |
| <b>Investments in associated companies</b> |                  |                                 |   |
| Uno-e Bank, S.A.                           | 189.83           | (41.33)                         | –   |

The effect of the incorporation of the investments of Terra Networks, S.A. described above, combined with the retirement of the investment in Terra Networks, S.A. held by Telefónica S.A. at December 31, 2004, which was recognized at a gross value of 2,897.99 million euros (less investment writedown provisions of 1,587.97 million euros), is shown in the "Merger with Terra Networks, S.A." column of the tables of changes in long-term investments and investment writedown provisions.

#### 7.4. Impact on long-term investments of the dissolution of Terra Networks Latam.

The deed for the dissolution without liquidation of Terra Networks Latam ETVE, S.L. through the overall transfer of its assets and liabilities to Telefónica, S.A., which via the above merger became owner of all shares constituting its capital stock, was formalized on June 9, 2005. The detail of the amounts transferred from Terra Networks Latam ETVE, S.L. to “Investments in Group companies” and “Investment writedown provisions” is as follows:

| Millions of euros                                  | Acquisition cost | Investment writedown provisions | Additional provision for negative net book value of the investment (see Note 4.d) |
|--|------------------|---------------------------------|---|
| Telefónica Interactiva Brasil, Ltda.               | 359.66           | (259.88)                        | –   |
| T. N. Brasil, S.A.                                 | 174.84           | (174.84)                        | –   |
| T.N. México Holding, S.A. de C.V.                  | 356.66           | (356.66)                        | (29.91)   |
| T.N. Chile Holding Limitada, S.A.                  | 95.18            | (70.28)                         | –   |
| T.N. Perú, S.A.                                    | 52.80            | (51.36)                         | –   |
| T.N. Argentina, S.A.                               | 50.92            | (50.92)                         | (0.4)   |
| T.N. Colombia Holding, S.A.                        | 40.52            | (40.52)                         | (1.31)  |
| T.N. Servicios de Acceso a Internet e Trading, Lda | 0.01             | (0.01)                          | –   |
| T.N. Venezuela, S.A.                               | 20.88            | (20.88)                         | (1.79)  |
| T.N. Maroc, S.A.R.L.                               | 0.03             | (0.03)                          | –   |
| T.N. Guatemala, S.A.                               | 17.22            | (17.22)                         | (0.27)  |
| <b>Total</b>                                       | <b>1,168.72</b>  | <b>(1,042.60)</b>               | <b>(33.68)</b>  |

The effect of the incorporation of the investments of Terra Networks Latam ETVE, S.L. described above, combined with the retirement of the investment in Terra Networks Latam ETVE, S.L. held by Telefónica S.A. on the date of its dissolution which was recorded at a gross value of 540.70 million euros, (less investment writedown provisions of 429.77 million euros), is shown in the “Dissolution of Terra Networks Latam, S.L.” column of the tables of changes in long-term investments and investment writedown provisions.

#### 7.5. The detail of securities investments sold and acquired by Telefónica is as follows:

##### a) Acquisitions of participations and capital increases:

##### 2005

##### Companies

Millions of euros

##### Subsidiaries:

|                     |          |
|---------------------|----------|
| Cesky Telecom, a.s. | 3,662.53 |
| Others              | 5.23     |

**Total subsidiaries** **3,667.76**

##### Associated companies:

|                                   |             |
|-----------------------------------|-------------|
| Sogecable, S.A.                   | 2.97        |
| <b>Total associated companies</b> | <b>2.97</b> |

##### Other securities investments

|   |                 |
|---|-----------------|
| O2 Plc                                    | 1,265.83        |
| <b>Total other securities investments</b> | <b>1,265.83</b> |

The European Commission approved Telefónica’s bid to take control of Czech operator Cesky Telecom a.s. via the acquisition of 51.1% of its share capital on June 10, 2005 and the transaction was concluded on June 16 at a price of 502 Czech crowns per share. As part of the takeover process, Telefónica launched a tender offer to buyout the 48.9% of Cesky Telecom held by minority shareholders. The offer was completed on September 19, with Telefónica having acquired 58,985,703 shares at a price of 456 Czech crowns per share.

Telefónica's total outlay in the acquisition of the Czech company was therefore 3,662.53 million euros. At the close of the operation, Telefónica owned 69.41% of the total share capital of the Czech telecoms operator.

Sogecable, S.A. increased its share capital by 7,560,261 shares each with a par value of 2 euros each with a share premium of 22.47 euros in the course of 2005. Telefónica subscribed to the capital increase, buying 121,200 shares and paying a total of 2.97 million euros and maintains its 1.60% direct interest in Sogecable's capital.

"Other investments" include the acquisition of O2, Plc shares on the London Stock Exchange, subsequent to the takeover bid for 100% of the company launched by Telefónica. At December 31, 2005, Telefónica owned 435,606,107 shares in O2 plc, equivalent to approximately 4.97% of its capital stock. The cost of acquiring these shares was 1,265.83 million euros (see Note 19 on subsequent events).

## 2004

| Company                            | Millions of euros |
|------------------------------------|-------------------|
| <b>Subsidiaries:</b>               |                   |
| Terra Networks, S.A.               | 10.69             |
| Telefónica Móviles, S.A.           | 6.92              |
| Telfisa Perú SAC                   | 2.75              |
| Other companies                    | 2.44              |
| <b>Total subsidiaries:</b>         | <b>22.80</b>      |
| <b>Associated companies:</b>       |                   |
| Portugal Telecom, S.G.P.S., S.A.   | 475.14            |
| <b>Total associated companies:</b> | <b>475.14</b>     |

Telefónica, S.A. acquired 52,820,862 shares in Portugal Telecom, S.G.P.S., S.A. for 475.14 million euros in 2004. In addition, on December 29, 2004 Portugal Telecom reduced capital by canceling 87,799,950 shares of treasury stock representing 7% of its capital stock. Following these transactions, Telefónica increased its direct holding in this company to 8.55%.

In 2004, Telefónica, S.A. also acquired 3,753,140 shares of Terra Networks, S.A. on the stock market for 10.69 million euros. The direct holding in this company at December 31, 2004 was 76.80%, taking into account the treasury stock held by Terra Networks, S.A.

Telefónica, S.A. also acquired 804,689 shares of Telefónica Móviles, S.A. for 6.92 million euros, thereby increasing its direct holding in this company to 71.03% at December 31, 2004.

Telfisa Perú, S.A.C. was incorporated in December 2004 with an initial capital of 12 million new soles, consisting of 120,000 shares, 119,999 of which were bought and paid by the Company for 2.75 million euros.

## b) Disposal of investments

| Company   | Gross book value |
|---|------------------|
| <b>Subsidiaries</b>   |                  |
| Terra Group companies in Latin America                              | 1,182.93         |
| Telefónica Gestión de Servicios Compartidos México, S.A. de C.V.    | 6.75             |
| Telefónica Gestao de Serviços Compartilhados do Brasil, Ltda.       | 5.00             |
| Telefónica Gestión de Servicios Compartidos Perú, S.A.C.            | 3.91             |
| Telefónica Gestión de Servicios Compartidos Argentina, S.A. de C.V. | 0.01             |
| Telefónica Publicidad e Información, S.A.                           | 0.08             |
| Other companies   | 0.80             |
| <b>Total subsidiaries</b>   | <b>1,199.48</b>  |
| <b>Associated companies</b>   |                  |
| Portugal Telecom, S.G.P.S., S.A.                                    | 5.13             |
| Other companies   | 1.22             |
| <b>Total associated companies</b>                                   | <b>6.35</b>      |

In line with the strategy for business management pursued by the Company in recent years, following the dissolution of Terra Networks Latam ETVE, S.L., Telefónica, S.A. sold the companies that the Terra Group formerly operated in Latin America to its subsidiary Telefónica Internacional, S.A.U. The companies were sold at the values resulting from the merger with Terra Networks, S.A. and the dissolution of Terra Networks Latam ETVE, S.L., thereby generating a total gain for Telefónica, S.A. of 45.99 million euros and losses of 3.14 million euros (see Notes 16.6 and 16.7).

In 2005, Telefónica also sold all its interests in the Mexican company Telefónica Gestión de Servicios Compartidos México, S.A. de C.V., Brazilian company Telefónica Gestao de Serviços Compartilhados do Brasil, Ltda., Argentine company Telefónica Gestión de Servicios Compartidos Argentina, S.A. and Peruvian company Telefónica Gestión de Servicios Compartidos Perú S.A.C. to its Spanish subsidiary Telefónica Gestión de Servicios Compartidos, S.A. at their underlying book value.

On June 6, 2005 Telefónica, S.A. sold 4,300,000 shares representing 1.19% of the capital stock of Telefónica Publicidad e Información, S.A., generating a capital gain of 28.65 million euros recorded under "Gains on fixed asset disposals" (see Note 16.6). At December 31, 2005, Telefónica, S.A.'s ownership interest in Telefónica Publicidad e Información, S.A. was 59.905%.

In the course of 2005 Telefónica, S.A. also sold 611,824 shares in Portugal Telecom, S.G.P.S., S.A. for a total of 5.13 million euros, generating a capital gain on disposal of 1.18 million euro (see Note 16.6). On December 21, Portugal Telecom cancelled 37,628,550 shares of treasury stock representing 3.23% of its current capital stock. After this operation, Telefónica owned 8.78% of the total capital stock of the Portuguese company.

| Company  | Gross book value |
|--|------------------|
| <b>Subsidiaries</b>  |                  |
| Terra Networks, S.A.                                       | 868.65           |
| Corporación Admira Media, S.A.U.                           | 6.06             |
| Telefónica Procesos y Tecnología de la Información, S.A.U. | 3.00             |
| <b>Total subsidiaries</b>                                  | <b>877.71</b>    |



In 2004 Terra Networks, S.A. paid a dividend of two euros per share charged to "Share premium." This refund of capital contributions reduced the value of the holding by the amount received, but did not change the Company's percentage of ownership.

In the first quarter of 2004 Telefónica, S.A. sold its 100% holding in Corporación Admira Media, S.A. to its subsidiary Telefónica de Contenidos, S.A.U. at its underlying book value. Subsequently, Corporación Admira Media, S.A. was merged into Telefónica de Contenidos, S.A.U. The gain booked by Telefónica, S.A. in its individual financial statements on this sale amounted to 4.12 million euros (see Note 16.6).

Telefónica, S.A. also sold its 100% holding in Telefónica Procesos y Tecnología de la Información, S.A.U. to its investee Telefónica Gestión de Servicios Compartidos, S.A.U. at the underlying book value of the investment, obtaining a gain of 5.70 million euros (see Note 16.6).

#### ***c) Non-monetary contributions of holdings to Group companies***

##### **2005**

On April 19, 2005, Telefónica's Spanish subsidiary Telefónica Datacorp, S.A., Telefónica Wholesale Services, S.L. (TIWS) increased its capital by 212.68 million euros. The new shares were subscribed and paid in full by Telefónica, S.A. via the non-monetary contribution of its holding in Uruguayan company Telefónica International Wholesale Services America, S.A. The gross book value of this participation was 499.05 million euros and the investment writedown provision was 286.37 million euros. At the close of the operation, Telefónica's direct ownership interest in TIWS's capital was 92.513%.

##### **2004**

In 2004 Telefónica Gestión de Servicios Compartidos, S.A.U. increased capital through the issuance of 5,468,186 new shares with a par value of one euro each, which were fully subscribed by its sole shareholder Telefónica, S.A. through the contribution of its 100% holding in Zeleris, Soluciones Integrales, S.A.U.

#### ***d) Transactions protected for tax purposes***

Transactions carried out in 2005 and 2004 that are considered protected for tax purposes, as defined in Articles 83 and 94, as applicable, of Chapter VII of Title VII of Legislative Royal Decree 4/2004 of March 5 approving the Revised Spanish Corporate Income Tax Law, are detailed in the following paragraphs. Transactions performed prior to 2004 were duly disclosed in prior years' financial statements.

##### **2005**

In 2005, Terra Networks, S.A. was taken over by Telefónica, S.A. and consequently dissolved. The operation included the block transfer of all Terra's assets and liabilities to Telefónica, S.A., which, via the overall transfer, assumed all its rights and obligations.

The dissolution without liquidation of Terra Networks Latam ETVE, S.L, through the overall transfer of its assets and liabilities to Telefónica,

S.A., which following the merger with Terra Networks, S.A., became owner of all shares constituting its capital stock, was ratified by public deed on June 9, 2005.

##### **2004**

In 2004 Inmobiliaria Telefónica, S.L.U. was dissolved without liquidation, and subsequently extinguished, through the overall transfer of its assets and liabilities to its sole shareholder. The value of this company per Telefónica, S.A.'s books was 103.44 million euros and the difference from the net assets contributed in the transfer of assets and liabilities (19.43 million euros) is classified as unrestricted reserves under "Shareholders' equity" in the accompanying balance sheet.

**7.6.** The detail of loans to Group and associated companies is as follows:

Millions of euros

| Company   | 2005             |                 | 2004             |                 |
|---|------------------|-----------------|------------------|-----------------|
|   | Long-term        | Short-term      | Long-term        | Short-term      |
| Telefónica Móviles, S.A.                                  | 5,890.00         | 3,362.73        | 7,276.43         | 1,739.86        |
| Telefónica de España, S.A.U.                              | 4,587.91         | 1,493.50        | 5,365.97         | 1,361.52        |
| Telefónica Internacional, S.A.                            | 1,087.58         | 2,260.16        | 5,081.88         | 459.09          |
| Telefónica de Contenidos, S.A.U.                          | 1,411.19         | 84.71           | 1,783.41         | 147.59          |
| Telefónica International Wholesale Services America, S.A. | 157.94           | 296.69          | 283.62           | 120.87          |
| Terra Networks España, S.A.                               | 397.03           | 12.67           | –                | –               |
| Atento, N.V.  | 103.63           | 52.44           | 144.48           | 28.06           |
| Telefónica Datacorp, S.A.U.                               | 96.57            | 73.54           | 285.80           | 155.78          |
| Telefónica Móviles España, S.A.U.                         | 0.40             | 1,818.35        | 0.40             | 2,057.60        |
| Telefónica Publicidad e Información, S.A.                 | 87.96            | 14.80           | 86.98            | 11.21           |
| Comunicapital Inversiones, S.A.U.                         | 65.60            | –               | 55.06            | –               |
| Lotca, Servicios Integrales, S.A.U.                       | 45.93            | 3.64            | 25.69            | 2.64            |
| Terra Networks Asociadas, S.L.                            | 33.04            | 0.72            | –                | –               |
| Terra Networks, S.A.                                      | –                | –               | 26.18            | –               |
| Telefónica Soluciones de Informática y Comunicación S.A.  | –                | –               | –                | 12.77           |
| Telefónica B2B Licencing Inc.                             | 11.78            | –               | 10.20            | –               |
| Telefónica Internacional Wholesale Services, S.L.         | –                | 86.42           | 86.40            | 12.44           |
| Telefónica Data España, S.A.                              | –                | 33.21           | –                | 50.51           |
| Others  | 28.10            | 20.57           | 18.91            | 24.42           |
| <b>Total</b>  | <b>14,004.66</b> | <b>9,614.15</b> | <b>20,531.41</b> | <b>6,184.36</b> |

The main loans granted to Group companies are described below.

- Loans granted to Telefónica Móviles, S.A. consist mainly of the following:

Loans to provide funds for the acquisition of the various Latin American operators owned by BellSouth amounting to 3,283.52 million euros and 1,597.03 million dollars (1,353.75 million euros) bearing interest at three-month Euribor and three-month Libor rates plus a predetermined market spread. The loans in euros mature in 2006, while the US dollar loans fall due in 2009 and 2016.

Financing of 469.67 million euros and 240.27 million dollars (203.67 million euros), earning interest at rates based on the Libor or Euribor plus a predetermined spread and repayable by 2011 at the latest, for the company's investments in Puerto Rico, Chile, Guatemala, Brazil and Argentina.

Financing for the direct or indirect acquisition of or investments in companies in Mexico and Uruguay amounting to 2,567.65 million euros and 281.30 million dollars (238.45 million euros), earning interest at market rates and maturing in 2007, 2008 and 2009.

- Funding granted to Telefónica de España, S.A.U. consists mainly of a loan on January 4, 1999 resulting from the company's spin-off from Telefónica on January 1, 1999, that bears interest at 6.80% and had an outstanding balance of 4,882.68 million euros at December 31, 2005, of which 4,185.17 million euros mature in the long term and 697.51 million euro mature in the short term.

- Loans granted to Telefónica Internacional, S.A.U. consist mainly of the following:

A subordinated long-term interest-free loan of 3,305.57 million euros, repayable in 12 equal quarterly installments from September 30, 2005 to June 30, 2008. At December 31, 2005, this loan had an outstanding balance of 1,730.50 million euros.

A participating loan with an outstanding balance of 1,414.26 million euros at December 31, 2005 that falls due on December 30, 2006. Interest is calculated based on the company's net income and the loan can only be cancelled early by means of conversion to capital stock.

- The main loans granted to Telefónica de Contenidos, S.A.U. are as follows:

A fully drawn down ten-year participating loan of 1,141.81 million euros, which bears interest based on Telefónica de Contenidos, S.A.U.'s business performance.

A participating loan of 79.23 million euros maturing in 2015 to provide Telefónica de Contenidos, S.A.U.'s funding to cover the financial charges linked to the participating loan detailed above.

A loan of 190.16 million euros to cover the disbursement of the subordinated loan granted to the company and Sogetel, S.A. in 2003 for the merger of DTS, Distribuidora de Televisión Digital, S.A. (Vía Digital) into Sogetel, S.A.

- A participating loan of 536.32 million dollars (454.63 million euros) to Telefónica International Wholesale Services, S.A., which bears interest based on the performance of the company's operating results, with repayments from July 2004 to July 31, 2007. The loan amount was fully drawn at December 31, 2005.
- Terra Networks, S.A. had granted a 397.03 million euros participating loan to Terra Networks España, S.A., which was assumed by Telefónica, S.A. under the terms of the merger (see Note 1). This loan matures on November 30, 2008 and bears interest at a rate based on Terra Networks España's earnings. In 2005 the loan earned interest of 12.67 million euros.
- Loans granted to Atento, N.V. consist of the following:

A participating loan for 75 million euros, repayable in 2013. The loan bears interest based on Atento, N.V.'s operating profit. At December 31, 2005, this loan had an outstanding balance of 60 million euros.

Loan of 213.73 million euros to cater for its subrogation to the position of Atento Holding with its subsidiaries, earning interest at market rates and maturing in 2008. The balance outstanding at December 31, 2005 was 96.07 million euros.
- The financing provided to Telefónica Datacorp, S.A.U. relates to several credit facilities and loans arising from debt refinancing totaling 446.51 million euros and 5.10 million dollars (4.32 million euros), earning interest at a variable rate linked mainly to the three-month Euribor and maturing in 2006 and 2007. The balance outstanding at December 31, 2005 was 165.41 million euros.
- The Company has also extended loans to Telefónica Móviles España, S.A. and Telefónica de España, S.A.U. mainly in connection with the taxation of Telefónica, S.A. as the head of the tax Group pursuant to the consolidated tax regime applicable to corporate groups (see Note 14).

The balance of loans to Group companies also includes interest accrued but unpaid at December 31, 2005 amounting to 198.56 million euros (96.21 million euros at December 31, 2004).

The transfers under the "Loans to Group and associated companies" column of the table of changes in investments relate mainly to movements to short-term investments based on the loan repayment schedules.

## 7.7. Short-term investment securities

These consist mainly of placements of temporary cash surpluses in short-term investments.

