

# The best combination of growth and returns in the industry

**Santiago Fernández Valbuena, CFO**

**Telefónica S.A.**

March 16<sup>th</sup>, 2007



*Telefónica*

# Disclaimer

This document contains statements that constitute forward looking statements in its general meaning and within the meaning of the Private Securities Litigation Reform Act of 1995. 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.

Such forward-looking statements are not guarantees of future performance and involve risks and uncertainties, and other important factors that could cause actual developments or results to differ materially from those expressed in our forward looking statements.

Analysts and investors are cautioned not to place undue reliance on those forward looking statements which speak only as of the date of this presentation. 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 this presentation, including, without limitation, changes in Telefónica's business or acquisition strategy or to reflect the occurrence of unanticipated events. Analysts and investors 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.

The financial information contained in this document has been prepared under International Financial Reporting Standards (IFRS). This financial information is un-audited and, therefore, is subject to potential future modifications.

# Index

## ■ 2006 results underpin our unique profile

High top-line growth, through commercial focus & diversification

Solid profitability, gaining further efficiencies & synergies

Strong cash generation, despite CapEx effort

## ■ We are facing your main concerns

1. Renewed competition in broadband & mobile in Spain

2. Potential loss of momentum in the UK

3. Price erosion in the German mobile market

4. Underperformance of Brazilian mobile asset

5. Sustainability of Mexican turn-around

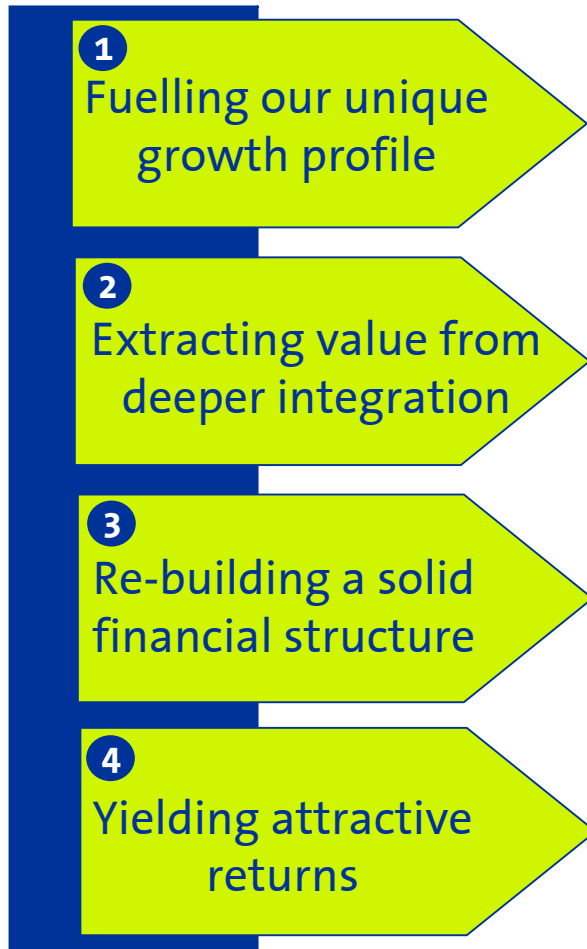
## ■ What are you maybe missing?

1. Mobile growth & profitability prospects in Latin America

# 2006 performance strengthens our profile as the best combination of growth & returns in the industry...

*4 areas of management focus in 2006...*

*...that delivered tangible results*



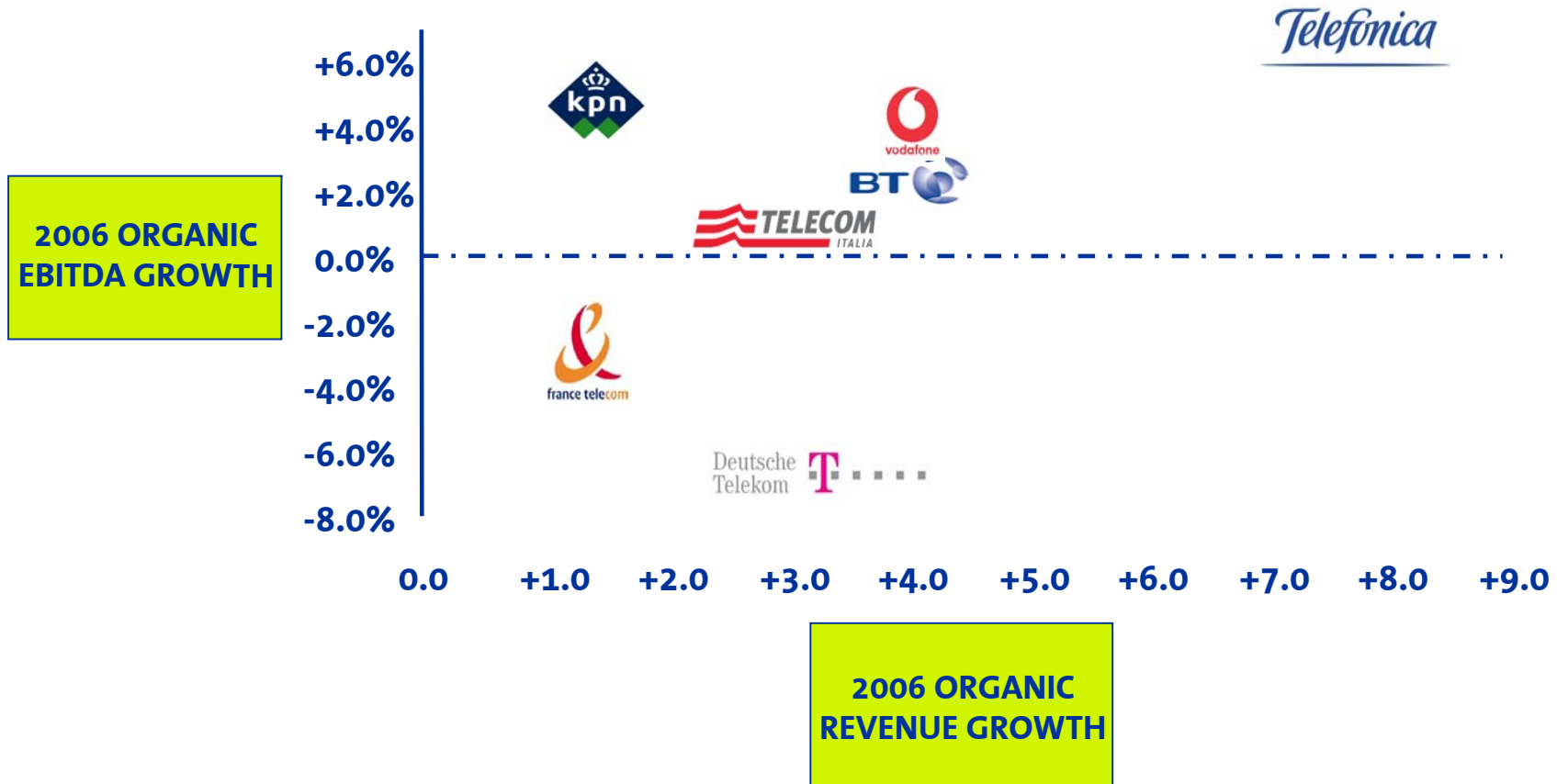
**+42.9% EPS growth**

**>1 bn.€ of synergies cashed-in (OIBDA-CapEx)**

**Net Debt<sup>1</sup>/OIBDA progressing towards our 2.5x target**

**>3.5 bn.€ returned to shareholders (40% of FCF<sup>2</sup>)**

# ...clearly outperforming the peer group...







**TELEFONICA S.A.**  
Investor Relations

Source: company press releases

BT: April-December 06 vs. 05; EBITDA excludes specific items; organic EBITDA excludes specific items and leaver costs. Nominal growth rates for revenues  
 DT: EBITDA growth adjusted for special factors. Revenue growth in nominal terms  
 KPN: Organic Revenue/EBITDA growth: adjusted Revenue/EBITDA for guidance calculation  
 VOD: April-September 06 vs. 05; Next reporting period April06-March07



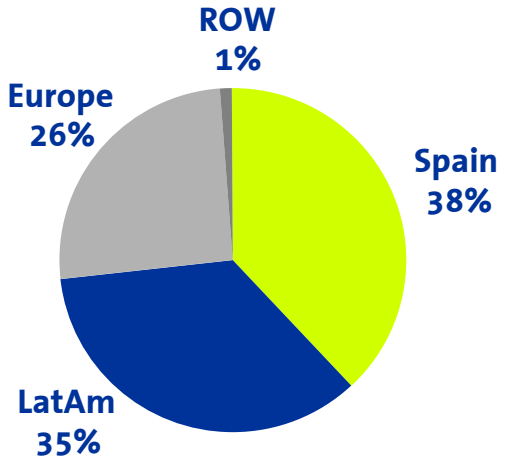
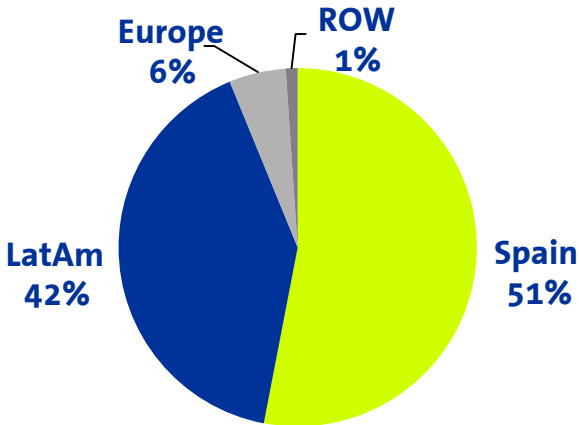
## ...and consistently delivering or outperforming on guidance, hitting again 2006 P&L targets...

		GUIDANCE	RESULTS <sup>1</sup>	
<b>2003</b>	Revenues	5% / 8%	<b>6.0%</b>	
	EBITDA	6% / 9%	<b>12.5%</b>	
	EBIT	18% / 21 %	<b>29.7%</b>	
<b>2004</b>	Revenues	7% / 10%	<b>8.6%</b>	
	EBITDA	5% / 7%	<b>6.0%</b>	
	EBIT	15% / 18 %	<b>15.5%</b>	
<b>2005</b>	Revenues	12% / 15%	<b>17.2%</b>	
	OIBDA	10% / 13%	<b>12.3%</b>	
	OI	12% / 18 %	<b>16.1%</b>	
<b>2006</b>	Revenues	34% / 37%	<b>38.8%</b>	
	OIBDA	26% / 29%	<b>28.9%</b>	
	OI	26% / 30%	<b>29.2%</b>	

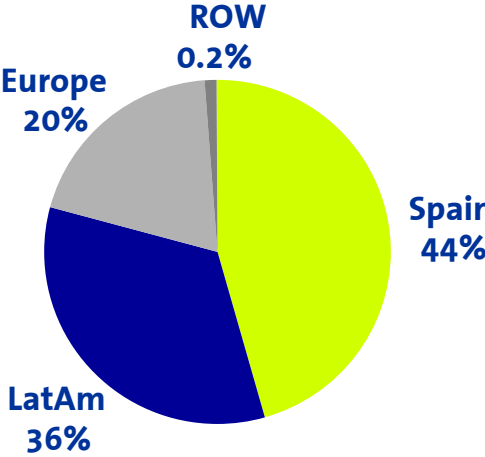
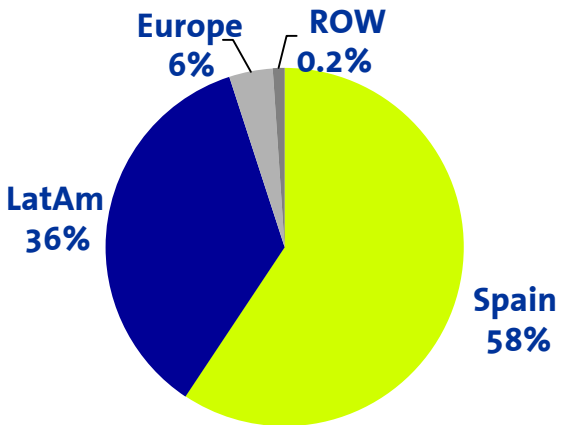
# ...benefiting from the value of being diversified

2005 2006

Revenues  
by  
region



OIBDA  
by  
region



# Index

## ■ 2006 results underpin our unique profile

1. High top-line growth, through commercial focus & diversification
2. Solid profitability, gaining further efficiencies & synergies
3. Strong cash generation, despite CapEx effort