## (8) Deferred Charges

The detail of this heading and the related amortization schedule at December 31, 2005 and 2004 is as follows:

|  | 2006         | 2007         | Maturity<br>2008 | 2009         | 2010         | Subsequent<br>years | Balance at<br>12-31-05 | Balance at<br>12-31-04 |
|--|--------------|--------------|------------------|--------------|--------------|---------------------|------------------------|------------------------|
| Interest on long-term promissory notes | 7.34         | 7.13         | 7.27             | 7.42         | 7.66         | 0.95                | 37.77                  | 44.48                  |
| Debt arrangement expenses              | 45.48        | 26.92        | 25.43            | 20.59        | 19.54        | 35.03               | 172.99                 | 162.66                 |
| Other deferred charges                 | 10.82        | 10.51        | 10.40            | 8.10         | 5.46         | 8.99                | 54.28                  | 59.08                  |
| <b>Total</b>                           | <b>63.64</b> | <b>44.56</b> | <b>43.10</b>     | <b>36.11</b> | <b>32.66</b> | <b>44.97</b>        | <b>265.04</b>          | <b>266.22</b>          |

## (9) Shareholders' equity

The detail of the movements in this heading in 2004 and 2005 is the following:

|                            | Balance at<br>12-31-03 | Appropriation<br>of 2003<br>income | Distribution<br>of dividends | Other<br>changes | Balance at<br>12-31-04 | Appropriation<br>of 2004<br>income | Distribution<br>of share<br>premium | Other<br>changes  | Balance at<br>12-31-05 |
|----------------------------|------------------------|------------------------------------|------------------------------|------------------|------------------------|------------------------------------|-------------------------------------|-------------------|------------------------|
| Capital stock              | 4,955.89               | -                                  | -                            | -                | 4,955.89               | -                                  | -                                   | (34.76)           | 4,921.13               |
| Share premium              | 7,987.14               | -                                  | (951.64)                     | (1,747.82)       | 5,287.68               | -                                  | (1,296.27)                          | (2,320.58)        | 1,670.83               |
| Revaluation reserves       | 1,368.89               | -                                  | -                            | -                | 1,368.89               | -                                  | -                                   | -                 | 1,368.89               |
| Legal reserve              | 652.57                 | 137.37                             | -                            | -                | 789.94                 | 130.14                             | -                                   | -                 | 920.08                 |
| Voluntary reserve          | -                      | 1,236.34                           | (972.53)                     | (263.81)         | -                      | 88.11                              | -                                   | (88.11)           | -                      |
| Reserve for treasury stock | 133.46                 | -                                  | -                            | 556.72           | 690.18                 | -                                  | -                                   | (341.70)          | 348.48                 |
| Other restricted reserves  | 5.40                   | -                                  | -                            | -                | 5.40                   | -                                  | -                                   | -                 | 5.40                   |
| Income (loss) for the year | 1,373.71               | (1,373.71)                         | -                            | 1,301.40         | 1,301.40               | (1,301.40)                         | -                                   | 1,754.39          | 1,754.39               |
| <b>Total</b>               | <b>16,477.06</b>       | <b>-</b>                           | <b>(1,924.17)</b>            | <b>(153.51)</b>  | <b>14,399.38</b>       | <b>(1,083.15)</b>                  | <b>(1,296.27)</b>                   | <b>(1,030.76)</b> | <b>10,989.20</b>       |

### a) Capital stock

At December 31, 2005, Telefónica, S.A.'s capital stock totaled 4,921,130,397 euros and consisted of 4,921,130,397 fully paid common shares of a single series and a par value of one euro each, all recorded by the book-entry system and traded on the Spanish computerized trading system ("Continuous Market") (in the selective "Ibex 35" Index), on the four Spanish Stock Exchanges (Madrid, Barcelona, Valencia and Bilbao) and on the New York, London, Paris, Frankfurt, Tokyo, Buenos Aires, Sao Paulo and Lima Stock Exchanges.

On June 15, 2001, authorization was given at the Shareholders' Meeting of Telefónica, S.A. for the Board of Directors to increase the Company's capital, one or several times within a maximum period of five years from that date, under the terms of Article 153.1.b) of Spanish Corporation Law (authorized capital) up to a maximum of 2,274.68 million euros, by issuing for this purpose the related new common shares, whether redeemable or of any other type permitted by Law, with a fixed or variable premium, with or without pre-emptive subscription rights and, in all cases, with disbursements for the new shares issued in the form of monetary contributions. As of December 31, 2005, the Board of Directors had not made use of this authorization.

In addition, at the Shareholders' Meeting of April 11, 2003, the Board of Directors was granted the powers necessary to issue fixed-

income securities one or several times within a maximum period of five years from the date of adoption of the related resolution. The fixed-income securities issued may be debentures, bonds, promissory notes or any other kind of fixed-income security, both simple and, in the case of debentures and bonds, exchangeable for shares of the Company or any other Group company and/or convertible into shares of the Company. As of December 31, 2005, the Board of Directors had not exercised these powers, except to approve three corporate promissory note issue programs for 2004, 2005, and 2006.

At the Shareholders' Meeting held on May 31, 2005, shareholders also authorized the Board of Directors for the derivative acquisition of treasury stock, for a consideration, up to the limits and pursuant to the terms and conditions established at the Shareholders' Meeting, within a maximum period of 18 months from that date. However, it was also established that in no case could the par value of the shares acquired added to that of the treasury stock already held by Telefónica, S.A. and any of its controlled subsidiaries exceed 5% of Telefónica's capital stock.

At December 31, 2005 and 2004, Telefónica Group companies held the following shares in the Telefónica S.A. parent company:

|                            | Number<br>of shares | Euros per share      |                 | Market<br>value | %        |
|----------------------------|---------------------|----------------------|-----------------|-----------------|----------|
|                            |                     | Acquisition<br>price | Market<br>price |                 |          |
| Treasury stock at 12-31-05 | 136,647,061         | 13.00                | 12.71           | 1,736.78        | 2.77674% |
| Treasury stock at 12-31-04 | 207,245,179         | 11.83                | 13.23           | 2,741.44        | 4.18179% |

In 2005 the Company paid 2,744.03 million euros to acquire 230,038,870 shares of treasury stock and sold 48,503,517 for 647.45 million euros.

In addition, the Company used 29,274,686 shares of treasury stock to cover the terms of the share exchange for Terra Networks, S.A. (see Note 1), 34,760,964 to reduce capital and 188,096,296 for the distribution of share premium to shareholders via the delivery of treasury stock (the last two transactions are described in more detail later in this note). Finally, 1,525 shares of treasury stock were allocated to the stock option plan established for Endemol Group employees (see Note 18.c).

The balance sheets at December 31, 2005 and 2004 include the acquisition cost of the shares of treasury stock (1,775.81 million euros and 2,452.31 million euros, respectively) net of provisions of 1,427.33 million euros and 1,762.13 million euros, respectively, recorded in accordance with current accounting regulations (see Note 4.f), against extraordinary results for the amount by which the acquisition cost exceeds market price and against "Unrestricted reserves" for the amount by which the market price exceeds the underlying book value. The provision charged against extraordinary results in 2005 totaled 375.7 million euros (see Note 16.6). As to the provision charged to unrestricted reserves, the changes in 2005 and 2004 were a credit of 372.38 million euros and a debit of 1,474.33 million euros, respectively.

The Company has established the corresponding restricted reserve in the amount of the underlying book value of the shares of treasury stock.

**Changes in capital stock and share premium in 2005**

Changes in these headings in 2005 were as follows:

| Millions of euros                            | Number of shares     | Capital stock   | Share premium   |
|--|----------------------|-----------------|-----------------|
| <b>Balance at 12-31-04</b>                   | <b>4,955,891,361</b> | <b>4,955.89</b> | <b>5,287.68</b> |
| Capital decrease                             | (34,760,964)         | (34.76)         | (122.68)        |
| Cash dividend charged against share premium  | –                    | –               | (1,296.27)      |
| Distribution of treasury stock               |                      |                 | (2,571.27)      |
| Restricted reserve for treasury stock        | –                    | –               | 341.70          |
| Valuation of treasury stock                  | –                    | –               | 460.49          |
| Reverse for merger with Terra Networks, S.A. |                      |                 | (428.82)        |
| <b>Balance at 12-31-05</b>                   | <b>4,921,130,397</b> | <b>4,921.13</b> | <b>1,670.83</b> |

The deed ratifying the capital reduction through which the Company's Board of Directors implemented the resolution adopted by shareholders at the meeting held on May 31, 2005, was executed on June 6, 2005. Capital stock was reduced via the cancellation of shares of treasury stock previously acquired by the Company pursuant to the authorization granted at the Shareholders' Meeting. As a result, 34,760,964 Telefónica S.A. shares of treasury stock were cancelled and the Company's capital stock was reduced by a par value of 34,760,964 euros; Article 5 of the bylaws relating to the value of capital stock, which as of this date was set at 4,921,130,397 euros, was amended accordingly. Likewise, to render null and void the right of opposition provided for in Article 166 of the same Law, it was likewise decided, as permitted by Article 167.3 of the Spanish Corporation Law, to record a reserve for cancelled share capital equal to the par value of the cancelled shares, which can only be used if the same requirements as those applicable to the reduction of share capital are met. The cancelled shares were excluded from official listing on June 9, 2005 (see Note 16.3.c).

In addition, at their meeting held on February 23, 2005 Telefónica, S.A.'s Board of Directors agreed to distribute an interim dividend from 2004 income in a fixed amount of 0.23 euros gross per share for each of the Company's outstanding shares carrying dividend rights. This dividend was paid on May 13, 2005, and the total amount disbursed was 1,083.15 million euros.

At the General Shareholders' Meeting held on May 31, 2005, shareholders also approved a fixed cash dividend of 0.27 euros per share to be distributed from share premium for each share carrying rights to participate in the transaction on the date of disbursement. The payment was made on November 11, 2005, and the total amount was 1,296.27 million euros.

Shareholders at this meeting likewise approved the distribution of shares of treasury stock to shareholders, against the share premium account, at a ratio of one share for every 25 shares already owned. The shares were distributed on June 28, 2005 and entailed a charge against the share premium account of 2,571.27 million euros. The Company also recognized 286.21 million euros in extraordinary income corresponding to the amount by which the market value of the treasury stock distributed to shareholders exceeded the acquisition cost (see Note 16.6).

As mentioned in Note 1, the proposed merger and takeover of Terra Networks, S.A. by Telefónica, S.A. was approved at the General Shareholders' Meetings of Telefónica, S.A. and Terra Networks, S.A. held on May 31, 2005 and June 2, 2005 respectively. The transaction was registered in the Madrid Mercantile Register on July 16, 2005, effective retrospectively, for financial purposes, from January 1, 2005. The effect of the merger on Telefónica, S.A.'s shareholders equity was a 428.82 million euros decrease in share premium.

**Changes in capital stock and share premium in 2004**

Movements in these headings in 2004 is as follows:

| Millions of euros                     | Number of shares     | Capital stock   | Share premium   |
|---------------------------------------|----------------------|-----------------|-----------------|
| <b>Balance at 12-31-03</b>            | <b>4,955,891,361</b> | <b>4,955.89</b> | <b>7,987.14</b> |
| Cash dividend                         | –                    | –               | (951.64)        |
| Restricted reserve for treasury stock | –                    | –               | (556.72)        |
| Valuation of treasury stock           | –                    | –               | (1,191.10)      |
| <b>Balance at 12-31-04</b>            | <b>4,955,891,361</b> | <b>4,955.89</b> | <b>5,287.68</b> |

The Company carried out no capital increases or reductions in 2004.

At their General Meeting held on April 30, 2004, the shareholders resolved to pay a 0.20 euro cash dividend from 2003 income for each share outstanding. The dividend was distributed on May 14, 2005 and the total amount paid was 972.53 million euros.

Shareholders at this meeting also approved the distribution of a portion of the share premium recorded in the Company's balance sheet through the payment of 0.20 euro for each share outstanding, charged against the share premium account. The payment was made on November 12, 2004, and the total amount paid was 951.64 million euros.

**b) Legal reserve**

Under the revised Spanish Corporation Law, 10% of income for each year must be transferred to the legal reserve until the balance of this reserve reaches at least 20% of capital stock. The legal reserve can be used to increase capital in the amount that exceeds 10% of capital stock following the increase. Otherwise, until the balance in the reserve exceeds 20% of capital, it can be used only to offset losses, provided that sufficient other reserves are not available for this purpose.

**c) Revaluation reserves**

The balance of "Revaluation reserves" arose as a result of revaluations made from 1946 to 1987 and of the revaluation carried out pursuant to Royal Decree-Law 7/1996, dated June 7. No changes in these reserves were recorded in 2005 and 2004.

The balance of the revaluation reserve may be used, without incurring taxes, to offset any accounting losses that could occur in the future or to increase capital. From January 1, 2007, the reserve may also be transferred to unrestricted reserves, provided that the capital gain is recorded. This capital gain shall be deemed to have

been realized on the portion corresponding to the amortization booked or when the restated asset items have been transferred or removed from the balance sheet.

#### *d) Legal regulating the sale of holdings*

Law 62/2003, December 30 on Tax, Administrative, Labor and Social Security Measures, based on the judgment of the European Court of Justice of May 13, 2003, amended the administrative authorization system set out in Law 5/1995 of March 23 on the legal regime applicable to the disposal of public shareholdings in certain companies, to which certain corporate transactions and agreements of Telefónica S.A., Telefónica Móviles S.A., Telefónica Móviles España, S.A.U. and Telefónica de España, S.A.U. are subject pursuant to Royal Decree 8/1997 of January 10.

The reform introduced a new model for administrative involvement, replacing the system of prior authorization with that of subsequent notification. The cases that must be notified were also reduced.

Specifically, provided no change in control occurs, it is now no longer necessary to notify the sale or encumbrance of shares representing up to 50% of the share capital in transactions concerning (i) Telefónica S.A.'s shares in Telefónica de España S.A.U., (ii) Telefónica S.A.'s shares in Telefónica Móviles S.A. and (iii) Telefónica Móviles S.A.'s shares in Telefónica Móviles España S.A.U.

Notification is still required, however, for any direct, indirect or triggered acquisition, even through third-party trusts or third-party intermediaries, of shares in Telefónica S.A. or in Telefónica Móviles S.A. when they result in the disposal of at least 10% of the share capital. However, cases constituting mere financial transactions that do not have as their objective the control and/or management of these companies are excluded.

In addition, the disposal or encumbrance by Telefónica de España and Telefónica Móviles España of certain strategic assets located in Spain still have to be notified, except when these transactions are carried out between Group companies.

Pursuant to the reasoned opinion sent by the European Commission to the Spanish government on November 25, 2005, the Spanish Cabinet approved a bill to do away with this framework for the disposal of publicly owned holdings in certain companies. If passed, this bill would bring forward the end of this system, which in Telefónica's case was scheduled to finish on February 18, 2007.

## **(10) Debentures, bonds and other marketable debt securities**

**10.1.** The detail of the movements in the balances at December 31, 2005 and 2004 of debentures, bonds and corporate promissory notes is as follows:

| Millions of euros                | Non-convertible<br>debentures<br>and bonds | Corporate<br>promissory<br>notes | Total           |
|----------------------------------|--|----------------------------------|-----------------|
| <b>Balance at 12-31-03</b>       | <b>2,595.21</b>                            | <b>606.45</b>                    | <b>3,201.66</b> |
| New issues                       | –  | 1,672.20                         | 1,672.20        |
| Redemptions                      | (69.24)                                    | (1,314.81)                       | (1,384.05)      |
| Adjustments and other<br>changes | 97.71                                      | 92.90                            | 190.61          |
| <b>Balance at 12-31-04</b>       | <b>2,623.68</b>                            | <b>1,056.74</b>                  | <b>3,680.42</b> |
| New issues                       | –  | 1,956.12                         | 1,956.12        |
| Redemptions                      | (896.40)                                   | (1,697.67)                       | (2,594.07)      |
| Adjustments and other<br>changes | 101.04                                     | 18.01                            | 119.05          |
| <b>Balance at 12-31-05</b>       | <b>1,828.32</b>                            | <b>1,333.20</b>                  | <b>3,161.52</b> |
| Maturity                         |  |                                  |                 |
| Long-term                        | 1,828.32                                   | 86.33                            | 1,914.65        |
| Short-term                       | –  | 1,246.87                         | 1,246.87        |
| Unmatured accrued<br>interest    | 50.34                                      | –                                | 50.34           |



**10.2.** The detail and main features of debentures and bonds outstanding at December 31, 2005 are as follows:

| Debentures and bonds | Type of interest rate | % interest rate | Maturity |        |        |        |       | Subsequent years | Total    |
|----------------------|-----------------------|-----------------|----------|--------|--------|--------|-------|------------------|----------|
|                      |                       |                 | 2006     | 2007   | 2008   | 2009   | 2010  |                  |          |
| DEBENTURES           |                       |                 |          |        |        |        |       |                  |          |
| FEBRUARY 1990        |                       |                 |          |        |        |        |       |                  |          |
| SERIES C             | FIXED                 | 12.6000         | –        | –      | –      | –      | 3.76  | –                | 3.76     |
| FEBRUARY 1990        |                       |                 |          |        |        |        |       |                  |          |
| SERIES F             | ZERO COUPON           | 12.5793         | –        | –      | –      | –      | 9.18  | –                | 9.18     |
| APRIL 99             | FIXED                 | 4.5000          | –        | –      | –      | 500.00 | –     | –                | 500.00   |
| JUNE 99              | FLOATING              | 2.7030          | –        | –      | –      | 300.00 | –     | –                | 300.00   |
| JULY 99              | ZERO COUPON           | 6.3700          | –        | –      | –      | –      | –     | 44.67            | 44.67    |
| MARCH 00             | FLOATING              | 5.137 (*)       | –        | –      | –      | –      | –     | 50.00            | 50.00    |
| APRIL 00             | FIXED                 | 5.6250          | –        | 500.00 | –      | –      | –     | –                | 500.00   |
| BONDS                |                       |                 |          |        |        |        |       |                  |          |
| MARCH 98             | FIXED                 | 4.8414          | –        | –      | 420.71 | –      | –     | –                | 420.71   |
| Total issues         |                       |                 | –        | 500.00 | 420.71 | 800.00 | 12.94 | 94.67            | 1,828.32 |

(\*) The applicable interest rate (floating, set annually) is the one of the ten year swap on the sterling pound multiply by 1.0225.

**10.3.** Zero-coupon debentures and bonds are recognized in the balance sheet at their issue value plus the related accrued interest.

The detail of the maturities and redemption values of these debentures and bonds is as follows:

| Issue                  | Redemption date | Redemption rate | Current value | Redemption value |
|------------------------|-----------------|-----------------|---------------|------------------|
| <b>DEBENTURES</b>      |                 |                 |               |                  |
| FEBRUARY 1990 SERIES F | 02/26/2010      | 1,069.479 %     | 9.18          | 15.04            |
| JULY-99                | 07/21/2029      | 637.638 %       | 44.67         | 191.29           |
| <b>Total</b>           |                 |                 | <b>53.85</b>  | <b>206.33</b>    |

**10.4.** At December 31, 2005, there was a series promissory note issue program outstanding, as per the following detail:

| Amount<br>(Millions of euros) | Placement method                                    | Par value     | Maturity               | Placement                                 |
|-------------------------------|---|---------------|------------------------|---|
| 2,000                         | Through auctions                                    | 1,000 euros   | 3, 6, and 12 months    | Competitive tenders at least once a month |
|                               | Customized, intermediated by participating entities | 100,000 euros | Between 7 and 364 days | Specific transactions                     |

With respect to the transaction performed with La Estrella, S.A. de Seguros consisting of the issuance of 42 bearer promissory notes, which matured on February 15, 2001, and included a commitment to issue new promissory notes, on February 15, 2001, Telefónica, S.A. issued 74 bearer promissory notes with a principal amount of 126.29 million euros and final maturity in February 2011. The principal outstanding at year end was 92.90 million euros.

**10.5.** The average interest rate on outstanding debentures and bonds outstanding at the year of the end was 7.23% in 2005 (7.12% in 2004), and the average interest rate on corporate promissory notes was 2.351% in 2005 (2.244% in 2004).

## (11) Payable to credit institutions

**11.1.** The detail of these balances at December 31, 2005 and 2004 is as follows:

| Millions of euros                  | Average interest rate |      | 2005            |                 |                  | 2004            |                 |                 |
|------------------------------------|-----------------------|------|-----------------|-----------------|------------------|-----------------|-----------------|-----------------|
|                                    | 2005                  | 2004 | Short-term      | Long-term       | Total            | Short-term      | Long-term       | Total           |
| Loans and credits                  | 2.47                  | 3.44 | 3,038.58        | 8,763.50        | 11,802.08        | 2,520.06        | 2,346.10        | 4,866.16        |
| Foreign currency loans and credits | 3.80                  | 1.77 | 92.33           | 1,101.10        | 1,193.43         | 87.79           | 604.46          | 692.25          |
| <b>Total</b>                       |                       |      | <b>3,130.91</b> | <b>9,864.60</b> | <b>12,995.51</b> | <b>2,607.85</b> | <b>2,950.56</b> | <b>5,558.41</b> |

**11.2.** These balances mature as follows:

|                                    | Maturity        |               |               |                 |               | Subsequent years | Balance at 12-31-05 |
|------------------------------------|-----------------|---------------|---------------|-----------------|---------------|------------------|---------------------|
|                                    | 2006            | 2007          | 2008          | 2009            | 2010          |                  |                     |
| Loans and credits                  | 3,038.58        | 172.91        | 70.76         | 1,813.73        | 583.88        | 6,122.22         | 11,802.08           |
| Foreign currency loans and credits | 92.33           | 38.65         | 38.65         | 1,015.16        | 8.64          | –                | 1,193.43            |
| <b>Total</b>                       | <b>3,130.91</b> | <b>211.56</b> | <b>109.41</b> | <b>2,828.89</b> | <b>592.52</b> | <b>6,122.22</b>  | <b>12,995.51</b>    |

**11.3.** On June 28, 2005, Telefónica, S.A. took out a 6,000 million euros syndicated loan maturing on June 28, 2011, with a syndicate of 40 Spanish and international banks. The loan is denominated in euros but, in addition to euros, may be drawn down in dollars, sterling, yen, Swiss francs and any other currency, subject to prior confirmation of availability from the banks forming the syndicate. At the year end, following various disposals, the full amount of the loan had been drawn down.

On July 6, 2004, Telefónica arranged a syndicated credit facility of 3,000 million euros with a syndicate of Spanish and international banks. This credit facility matures in five years (on July 6, 2009) and at the Euribor/Libor plus a spread based on the Company's credit rating. The commitments and obligations of the parties are those ordinarily assumed in syndicated financing transactions. In 2005 the Company drew down 1,300 million euros and 392 million dollars. In 2004, the Company drew down 500 million euros and 760 million dollars.

On November 26, 2004, Telefónica, S.A. and several branches of ABN Amro Bank N.V. entered into a credit facility agreement amounting to 377.08 million dollars, secured by the export credit agencies of Finland ("Finnvera") and Sweden ("EKN"), bearing fixed interest of 3.26% and with final maturity on November 15, 2010. The facility will be used to repay a maximum of 85% of the network equipment purchased by Telefónica Móviles Group companies from Ericsson and Nokia.

In the course of 2004, Telefónica, S.A. made one pre-payment and repayment in settlement of the 1,200 million euro syndicated loan arranged with various financial institutions in 1999. 120 million euros was prepaid on January 30 and 254.25 million euro repaid on February 19. Both payments were made to Banco Santander Central Hispano (BSCH) to settle tranche A of the aforementioned syndicated loan. The total amount drawn down at December 31, 2005 was 555.75 million euros.

**11.4. Unused credit facilities**

The “Loans and credit” balances relate only to amounts drawn down.

At December 31, 2005, Telefónica had undrawn credit facilities amounting to 4,397 million euros.

At December 31, 2005, Telefónica had also arranged, but not drawn down any amounts on, a syndicated loan of 18,000 million pounds sterling to acquire O2, Plc. The loan was arranged through Telefónica Europe, BV.

The claimability of some financing arranged by Telefónica is subject to compliance with certain financial covenants. Telefónica complied with all these covenants at the date of preparation of these financial statements.

## (12) Payable to Group and associated Companies

**12.1.** The detail of this heading at December 31, 2005 and 2004 is as follows:

| Millions of euros  | 2005             |                  |                  | 2004             |                  |                  |
|--|------------------|------------------|------------------|------------------|------------------|------------------|
|  | Long-term        | Short-term       | Total            | Long-term        | Short-term       | Total            |
| Loans  | 9,167.98         | 9,598.99         | 18,766.97        | 10,129.08        | 9,956.47         | 20,085.55        |
| Accounts payable to Group companies for purchases and services         | –                | 81.94            | 81.94            | –                | 116.38           | 116.38           |
| Accounts payable to subsidiaries due to taxation on consolidated basis | 2,454.30         | 1,297.04         | 3,751.34         | 5,568.32         | 1,478.57         | 7,046.89         |
| <b>Total</b>   | <b>11,622.28</b> | <b>10,977.97</b> | <b>22,600.25</b> | <b>15,697.40</b> | <b>11,551.42</b> | <b>27,248.82</b> |

Total financing received from Telefónica Europe, B.V. at December 31, 2005 amounted to 9,982.33 million euros (compared with 11,269.72 million euros at December 31, 2004). These loans bear interest at market rates (Euribor plus a spread). The average interest rate in 2005 was 5.949% (compared with 5.76 % in 2004). The financing arranged includes associated costs as fees or premiums that are charged to the income statement as the financing. (see Note 8).

In addition, at December 31, 2005, the Company had been granted financing from Telefónica Finanzas, S.A. amounting to 7,531.11 million euros (7,332.80 million euros at December 31, 2004), and from Telefónica de España, S.A.U., amounting to 1,042.39 million euros (unchanged from December 31, 2004).

“Loans to Group companies” also includes accrued interest unpaid at December 31, 2005 amounting to 198.76 million euros (218.31 million euros at December 31, 2004).

**12.2.** The detail of the short-term accounts payable to Group companies for purchases and services is as follows:

| Millions of euros                                   | 2005         | 2004          |
|---|--------------|---------------|
| Telefónica de España, S.A.U.                        | 10.59        | 49.60         |
| Telefónica de Contenidos, S.A.U.                    | 10.16        | 13.17         |
| Telefónica Móviles, S.A.                            | 11.11        | 21.91         |
| Telefónica Móviles España, S.A.U.                   | 1.68         | 2.48          |
| Terra Networks España, S.A.U.                       | 6.97         | 3.39          |
| Telefónica Holding Argentina, S.A.                  | 7.83         | 6.11          |
| Terra Lycos Intangibles, S.A.                       | 13.54        | –             |
| Telefónica Investigación y Desarrollo, S.A.U.       | 2.81         | 0.60          |
| Telefónica Gestión de Servicios Compartidos, S.A.U. | 3.19         | 0.58          |
| Other   | 14.06        | 18.54         |
| <b>Total</b>  | <b>81.94</b> | <b>116.38</b> |

**12.3.** The balance of “Accounts payable to subsidiaries due to taxation on a consolidated basis” includes basically accounts payable to these companies for their contribution of tax losses to the tax group headed by Telefónica, S.A. (see Note 14.2). The Company classifies this balance as short- or long-term on the basis of the projected maturity of the payments.

The main amounts are those relating to Telefónica Internacional, S.A. (1,711.19 million euros), Telefónica Móviles España, S.A.U. (797.86 million euros), Telefónica Móviles, S.A. (784.72 million euros), Telefónica de Contenidos, S.A.U. (196.13 million euros) and Telefónica Data Corp, S.A.U. (195.83 million euros).

## (13) Derivatives

In 2005 the Company continued to use derivatives both to limit interest rate and exchange risks on uncovered positions and to adapt its debt structure to market conditions.

At December 31, 2005, the total outstanding balance of the derivatives portfolio was 39,350.03 million euros (40,361.81 million euros at December 31, 2004), of which 17,912.35 million euros related to interest rate and 21,437.68 million euros to exchange rate risk (24,069.84 million euros and 16,056.50 million euros, respectively, at December 31, 2004).

It should be noted that at December 31, 2005, Telefónica S.A. had arranged transactions with financial institutions to hedge interest and exchange rate risks for other Telefónica Group companies amounting to 1,224.40 million euros and 6,883.79 million euros, respectively (1,482.64 million euros and 6,515.80 million euros, respectively, at December 31, 2004). In parallel, intragroup transactions identical to the external transactions intends and conditions, are entered into. Accordingly, they do not involve any risk for Telefónica S.A. External derivatives transactions not backed with identical intragroup transactions consist of hedges on net investment and future acquisition, that, by their nature, cannot be transferred to Group companies and/or transactions to hedge financing raised by Telefónica, S.A. as parent company of the Telefónica Group, which are transferred to Group subsidiaries in the form of financing rather than via derivative transactions.

Most of the derivatives transactions are assigned directly to individual asset or liability positions in the balance sheet. The Company also has a transaction portfolio aimed at hedging financial risks. For this latter type of transactions, the net financial loss obtained in 2005 was 16.19 million euros (net financial gain of 123.80 million euros in 2004).

The detail of the portfolio by type of derivative at December 31, 2005, is the following:

| Type of Risk                               | Value in euros   | 2005                |          |                 |          |
|--|------------------|---------------------|----------|-----------------|----------|
|  |                  | Telefónica receives |          | Telefónica pays |          |
|  |                  | Value               | Currency | Value           | Currency |
| <b>Euro interest rate swaps</b>            | <b>10,893.99</b> |                     |          |                 |          |
| Fixed to floating                          | 2,147.19         | 2,147.19            | EUR      | 2,147.19        | EUR      |
| Floating to fixed                          | 8,269.43         | 8,269.43            | EUR      | 8,269.43        | EUR      |
| Floating to floating                       | 477.37           | 477.37              | EUR      | 477.37          | EUR      |
| <b>Foreign currency interest rate swap</b> | <b>2,331.49</b>  |                     |          |                 |          |
| <b>Fixed to floating</b>                   | <b>550.99</b>    |                     |          |                 |          |
| USD/USD                                    | 550.99           | 650.00              | USD      | 650.00          | USD      |
| <b>Floating to fixed</b>                   | <b>1,780.50</b>  |                     |          |                 |          |
| USD/USD                                    | 789.05           | 930.84              | USD      | 930.84          | USD      |
| MXN/MXN                                    | 169.24           | 2,151.83            | MXN      | 2,151.83        | MXN      |
|  | 822.21           | 23,848.20           | CZK      | 23,848.20       | CZK      |
| <b>Exchange rate swaps</b>                 | <b>7,658.86</b>  |                     |          |                 |          |
| <b>Fixed to fixed</b>                      | <b>2,779.38</b>  |                     |          |                 |          |
| USD/EUR                                    | 2,476.03         | 2,327.20            | USD      | 2,476.03        | EUR      |
| EUR/CLP                                    | 303.35           | 242.57              | EUR      | 183,405.15      | CLP      |
| <b>Fixed to floating</b>                   | <b>379.66</b>    |                     |          |                 |          |
| EUR/CLP                                    | 20.21            | 16.49               | EUR      | 12,217.00       | CLP      |
| EUR/USD                                    | 31.37            | 30.60               | EUR      | 37.01           | USD      |
| USD/EUR                                    | 328.08           | 309.00              | USD      | 328.08          | EUR      |
| <b>Floating to fixed</b>                   | <b>1,405.77</b>  |                     |          |                 |          |
| EUR/BRL                                    | 104.36           | 96.99               | EUR      | 288.17          | BRL      |
| EUR/MAD                                    | 91.68            | 89.87               | EUR      | 1,000.00        | MAD      |
| USD/ARS                                    | 379.13           | 466.70              | USD      | 1,356.11        | ARS      |
| USD/CLP                                    | 238.55           | 248.36              | USD      | 144,227.31      | CLP      |
| USD/COP                                    | 294.67           | 330.06              | USD      | 794,053.65      | COP      |
| USD/MXN                                    | 13.83            | 17.14               | USD      | 175.90          | MXN      |
| USD/PEN                                    | 283.55           | 346.42              | USD      | 1,148.84        | PEN      |
| <b>Floating to floating</b>                | <b>3,094.05</b>  |                     |          |                 |          |
| EUR/USD                                    | 1,090.25         | 1,060.72            | EUR      | 1,286.17        | USD      |
| USD/EUR                                    | 542.14           | 589.75              | USD      | 542.14          | EUR      |
| EUR/CZK                                    | 1,183.27         | 1,150.00            | EUR      | 34,320.70       | CZK      |
| EUR/CLP                                    | 17.61            | 14.39               | EUR      | 10,645.55       | CLP      |
| USD/MXN                                    | 260.78           | 325.36              | USD      | 3,315.77        | MXN      |
| <b>Forwards</b>                            | <b>12,213.07</b> |                     |          |                 |          |
| EUR/USD                                    | 586.12           | 552.36              | EUR      | 691.45          | USD      |
| USD/EUR                                    | 30.87            | 37.60               | USD      | 30.87           | EUR      |
| EUR/BRL                                    | 210.35           | 206.52              | EUR      | 580.84          | BRL      |
| EUR/CLP                                    | 259.77           | 220.07              | EUR      | 157,055.95      | CLP      |
| EUR/CZK                                    | 690.76           | 674.74              | EUR      | 20,035.36       | CZK      |
| EUR/GBP                                    | 1,270.97         | 1,278.30            | EUR      | 870.99          | GBP      |
| GBP/EUR                                    | 8,081.76         | 5,500.00            | GBP      | 8,081.76        | EUR      |
| USD/ARS                                    | 224.05           | 270.13              | USD      | 801.41          | ARS      |
| ARS/USD                                    | 93.35            | 322.43              | ARS      | 110.13          | USD      |
| USD/CLP                                    | 102.33           | 120.00              | USD      | 61,870.20       | CLP      |
| CLP/USD                                    | 101.72           | 61,745.00           | CLP      | 120.00          | USD      |
| USD/MXN                                    | 561.02           | 660.39              | USD      | 7,132.93        | MXN      |
| <b>Subtotal</b>                            | <b>33,097.41</b> |                     |          |                 |          |

| Notional amounts of structured products with options |                  |          |     |
|--|------------------|----------|-----|
|  | Euros            | Notional |     |
| <b>Interest rate options</b>                         | <b>4,686.87</b>  |          |     |
| <b>Caps &amp; Floors</b>                             | <b>4,607.54</b>  |          |     |
| External counterparties                              |                  |          |     |
| US DOLLAR  | 1,123.17         | 1,325.00 | USD |
| EURO CURRENCY  | 3,484.37         | 3,484.37 | EUR |
| <b>Swaptions</b>                                     | <b>79.33</b>     |          |     |
| EURO CURRENCY  | 79.33            | 79.33    | EUR |
| <b>Currency options</b>                              | <b>1,565.75</b>  |          |     |
| External counterparties                              |                  |          |     |
| USD/EUR  | 839.09           | 989.87   | USD |
| USD/ARS  | 571.20           | 673.85   | USD |
| USD/MXN  | 155.46           | 183.40   | USD |
| <b>Subtotal</b>                                      | <b>6,252.62</b>  |          |     |
| <b>TOTAL</b>   | <b>39,350.03</b> |          |     |

The detail of the portfolio by type of derivative at December 31, 2004 is the following:

| Type of Risk                               | Value in euros   | 2004                |          |                 |          |
|--|------------------|---------------------|----------|-----------------|----------|
|  |                  | Telefónica receives |          | Telefónica pays |          |
|  |                  | Value               | Currency | Value           | Currency |
| <b>Euro interest rate swaps</b>            | <b>13,437.99</b> |                     |          |                 |          |
| Fixed to floating                          | 2,951.90         | 2,951.90            | EUR      | 2,951.90        | EUR      |
| Floating to fixed                          | 9,719.37         | 9,719.37            | EUR      | 9,719.37        | EUR      |
| Floating to floating                       | 766.72           | 766.72              | EUR      | 766.72          | EUR      |
| <b>Foreign currency interest rate swap</b> | <b>2,446.70</b>  |                     |          |                 |          |
| <b>Fixed to floating</b>                   | <b>1,554.15</b>  |                     |          |                 |          |
| USD/USD                                    | 1,367.01         | 1,862.00            | USD      | 1,862.00        | USD      |
| MXN/MXN                                    | 187.14           | 2,871.43            | MXN      | 2,871.43        | MXN      |
| <b>Floating to fixed</b>                   | <b>892.55</b>    |                     |          |                 |          |
| USD/USD                                    | 705.41           | 960.84              | USD      | 960.84          | USD      |
| MXN/MXN                                    | 187.14           | 2,871.43            | MXN      | 2,871.43        | MXN      |
| <b>Exchange rate swaps</b>                 | <b>9,506.86</b>  |                     |          |                 |          |
| <b>Fixed to fixed</b>                      | <b>2,670.89</b>  |                     |          |                 |          |
| USD/EUR                                    | 2,405.03         | 2,214.85            | USD      | 2,405.03        | EUR      |
| EUR/CLP                                    | 265.86           | 267.27              | EUR      | 201,848.65      | CLP      |
| <b>Fixed to floating</b>                   | <b>1,407.31</b>  |                     |          |                 |          |
| ARS/USD                                    | 91.77            | 363.45              | ARS      | 125.00          | USD      |
| BRL/EUR                                    | 96.99            | 288.17              | BRL      | 96.99           | EUR      |
| CLP/EUR                                    | 242.57           | 183,405.15          | CLP      | 242.57          | EUR      |
| COP/USD                                    | 114.79           | 392,123.65          | COP      | 156.36          | USD      |
| EUR/CLP                                    | 16.10            | 16.49               | EUR      | 12,217.00       | CLP      |
| EUR/USD                                    | 27.17            | 30.60               | EUR      | 37.01           | USD      |
| MAD/EUR                                    | 33.76            | 349.09              | MAD      | 33.76           | EUR      |
| MXN/USD                                    | 25.17            | 348.46              | MXN      | 34.29           | USD      |
| PEN/USD                                    | 227.59           | 1,073.29            | PEN      | 310.00          | USD      |
| USD/EUR                                    | 531.40           | 543.83              | USD      | 531.40          | EUR      |
| <b>Floating to fixed</b>                   | <b>733.21</b>    |                     |          |                 |          |
| EUR/BRL                                    | 79.70            | 96.99               | EUR      | 288.17          | BRL      |
| EUR/MAD                                    | 31.09            | 33.76               | EUR      | 349.09          | MAD      |
| EUR/USD                                    | 85.38            | 126.21              | EUR      | 116.29          | USD      |
| USD/ARS                                    | 89.57            | 125.00              | USD      | 363.45          | ARS      |
| USD/CLP                                    | 64.20            | 80.36               | USD      | 48,745.31       | CLP      |
| USD/COP                                    | 120.47           | 156.36              | USD      | 392,123.65      | COP      |
| USD/MXN                                    | 22.71            | 34.29               | USD      | 348.46          | MXN      |
| USD/PEN                                    | 240.09           | 310.00              | USD      | 1,073.29        | PEN      |
| <b>Floating to floating</b>                | <b>4,695.45</b>  |                     |          |                 |          |
| EUR/USD                                    | 1,422.80         | 1,807.87            | EUR      | 1,937.99        | USD      |
| USD/EUR                                    | 2,785.78         | 2,888.25            | USD      | 2,785.78        | EUR      |
| CLP/EUR                                    | 30.88            | 22,862.55           | CLP      | 30.88           | EUR      |
| EUR/CLP                                    | 14.02            | 14.39               | EUR      | 10,645.55       | CLP      |
| USD/MXN                                    | 209.98           | 316.00              | USD      | 3,221.87        | MXN      |
| MXN/USD                                    | 231.99           | 3,221.87            | MXN      | 316.00          | USD      |
| <b>Forwards</b>                            | <b>4,516.31</b>  |                     |          |                 |          |
| USD/EUR                                    | 1,683.62         | 2,174.50            | USD      | 1,683.62        | EUR      |
| EUR/USD                                    | 1,656.91         | 1,740.03            | EUR      | 2,256.87        | USD      |
| USD/PEN                                    | 48.21            | 65.00               | USD      | 215.52          | PEN      |
| PEN/USD                                    | 47.72            | 215.52              | PEN      | 65.00           | USD      |
| USD/COP                                    | 126.17           | 155.00              | USD      | 410,705.00      | COP      |
| COP/USD                                    | 84.43            | 305,265.00          | COP      | 115.00          | USD      |
| USD/BRL                                    | 86.79            | 111.07              | USD      | 313.78          | BRL      |
| BRL/USD                                    | 81.54            | 313.78              | BRL      | 111.07          | USD      |
| USD/CLP                                    | 260.14           | 317.39              | USD      | 197,507.50      | CLP      |
| CLP/USD                                    | 233.02           | 197,507.50          | CLP      | 317.39          | USD      |
| USD/ARS                                    | 105.42           | 139.41              | USD      | 427.76          | ARS      |
| ARS/USD                                    | 102.34           | 427.76              | ARS      | 139.41          | USD      |
| <b>Subtotal</b>                            | <b>29,907.86</b> |                     |          |                 |          |



| Notional amounts of structured products with options |                  |          |     |
|--|------------------|----------|-----|
|  | Euros            | Notional |     |
| <b>Interest rate options</b>                         | <b>8,185.15</b>  |          |     |
| <b>Caps &amp; Floors</b>                             | <b>8,026.49</b>  |          |     |
| External counterparties                              |                  |          |     |
| US DOLLAR  | 972.77           | 1,325.00 | USD |
| EURO CURRENCY  | 6,869.38         | 6,869.38 | EUR |
| Intermediated Group companies                        |                  |          |     |
| US DOLLAR  | 184.34           | 251.10   | USD |
| <b>Swaptions</b>                                     | <b>79.33</b>     |          |     |
| EURO CURRENCY  | 79.33            | 79.33    | EUR |
| <b>Interest rate options</b>                         | <b>79.33</b>     | 79.33    | EUR |
| <b>Currency options</b>                              | <b>2,033.33</b>  |          |     |
| USD/EUR  | 1,833.93         | 2,498.00 | USD |
| USD/ARS  | 199.40           | 271.60   | USD |
| <b>Equity options</b>                                | <b>235.47</b>    |          |     |
| <b>Subtotal</b>                                      | <b>10,453.95</b> |          |     |
| <b>TOTAL</b>   | <b>40,361.81</b> |          |     |

*Note: The equity option position included call spread positions on 3 million shares of treasury stock with strike prices of 12.62 and 13.82 euros and call options bought on 5 million shares of treasury stock with a strike price of 13.52 euros*

The detail, by average maturity, of hedging transactions carried out in 2005 and 2004 is the following:

| Hedged underlying item            | 2005             |                  |                   |                   |                 |
|-----------------------------------|------------------|------------------|-------------------|-------------------|-----------------|
|                                   | Amount           | Up to 1 year     | From 1 to 3 years | From 3 to 5 years | Over 5 years    |
| <b>With underlying instrument</b> |                  |                  |                   |                   |                 |
| Promissory notes                  | –                | –                | –                 | –                 | –               |
| Loans                             | 11,295.66        | 1,291.21         | 2,129.83          | 2,380.69          | 5,493.93        |
| In national currency              | 9,038.91         | 1,082.78         | 1,329.41          | 1,425.72          | 5,201.00        |
| In foreign currencies             | 2,256.75         | 208.43           | 800.42            | 954.97            | 292.93          |
| <b>Debentures and MTN bonds</b>   | <b>6,374.40</b>  | <b>364.73</b>    | <b>1,135.41</b>   | <b>4,765.09</b>   | <b>109.17</b>   |
| In national currency              | 2,475.72         | 338.09           | 1,135.41          | 893.05            | 109.17          |
| In foreign currencies             | 3,898.68         | 26.64            | –                 | 3,872.04          | –               |
| <b>Liabilities</b>                | <b>21,679.97</b> | <b>15,707.84</b> | <b>1,786.09</b>   | <b>2,594.36</b>   | <b>1,591.68</b> |
| Swaps                             | 7,901.15         | 1,929.02         | 1,786.09          | 2,594.36          | 1,591.68        |
| Currency options                  | 1,565.75         | 1,565.75         | –                 | –                 | –               |
| Interest rate options             | –                | –                | –                 | –                 | –               |
| Forward                           | 12,213.07        | 12,213.07        | –                 | –                 | –               |
| <b>Total</b>                      | <b>39,350.03</b> | <b>17,363.78</b> | <b>5,051.33</b>   | <b>9,740.14</b>   | <b>7,194.78</b> |

The debentures and bonds hedged related to those issued both by Telefónica, S.A. and by Telefónica Europe B.V.

|                                   | Amount           | 2004             |                   |                   |                 |
|-----------------------------------|------------------|------------------|-------------------|-------------------|-----------------|
|                                   |                  | Up to 1 year     | From 1 to 3 years | From 3 to 5 years | Over 5 years    |
| <b>Hedged underlying asset</b>    |                  |                  |                   |                   |                 |
| <b>With underlying instrument</b> |                  |                  |                   |                   |                 |
| <b>Promissory notes</b>           | -                | -                | -                 | -                 | -               |
| <b>Loans</b>                      | <b>18,932.23</b> | <b>6,540.81</b>  | <b>3,297.93</b>   | <b>6,564.53</b>   | <b>2,528.96</b> |
| In national currency              | 14,264.69        | 5,762.10         | 1,805.44          | 4,692.52          | 2,004.63        |
| In foreign currencies             | 4,667.54         | 778.71           | 1,492.49          | 1,872.01          | 524.33          |
| <b>Debentures and MTN bonds</b>   | <b>14,070.19</b> | <b>7,073.08</b>  | <b>640.85</b>     | <b>1,554.28</b>   | <b>4,801.98</b> |
| In national currency              | 7,943.46         | 4,582.63         | 640.85            | 1,289.98          | 1,430.00        |
| In foreign currencies             | 6,126.73         | 2,490.45         | -                 | 264.30            | 3,371.98        |
| <b>Liabilities</b>                | <b>7,123.92</b>  | <b>6,640.14</b>  | <b>270.30</b>     | <b>-</b>          | <b>213.48</b>   |
| Swaps                             | 574.28           | 91.34            | 269.46            | -                 | 213.48          |
| Currency options                  | 2,033.33         | 2,033.33         | -                 | -                 | -               |
| Interest rate options             | -                | -                | -                 | -                 | -               |
| Forward                           | 4,516.31         | 4,515.47         | 0.84              | -                 | -               |
| <b>Shares</b>                     | <b>235.47</b>    | <b>235.47</b>    | <b>-</b>          | <b>-</b>          | <b>-</b>        |
| <b>Total</b>                      | <b>40,361.81</b> | <b>20,489.50</b> | <b>4,209.08</b>   | <b>8,118.81</b>   | <b>7,544.42</b> |

Note: The equity option position included call spread positions on 3 million shares of treasury stock with strike prices of 12.62 and 13.82 euros and call options bought on 5 million shares of treasury stock with a strike price of 13.52 euros.