## ■ We are facing your main concerns

Renewed competition in broadband & mobile in Spain

Potential loss of momentum in the UK

Price erosion in the German mobile market

Underperformance of Brazilian mobile asset

Sustainability of Mexican turn-around

## ■ What are you maybe missing?

1. Mobile growth & profitability prospects in Latin America

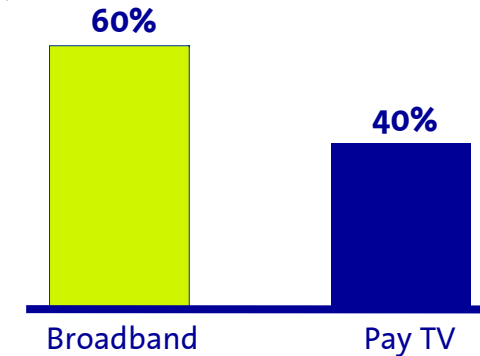


# Spain fixed: can we sustain market leadership without a significant pressure on ARPU?

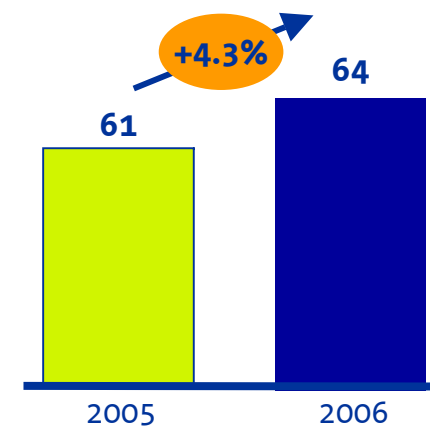
## BEST PERCEIVED OFFER

- Greater coverage
- Better product quality (speed & reliability)
- Stronger innovation (Imagenio & VAS)
- More attractive content (>80 channels, football, VoD)
- Better provisioning & customer care

TdE's retail market share of net adds (4Q06)



TdE's total client ARPU (€/month)



# Spain mobile: can we offset the pressure of new entrants?

## CONCERNS ON OUR MOBILE OPERATIONS IN SPAIN

### INTERCONNECTION FRAMEWORK

- 2006-09 framework approved in October 2006: fixed absolute cuts each six months
- 2G/3G termination rate
- End of asymmetry between operators

Fully aligned with guidance

### YOIGO & MVNO

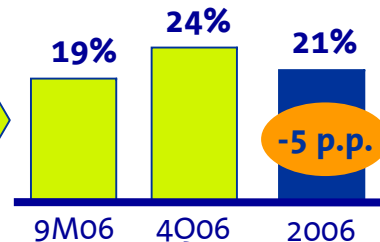
Population Penetration  
Customers in 1<sup>st</sup> month of operation

SPAIN (Yoigo & MVNO)	SLOVAKIA (Telefónica)
45MM	5.4MM
104%	97%
~60 K <sup>1</sup> Xmas	~200 K February

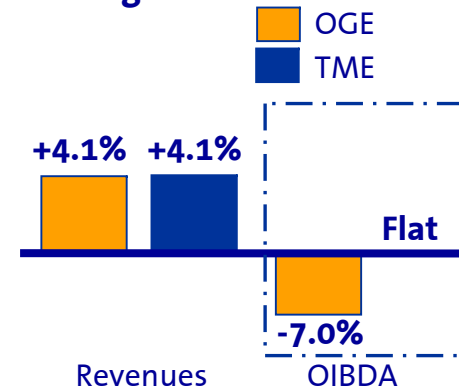
>3x

### RE-BRANDING OF ORANGE

#### OGE Net adds market share



#### 2006 figures



2006
■ OGE EBITDA of 932 M€
■ TME 1.2 bn€ in SAC+SRC

# Spain mobile: can we offset the pressure of new entrants?

## DIFFERENTIATING FROM NEW ENTRANTS BY...

### ON-NET EFFECT

- Biggest *on-net community*: >45% market share
- Attractive *on-net prices* :: Xmas campaign joined by >1.2MM

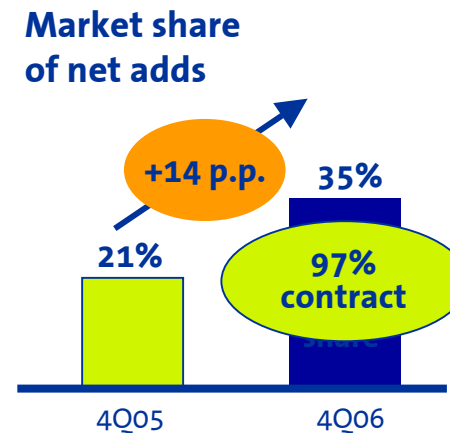
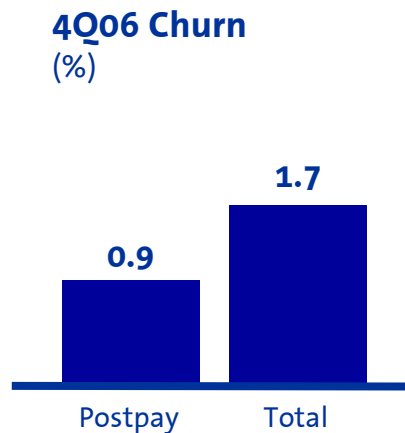
### CHURN CONTROL

- Clients with *on-net plans* have **45-50% lower** churn
- **Increasing** proportion of *long term contracts*

### DATA OPPORTUNITY

- New platforms/devices (*handset upgrades with strong focus on 3G*: +25% vs. 4Q05)
- Enhanced speeds (**3G/HSDPA**) to increase connectivity, browsing...
- **Non-P2P** SMS data(+24% y-o-y)

## IS HELPING TO MAINTAIN MOMENTUM



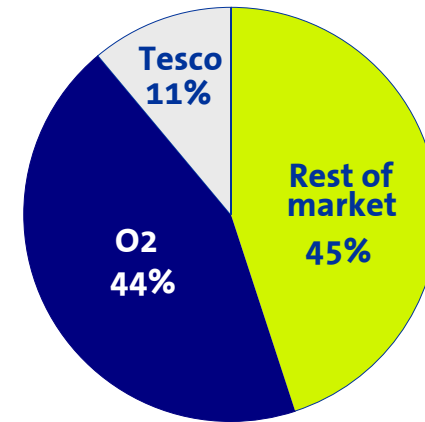
# UK: can we keep current strong operational momentum?



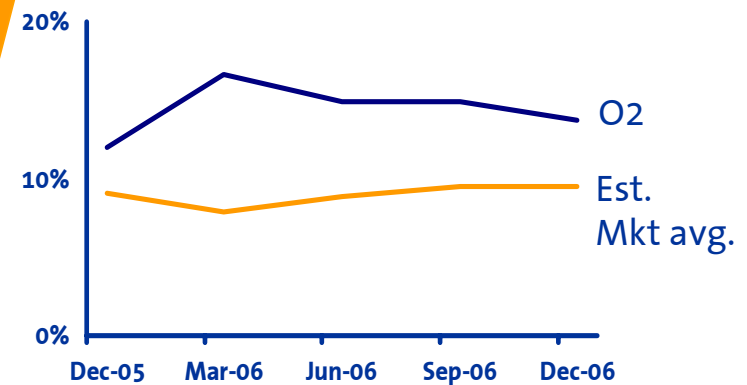
- Focus growth on high value customers  
*35% of base on contract (+1 p.p. vs. 2005)*
- Loyalty initiatives to reduce churn  
*Over 6 million subs on "O2 Rewards"*
- Value pricing to stimulate voice  
*+9.2% in MOU<sup>1</sup> in 4Q06*
- Exploit data uplift  
*+5.9% in data ARPU<sup>1</sup> in 4Q06*
- Direct channels (low churn & low SAC)  
*around 60% of 4Q06 gross adds through O2 shops and on-line*
- Expand into Broadband  
*Market entry mid 07*



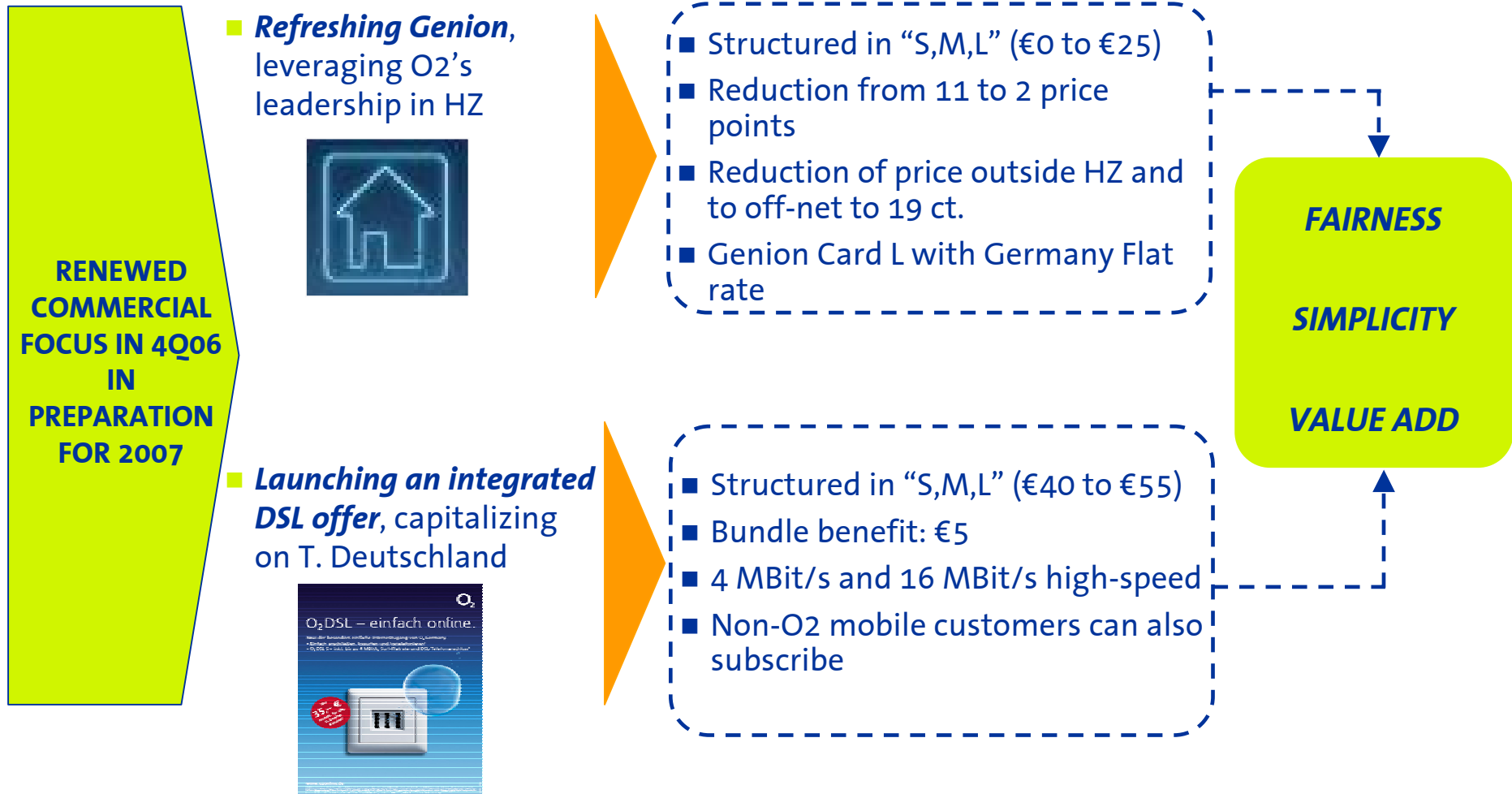
**Share of Net Adds<sup>2</sup>**  
( Dec 05-Dec 06)



**Service revenue growth<sup>2</sup>**  
(y-o-y)



# Germany: can we offset price erosion and keep growing ahead of competitors?



# Brazil: can we strengthen our competitive position to recover the path of profitable growth?

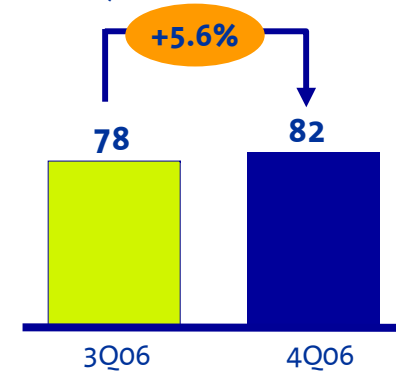
MANAGING CURRENT OPERATIONS TO IMPROVE OUR COMPETITIVE POSITIONING

- Focus on value clients
- Eliminate fraud
- New pricing plans drive MoU & ARPU increases
- Improve client service