The fair value of Telefónica, S.A.'s derivatives portfolio at December 31, 2005 was equivalent to a liability of 966.15 million euros (1,214.93 million euros at December 31, 2004). The detail by type of derivatives is as follows:

| Millions of euros                | 2005          | 2004            |
|----------------------------------|---------------|-----------------|
| Interest rate hedge              | (48.64)       | (58.58)         |
| Exchange rate hedge              | 852.94        | 743.88          |
| Interest and exchange rate hedge | 161.85        | 529.63          |
| <b>Total</b>                     | <b>966.15</b> | <b>1,214.93</b> |

## (14) Tax Matters

Pursuant to a Ministerial Order dated December 27, 1989, since 1990 Telefónica, S.A. has filed consolidated tax returns with certain Group companies. A total of 48 companies formed the consolidated tax group in 2005.

### 14.1. Deferred tax assets and liabilities

The detail and movements of Telefónica's deferred tax assets and liabilities at December 31, 2005 and 2004 are as follows:

|                            | Deferred tax assets<br>Long-term | Intercompany deferred tax assets<br>Long-term | Intercompany deferred tax liabilities<br>Long-term |
|----------------------------|----------------------------------|---|--|
| <b>Balance at 12-31-03</b> | <b>80.18</b>                     | <b>-</b>                                      | <b>39.34</b>                                       |
| Reversal                   | (8.62)                           | -   | (0.24)   |
| Arising in the year        | 7.78                             | 31.96   | 7.57   |
| Other changes              | 6.25                             | -   | 0.25   |
| <b>Balance at 12-31-04</b> | <b>85.59</b>                     | <b>31.96</b>                                  | <b>46.92</b>                                       |
| Reversal                   | (35.14)                          | (31.61)                                       | (3.90)   |
| Arising in the year        | 4.04                             | -   | -  |
| <b>Balance at 12-31-05</b> | <b>54.49</b>                     | <b>0.35</b>                                   | <b>43.02</b>                                       |

Telefónica's deferred tax assets relate mainly to accounting provisions recorded for investments in companies with negative underlying book values.

The other intercompany timing differences relate to the effects of consolidated taxation.

#### 14.2. Taxes payable and tax receivables

The detail of these headings at December 31, 2005 and 2004 is as follows:

| Millions of euros                          | Balance at<br>12-31-05 | Balance at<br>12-31-04 |
|--|------------------------|------------------------|
| <b>Tax payables:</b>                       |                        |                        |
| Long-term tax payables:                    | 43.02                  | 46.92                  |
| Deferred tax liabilities                   | 43.02                  | 46.92                  |
| Short-term tax payables:                   | 26.23                  | 17.31                  |
| Personal income tax withholdings           | 3.90                   | 2.37                   |
| Withholding on investment income and other | 21.37                  | 14.94                  |
| Accrued social security taxes              | 0.96                   | -                      |
| <b>Total</b>                               | <b>69.25</b>           | <b>64.23</b>           |

| Millions of euros                                      | Balance at<br>12-31-05 | Balance at<br>12-31-04 |
|--|------------------------|------------------------|
| <b>Tax receivables:</b>                                |                        |                        |
| Long-term tax receivables: (Note 7)                    | 3,255.69               | 4,343.19               |
| Deferred tax assets                                    | 54.84                  | 117.55                 |
| Long-term tax loss carryforwards                       | 3,200.85               | 4,225.64               |
| Short-term tax receivables:                            | 61.60                  | 27.89                  |
| Tax withholdings                                       | 15.04                  | 11.62                  |
| Corporate income tax refundable                        | 0.32                   | 0.32                   |
| Taxes recoverable and other                            | 4.82                   | -                      |
| VAT and Canary Islands general indirect tax refundable | 41.42                  | 15.95                  |
| <b>Total</b>   | <b>3,317.29</b>        | <b>4,371.08</b>        |

At December 31, 2005 the tax group had tax loss carryforwards pending application amounting to 11,143.96 million euros. Of this total, 332.43 million euros were generated in 2003 and 10,811.52 million euros in 2002. These losses must be applied within 15 years. The balance at December 31, 2005 includes tax loss carryforwards amounting to 3,152.35 million euros corresponding to tax losses of 9,006.71 million euros that have yet to be offset.

#### 14.3. Reconciliation of book profit to taxable income and calculation of corporate income tax charge and the net tax refundable.

The detail of the calculation of corporate income tax charge and the net tax refundable for 2005 and 2004 is as follows.

| Millions of euros  | 2005            | 2004            |
|--|-----------------|-----------------|
| Book profit before taxes                                 | 1,652.01        | 1,165.32        |
| Permanent differences                                    | (1,814.73)      | (1,484.74)      |
| Timing differences                                       |                 |                 |
| Arising in the year                                      | 12.12           | 22.24           |
| Arising in prior years                                   | (36.25)         | (24.62)         |
| <b>Tax base</b>  | <b>(186.85)</b> | <b>(321.80)</b> |
| Gross tax payable  | (65.40)         | (112.63)        |
| Tax credits capitalized                                  | (34.19)         | (29.32)         |
| <b>Corporate income tax refundable</b>                   | <b>(99.59)</b>  | <b>(141.95)</b> |
| Timing differences                                       | 8.45            | 0.83            |
| <b>Corporate income tax accrued in Spain</b>             | <b>(91.14)</b>  | <b>(141.12)</b> |
| Foreign taxes  | 5.07            | 3.91            |
| Adjustments to prior year's corporate income tax expense | (16.31)         | 1.13            |
| <b>Total income tax</b>                                  | <b>(102.38)</b> | <b>(136.08)</b> |

The tax credits taken relate basically to double taxation.

The permanent differences relate mainly to investment writedown provisions recorded by the tax group companies included in the consolidated corporate income tax return to avoid duplication, since these companies recorded the tax asset in their individual financial statements, to dividends received from tax group companies or foreign companies taxed at source and to non-deductible provisions.

The detail of changes in timing differences in 2005 is as follows:

|                          | Millions of euros |
|--------------------------|-------------------|
| Timing differences:      |                   |
| Commitments to employees | 5.55              |
| Period provisions        | (29.68)           |
| <b>Total</b>             | <b>(24.13)</b>    |

Taxes incurred abroad relate mainly to corporate income tax borne by the permanent establishment in Argentina.

14.4. On September 25, 2002, tax audits commenced at several of the companies included in tax group 24/90 of which Telefónica, S.A. is the parent company. The taxes subject to review are corporate income tax (for the years 1998 to 2000), VAT, tax withholdings and payments on account in respect of personal income tax, tax on investment income, property tax and non-resident income tax (1998 to 2001). The Company expects that the Tax and Treasury Court will rule in favor of the appeals filed against the aforementioned assessments, and therefore it does not anticipate the need to record any significant liabilities for this concept in its financial statements.

The years open for review by the tax authorities for the main applicable taxes since the latest tax audit, which ended in 2005, are from 2002 for tax withholdings and prepayments relating to personal income tax, tax on investment income, property tax, non-resident income tax and VAT, from 2001 for corporate income tax, and the last five years for the taxes applicable to the Company's permanent establishment in Argentina.

The Company does not expect that any additional material liabilities will materialize from future audits of the years open to review.

In respect of the sale of the shareholding in Lycos Inc. previously owned by Terra Networks, S.A., Terra Networks, S.A. (now Telefónica, S.A.) recorded a tax credit of 272 million euros in 2004. This tax credit arises from the difference between the sale price of Lycos Inc. shares (89 million euros) and the value recorded for the capital increase through which the company was acquired, less the restatements (essentially charges to the investment writedown provision) which were already tax deductible prior to the sale.

The Company has also commenced formal procedures to seek authorization to recognize greater tax losses, up to a maximum amount of 7,418 million euros for 2004 as a result of applying, as taxable acquisition cost, the price obtained by using the market value of the Lycos Inc. shares acquired rather than their book value, pursuant to the provisions of Article 159 of the Spanish Corporation Law. However, in view of the opposition of the tax authorities in response to tax queries raised in similar cases and the uncertainty surrounding the final decision to be adopted at the date on which the statements were drawn up, the effect of this adjustment is not taken into account in these financial statements.

## (15) Other Non-Trade Payables

The balance of this heading relates mainly to compensation payable, to other payables relating to fixed asset purchases and to the amount payable for certified construction work on the Telefónica Group's new headquarters. It also includes provisions for commitments assumed that are due to be settled within the next 12 months.

## (16) Revenues and Expenses

### 16.1. Operating revenues

The revenues from sales and services in 2005 and 2004 related to sales to Group companies and, principally, to the Company's management contract with Telefónica de Argentina, S.A.

In November 1990 Telefónica and Telefónica Argentina, S.A. entered into a renewable management agreement expiring in 2003 which regulates the consultancy and advisory services provided by Telefónica and the price of such services. Revenues received for this concept in 2005 and 2004 totaled 28.73 million euros and 20.85 million euros, respectively, and are recorded under "Net sales to Group companies" in the accompanying income statement.

"Non-core and other current operating revenues – Group companies" relates to revenues on centralized services that Telefónica, S.A., as head of the Group, provides to its subsidiaries. Telefónica, S.A. bears the full cost of these services and then charges each individual subsidiary for the applicable portion. The amount mainly includes billings to Telefónica Móviles España, S.A.U. for 32.63 million euros (39.65 million euros in 2004) and to Telefónica de España, S.A.U. for 28.01 million euros (32.81 million euros in 2004).

Operating revenues also include income from property leases (see Note 6) amounting to 7.30 million euros (6.32 million euros in 2004).

### 16.2. Personnel expenses and employee benefits

The detail of "Personnel expenses" is as follows:

| Item                                | 2005          | 2004         |
|-------------------------------------|---------------|--------------|
| Wages and salaries                  | 87.29         | 75.40        |
| Pension plans (Note 4.h)            | 2.73          | 2.30         |
| Employee welfare expenses and other | 16.44         | 17.24        |
| <b>Total</b>                        | <b>106.46</b> | <b>94.94</b> |

"Wages and salaries" includes the indemnities paid to five senior executives that left the Company in 2005, as provided for in their senior management contracts.

The senior management contracts signed with members of the Executive Committee generally provide for severance pay equivalent to three years of salary plus another year based on years of service at the Company. The annual salary on which the indemnity is based is the director's last fixed salary and the average amount of the last two variable payments received pursuant to the terms of the contract.

### Compensation systems linked to share market price

At year end 2005, Telefónica had no remuneration systems tied to the market price of the Company's shares. However, as a result of its merger and takeover of Terra Networks, S.A., the Company has assumed the obligations of the former Terra Networks, S.A. with respect to its stock options plan.

#### a) Terra Networks, S.A. stock option plan (now assumed by Telefónica, S.A.)

The main features of the plan are as follows:

- Each option entitles the employee to acquire one share in Terra Networks, S.A. (now shares in Telefónica, S.A.) at a strike price established at the time the options are granted.
- The options are open for exercise within four to six years following the grant date.
- The exercise of the options is contingent upon the beneficiary remaining an employee of the Terra Group (now the Telefónica Group).
- At the exercise date, the options may be settled either Telefónica, S.A. equity settled, once the beneficiary has paid the option strike price, or cash settled.

The total number of outstanding options at December 31, 2005 was 117,900. The changes in 2005 and 2004 are as follows:

|   | Number of options | Average strike price |
|---|-------------------|----------------------|
| <b>Options outstanding at December 31, 2003</b>                                       | <b>6,438,696</b>  | <b>14.70</b>         |
| Operations expired/cancelled  | (4,054,876)       |                      |
| <b>Options outstanding at December 31, 2004<br/>(on Terra shares)</b>                 | <b>2,383,820</b>  | <b>14.21</b>         |
| <b>Equivalent options outstanding<br/>at December 31, 2004 (on Telefónica shares)</b> | <b>529,738</b>    | <b>63.95</b>         |
| Options exercised   | 33,276            |                      |
| Options expired/cancelled   | (445,114)         |                      |
| <b>Options outstanding at December 31, 2005</b>                                       | <b>117,900</b>    | <b>28.28</b>         |

#### b) Terra Networks, S.A. stock option plan, resulting from its assuming Lycos, Inc.'s stock option plans (now assumed by Telefónica, S.A.)

The main features of the plan are as follows:

- Each of the options entitles the holder to acquire one share of Terra Networks, S.A. (now Telefónica, S.A.) at the strike price established at the time the options are granted.
- The options are open to exercise within ten years of the year in which it was granted.
- At the exercise, the options will be settled via the delivery of shares of Telefónica, S.A., once the beneficiary has paid the option strike price.

The total number of options outstanding at December 31, 2005 was 527,425. The changes in 2005 and 2004 are as follows:

|   | Number of options | Average strike price |
|---|-------------------|----------------------|
| <b>Options outstanding at December 31, 2003</b>                                   | <b>19,272,198</b> | <b>USD 20.77</b>     |
| Options exercised   | (1,089,238)       |                      |
| Options expired/cancelled   | (7,319,721)       |                      |
| <b>Options outstanding at December 31, 2004 (on Terra shares)</b>                 | <b>10,863,239</b> | <b>USD 20.39</b>     |
| <b>Equivalent options outstanding at December 31, 2004 (on Telefónica shares)</b> | <b>2,414,053</b>  | <b>USD 91.76</b>     |
| Options exercised   | (161,982)         |                      |
| Options expired/cancelled   | (1,724,646)       |                      |
| <b>Options outstanding at December 31, 2005</b>                                   | <b>527,425</b>    | <b>USD 59.57</b>     |

#### c) Termination of the TIES Program

February 15, 2005 was the third and final exercise date for the TIES Program, a compensation plan based on the Telefónica S.A. share price involving share subscriptions and granting of share options, targeted at non-executive personnel of Telefónica group and created by resolutions of the Shareholders' Meeting of April 7, 2000. However, as the initial reference value was higher than the market price at that time, there were no exercisable options and therefore all options were expired and cancelled and the TIES program was terminated.

Accordingly, the shares which were acquired in the past as the initial assignment to participate in the program ceased to be covered by it.

In February 2005, in accordance with a report issued by the Board of Directors on the resolutions adopted by the Shareholders' Meeting on April 7, 2000, in connection with item IX on the agenda (relating to the establishment of the TIES Program), Telefónica, S.A. acquired 34,760,964 shares from the two financial institutions acting as agents for the plan. These institutions had subscribed and fully paid in these shares when they were issued with the intention that they would subsequently be delivered to the plan's beneficiaries. They were held as treasury stock.

Finally, in the Ordinary General Meeting on May 31, 2005 the shareholders approved a reduction through the cancellation of the aforementioned 34,760,964 treasury shares. The deed ratifying the capital reduction was granted on June 6, 2005 and the 34,760,964 shares of Telefónica, S.A. treasury stock were cancelled. The Company's capital stock was thus reduced by a par value of 34,760,964 euros and Article 5 of the bylaws relating to the value of capital stock reworded accordingly. The cancelled shares were excluded from official listing on June 9, 2005 (see Note 9).

#### 16.3. Average number of employees

| Category   | 2005       | 2004       |
|--|------------|------------|
| University graduates and other line personnel        | 505        | 504        |
| Junior college graduates and technicians (draftsmen) | 4          | 5          |
| Supervisors and data processing assistants           | 143        | 157        |
| Building and services personnel                      | 1          | 2          |
| <b>Total</b>   | <b>653</b> | <b>668</b> |

The total number of employees at December 31, 2005, was 678 (622 at December 31, 2004).

#### 16.4. Other interest on accounts payable and similar expenses and revenues from other equity investments and loans

The detail of these headings is as follows:

|  | 2005            | 2004            |
|--|-----------------|-----------------|
| Debentures, bonds and other marketable debt securities         | 213.84          | 206.97          |
| Euro loans and credits   | 777.52          | 672.61          |
| Foreign currency loans   | 396.11          | 336.94          |
| <b>Total interest on accounts payable and similar expenses</b> | <b>1,387.47</b> | <b>1,216.52</b> |
| Interest on loans to subsidiaries and associates               | 1,016.40        | 968.95          |
| Revenues from investments in local currency                    | 3.62            | 39.13           |
| Revenues from financial derivatives                            | 1.16            | 92.76           |
| <b>Total revenues from other equity investments and loans</b>  | <b>1,021.18</b> | <b>1,100.84</b> |

873.92 million euros and 891.56 million euros of the expenses related to interest on accounts payable to Group companies in 2005 and 2004, respectively (see Note 16.8).

#### 16.5. Exchange rate differences

The detail of exchange losses charged against income is as follows:

|  | 2005            | 2004          |
|--|-----------------|---------------|
| Repayment of loans maturing in the year              | 118.05          | 12.61         |
| Potential losses in the current and subsequent years | 678.92          | 192.18        |
| Current operations and derivatives                   | 503.08          | 446.99        |
| <b>Total</b>   | <b>1,300.05</b> | <b>651.78</b> |

The detail of exchange gains credited to income is as follows:

|   | 2005            | 2004          |
|---|-----------------|---------------|
| Repayment of loans maturing in the year | 79.98           | 6.44          |
| Adjustment of foreign loans             | 329.62          | 395.14        |
| Current operations and derivatives      | 824.57          | 303.60        |
| <b>Total</b>                            | <b>1,234.17</b> | <b>705.18</b> |

The change in exchange gains and exchange losses in 2005 with respect to 2004 was due mainly to significant fluctuations in the US\$/euro exchange rate (the dollar gained 15.46% in 2005 after losing 7.28% in 2004), which was offset by the effect of hedges arranged for this purpose.

#### 16.6. Extraordinary revenues

This heading in the accompanying income statement relates to non-recurring revenues obtained by the Company during the year. The detail is as follows:

|                                      | 2005          | 2004         |
|--------------------------------------|---------------|--------------|
| Gains on fixed asset disposals       | 82.89         | 16.26        |
| Gains on treasury stock transactions | 343.74        | -            |
| Other extraordinary revenues         | 50.76         | 0.51         |
| <b>Total</b>                         | <b>477.39</b> | <b>16.77</b> |

"Gains on fixed asset disposals" mainly include the gains realized on the disposal of Terra Group companies in Latin America and on the sale of 4,300,000 shares in Telefónica Publicidad e Información, S.A., which

came to 45.99 million euros and 28.65 million euros, respectively. Also included is the gain of 1.18 million euros realized on the sale of 611,824 Portugal Telecom shares (see Note 7.5) and on the gains of 5.26 million euros on the disposal of property, plant and equipment (see Note 6).

On the 2004 income statement, the main revenues included under this heading were the gains on the disposal of holdings in Corporación Admira Media, S.A.U. and Telefónica Procesos y Tecnología de la Información, S.A.U. (4.12 million euros and 5.70 million euros, respectively, see Note 7.5.b), as well as gains on the disposal of property, plant and equipment (6.09 million euros) as part of the real estate divestment process under way at the Telefónica Group (see Note 6).

Gains on treasury stock transactions realized in 2005 include the income of 286.21 million euros generated in the distribution of share premium via the delivery to Telefónica, S.A. shareholders of shares in the Company held as treasury stock (see Note 9).

In 2005, the Company reversed 36.38 million euros from the provision for contingencies and expenses established to cover the negative underlying book value of investments in Group companies (see Note 4.d), mainly as a result of the increase in the net worth of Terra Networks España, S.A. following the merger of Telefónica, S.A. and Terra Networks, S.A. (see Note 7.3).

#### 16.7. Extraordinary expenses

The detail of extraordinary expenses is as follows:

|   | 2005         | 2004         |
|---|--------------|--------------|
| Prior year losses   | 0.78         | 0.64         |
| Losses on long-term investments   | 7.39         | 0.04         |
| Gains on treasury stock transactions  | 7.98         |              |
| Transfer to provisions for treasury stock charged against income (see Note 9.a) | 37.57        | –            |
| Other extraordinary expenses  | 32.50        | 69.02        |
| <b>Total</b>  | <b>86.22</b> | <b>69.70</b> |

"Other extraordinary expenses" relate to non-recurrent expenses that are not related to the Company's usual activities. In 2004, Bidland Systems Inc. and TI Capital Management, LLC reached a final agreement with Katalyx, Inc. and Telefónica, S.A. to resolve in court the two claims filed by the former alleging breach of certain contractual obligations assumed in respect of the creation of a joint venture. Under this agreement, the damages initially sought were reduced to 38 million dollars and each party undertook to bear its respective lawyers' fees. The 15.31 million euros expense borne by Telefónica, S.A. in this connection were recorded under other extraordinary expenses.

#### 16.8. Transactions with Group companies

Telefónica's main transactions with Group companies in 2005 and 2004 were as follows:

|  | 2005     | 2004     |
|--|----------|----------|
| Dividends received   | 1,692.90 | 795.41   |
| Accrued interest   | 1,016.25 | 968.32   |
| Financial expenses (Note 16.4)   | (873.92) | (891.56) |
| Acquisitions of goods and services from the Telefónica Group               | (71.04)  | (50.45)  |
| Telefónica de Argentina management fee transferred to Telefónica de España | (1.08)   | (1.04)   |

The dividends received in 2005 include most notably the 1,029.15 million euro dividend paid by Telefónica de España, S.A.U. (165.15 million euros in 2004), the 593.97 million euro dividend paid by Telefónica Móviles, S.A. (565.22 million euros in 2004) and the payment of 66.17 million euros (55.14 million euros in 2004) by Telefónica Publicidad e Información, S.A.

The accrued interest in 2005 mostly included 367.89 million euros on the loans granted to Telefónica de España, S.A.U. (419.84 million euros in 2004), 439.27 million euros on the loans granted to Telefónica Móviles, S.A. (318.17 million euros in 2004) and 116.86 million euros (127.70 million euros in 2004) on the loans granted to Telefónica de Contenidos, S.A.U.

The financial expenses paid to Group companies mostly include the those arising from the financing received from Telefónica Europe, B.V. and Telefónica Finanzas, S.A.U., the cost of which was 629.84 million euros and 219.17 million euros, respectively, in 2005 (689.37 million euros and 177.50 million euros, respectively, in 2004) (see Note 12.1).

## (17) Directors' Compensation and Other benefits

### a) Directors' compensation and other benefits

The compensation of Telefónica, S.A.'s directors is governed by Article 28 of the bylaws, which states that the compensation paid by the Company to its directors shall be determined by the Shareholders' Meeting and shall remain in force until the Shareholders' Meeting resolves to change it. The Board of Directors is responsible for setting the exact amount to be paid within the stipulated limits and distributing it among the directors. In this regard, on April 11, 2003, shareholders set the maximum gross annual amount to be paid to the Board of Directors at 6 million euros. This includes a fixed payment and fees for attending meetings of the Board of Directors' advisory or control committees.

Therefore, the compensation of Telefónica's directors in their capacity as members of the Board of Directors and/or of the Standing Committee and the advisory and control committees consists of a fixed amount payable monthly plus fees for attending the meetings of the Board's advisory or control committees. In addition, executive directors receive the appropriate amounts for discharging their executive duties as stipulated in their respective contracts.

In 2005 the members of the Board of Directors of Telefónica, S.A. earned the following total compensation for discharging their duties as such: Fixed payments of 4,578,161.61 euros (including the compensation earned as members of the Boards of Directors or of the advisory or control committees of other Telefónica Group companies) and attendance fees of 228,394.18 for attending the Board of Directors advisory committee meetings (including fees for attending Board advisory committee meetings of other Telefónica Group companies).

In their capacity as company executives, the executive directors César Alierta Izuel, Antonio J. Alonso Ureba (who left Telefónica group on September 30, 2005), Luis Lada Díaz, Julio Linares López (appointed director of Telefónica, S.A. on December 21, 2005), Mario E.



Vázquez and Antonio Viana-Baptista received: 7,422,040.98 euros in salaries and variable compensation; 169,541.43 euros in compensation in kind, which included life insurance premiums; and 47,000.00 euros in contributions made to Company-sponsored pension plans.

The detail of the compensation and benefits received by Telefónica's directors in 2005 is as follows:

**Board of Directors.** Fixed payment for each director (in euros):

| Position              | 2005           |
|-----------------------|----------------|
| Chairman              | 240,000.00     |
| Vice Chairmen         | 200,000.00     |
| Directors (1):        |                |
| Executives            | 120,000.00 (*) |
| Nominee directors     | 120,000.00     |
| Independent directors | 120,000.00     |

(1) One of the directors, non-resident in Spain, receives an additional annual payment of 60,101.16 euros due to the key importance to the company of his experience and dedication in Latin America

(\*) Antonio Alonso Ureba left the Telefónica Group on September 30, 2005, having received fixed compensation to that date of 90,000 euros.

**Standing Committee.** Fixed payment for each director forming part of the Standing Committee, by post (in euros):

| Position      | 2005          |
|---------------|---------------|
| Chairman      | 80,000.04     |
| Vice chairman | 80,000.04     |
| Directors     | 80,000.04 (*) |

(\*) Antonio Alonso Ureba left Telefónica Group on September 30, 2005, having received compensation to that date of 60,000 euros.

Directors receive no attendance fees for Board and Standing Committee meetings.

**Other Board committees**

a) Fixed payment for each director forming part of one of the Board committees, by post (in euros):

| Position | 2005      |
|----------|-----------|
| Chairman | 20,000.00 |
| Members  | 10,000.00 |

b) Total fees paid to directors in 2005 for attending meetings of the advisory or control committees (in euros):

| Committee   | 2005   |
|---|--|
| Audit and Control                                 | Attendance fee per meeting: 1,250.00<br>Number of meetings paid: 12<br>Total paid: 51,250.00 |
| Appointments and Compensation and Good Governance | Attendance fee per meeting: 1,250.00<br>Number of meetings paid: 11<br>Total paid: 43,750.00 |
| Human Resources and Corporate Reputation          | Attendance fee per meeting: 1,250.00<br>Number of meetings paid: 6<br>Total paid: 27,500.00  |
| Regulation  | Attendance fee per meeting: 1,250.00<br>Number of meetings paid: 10<br>Total paid: 41,250.00 |
| Service Quality and Commercial Service            | Attendance fee per meeting: 1,250.00<br>Number of meetings paid: 4<br>Total paid: 15,000.00  |
| International Affairs                             | Attendance fee per meeting: 1,250.00<br>Number of meetings paid: 6<br>Total paid: 31,086.10  |

**Executive directors.** The total paid to executive directors César Alierta Izuel, Antonio J. Alonso Ureba (who left Telefónica group on September, 30 2005), Luis Lada Díaz, Julio Linares López (appointed director of Telefónica, S.A. on December 21, 2005), Mario E. Vázquez and Antonio Viana-Baptista for performing their functions as group executives by concept (in euros) was the following (Julio Linares López is included solely for the compensation received from the month of his appointment as director):

| Items                          | 2005         |
|--------------------------------|--------------|
| Salary                         | 3,572,766.84 |
| Variable compensation          | 3,849,274.14 |
| Compensation in kind           | 169,541.43   |
| Contributions to pension plans | 47,000.00    |

In addition, it should be noted that the non-executive directors do not receive and did not receive in 2005 any compensation in the form of pensions or life insurance, and they do not participate in the compensation plans linked to share market price.

The Company does not grant and did not grant in 2005 any advances, loans or credits to the directors, or to its top executives, thus complying with the requirements of the Sarbanes-Oxley Act passed in the U.S. which is applicable to Telefónica as a listed company in that market.

Finally, the six Company directors who are members of the Catalonia, Andalusia and Valencia advisory committees received a total amount of 84,999.77 euros in 2005.

The nine directors who became senior executives of the Company in December 2005 –in accordance with the provisions of Royal Decree-Law 377/1991, March 15 director is understood to be general managers or similar who perform senior management functions and report directly to the Management Bodies, Executive Committees or CEOs of the listed company- excluding those who are members of the Board of Directors were paid a total in 2005 for all items of 7,715,244.43 million euros. One of these directors, Julio Linares López, is only included in the compensation paid from January to November 2005 as he was appointed to the Board in December.



*b) Detail of the equity investments in companies engaging in an activity that is identical, similar or complementary to that of the Company and the performance of similar activities by the directors on their own behalf or on behalf of third parties*

Pursuant to Article 127 ter. 4 of the Spanish Corporation Law, introduced by Law 26/2003, July 17 which amends Securities Market Law 24/1988, and the revised Spanish Corporation Law, in order to reinforce the transparency of listed corporations, we have included below details of the companies engaging in an activity that is identical, similar or complementary to the corporate purpose of Telefónica, S.A., in which the members of the Board of Directors own equity interests, and of the functions, if any, that they discharge in them:

| Owner                     | Investee  | Activity   | % of ownership | Position           |
|---------------------------|---|--|----------------|--------------------|
| Isidro Fainé Casas        | Abertis Infraestructuras, S.A.                                      | Telecommunications   | < 0.01%        | Chairman           |
| Maximino Carpio García    | Telefónica Móviles, S.A.  | Telecommunications   | < 0.01%        | Director           |
| Miguel Horta e Costa      | Portugal Telecom, SGPS S.A.   | Telecommunications   | < 0.01%        | Executive chairman |
| Luis Lada Díaz            | Telefónica Móviles S.A.   | Telecommunications   | < 0.01%        | Director           |
|                           | Sogecable S.A.  | Television, telecommunications and audiovisual production services | < 0.01%        | Director           |
| Julio Linares López       | Telefónica Móviles, S.A.  | Telecommunications   | < 0.01%        | —                  |
| Antonio Massanell Lavilla | Telefónica Móviles S.A.   | Telecommunications   | < 0.01%        | Director           |
| Enrique Used Aznar        | Amper, S.A.   | Telecommunications equipment supplier                              | 0.39%          | Chairman           |
| Antonio Viana-Baptista    | Telefónica Móviles, S.A.  | Telecommunications   | < 0.01%        | Executive Chairman |
|                           | PT Multimedia-Serviços de Telecomunicações e Multimedia, SGPS, S.A. | Internet   | < 0.01%        | —                  |
|                           | Portugal Telecom, SGPS S.A.   | Telecommunications   | < 0.01%        | Director           |

<sup>1</sup> < 0.01% is shown if the holding is less than 0.01% of capital

The table below, in accordance with the same Law, gives details of activities carried out, on their own account or on behalf of third parties, by the various members of the Company Board of Directors that are identical, or similar or complementary to the corporate purpose of Telefónica, S.A.:

| <b>Name</b>                             | <b>Activity carried out</b>  | <b>Arrangement under which activity is performed<sup>1</sup></b> | <b>Company through which activity is performed</b>                      | <b>Positions held or functions performed</b> |
|---|--|--|---|--|
| Isidro Fainé Casas                      | Telecommunications   | As behalf of third parties o employee                            | Abertis Infraestructuras, S.A.  | Chairman                                     |
| Gregorio Villalabeitia Galarraga        | Telecommunications   | As behalf of third parties o employee                            | Telefónica Internacional, S.A.  | Director                                     |
| José Fernando de Almansa Moreno-Barreda | Telecommunications   | As behalf of third parties o employee                            | Telefónica Móviles, S.A.  | Director                                     |
|   | Telecommunications   | As behalf of third parties o employee                            | Telefónica del Perú, S.A.A.   | Director                                     |
|   | Telecommunications   | As behalf of third parties o employee                            | Telefónica de Argentina, S.A.   | Director                                     |
|   | Telecommunications   | As behalf of third parties o employee                            | Telecomunicaciones de Sao Paulo, S.A.                                   | Director                                     |
|   | Telecommunications   | As behalf of third parties o employee                            | Telefónica Internacional, S.A.  | Director                                     |
| Maximino Carpio García                  | Telecommunications equipment provider                              | As behalf of third parties o employee                            | Abengoa, S.A.   | Member of Advisory Committee                 |
|   | Telecommunications   | As behalf of third parties o employee                            | Telefónica Móviles, S.A.  | Director                                     |
| Alfonso Ferrari Herrero                 | Telecommunications   | As behalf of third parties o employee                            | Compañía de Telecomunicaciones de Chile, S.A.                           | Director                                     |
|   | Telecommunications   | As behalf of third parties o employee                            | Telefónica de Perú, S.A.A.  | Director                                     |
|   | Telecommunications   | As behalf of third parties o employee                            | Telefónica Internacional, S.A.  | Director                                     |
| Miguel Horta e Costa                    | Telecommunications   | As behalf of third parties o employee                            | Portugal Telecom, SGPS S.A.   | Executive Chairman                           |
|   | Telecommunications   | As behalf of third parties o employee                            | PT Comunicações, S.A.   | Executive Chairman                           |
|   | Telecommunications   | As behalf of third parties o employee                            | PT Multimedia-Serviços de Telecomunicações e Multimédia, SGPS, S.A.     | Chairman                                     |
|   | Telecommunications   | As behalf of third parties o employee                            | TMN-Telecomunicações Móveis Nacionais, S.A.                             | Chairman                                     |
|   | Telecommunications   | As behalf of third parties o employee                            | PT Movéis-Serviços de Telecomunicações e Multimedia, SGPS, S.A.         | Chairman                                     |
|   | Telecommunications   | As behalf of third parties o employee                            | PT Sistemas de Informação, S.A.   | Chairman                                     |
|   | Telecommunications   | As behalf of third parties o employee                            | PT Corporate-Soluções Empresariais de Telecomunicações e Sistemas, S.A. | Chairman                                     |
|   | Telecommunications   | As behalf of third parties o employee                            | PT Compras-Serviços de Consultoria e Negociação, S.A.                   | Chairman                                     |
|   | Telecommunications   | As behalf of third parties o employee                            | PT Investimentos Internacionais-Consultoria Internacional, S.A.         | Chairman                                     |
| Gonzalo Hinojosa Fernández de Angulo    | Telecommunications   | As behalf of third parties o employee                            | Telefónica Internacional, S.A   | Director                                     |
| Luis Lada Díaz                          | Telecommunications   | As behalf of third parties o employee                            | Telefónica de España, S.A.  | Executive Chairman                           |
|   | Telecommunications   | As behalf of third parties o employee                            | Telefónica Móviles, S.A.  | Director                                     |
|   | Television, telecommunications and audiovisual production services | As behalf of third parties o employee                            | Sogecable, S.A.   | Director                                     |
|   | Telecommunications   | As behalf of third parties o employee                            | Telefónica Internacional, S.A.  | Director                                     |
|   | Telecommunications   | As behalf of third parties o employee                            | Cesky Telecom, a.s.   | Vice Chairman of Supervisory Board           |
| Julio Linares López                     | Telecommunication equipment provider                               | As behalf of third parties o employee                            | Teleinformática y Comunicaciones, S.A. (TELYCO)                         | Chairman                                     |
|   | Telecommunications   | As behalf of third parties o employee                            | Cesky Telecom, a.s.   | Chairman of Supervisory Board                |
|   | Telecommunications   | As behalf of third parties o employee                            | Telefónica de España, S.A.  | Director                                     |
|   | Telecommunications   | As behalf of third parties o employee                            | Telefónica DataCorp, S.A.   | Director                                     |
|   | Telecommunications   | As behalf of third parties o employee                            | Telefónica Data España, S.A.  | Director                                     |

| Name                      | Activity carried out                  | Arrangement under which activity is performed <sup>1</sup> | Company through which activity is performed        | Positions held or functions performed |
|---------------------------|---------------------------------------|--|--|---------------------------------------|
| Antonio Massanell Lavilla | Telecommunications                    | As behalf of third parties o employee                      | Telefónica Móviles, S.A.                           | Director                              |
| Enrique Used Aznar        | Telecommunications equipment provider | As behalf of third parties o employee                      | Amper, S.A.  | Chairman                              |
|                           | Telecommunications                    | As behalf of third parties o employee                      | Telecomunicaciones de Sao Paulo, S.A.              | Director                              |
|                           | Telecommunications                    | As behalf of third parties o employee                      | Telefónica de Perú, S.A.A.                         | Director                              |
|                           | Telecommunications                    | As behalf of third parties o employee                      | Telefónica Internacional, S.A.                     | Director                              |
| Mario Eduardo Vázquez     | Telecommunications                    | As behalf of third parties o employee                      | Telefónica Internacional, S.A.                     | Director                              |
|                           | Telecommunications                    | As behalf of third parties o employee                      | Telefónica de Argentina, S.A.                      | Chairman                              |
|                           | Telecommunications                    | As behalf of third parties o employee                      | Telefónica Holding de Argentina, S.A.              | Vice Chairman                         |
|                           | Telecommunications                    | As behalf of third parties o employee                      | Compañía Internacional de Telecomunicaciones, S.A. | Vice Chairman                         |
|                           | Telecommunications                    | As behalf of third parties o employee                      | Telefónica Móviles Argentina, S.A.                 | Chairman                              |
|                           | Telecommunications                    | As behalf of third parties o employee                      | Telefónica Comunicaciones Personales, S.A.         | Owner/director                        |
|                           | Telecommunications                    | As behalf of third parties o employee                      | Radio Servicios S.A.                               | Owner/director                        |
|                           | Telecommunications                    | As behalf of third parties o employee                      | Telinver, S.A.                                     | Chairman                              |
|                           | Internet and e-commerce               | As behalf of third parties o employee                      | Terra Networks Argentina, S.A.                     | Vice chairman                         |
|                           | Telecommunications                    | As behalf of third parties o employee                      | Telefónica Data Argentina, S.A.                    | Chairman                              |
| Antonio Viana Baptista    | Telecommunications                    | As behalf of third parties o employee                      | Telefónica Móviles, S.A.                           | Executive Chairman                    |
|                           | Telecommunications                    | As behalf of third parties o employee                      | Telefónica Internacional, S.A.                     | Director                              |
|                           | Telecommunications                    | As behalf of third parties o employee                      | Telefónica Móviles España, S.A.                    | Chairman                              |
|                           | Telecommunications                    | As behalf of third parties o employee                      | Brasilcel, N.V.                                    | Director                              |
|                           | Telecommunications                    | As behalf of third parties o employee                      | Portugal Telecom, SGPS, S.A.                       | Director                              |
|                           | Telecommunications                    | As behalf of third parties o employee                      | Telefónica de España, S.A.                         | Director                              |
|                           | Telecommunications                    | As behalf of third parties o employee                      | Cesky Telecom, a.s.                                | Member of Supervisory Board           |

<sup>1</sup> Only assigned when the service is provided on behalf of others and, accordingly, is performed through a company.

Pursuant to Article 114.2 of the Spanish Corporation Law, also introduced by Law 26/2003, it is hereby stated that in the year to which these consolidated financial statements refer, the directors, or persons acting on their behalf, did not perform any transactions with Telefónica or any other company in the Telefónica Group other than in the normal course of the Company's business or that were not at arm's length.

## (18) Other Information

### a) Financial guarantees

|  | 2005      | 2004      |
|--|-----------|-----------|
| Guarantees provided for financial transactions | 12,363.38 | 13,534.71 |

"Guarantees provided for financial transactions" relates mainly to guarantees provided by Telefónica for its subsidiaries and investees to secure their transactions with third parties.

No significant losses are expected to arise for the Company in connection with these commitments.

The main amount included in this heading is the guarantee amounting to 7,624.25 million euros provided in relation to Telefónica Europe, B.V.

### b) Litigation

Telefónica, S.A. and its group companies are party to several lawsuits that are currently in progress in the courts of law and the arbitration bodies of the various countries in which the Telefónica group is present.