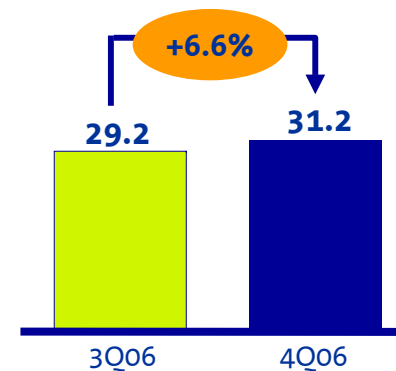
MIGRATING TO GSM IN TWO YEARS FOR THE BENEFIT OF SALES & MARGINS

- **Network deployed in a record time**
- Prepay GSM available: 7,000 customers in January
- On track **within announced investment** (400 M € 1:1 overlay)

MoU  
(minutes)



ARPU  
(local currency)

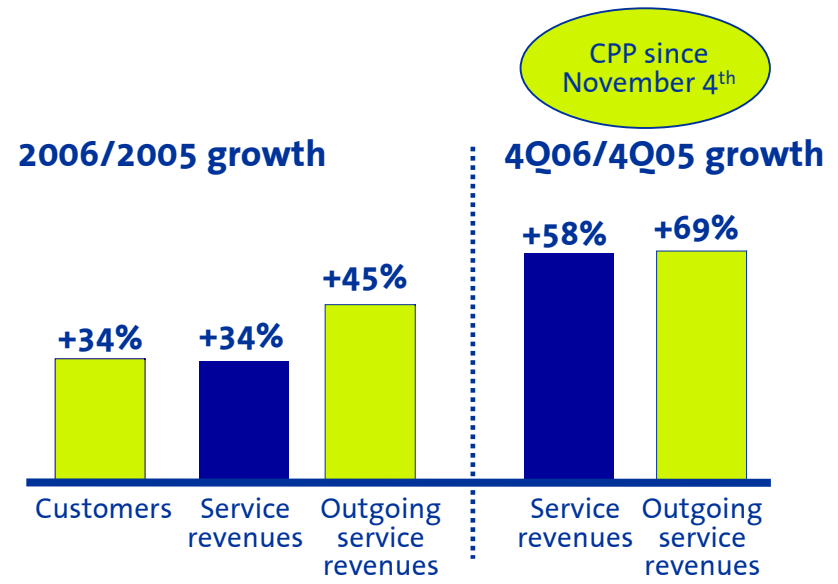


# Mexico: can we sustain operational turn-around?

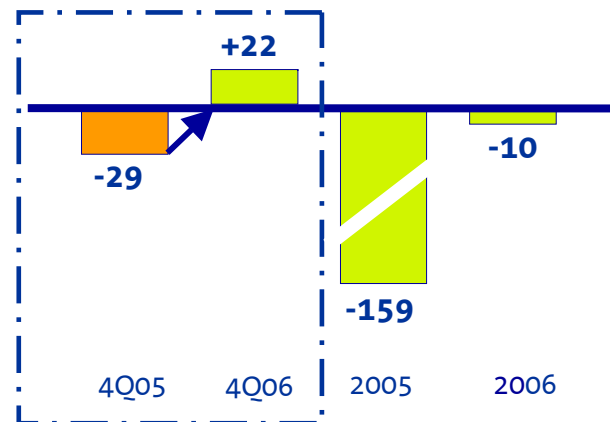
**A focused strategy that is making good progress**

- Improve GSM network coverage & quality (**around 80% total POPs covered as of Dec.06**)
- Enhance capillarity of high quality distribution channels (**>11,500 POS as of Dec.06, +22% vs. Dec.05**)
- Develop high-standard customer service
- Renew commercial offer to play elasticity **+12% in ARPU vs. 2005**) & reduce churn

**PRIORITIZE QUALITY GROWTH AGAINST SPEED OF GROWTH**



**OIBDA**  
(€ in millions)



# Index

## ■ 2006 results underpin our unique profile

1. High top-line growth, through commercial focus & diversification
2. Solid profitability, gaining further efficiencies & synergies
3. Strong cash generation, despite CapEx effort

## ■ We are facing your main concerns

1. Renewed competition in broadband & mobile in Spain
2. Potential loss of momentum in the UK
3. Price erosion in the German mobile market
4. Underperformance of Brazilian mobile asset
5. Sustainability of Mexican turn-around

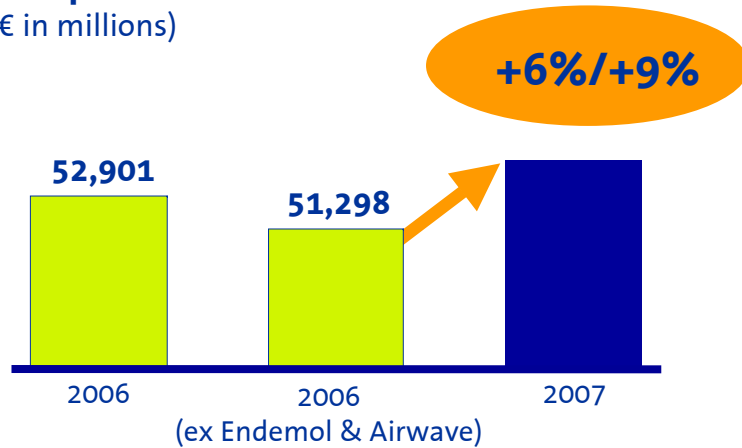
## ■ What are you maybe missing?