Based on the advice of the Company's legal counsel, it is reasonable to assume that this litigation will not materially affect the financial position or solvency of Telefónica group, even in the event the company should lose. We highlight the following unresolved cases:

#### 1. A proceeding contesting certain resolutions adopted at the General Shareholders' Meeting of Telefónica, S.A. on June 15, 2001.

Shareholder Javier Sotos García filed a complaint contesting some of the resolutions adopted at the General Shareholders' Meeting of June 15, 2001. The suit was heard by the Madrid Court of First Instance no. 15, case number 628/2001.

The complaint was based on an alleged infringement of the contesting shareholder's right to information and the legal rules for disapplication of pre-emptive subscription rights in capital increases.

On January 23, 2004, the Company was notified that the proceeding had been stayed until such time as either the parties applied for its resumption or the instance lapsed.

Based on the opinion of its legal counsel, the Company believes that the outcome of the aforementioned court proceeding will be wholly satisfactory for the Company.

#### 2. Procedures deriving from bankruptcy proceeding of Sistemas e Instalaciones de Telecomunicación, S.A.U. (Sintel).

As a result of the voluntary bankruptcy proceeding heard by Madrid Court of First Instance no. 42, case number 417/2001, two criminal proceedings have commenced which affect Telefónica, S.A.

"Abbreviated" proceeding no. 273/2001 being heard before Central Examining Court no. 1, in relation to which, on September 24, 2002, Telefónica, S.A. and Telefónica de España, S.A. filed a civil suit for damages against the directors of Sintel and of Mastec Internacional, S.A.

Preliminary proceeding no. 362/2002, which commenced on October 23, 2002, before Central Examining Court no. 1 for a possible offence of extortion and was subsequently assimilated to the preliminary proceedings in case no. 273/2001 above.

The two proceedings having been combined, on April 2004, the motion filed by counsel for Telefónica, S.A. to have the case dismissed was rejected and it was ruled that the preliminary proceedings should continue. It is important to emphasize that so far no liability has been established and the plaintiffs' claim in this regard has been explicitly dismissed.

On June 29, 2004, notice was given of a plea filed by counsel for former Sintel employees seeking to further expand the criminal complaint. This time they alleged a purported offence of criminal insolvency committed in the sale of Sintel to Mastec Internacional, Inc in April 1996. On July 4 and August 5, 2004, Telefónica, S.A. filed submissions to have this latest allegation declared inadmissible. The court has yet to rule on whether it will admit this extension of the criminal complaint.

#### 3. Class actions filed by shareholders of Terra in the U.S. in connection with Telefónica, S.A.'s takeover bid for Terra Networks, S.A.

On May 29, 2003, certain Terra Networks, S.A. shareholders filed two class actions with the Supreme Court of New York State against Telefónica, S.A., Terra Networks, S.A. and certain directors of Terra Networks, S.A.

These actions are founded mainly on the claim that, in the view of the plaintiffs, the price offered to the shareholders of Terra Networks, S.A. was not in keeping with the intrinsic value of the shares of that company, and they are seeking to block the takeover or, alternatively, to win damages.

It should be noted that since complaints were filed, the related proceedings have remained inactive.

Based on the opinion of its legal counsel, the Company considers that it has a sound defense against both the form and the substance of the claims filed against it and, accordingly, is confident that the outcome of the litigation should not be adverse for Telefónica.

#### 4. Appeal for judicial review no. 6/461/03 filed at the National Appellate Court by the World Association of Shareholders of Terra Networks, S.A. (ACCTER) against the administrative decision rendered by the Spanish National Securities Market Commission (CNMV) on June 19, 2003, to authorize the share offer by Telefónica, S.A. for Terra Networks, S.A.

Telefónica, S.A. appears in these proceedings as an intervening non-party in the case to defend the lawfulness of the CNMV's decision.

On March 8, 2005, ACCTER filed a plea to extend the facts in the case to cover the announcement of the merger between Telefónica S.A. and Terra Networks, S.A. Both Telefónica, S.A. and Government Legal Service filed submissions contesting the pleading.

The ruling was scheduled for January 10, 2006 and the parties were notified on January 27, 2006 (see Note 19 for Subsequent Events after December 31, 2006).

5. Proceeding contesting the merger resolution voted at the General Shareholders' Meeting of Terra Networks, S.A. held on June 2, 2005.

On June 30, 2005 the World Association of Shareholders of Terra Networks, S.A. (ACCTER) and its President, on his own account, filed a complaint contesting the merger resolution adopted by the Shareholders' Meeting of Terra Networks S.A. of June 2, 2005 alleging a breach of article 60.4 of the Securities Market Law. The plaintiffs maintain that before the merger, Telefónica S.A. should have presented a public tender for the rest of the company's outstanding voting shares admitted to trading.

On December 21, 2005 Telefónica S.A. filed its answer to the claim.

### c) Commitments

#### **Agreements with Portugal Telecom (Brazil)**

On January 23, 2001, Telefónica, S.A. and its subsidiary Telefónica Móviles, S.A., on the one hand, and Portugal Telecom SGPS, S.A. and its subsidiary PT Móveis, SGPS, S.A., on the other, agreed to group together all their wireless telephony businesses in Brazil. They therefore undertook to contribute all their wireless telephony assets in Brazil to a joint venture, which, subject to the necessary regulatory authorizations, would be a subsidiary of the two groups, and in which they would each have a 50% ownership interest. In addition, under the terms of this agreement, the two parties expressed their interest in increasing their reciprocal ownership interests, subject to compliance with the applicable regulations and bylaws.

On October 17, 2002, Telefónica Móviles, S.A., on the one hand, and Portugal Telecom SGPS, S.A. and its subsidiary PT Móveis SGPS, S.A., on the other, entered into the definitive agreements (Shareholders' Agreement and Subscription Agreement) that implement the aforementioned agreement signed in January 2001. On December 27, 2002 (after having obtained the necessary authorizations), the two groups' holdings in their respective Brazilian wireless telephony operators were contributed to a Dutch joint venture, Brasilcel N.V., in accordance with the provisions of the aforementioned Subscription Agreement.

In accordance with the aforementioned definitive agreements, Telefónica Móviles, S.A. and the Portugal Telecom group will have the same voting rights at Brasilcel, N.V. This equality in voting rights will cease to exist if, as a result of capital increases at Brasilcel, N.V., the percentage ownership of either of the parties falls below 40% during an uninterrupted period of six months. In this event, if the group with the reduced interest were the Portugal Telecom group, it would be entitled to sell to Telefónica Móviles, S.A., which would be obliged to buy (directly or through another company), all the Portugal Telecom group's ownership interest in Brasilcel N.V. This right expires on December 31, 2007. The price for the acquisition of the Portugal Telecom group's holding in Brasilcel, N.V. would be calculated on the basis of an independent appraisal (in the terms provided for in the definitive agreements) performed by investment banks, selected using the procedure established in these agreements. Subject to certain conditions, the payment could be made, at Telefónica Móviles' choice, in (i) cash, (ii) Telefónica Móviles S.A. shares and/or Telefónica, S.A. shares, or (iii) a combination of the two. This put option would be exercisable in the 12 months subsequent to the

end of the aforementioned six-month period, provided that the Portugal Telecom group had not increased its ownership interest to 50% of the total capital share of Brasilcel N.V.

In addition, in accordance with the definitive agreements, the Portugal Telecom group will be entitled to sell to Telefónica Móviles, S.A., which will be obliged to buy, its holding in Brasilcel, N.V. should there be a change in control at Telefónica, S.A., at Telefónica Móviles, S.A. or at any other subsidiary of the latter that held a direct or indirect ownership interest in Brasilcel N.V. Similarly, Telefónica Móviles, S.A. will be entitled to sell to the Portugal Telecom group, which will be obliged to buy, its holding in Brasilcel, N.V. if there is a change of control at Portugal Telecom SGPS, S.A., at PT Móveis SGPS, S.A. or at any other subsidiary of either company that held a direct or indirect ownership interest in Brasilcel N.V. The price will be determined on the basis of an independent appraisal (in the terms provided for in the definitive agreements) performed by investment banks, selected using the procedure established in these agreements. The related payment could be made, at the choice of the group exercising the put option, in cash or in shares of the wireless telephony operators contributed by the related party, making up the difference, if any, in cash.

#### **Newcomm Wireless Services, Inc. (Puerto Rico.)**

On December 23, 2003, Telefónica Móviles, S.A. arranged a counter guarantee for Telefónica, S.A. for the obligation of Newcomm Wireless Services, Inc. de Puerto Rico, regarding a 61 million dollar bridging loan granted by ABN AMRO which matures on June 30, 2005. These guarantees are deemed to be recoverable on the basis of the company's business plan and of the seniority of their claim over equity.

Subsequently, on April 20, 2005, it was agreed to extend the term of the bridging loan to June 30, 2008, with the possibility of a further 2-year extension, with a corresponding extension of the counter guarantee.

On April 20, 2005, Telefónica Móviles S.A. arranged a counter guarantee for Telefónica, S.A. for the obligation of Newcomm Wireless Services, Inc. de Puerto Rico, regarding a subordinated loan of up to 40 million dollars granted by ABN AMRO to meet Newcomm's license payments to the FCC (Federal Communications Commission) maturing June 30, 2010.

#### **Atento**

Within the framework of the strategic agreement entered into on February 11, 2000, by Banco Bilbao Vizcaya Argentaria S.A. (BBVA) and Telefónica, on December 4, 2001, the two signed an agreement establishing the procedure and conditions for the integration in Atento, a Telefónica group subsidiary, of the BBVA group's Spanish and international call center business.

The agreement provided for the initial contribution by Telefónica S.A. of all its contact center business to a newly-formed subsidiary (Atento N.V.) and the subsequent inclusion of the BBVA group in the shareholder structure of Atento N.V. through the contribution of the Spanish companies Procesos Operativos, S.A. and Leader Line, S.A., which entailed the transfer to Atento of the BBVA group's Spanish and international call center business.

The transaction also envisaged the signing of various specific agreements for the provision to the BBVA group by Atento of call center services in Spain and Portugal and in several Latin American countries.

Atento N.V. was incorporated on May 31, 2002. All Telefónica, S.A.'s call center business was contributed to it on that date. The contributions by the BBVA group under the terms of the agreement discussed in this section have not yet been made.

On October 24, 2003, BBVA, Telefónica, S.A. and Atento N.V. entered into an Agreement establishing the terms and conditions under which BBVA, through General de Participaciones Empresariales, S.L. (GPE) became a shareholder of Atento N.V. by contributing all the shares of Procesos Operativos, S.A. As a result of this Agreement, Telefónica, S.A. currently owns shares representing 91.35% of Atento N.V.'s share capital, while GPE (a BBVA group company) owns the remaining 8.65%.

Subsequently, on December 1, 2003, the Atento Group company Atento Teleservicios España, S.A. acquired all the shares of Leader Line, S.A.

On November 27, 2003, BBVA and Atento N.V. entered into a framework contract for services, with a term of four years, establishing the terms under which Atento N.V. and its subsidiaries will provide call center activities and services to the BBVA group.

At the same time as the aforementioned acquisition of Leader Line, S.A., Telefónica and GPE entered into a put option contract whereby GPE has the right to sell to Telefónica, which will be obliged to buy, all the shares of Atento N.V. that GPE owns at the time the option is exercised.

#### ***Commitments in relation to Sogecable***

As a result of the agreements dated May 8, 2002 and January 29, 2003, between Telefónica, S.A., Telefónica de Contenidos, S.A.U. and Sogecable, S.A., relating to the merger of Via Digital into Sogecable, on January 29, 2003, Telefónica, S.A. informed the Spanish securities exchange commission (the SEC) through a relevant event notification that its strategic plans at that date did not envisage the disposal of the 16.38% shareholding within a period of at least three years from the date of the exchange.

#### ***Terra Networks, S.A. (now Telefónica, S.A.) – BBVA (Uno-e Bank, S.A.)***

By virtue of the agreements entered into in February 2000 by Telefónica, S.A. and Banco Bilbao Vizcaya Argentaria, S.A. (BBVA), in August 2001 Terra Networks, S.A. acquired a 49% holding in Uno-e Bank, S.A. for 160.43 million euros.

On May 15, 2002, Terra Networks, S.A. and BBVA entered into a memorandum of understanding to integrate the consumer finance lines of business of Finanzia Banco de Crédito, S.A. (a wholly-owned subsidiary of BBVA) and Uno-e Bank, S.A. The agreement relating to this integration was subject to a legal, financial and business review, and to the relevant internal and administrative authorizations. After integration, Terra Networks, S.A.'s ownership interest in Uno-e Bank, S.A. was 33% and that of the BBVA Group was 67%.

On that same date (May 15, 2002), BBVA and Terra Networks, S.A. entered into a liquidity agreement in which they established certain

liquidity mechanisms (call and put options) relating to the Uno-e Bank, S.A. shares owned by Terra Networks, S.A., which would be modified if a definitive agreement were reached regarding the aforementioned integration of the consumer finance lines of business of Finanzia Banco de Crédito, S.A. and Uno-e Bank, S.A., to the effect that BBVA would lose its call option and Terra Networks, S.A. would retain its put option, but only at the market value as determined by an investment bank.

On January 10, 2003, Terra Networks, S.A. and BBVA entered into an agreement for the integration of the consumer finance line of business of Finanzia Banco de Crédito, S.A. and Uno-e Bank, S.A., in terms more suited to their respective interests than those established in the memorandum of understanding of May 15, 2002, which was then rendered void. The definitive agreement was subject to the related internal and administrative authorizations, which had to be granted before June 30, 2003, as a condition for the formalization and execution of the integration transaction. After the integration had taken place, Terra Networks, S.A.'s ownership interest in Uno-e Bank, S.A. was 33% and that of the BBVA Group was 67%.

On that same date (January 10, 2003), BBVA and Terra Networks, S.A. entered into a liquidity agreement that replaced that dated May 15, 2002, when the aforementioned integration took place. This agreement establishes the following liquidity mechanism (put options) relating to the Uno-e Bank, S.A. shares owned by Terra Networks, S.A.: Terra Networks, S.A. has the right to sell to BBVA, and BBVA is obliged to acquire, Terra Networks, S.A.'s holding in Uno-e Bank, S.A. between April 1, 2005 and September 30, 2007, at market value, established as the higher of the two following values: (i) that determined by an investment bank; and (ii) that obtained by multiplying the income after taxes of Uno-e Bank, S.A. by the P/E ratio of BBVA, multiplied by the percentage of ownership held by Terra Networks, S.A. that it intended to sell as of that date.

In addition, the strike price of the aforementioned option may not be lower than 148.5 million euros if Uno-e Bank, S.A. does not achieve the net ordinary revenue and pre-tax profit targets set for 2005 and 2006 in the above-mentioned liquidity agreement.

In accordance with the terms of the aforementioned agreement dated January 10, 2003, once the relevant authorizations had been obtained, on April 23, 2003, approval was given at the Extraordinary Shareholders' Meeting of Uno-e Bank, S.A. for a capital increase at Uno-e Bank, S.A. to be subscribed in full by Finanzia Banco de Crédito, S.A., through the non-monetary contribution of the latter's consumer finance business line, at whose Extraordinary Shareholders' Meeting held on the same date approval was given for the contribution and the subscription in full of the capital increase.

This capital increase led to the integration of the consumer finance business line of Finanzia Banco de Crédito, S.A. into Uno-e Bank, S.A., following which the holdings of the BBVA Group and Terra Networks, S.A. (now Telefónica, S.A.) in Uno-e Bank, S.A. are 67% and 33%, respectively.

#### ***Telefónica, S.A. share option plan aimed at employees of Endemol ("EN-SOP Program")***

This program consists of the grant to the beneficiaries (all the Endemol Group's permanent employees on January 1, 2001, who are not participating in another similar share or share option plan),



effective January 1, 2001, 2002, 2003 and 2004, of a variable number (based on the various wage and functional categories) of purchase options on Telefónica, S.A. shares. The duration of the options will be four years from the grant date, and the options may be exercised at a rate of one-half each year three and four years after the related grant date.

The option strike price will be the related annual reference value, and the exercise terms will be the customary terms in programs of this nature. The beneficiaries must remain uninterruptedly permanent employees of Endemol until the options are exercised, without prejudice to the regulation of cases of early settlement of the options in certain cases in which the employment relationship is interrupted prior to the exercise of the options.

The options may be settled through the acquisition by the beneficiary of the underlying shares or, alternatively, through a cash settlement.

The movements in 2004 and 2005 are as follows:

|   | Number<br>of options | Average<br>strike price |
|---|----------------------|-------------------------|
| <b>Options outstanding at December 31, 2003</b> | <b>5,679,562</b>     | <b>11.81</b>            |
| Options exercised                               | 2,246,732            |                         |
| Options expired/cancelled                       | (1,243,495)          |                         |
| <b>Options outstanding at December 31, 2004</b> | <b>6,682,799</b>     | <b>11.54</b>            |
| Options exercised                               | (492,277)            | 11.88                   |
| Options expired/cancelled                       | (1,280,688)          |                         |
| <b>Options outstanding at December 31, 2005</b> | <b>4,909,834</b>     | <b>10.78</b>            |

#### **Other commitments in the form of performance bonds for concessions or licenses**

1. Telefónica Móviles España, S.A.U., a subsidiary of Telefónica Móviles, S.A., which is in turn a subsidiary of Telefónica, S.A., provided certain financial guarantees to the Spanish State amounting to 1,100 million euros in relation to the UMTS license in Spain granted to Telefónica Móviles España, S.A.U. These guarantees ensure fulfillment of the commitments assumed by the company awarded the license in relation to network deployment, job creation, investments, etc.

Telefónica Móviles España, S.A.U. initiated negotiations with the Ministry of Science and Technology with a view to changing the existing system of guarantees. The process was completed through an Official Notice issued by the Secretary of State for Telecommunications and for the Information Society on July 28, 2003, as a result of which the 71 guarantees in force at that date amounting to 630.9 million euros that were securing the commitments assumed under the UMTS license were returned to Telefónica Móviles España, S.A.U., after the latter had arranged, in the same month, a guarantee of 167.5 million euros with the Government Depositary, to secure compliance with the UMTS service commitments prior to launch of the UMTS and the commitments of the first year from the date of commercial launch, in accordance with the new system of guarantees. In September 2003, Telefónica Móviles España, S.A.U. cancelled the returned guarantees at the respective banks.

On June 23, 2004, the Ministry of Industry, Tourism and Commerce issued an order authorizing the change in the

commitments assumed by Telefónica Móviles España, S.A.U. in connection with the operation of the third-generation wireless telecommunications (UMTS) service. Under this order the requests filed by Telefónica Móviles España, S.A.U. in this respect were upheld, compliance with certain commitments was reinterpreted and other commitments were eliminated for the benefit of public interest.

As a result of this change, the amount to be guaranteed by Telefónica Móviles España, S.A.U. as a performance bond for the commitments assumed prior to the launch of the UMTS service and in the first year of service was reduced to 157.5 million euros. The guarantee therefore amounted to 157.5 million euros at December 31, 2005.

Telefónica Móviles de España, S.A. has begun the procedures to accredit its first year of operating the UMTS service before the Ministry. Compliance with the commitment would reduce the amount guaranteed.

2. Telefónica Móviles S.A. is backing the commitments assumed by Grupo de Telecomunicaciones Mexicanos, S.A. de C.V. (GTM) with the regulator, COFETEL, for its domestic long-distance (DLD) license. The maximum amount of this support is 124.15 million Mexican pesos. As of the date of preparation of these consolidated financial statements no disbursements had been made in this respect.
3. In 1999 Telefónica de Argentina, S.A. provided guarantees for the promissory notes amounting to 22.5 million dollars provided by Telefónica Comunicaciones Personales, S.A. to the Argentine Government to guarantee the fulfillment of the obligations assumed in the obtainment of the PCS licenses for areas I and III. In addition, Telefónica de Argentina, S.A. jointly and severally guaranteed, with Telecom Argentina Stet-France Telecom, S.A., the promissory notes amounting to 45 million Argentine pesos provided jointly by Telefónica Comunicaciones Personales, S.A. and Telecom Personal, S.A. to the Argentine Government to guarantee the fulfillment of the obligations assumed in the obtainment of the PCS licenses for area II. These guarantees are still in force, pending verification by the Regulatory Authority of the fulfillment of the PCS network coverage obligations secured by these guarantees. In 2003 the Regulatory Authority verified substantially all the coverage obligations in areas I and III, leaving only the cities of La Rioja, Córdoba and Catamarca. The Regulatory Authority completed the verification of the PCS network coverage obligations in the aforementioned cities and in area II in 2004. The Regulatory Authority must now decide whether to return the guarantees.

Telefónica, S.A. and its subsidiaries, which in turn head subgroups, perform, as holding companies, various equity investment purchase and sale transactions in the course of their business activities, in which it is standard practice to receive or provide guarantees regarding the nonexistence of liabilities, contingencies, etc. in the investments forming the subject matter of the related transactions.

The contingencies arising from the commitments described above were evaluated when the consolidated financial statements at December 31, 2005, were prepared, and the provisions recorded with respect to the commitments taken as a whole are not representative.



#### d) Auditors' fees

Fees paid to the various companies forming part of the Ernst & Young International Group, to which Ernst & Young, S.L. (the auditors of Telefónica, S.A.) belongs, totaled 1.63 million euros in 2005. Fees paid to the various companies forming part of the Deloitte Touche Tohmatsu International Group, to which Deloitte, S.L. (the auditors of Telefónica, S.A. in 2004) belongs, totaled 1.84 million euros in 2004.

The detail of these amounts is as follows:

| Millions of euros             | 2005<br>Ernst & Young | 2004<br>Deloitte |
|-------------------------------|-----------------------|------------------|
| Audit of financial statements | 0.70                  | 0.57             |
| Other audit services          | 0.66                  | 0.71             |
| Non-audit work                | 0.27                  | 0.56             |
| <b>Total</b>                  | <b>1.63</b>           | <b>1.84</b>      |

#### e) Environmental matters

As head of the Telefónica Group, Telefónica, S.A. engages in activities relating to the ownership of shares and the provision of financing and corporate advisory services to various Group companies. In view of the business activities in which the Company engages, it has no liabilities, expenses, assets, provisions or contingencies of an environmental nature that could be material with respect to its net worth, financial position and operating results. Accordingly, no specific disclosures relating to environmental issues are included in these notes to the 2005 financial statements.

### (19) Subsequent Events

In the period from December 31, 2005 through the date of preparation of these financial statements, the following significant events took place at Telefónica, S.A.:

#### *EMTN program for the issuance of debt instruments (Telefónica Emisiones, S.A.U.)*

On February 2, 2006, Telefónica Emisiones, S.A.U., a subsidiary of Telefónica, S.A., held four bond issues, two in euros (for a combined amount of 4,000 million euros) and two in pounds sterling (for a combined 1,250 million pounds sterling) in line with the 15,000 million euro EMTN (issue of medium-term notes) arranged on July 8, 2005. This program is underwritten by Telefónica, S.A.

#### *Lawsuits*

On January 27, 2006 the parties received notification of the ruling passed on January 24, according to which, Section 6 of the National Appellate Court has rejected the appeal for judicial review filed by ACCTER and also the appeal filed by Julián de Fabián López against the administrative decision taken by the CMNV on June 19, 2003 authorizing the share offer by Telefónica, S.A. for Terra Networks, S.A.

#### *Takeover bid for O2 plc*

With respect to the takeover bid for 100% of UK operator O2 plc, on January 3, 2006 Telefónica, S.A. waived the minimum acceptance restriction on the offer made November 21, 2005, declaring it "unconditional as to acceptances," in accordance with the procedures established by the UK City Code on Takeovers and Mergers.

On January 10, 2006, Telefónica, S.A. received notification of the European Commission's decision to authorize the concentration resulting for Telefónica, S.A.'s acquisition of the UK wireless operator, O2 plc.

On January 23, 2006, Telefónica, S.A. stated that it had complied with all the requirements of the full takeover of O2 plc made on November 21, 2005 and that, in accordance with the procedures established by the UK City Code on Takeovers and Mergers, the offer was wholly unconditional.

On January 27, 2006, having acquired or received acceptances representing more than 90% of the O2 plc shares included in the bid, Telefónica, S.A. announced its intention of initiating the forced sale of outstanding O2 plc shares in accordance with sections 428 to 430F (inclusive) of the UK Companies Act. Subsequent to this announcement, on February 22, 2006, notification was made that the procedure against shareholders rejecting the offer had commenced.

Meanwhile, on February 7, 2006 O2 plc announced the beginning of the process to delist O2 plc from the London Stock Exchange. The delisting is expected to occur on March 7, 2006.

#### *Interim dividend charged to 2005 income*

In accordance with the shareholder remuneration policy approved by Telefónica, S.A.'s Board of Directors, at its meeting of February 28, 2006, the Company's Board of Directors based on the financial information furnished to it, agreed, pursuant to Article 216 of the Spanish Corporation Law, to distribute a fixed interim dividend out of 2005 income of a gross 0.25 euros per share for the Company's outstanding shares carrying dividend rights, up to a maximum total amount of 1,230.28 million euros, proposing that this interim dividend be paid on May 12, 2006.

Accounting statement supporting the distribution of the interim dividend:

|   | Millions of euros |
|---|-------------------|
| Income obtained from January 1, 2005 to December 31, 2005 | 1,754.39          |
| Mandatory appropriations to reserves                      | (64.15)           |
| Unrestricted income                                       | 1,690.24          |
| Proposed interim dividend (maximum amount)                | 1,230.28          |

## Cash position:

As shown in the Telefónica, S.A. 2005 annual accounts approved by the Board of Directors at its meeting of February 28, 2006, at December 31, 2005, there was sufficient liquidity for the payment of dividends. This liquidity also existed at February 17, 2006, as evidenced by the following statement of liquidity:

| <b>Funds available for distribution</b>    | Millions of euros |
|--|-------------------|
| Cash and equivalents                       | 683.00            |
| Unused credit facilities                   | 6,750.00          |
| Proposed interim dividend (maximum amount) | (1,230.28)        |
| Difference                                 | 6,202.72          |

## (20) Statements of Source and Application of Funds

Millions of euros

| <b>APPLICATIONS OF FUNDS</b>  | <b>2005</b>      | <b>2004</b>     | <b>SOURCES OF FUNDS</b>   | <b>2005</b>      | <b>2004</b>     |
|---|------------------|-----------------|---|------------------|-----------------|
| – Funds applied in operations   | –                | –               | – Funds obtained from operations  | 953.77           | 469.26          |
| – Start-up and debt arrangement expenses  | 28.99            | 11.62           |   |                  |                 |
| – Acquisition of fixed asset:   |                  |                 | – Long-term deferred tax assets   | –                | 7.58            |
| a) Intangible assets  | 17.02            | 16.01           | – Long-term debt  | 2,834.86         | –               |
| b) Property, plant and equipment  | 271.36           | 72.77           | – Fixed asset disposals:  |                  |                 |
| c) Long-term investments  | 9,737.82         | 3,918.76        | a) Intangible fixed assets  | –                | 2.13            |
| – Capital reduction and distribution of treasury stock                                  | 2,728.72         | –               | b) Property, plant and equipment  | 8.90             | 7.01            |
| – Cash dividend   | 2,379.42         | 1,924.16        | c) Long-term investments  | 6,488.14         | 2,589.10        |
| – Long-term debt  | –                | 2,223.88        | – Transfer to short term of loans to Group companies  | 6,893.15         | 1,703.82        |
| – Long-term deferred tax liabilities  | 3.90             | –               | – Change in working capital due to inclusion of Terra Networks, S.A. and Terra Networks Latam E.T.V.E., S.A. (Note 2) | 378.46           | –               |
| – Change in working capital due to inclusion of Inmobiliaria Telefónica S.A.U. (Note 2) | –                | 30.88           |   |                  |                 |
| <b>TOTAL FUNDS APPLIED</b>  | <b>15,167.23</b> | <b>8,198.08</b> | <b>TOTAL FUNDS OBTAINED</b>   | <b>17,557.28</b> | <b>4,778.90</b> |
| <b>FUNDS OBTAINED IN EXCESS OF FUNDS APPLIED</b>  | <b>2,390.05</b>  | <b>–</b>        | <b>FUNDS APPLIED IN EXCESS OF FUNDS OBTAINED</b>  | <b>–</b>         | <b>3,419.18</b> |
| <b>(INCREASE IN WORKING CAPITAL)</b>  | <b>17,557.28</b> | <b>8,198.08</b> | <b>(DECREASE IN WORKING CAPITAL)</b>  | <b>17,557.28</b> | <b>8,198.08</b> |

## CHANGES IN WORKING CAPITAL

Millions of euros

| <b>Increase in Working Capital</b> | <b>2005</b>     | <b>2004</b>     |
|------------------------------------|-----------------|-----------------|
| Accounts payable                   | 109.60          | –               |
| Short-term investments             | 3,214.31        | 883.42          |
| Treasury stock                     | –               | 2,031.05        |
| Cash                               | –               | 221.99          |
| Prepayments and accrued income     | 23.64           | 6.90            |
| Accounts payable                   | 288.20          | –               |
| <b>Total</b>                       | <b>3,635.75</b> | <b>3,143.36</b> |
| <b>Change in Working Capital</b>   | <b>–</b>        | <b>3,419.18</b> |
|                                    | <b>3,635.75</b> | <b>6,562.54</b> |

Millions of euros

| <b>Decrease in Working Capital</b> | <b>2005</b>     | <b>2004</b>     |
|------------------------------------|-----------------|-----------------|
| Accounts receivable                | –               | 2.10            |
| Short-term investments             | –               | –               |
| Treasury stock                     | 1,012.27        | –               |
| Cash                               | 233.43          | –               |
| Accruals and deferred income       | –               | –               |
| Accounts payable                   | –               | 6,560.44        |
| <b>Total</b>                       | <b>1,245.70</b> | <b>6,562.54</b> |
| <b>Change in Working Capital</b>   | <b>2,390.05</b> | <b>–</b>        |
|                                    | <b>3,635.75</b> | <b>6,562.54</b> |

The reconciliation of the balances of in the income statement to the funds obtained from operations is as follows:

|  | <b>2005</b>     | <b>2004</b>     |
|--|-----------------|-----------------|
| <b>Profit for the year</b>                       | <b>1,754.39</b> | <b>1,301.40</b> |
| <b>Plus:</b>                                     |                 |                 |
| Depreciation and amortization expense            | 47.02           | 49.89           |
| Amortization of deferred charges                 | 30.17           | 34.31           |
| Short-term investment writedown provisions       | 10.71           | 0.26            |
| Period provisions                                | 37.57           | –               |
| Loss of disposal of long-term investments        | 7.39            | –               |
| Losses on treasury stock transactions            | 7.98            | –               |
| <b>Less:</b>                                     |                 |                 |
| Gains on disposal of long-term investments       | 82.89           | 16.26           |
| Gains on treasury stock transactions             | 343.74          | –               |
| Changes in provisions for securities investments | 313.45          | 761.77          |
| Reversal of provisions                           | 90.21           | 0.77            |
| Capitalized interest                             | 8.79            | 1.72            |
| Corporate income tax                             | 102.38          | 136.08          |
| <b>Funds obtained from operations</b>            | <b>953.77</b>   | <b>469.26</b>   |

## (21) Additional Note for English Translation

These financial statements are presented on the basis of accounting principles generally accepted in Spain. Consequently, certain accounting practices applied by the Company may not conform with generally accepted principles in other countries.

## APPENDIX I

## Details of Subsidiaries, Associates and Investees at December 31, 2005

| In millions of euros   | %<br>Ownership | Capital  | Reserves | Interim<br>Dividend | Profit<br>(Loss) | Gross Book<br>Value |
|--|----------------|----------|----------|---------------------|------------------|---------------------|
| <b>Telefónica de Contenidos, S.A.U. (SPAIN) (1) (6) (9)</b><br>Organization and operation of activities<br>and businesses related to multimedia services<br><i>Paseo de la Castellana, 141 - 28046 Madrid</i>      | 100.00%        | 2,163.60 | (948.54) | –                   | 78.83            | 2,241.88            |
| <b>Telefónica Datacorp, S.A.U. (SPAIN) (1)</b><br>Provision and operation of telecommunications services<br><i>Gran Vía, 28 - 28013 Madrid</i>   | 100.00%        | 1,226.76 | (525.95) | –                   | 15.42            | 1,335.81            |
| <b>Telefónica de España, S.A.U. (SPAIN) (1) (6) (9)</b><br>Provision and operation of telecommunications services<br><i>Gran Vía, 28 - 28013 Madrid</i>  | 100.00%        | 1,023.68 | 1,616.91 | –                   | 1,494.28         | 3,033.86            |
| <b>Taetel, S.L. (SPAIN) (5)</b><br>Acquisition, ownership and disposal of shares<br>and interests in other companies<br><i>Beatriz de Bobadilla, 3 - 28040 Madrid</i>  | 100.00%        | 28.25    | 5.66     | –                   | 0.50             | 28.25               |
| <b>Lotca Servicios Integrales, S.L. (SPAIN) (4)</b><br>Ownership and operation of aircraft<br>and the lease thereof<br><i>Gran Vía, 28 - 28013 Madrid</i>  | 100.00%        | 16.93    | –        | –                   | (0.52)           | 16.93               |
| <b>Terra Networks España, S.A. (SPAIN) (1)</b><br>internet service provider and portal<br><i>Vía Dos Castillas, 33 - Comp. Ática Ed. 1, 1ª Plta.<br/>Pozuelo de Alarcón - 28224 Madrid</i>                         | 100.00%        | 9.87     | (383.92) | –                   | 38.07            | 93.97               |
| <b>Telefónica Gestión de Servicios Compartidos, S.A. (*) (**) (SPAIN) (5) (6) (9)</b><br>Provision of management and administration services<br><i>Gran Vía, 28 - 28013 Madrid</i>                                 | 100.00%        | 7.70     | 2.78     | –                   | 4.46             | 23.81               |
| <b>Telefónica Capital, S.A. (SPAIN) (3)</b><br>Financial company<br><i>Gran Vía, 28 - 28013 Madrid</i>   | 100.00%        | 7.00     | 44.84    | –                   | 5.07             | 18.12               |
| <b>Ateseco Comunicación, S.A. (SPAIN) (1)</b><br>Holding company<br><i>C/ Gran Vía, 28 - 28.013 Madrid</i>   | 100.00%        | 6.12     | 41.70    | –                   | 0.70             | 107.57              |
| <b>Terra Networks Asociadas, S.L. (SPAIN)</b><br>Holding company<br><i>Vía de Dos Castillas, 33 - Comp. Ática Ed. 1, 1ª Plta.<br/>Pozuelo de Alarcón - 28224 Madrid</i>  | 100.00%        | 6.11     | (23.79)  | –                   | (0.47)           | 61.12               |
| <b>Telefónica Investigación y Desarrollo, S.A. (TIDSA) (SPAIN) (3)</b><br>Telecommunications research activities and projects<br><i>Emilio Vargas, 6 - 28043 Madrid</i>  | 100.00%        | 6.01     | 60.30    | –                   | 4.39             | 6.01                |
| <b>Communicapital Inversiones, S.A.U. (SPAIN) (5)</b><br>Global telecommunications fund<br><i>Gran Vía, 28 - 28013 MADRID</i>  | 100.00%        | 6.00     | (54.94)  | –                   | (6.62)           | 6.00                |
| <b>Compañía Española de Tecnología, S.A. (SPAIN) (3)</b><br>Promotion of business activities and disposition<br>of marketable securities<br><i>Villanueva, 2 duplicado planta 1ª Oficina 23 -<br/>28001 Madrid</i> | 100.00%        | 4.56     | (0.36)   | –                   | (0.05)           | 10.71               |
| <b>Telefónica Finanzas, S.A. (TELFISA) (SPAIN) (1)</b><br>Integrated cash management, advisory services<br>and financial support for Group companies<br><i>Gran Vía, 30 - 4ª Plta. - 28013 Madrid</i>              | 100.00%        | 3.01     | 10.89    | –                   | 1.70             | 12.61               |

| In millions of euros   | %<br>Ownership | Capital | Reserves | Interim<br>Dividend | Profit<br>(Loss) | Gross Book<br>Value |
|--|----------------|---------|----------|---------------------|------------------|---------------------|
| <b>Venturini España, S.A. (SPAIN) (2)</b><br>Printing, graphic arts and direct marketing<br><i>Avda. de la Industria, 17 Tres Cantos - 28760 Madrid</i>  | 100.00%        | 3.01    | 0.22     | –                   | 0.67             | 3.60                |
| <b>Telefónica Finanzas Perú, S.A.C. (PERÚ) (1)</b><br>Integrated cash management, advisory services<br>and financial support for Group companies<br><i>Ciudad de Lima</i>  | 100.00%        | 2.96    | (0.00)   | –                   | (0.04)           | 2.75                |
| <b>Telefónica Ingeniería de Seguridad, S.A. (SPAIN) (2)</b><br>Security services and systems<br><i>Condesa de Venadito, 1 - 28027 Madrid</i>   | 100.00%        | 0.90    | (3.39)   | –                   | (0.60)           | 3.58                |
| <b>Terra Lycos Intangibles, S.A. (SPAIN) (1)</b><br>Internet services provider<br><i>Vía Dos Castillas, 33 - Comp. Ática Ed. 1, 1ª Plta.<br/>Pozuelo de Alarcón - 28224 Madrid</i>   | 100.00%        | 0.66    | 13.24    | –                   | 0.00             | 19.29               |
| <b>Fisatel Mexico, S.A. de C.V. (MEXICO) (1)</b><br>Integrated cash management, advisory services<br>and financial support for Group companies<br><i>Boulevard Manuel Avila Camacho, 24 - 16ª Plta. -<br/>Lomas de Chapultepec - 11000 Mexico D.F.</i> | 100.00%        | 0.35    | 0.02     | –                   | 0.36             | 0.43                |
| <b>Communicapital Gestión, S.A.U. (SPAIN) (5)</b><br>Global telecommunications fund<br><i>Gran Vía, 28 - 28013 Madrid</i>  | 100.00%        | 0.06    | (0.02)   | –                   | –                | 0.06                |
| <b>Telefónica Participaciones, S.A. (SPAIN)</b><br>Issuance of preferred securities<br>and/or other financial debt instruments<br><i>Gran Vía, 28 - 28013 Madrid</i>   | 100.00%        | 0.06    | –        | –                   | –                | 0.06                |
| <b>Telefónica Emisiones, S.A. (SPAIN) (1)</b><br>Issuance of preferred securities and/or<br>other financial debt instruments<br><i>Gran Vía, 28 - 28013 Madrid</i>   | 100.00%        | 0.06    | –        | –                   | –                | 0.06                |
| <b>Telefónica Europe, B.V. (NETHERLANDS) (1)</b><br>Fund raising on capital markets<br><i>Strawinskylaan 1259; tower D; 12th floor 1077 XX - Amsterdam</i>   | 100.00%        | 0.05    | 6.65     | (1.92)              | 1.85             | 0.05                |
| <b>Terra Networks Maroc, S.A.R.L. (MOROCCO) (7)</b><br>Inactive company<br><i>332 Boulevard Brahim Roudani, Casablanca</i>   | 100.00%        | 0.03    | N/D      | N/D                 | N/D              | 0.03                |
| <b>Terra Lycos Holding, B.V. (NETHERLANDS)</b><br>Distribution of software licences<br><i>Koningslaan, 34. 1075 AD Amsterdam - Netherlands</i>   | 100.00%        | 0.02    | –        | –                   | –                | 0.02                |
| <b>Terra Networks Serviços de Acesso a Internet<br/>e Trading Ltd. (PORTUGAL) (7)</b><br>Inactive company<br><i>Avda. Arriaga, 73-2º andar, sala 212 -<br/>Freguesia de Se, Concelho do Funchal (Madeira)</i>  | 100.00%        | 0.01    | N/D      | N/D                 | N/D              | 0.01                |
| <b>Centro de Investigación y Experimentación<br/>de la Realidad Virtual, S.L. (SPAIN)</b><br>Design of communications products<br><i>Vía de Dos Castillas, 33 - Comp. Ática Ed. 1, 1ª Plta.<br/>Pozuelo de Alarcón - 28224 Madrid</i>                  | 100.00%        | 0.01    | N/D      | N/D                 | N/D              | 10.08               |
| <b>Telefónica Internacional USA Inc. (USA) (1)</b><br><i>1221 Brickell Avenue suite 600 - 33131 Miami - Florida</i>  | 100.00%        | –       | 0.72     | –                   | (0.59)           | –                   |
| <b>Telefónica B2B Licencing, Inc. (USA) (1)</b>  | 100.00%        | –       | (11.18)  | –                   | 3.56             | –                   |
| <b>Telefónica Media Internacional y de Contenidos USA, Inc. (USA) (8)</b><br>Operation of media services in the United States<br><i>1221 Brickell Av. - Miami</i>  | 100.00%        | –       | (4.25)   | –                   | (0.02)           | 0.33                |