Mobile growth & profitability prospects in Latin America

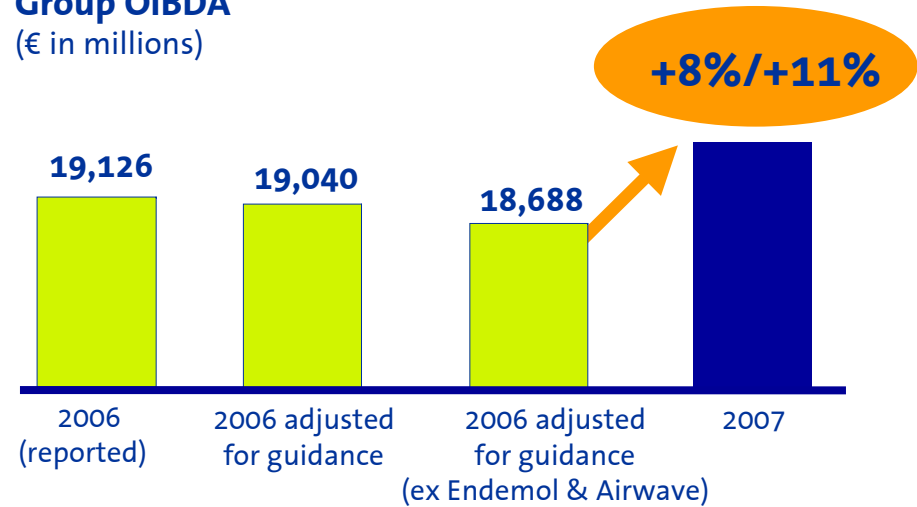


# We are setting benchmark targets again for 2007...

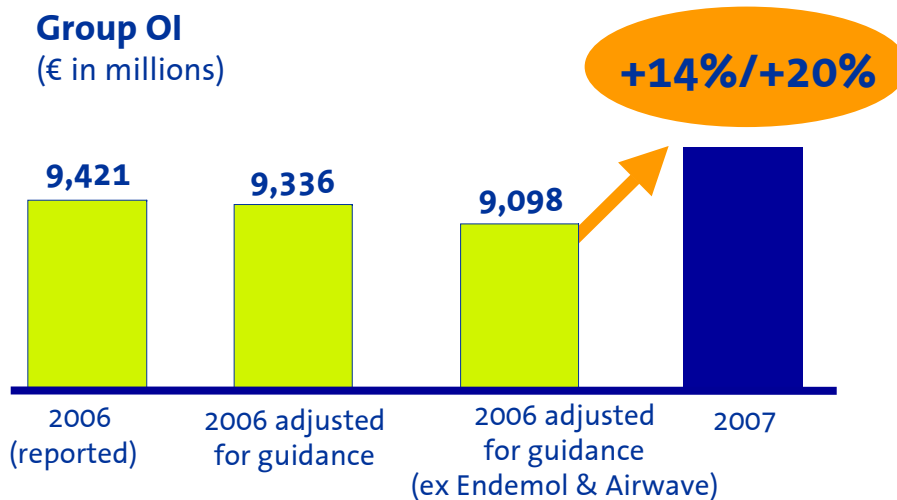
**Group Revenues**  
(€ in millions)



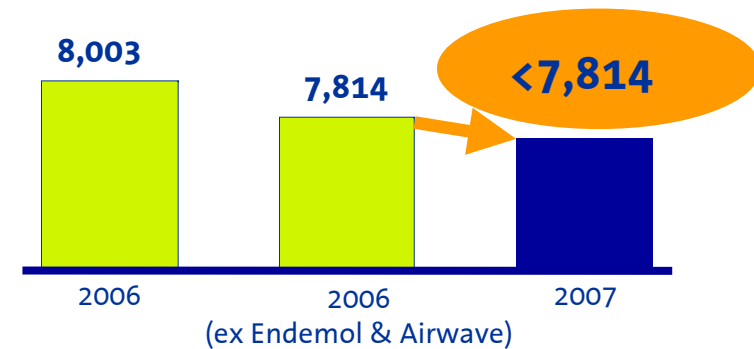
**Group OIBDA**  
(€ in millions)



**Group OI**  
(€ in millions)



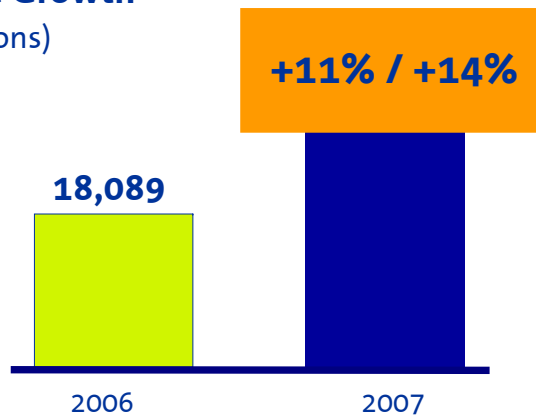
**Group CapEx**  
(€ in millions)



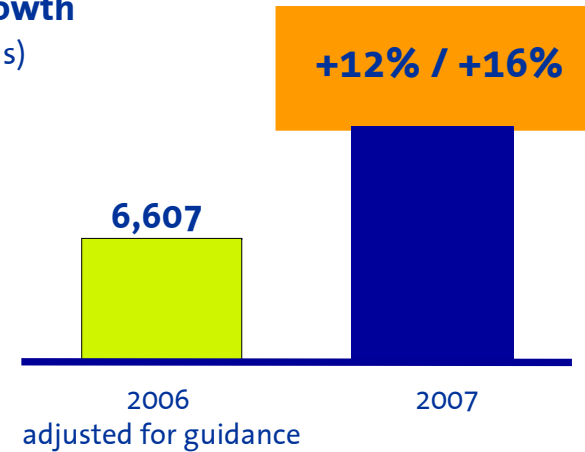
Base reported numbers include eleven months of O2 (consolidated since February 2006), eight months of Telefónica Telecom (consolidated since May 2006), six months of Iberbanda (consolidated since July 2006), three months of start-up losses in Slovakia (operations started in February 2007), and exclude Endemol and Airwave results. 2007 guidance assumes constant exchange rates as of 2006 and exclude changes in consolidation. In terms of guidance calculation, OIBDA and OI exclude other exceptional revenues/expenses not foreseeable in 2007. Personnel Restructuring (980 M€ in 2006 and estimated 630 M€ for 2007 for TdE) and Real Estate Programs are included as operating revenues/expenses. For comparison the equivalent other exceptional revenues/expenses registered in 2006 are also deducted from reported figures.

# ...supported by our distinctive growth profile in Latin America...

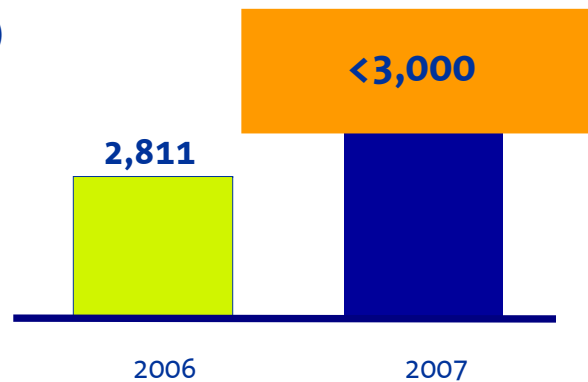
**Revenue Growth**  
(€ in millions)



**OIBDA Growth**  
(€ in millions)



**CapEx**  
(€ in millions)



# ...leveraging the potential of mobile Latam operations...

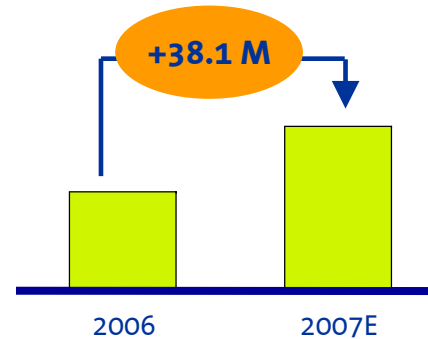
## STABLE MACRO OUTLOOK

- Mid-single digit rate GDP growth for major economies

+4.7% in 2007 for the Latam region <sup>1</sup>

## STRONG GROWTH PROSPECTS

- Strong penetration growth of mobile market (in T.Latam areas of operations)<sup>2</sup>



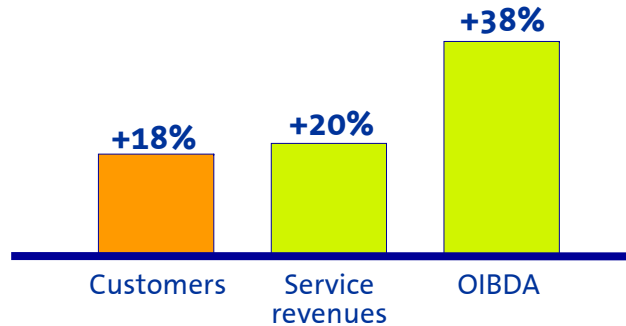
## LEADERSHIP IN MOBILE MARKET MAINTAINED

- Targeting a strong share of net adds in 2007 by:
  - ✓ Pushing **Fixed/Mobile integration** and collaboration to capture growth potential (sharing of sales channel)
  - ✓ Capitalizing on our **GSM footprint in all the region** after Brazil & Venezuela GSM migration

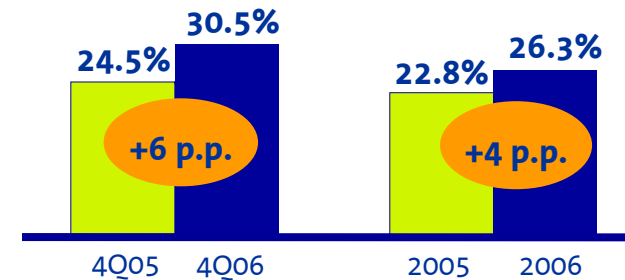
## LEVERAGING REGIONAL MANAGEMENT OF OPERATIONS

# ...whose financial profile has already shown tangible progress in 2006...

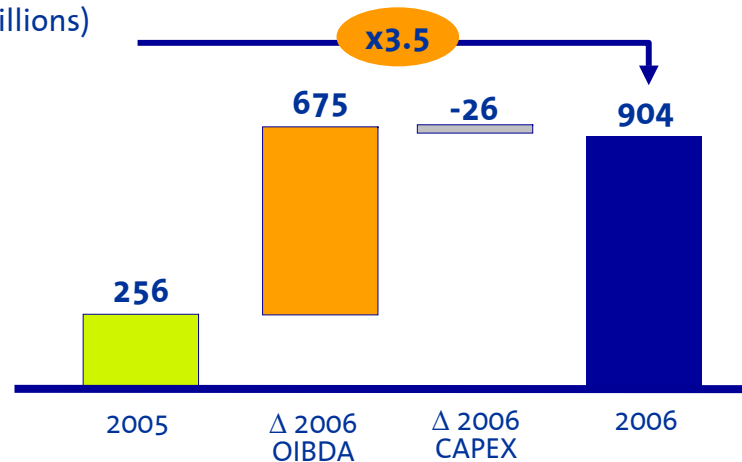
2006/2005 growth rates  
(local currency)



OIBDA margin



OpCF  
(€ in millions)



Margin improvement fully flowing to OpCF

# Telefónica offers shareholders a superior value proposition

- **Highest growth profile**, well ahead of peers
- **Best diversification**, by business and geographies
- **Clear potential to extract value** from scale and integrated management
- **A sound competitive position to face current challenges**
  - ✓ **Reliability**, always delivering results
  - ✓ Well preserved **financial discipline**
  - ✓ Growing path on **shareholders' returns**

A high growth & returns stock, that **will double** both  
**EPS and dividend by 2009**

*Telefonica*

---

# Appendix

# Operationally sound across our major divisions

## Spain

reinforced market position for a unique growth & profitability profile

- **Fixed:** lead in BB, enhanced Pay TV market share. Benchmark top-line & OIBDA
- **Mobile:** sound commercial delivery (top Xmas). Strong revenues & margins

## Latam

successfully managing growth and profitability

- **Fixed:** development of BB and Pay TV. Sustained OIBDA margins
- **Mobile:** rapid expansion of customer base. Tripling cash generation

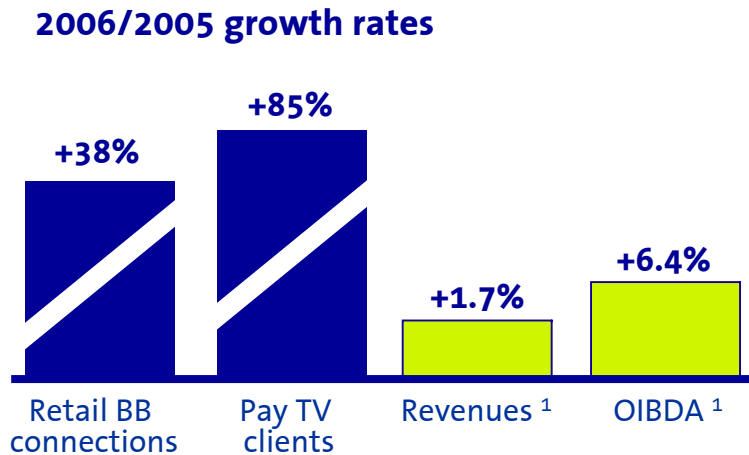
## Europe

exploiting mobile growth and extracting value from fixed

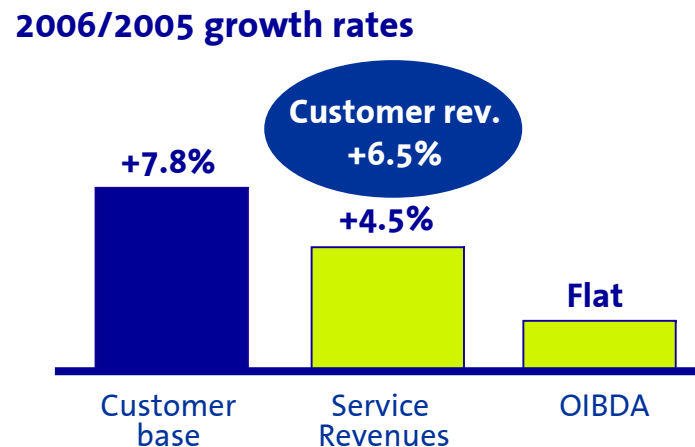
- **O2 UK:** solid net adds & ARPU. Top service revenue growth
- **O2 Germany:** push in postpay. Pressure on revenues
- **Czech Republic:** BB and mobile expansion. Financial turn-around