| In millions of euros  | %<br>Ownership | Capital  | Reserves | Interim<br>Dividend | Profit<br>(Loss) | Gross Book<br>Value |
|---|----------------|----------|----------|---------------------|------------------|---------------------|
| <b>Telefónica (USA) Advisors, Inc. (USA) (8)</b><br>All activities permitted under the laws of the State of Delaware<br>1013 Center Road, Wilmington - County of Newcastle - Delaware   | 100.00%        | N/D      | N/D      | N/D                 | N/D              | 0.87                |
| <b>LE Holding Corporation (USA)</b><br>Holding company<br>Corporation Trust Center, 1209 Orange Street - Wilmington, Delaware   | 100.00%        | N/D      | N/D      | N/D                 | N/D              | 47.88               |
| <b>Casiopea Reaseguradora, S.A. (LUXEMBURG) (1)</b><br>Reinsurance activities<br>6D, route de Trèves, L-2633 Senningerberg, Luxembourg  | 99.97%         | 3.60     | 156.32   | –                   | 11.26            | 2.99                |
| <b>Telefónica Internacional, S.A. (SPAIN) (1) (6) (9)</b><br>Investments in telecommunications industry overseas<br>C/ Gran Vía, 28 - 28013 Madrid  | 99.88%         | 2,838.68 | 3,693.98 | –                   | 1,106.67         | 8,131.75            |
| <b>Endemol Holding, N.V. (NETHERLANDS) (1) (6)</b><br>Holding company<br>Bergweg 70, 1217 SC Hilversum  | 99.70%         | 0.69     | 271.90   | –                   | 334.82           | 842.16              |
| <b>Seguros de Vida y Pensiones Antares, S.A. (SPAIN) (1)</b><br>Life insurance, pensions and health insurance<br>Avda. General Perón, 38 Master II - 17ª P. - 28020 Madrid  | 94.67%         | 204.33   | 17.74    | –                   | 14.71            | 206.62              |
| <b>Telefónica International Wholesale Services, S.L. (SPAIN) (1)</b><br>Provider of international services<br>Gran Vía, 28 - 28013 Madrid   | 92.51%         | 229.89   | 22.84    | –                   | (7.04)           | 212.68              |
| <b>Atento N.V. (NETHERLANDS) (1) (6)</b><br>Provision of telecommunications services<br>Locatellikade, 1 - 1076 AZ Amsterdam  | 91.35%         | 0.12     | 12.82    | (2.16)              | 48.22            | 302.71              |
| <b>Corporation Real Time Team, S.L. (SPAIN)</b><br>Internet design, advertizing and consultancy<br>Claudio Coello, 32, 1ª ext. - Madrid   | 87.96%         | 0.02     | N/D      | N/D                 | N/D              | 12.40               |
| <b>Telefónica Móviles, S.A. (SPAIN) (1) (6)</b><br>Holding company<br>Goya, 24 - 28001 Madrid   | 71.03%         | 2,165.28 | 1,661.87 | –                   | 1,918.91         | 2,661.41            |
| <b>Telefónica Publicidad e Información, S.A. (SPAIN) (1) (6)</b><br>Publication of directories and advertising in media of all types<br>Avda. de Manoteras, 12 - 28050 MADRID   | 59.90%         | 18.05    | 99.80    | –                   | 125.30           | 3.98                |
| <b>Cesky Telecom, a.s. (CZECH REPUBLIC) (1)</b><br>Provision of telecommunications services<br>Olsanska 55/5 - Praga 3, 130 34  | 69.41%         | 1,072.54 | 2,084.18 | –                   | 118.03           | 3,662.52            |
| <b>Pléyade Peninsular, Correduría de Seguros y Reaseguros del Grupo Telefónica, S.A. (SPAIN) (3)</b><br>Distribution, promotion and preparation of insurance policies, in the capacity of broker<br>Avda. General Perón, 38 Master II - 17ª P. - 28020 Madrid | 16.67%         | 0.36     | 1.28     | –                   | 2.16             | 0.06                |
| <b>Telefónica Gestión de Servicios Compartidos, S.A. (ARGENTINA) (5)</b><br>Provision of management and administration services<br>Tucuman 1, Piso 18 Ciudad de Buenos Aires  | 4.99%          | –        | –        | –                   | 0.30             | –                   |
| <b>Telefónica del Perú, S.A.A. (PERU) (1)</b><br>Operator of local, long-distance and international telephony services in Peru<br>Avda. Arequipa, 1155 Santa Beatriz - Lima   | 0.14%          | 414.08   | (12.39)  | –                   | 76.10            | 2.66                |
| <b>Telefónica Factoring Do Brasil, Ltd. (BRAZIL) (5)</b><br>Factoring<br>Avda. Paulista, 1106   | 40.00%         | 1.37     | 0.69     | (0.19)              | 1.66             | 0.96                |
| <b>Telefónica Factoring Establecimiento Financiero de Crédito, S.A. (SPAIN) (5)</b><br>Loans and credits, including consumer credit, mortgages, and commercial transactions<br>Pedro Teixeira, 8 - 28020 Madrid   | 50.00%         | 5.11     | 1.74     | –                   | 2.76             | 2.64                |

| In millions of euros  | %<br>Ownership | Capital  | Reserves  | Interim<br>Dividend | Profit<br>(Loss) | Gross Book<br>Value |
|---|----------------|----------|-----------|---------------------|------------------|---------------------|
| <b>Aliança Atlântica Holding B.V. (NETHERLANDS)</b><br>Holder of 5,225,000 shares in Portugal Telecom, S.A.<br><i>Strawinskylaan 1725, 1077 XX Amsterdam</i>  | 50.00%         | 40.00    | 1.83      | (3.33)              | 1.66             | 21.97               |
| <b>Torre de Collçerola, S.A. (SPAIN) (2)</b><br>Operation of telecommunications mast and provision<br>of technical assistance and consultancy services<br><i>Ctra. Vallvidrera-Tibidabo, s/nº - 08017 Barcelona</i> | 30.40%         | 12.02    | 0.56      | –                   | –                | 2.45                |
| <b>Sistemas Técnicos de Loterías del Estado, S.A. (SPAIN) (2)</b><br>Operation of a gaming terminal system<br>for the Spanish State Gaming Organization<br><i>Manuel Tovar, 9 - 28034 Madrid</i>                    | 31.75%         | 12.02    | 56.77     | –                   | 6.38             | 3.82                |
| <b>Portugal Telecom, S.G.P.S., S.A. (PORTUGAL) (5)</b><br>Holding company<br><i>Avda. Fontes Pereira de Melo, 40 - 1089 Lisboa</i>  | 8.78%          | 1,128.86 | 1,423.42  | –                   | 355.30           | 831.60              |
| <b>UNO-E Bank, S.A. (SPAIN)</b><br>On-line banking<br><i>Julián Camarillo, 4, Edificio C, 28037 - Madrid</i>  | 33.00%         | 80.32    | 31.15     | N/D                 | N/D              | 189.83              |
| <b>Sogecable, S.A. (SPAIN) (1) (6)</b><br>Indirect management of public TV service<br><i>Gran Vía, 32 - 3ª Pta. - 28013 Madrid</i>  | 1.60%          | 267.13   | 29.17     | –                   | 7.73             | 44.89               |
| <b>Banco Bilbao Vizcaya Argentaria, S.A. (SPAIN) (5) (6)</b><br>Bank<br><i>Plaza de San Nicolás, 4 - 48013 Bilbao (Vizcaya)</i>   | 1.07%          | 1,662.00 | 8,831.00  | (1,167.00)          | 3,806.00         | 555.62              |
| <b>O2 plc (REINO UNIDO) (2) (6)</b><br>Provider of mobile communications services in Europe<br><i>Wellington Street - Slough - Berkshire SL1 1YP</i>  | 4.97%          | 13.13    | 14,835.84 | –                   | 153.22           | 1,265.83            |
| <b>Amper, S.A. (SPAIN) (5) (6)</b><br>Development, manufacture and repair of telecommunications<br>systems, equipment and related components<br><i>Torrelaguna, 75 - 28027 Madrid</i>                               | 6.10%          | 27.91    | 17.95     | –                   | 4.90             | 11.82               |
| <b>I-CO Global Communications (HOLDINGS) Limited<br/>(UNITED KINGDOM)</b>   | N/D            | N/D      | N/D       |                     | N/D              | 6.02                |
| Other equity interests  | N/A            | N/A      | N/A       |                     | N/A              | 8.41                |
| <b>TOTAL SUBSIDIARIES (Note 7)</b>  |                |          |           |                     |                  | <b>23,127.69</b>    |
| <b>TOTAL ASSOCIATES (Note 7)</b>  |                |          |           |                     |                  | <b>1,098.16</b>     |
| <b>TOTAL INVESTEEES (Note 7)</b>  |                |          |           |                     |                  | <b>1,847.70</b>     |

(1) Company audited by Ernst &amp; Young, S.L.

(2) Company audited by PriceWaterhouseCoopers.

(3) Company audited by K.P.M.G. Peat Marwick.

(4) Company audited by B.D.O. Audiberia

(5) Company audited by Deloitte &amp; Touche. En España Deloitte &amp; Touche España, S.L..

(6) Consolidated figures

(7) Inactive company

(8) Company in liquidation.

(9) Pro forma figures.

Figures for associates and investees are provisional.

N/D No data available.

N/A Not applicable.



## MANAGEMENT REPORT TELEFÓNICA, S.A. 2005

### Initial summary

In 2005, the Telefónica Group continued to pursue its international expansion strategy, gaining a global dimension and becoming the benchmark telecommunications operator. During the year, Telefónica completed the integration of BellSouth's 10 Latin American cellular operators, acquired Czech operator Cesky Telecom and initiated the purchase of UK operator O2, which was completed successfully in January 2006. It also made a strategic investment in China Netcom. With these acquisitions, Telefónica has strengthened its position in Europe, where its presence was smaller. This new global dimension will enable Telefónica to serve its customers better and more efficiently, while giving rise to substantial synergies in the day-to-day running of the business.

Telefónica Group delivered an excellent earnings performance in 2005, driven by the international expansion of its customer base, enhanced operating efficiency and innovation efforts, making Telefónica one of the industry's major players and confirming its strategy of becoming the telecommunications operator that offers its shareholders the best combination of profitability and growth.

The Telefónica Group had to manage its businesses in an increasingly tough environment, characterized by the strong commercial pressure by competitors, the globalization of business, rapid technological development and the need to anticipate changes to meet customers' needs. Accordingly, the Group focused on the main market drivers: new products associated with broadband, mobility, solutions and multimedia. To do so, Telefónica has transformed its business model to become a clearly customer-oriented Group and, consequently, it has anticipated industry changes and now manages its business with greater operating efficiency.

The year's good results and the success of its strategy will enable Telefónica to maintain its shareholder remuneration policy. At the Telefónica Group's Fourth Investors' Conference in April 2005, the Company announced its decision to renew its current share buyback program, saying it was planning on buying back up to a total of 6,000 million euros worth of its own shares and extending the program until 2007.

Going forward, the Telefónica Group plans to continue with its strategy of making the customer the cornerstone of the Group by focusing on operating excellence, innovation as a competitive edge and personnel motivation. This new global dimension poses a challenge for Telefónica to maximize the synergies derived from the inclusion of new companies so it can leverage economies of scale and offer customers a higher quality service.

### Organization by business lines

In 2005 Telefónica maintained the organizational model by business line established in 2004, with the aim of ensuring a stronger management focus on the core businesses and achieving a leaner asset and cost structure.

The main organizational changes in the year were as follows:

- The completion of the acquisition of 100% of BellSouth Chile and BellSouth Argentina (Movicom) in January. This marked the last step in the integration of the BellSouth operators into the wireless business begun in 2004. In those countries where Telefónica was already present (Argentina, Chile, Guatemala and Peru), the two companies merged.
- Approval in February of the takeover of Terra Networks by Telefónica, S.A. This merger signals a return to the model based on the operational integration of the telephony and internet businesses, reflecting broader market trends –growth of broadband has increasingly blurred the line distinguishing these two businesses.
- The purchase of Cesky Telecom, approved in April, and its inclusion in the Group's consolidation scope in July 2005. Telefónica can use Cesky Telecom, the leading wireline and wireless operator in the Czech Republic, as a springboard for its profitable growth strategy.

Finally, at the end of December 2005 Telefónica adapted its organizational structure to its new multinational dimension and to its corporate integration and cultural change objectives. This new strategy aims to: maximize synergy benefits, continue to transform Telefónica into a customer-oriented group that emphasizes operating excellence, innovation and talent management, and anticipate market trends in order to offer integrated solutions to each customer segment.

In this respect, the Telefónica Group is organized around four Business Lines: Telefónica de España, Telefónica Móviles, Telefónica Latinoamérica and O2, which includes the businesses of Cesky Telecom, Telefónica Deutschland and O2. The businesses of TPI, Endemol, Atento, Telefónica Servicios Audiovisuales, S.A., Telefé and subsidiaries and investees are now managed by the Investees and Subsidiaries Division. This new organizational structure will come into effect as of 2006.

### Earnings

The Company posted income of 1,754.39 million euro in 2005, up from 1,301.40 million euros in 2004.

Highlights of the 2005 income statement include:

- An operating loss of 329.08 million euros, which was 22% higher than the loss recorded in 2004 and was due mainly to the merger with Terra Networks, S.A.
- A 75.71% increase in financial income to 1,276.47 million euros, due mainly to the increase in dividends received from Group companies.
- The combination of these two figures produced income from ordinary activities of 947.39 million euros, far outstripping the 456.48 recorded in 2004.
- Extraordinary income of 704.62 million euros, compared with 708.84 million euros in 2004. This relates mainly to reversions of investment writedown provisions prompted by increases in the net worth of Group subsidiaries.

## Investment activity

The main investments made by Telefónica, S.A. in 2005 were as follows:

On June 10, 2005 the European Commission approved Telefónica's bid to take control of Czech telecoms operator Cesky Telecom a.s. via the acquisition of 51.1% of its capital stock. The transaction was completed on June 16 at a price of 502 Czech crowns per share. Telefónica then launched a tender offer for the remaining 48.9% of Cesky Telecom then in the hands of minority shareholders. The offer concluded on September 19, with Telefónica acquiring 58,985,703 shares at a price of 456 Czech crowns per share. In all, Telefónica paid 3,662.53 million euros to increase its interest in the Czech telecom operator. After these acquisitions, Telefónica's owns 69.41% of the company.

In 2005 Sogecable, S.A. increased its capital stock by 7,560,261 shares each with a par value of two euros and with share premium of 22.47 euros. Telefónica subscribed for the capital increase, buying 121,200 shares and paying a total of 2.97 million euros to maintain its 1.60% direct interest in Sogecable's capital.

At December 31, 2005, Telefónica owned 435,606,107 shares in O2 plc representing approximately 4.97% of its total capital stock, having acquired the shares on the London Stock Exchange subsequent to the launch of its bid for 100% of the company. The company paid 1,265.83 million euros for these shares.

In addition, as part of its program of real estate activities, construction is currently underway on the Telefónica Group's new headquarters. As a result, additions to Telefónica, S.A.'s property, plant and equipment in 2005 totaled 280.15 million euros, compared with 74.49 million euros in 2004.

## Financing

The main financing transaction in 2005 was the arrangement of 6,000 million euro syndicated loan maturing on June 28, 2011 with a syndicate of 40 Spanish and international banks. The loan is denominated in euros but, in addition to euros, may be drawn down in dollars, sterling, yen, Swiss francs and any other currency, subject to confirmation of availability from the banks forming the syndicate. At the year end, following several disposals, the full amount of the loan had been drawn down.

At December 31, 2005, Telefónica had also concluded but not drawn down a syndicated loan of 18,000 million pounds sterling related to the acquisition of O2 plc arranged through Telefónica Europe, BV.

## Treasury stock

At the beginning of 2005 Telefónica held treasury stock representing 4.18179% of its capital stock; i.e. 207,245,179 shares with a book value of 11.83 euros per share giving a total of 2,452.31 million euros and a par value of 207.25 million euros.

On June 2, 2005, after the merger agreement was approved at Telefónica, S.A.'s General Shareholders' Meeting, approval was given at Terra's General Shareholders' Meeting for the takeover by Telefónica, S.A. of Terra Networks, S.A., implying the dissolution of Terra Networks, S.A.

and transfer of all its assets and liabilities to Telefónica, S.A., which thereby acquired, through the overall transfer, all of Terra's rights and obligations. Accordingly, Telefónica distributed 29,274,686 treasury shares to Terra shareholders at an exchange ratio of two Telefónica shares with a par value of one euro each for every nine Terra shares with a par value of two euros. No additional cash payment was involved and no new shares were issued.

The deed ratifying the capital reduction through which the Company's Board of Directors implemented the resolution adopted by shareholders at the meeting held on May 31, 2005, was executed on June 6, 2005. Capital stock was reduced via the cancellation of shares of treasury stock previously acquired by the Company pursuant to the authorization granted at the Shareholders' Meeting. As a result, 34,760,964 shares of Telefónica S.A. treasury stock were cancelled and the Company's capital stock was reduced by a par value of 34,760,964 euros. The cancelled shares were excluded from official listing on June 9, 2005.

In addition, approval was given at the General Shareholders' Meeting to distribute to Telefónica, S.A. shareholders, against the share premium account, 188,096,296 shares of treasury stock at a ratio of one share for every 25 shares already owned. At the same time, the Company recorded extraordinary income of 286.21 million euros, related to the difference between acquisition cost and the market value of the shares distributed to shareholders.

Meanwhile, 1,525 shares of treasury stock were allocated to the share option plan established for employees of the Endemol Group.

In the course of 2005 the Company bought 230,038,870 and sold 48,503,517 shares of treasury stock. As a result, the Company recorded extraordinary income of 57.53 million euros (in addition to the 286.21 million euro generated on the distribution of share premium) and an extraordinary expense of 7.98 million euros.

As a result of the transactions described above, at the close of 2005 the Company owned 136,647,061 treasury shares (representing 2.77674% of capital stock) acquired at an average price of 13.00 euros per share, implying a total outlay of 1,775.81 million euros and total par value of 136.54 million euros. Pursuant to current accounting legislation, these shares were valued at their underlying book value and, consequently, a provision of 1,427.33 million was recorded.

## Events subsequent to year end

The main events taking place for Telefónica, S.A. from December 31, 2005 to the date of preparation of these financial statements are as follows:

EMTN program for the issuance of debt instruments (Telefónica Emisiones, S.A.U.)

On February 2, 2006, Telefónica Emisiones, S.A.U., a subsidiary of Telefónica, S.A., held four bond issues, two in euros (for a combined amount of 4,000 million euros) and two in pounds sterling (for a combined 1,250 million pounds sterling) in line with the 15,000 million euro EMTN (issue of medium-term notes) arranged on July 8, 2005. This program is underwritten by Telefónica, S.A.

## Lawsuits

On January 27, 2006 the parties received notification of the ruling passed on January 24, according to which, Section 6 of the National Appellate Court has rejected the appeal for judicial review filed by ACCTER and also the appeal filed by Julián de Fabián López against the administrative decision taken by the CMNV on June 19, 2003 authorizing the share offer by Telefónica, S.A. for Terra Networks, S.A.

## Takeover bid for O2 plc

With respect to the takeover bid for 100% of UK operator O2 plc, on January 3, 2006 Telefónica, S.A. waived the minimum acceptance restriction on the offer made November 21, 2005, declaring it “unconditional as to acceptances,” in accordance with the procedures established by the UK City Code on Takeovers and Mergers.

On January 10, 2006, Telefónica, S.A. received notification of the European Commission’s decision to authorize the concentration resulting for Telefónica, S.A.’s acquisition of the UK wireless operator, O2 plc.

On January 23, 2006, Telefónica, S.A. stated that it had complied with all the requirements of the full takeover of O2 plc made on November 21, 2005 and that, in accordance with the procedures established by the UK City Code on Takeovers and Mergers, the offer was wholly unconditional.

On January 27, 2006, having acquired or received acceptances representing more than 90% of the O2 plc shares included in the bid, Telefónica, S.A. announced its intention of initiating the forced sale of outstanding O2 plc shares in accordance with sections 428 to 430F (inclusive) of the UK Companies Act. Subsequent to this announcement, on February 22, 2006, notification was made that the procedure against shareholders rejecting the offer had commenced.

Meanwhile, on February 7, 2006 O2 plc announced the beginning of the process to delist O2 plc from the London Stock Exchange. The delisting is expected to occur on March 7, 2006.

## Interim dividend charged to 2005 income

In accordance with the shareholder remuneration policy approved by Telefónica, S.A.’s Board of Directors, at its meeting of February 28, 2006, the Company’s Board of Directors based on the financial information furnished to it, agreed, pursuant to Article 216 of the Spanish Corporation Law, to distribute a fixed interim dividend out of 2005 income of a gross 0.25 euros per share for the Company’s outstanding shares carrying dividend rights, up to a maximum total amount of 1,230.28 million euros, proposing that this interim dividend be paid on May 12, 2006.

Accounting Statement Supporting the Distribution of the Interim Dividend

Millions of euros

|  |          |
|--|----------|
| Income obtained from January 1, 2005       |          |
| to December 31, 2005                       | 1,754.39 |
| Mandatory appropriations to reserves       | (64.15)  |
| Unrestricted income                        | 1,690.24 |
| Proposed interim dividend (maximum amount) | 1,230.28 |

Cash Position:

As shown in the Telefónica, S.A. 2005 individual annual accounts prepared by the Board of Directors at its meeting of February 28, 2006, at December 31, 2005, there was sufficient liquidity for the payment of dividends. This liquidity also existed at February 17, 2006, as evidenced by the following statement of liquidity:

| Cash available for distribution            | Millions of euros |
|--|-------------------|
| Cash and equivalents                       | 683.00            |
| Unused credit facilities                   | 6,750.00          |
| Proposed interim dividend (maximum amount) | (1,230.28)        |
| Difference                                 | 6,202.72          |



**Telefónica, S.A.**

Financial Report 2005

This Report is also available at Telefónica's Internet website:

**[www.telefonica.com/eng](http://www.telefonica.com/eng)**

Shareholders may request copies of this Report from  
**Telefonica's Shareholders Services Office** by calling freephone  
**900 111 004** (in Spain) or via email to  
**[accion.telefonica@telefonica.es](mailto:accion.telefonica@telefonica.es)**

The information required by law is also available to shareholders  
and to the general public

**Published by**

Secretaría General de Telefónica, S.A.

**Designed by**

Addison

**Printed by**

T.F. Artes Gráficas

Date of publication: June 2006

Legal deposit: M-25250-2006



[www.telefonica.com/eng](http://www.telefonica.com/eng)