# Spain: reinforced market position for a unique growth & profitability profile

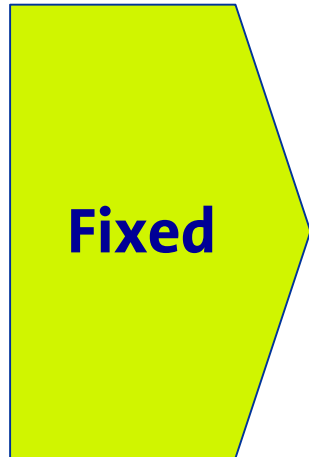


- Retail BB market share of **56%** as of Dec.06
- Pay TV market share of **10%**
- **+46%** in retail BB revenues y-o-y

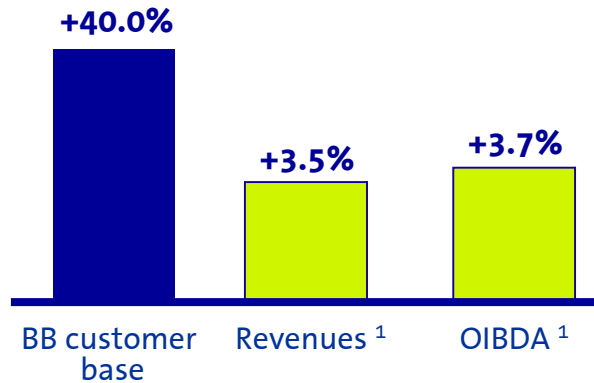


- **+18%** in gross adds and **+70%** in net adds, in 2006.
- **>90%** of net adds on postpay (postpay base up +13% y-o-y)
- Outgoing ARPU up annually by **1%**

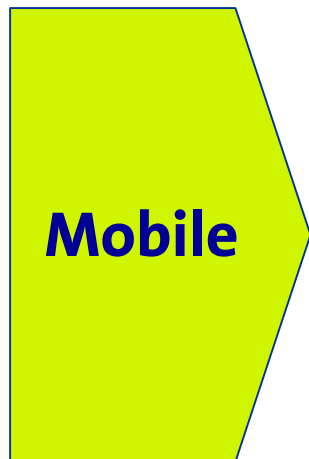
# Latam: successfully managing growth and profitability



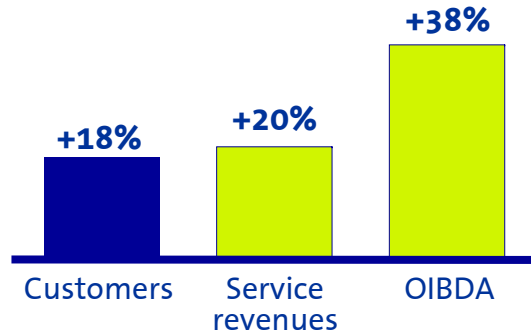
2006/2005 growth rates  
(€ terms)



- >30% annual growth in BB revenues in local currency
- All operators growing top-line
- >1 p.p. of OIBDA margin improvement since 1Q06

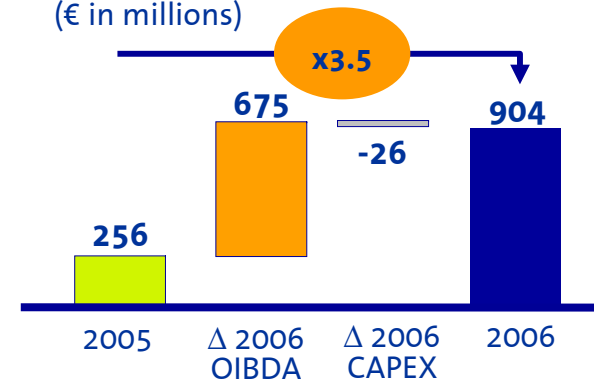


2006/2005 growth rates  
(€ terms)

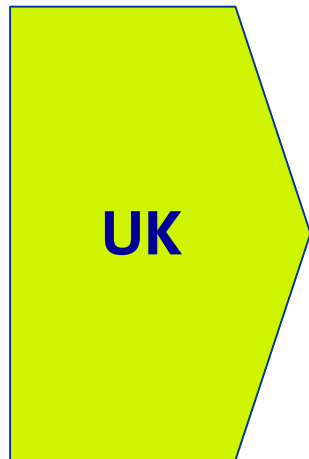


OpCF

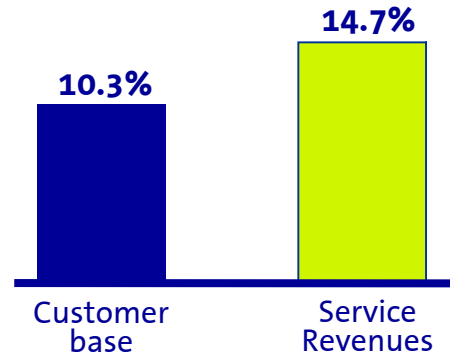
(€ in millions)



# Europe: exploiting mobile growth opportunities...



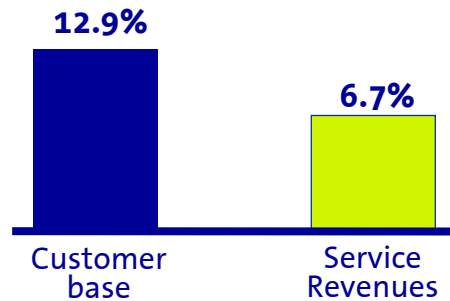
2006/2005 growth rates  
(£)



- **+13%** annual growth in postpay clients in 2006
- **35%** of base on postpay, +0.9 p.p. y-o-y
- 12 months **rolling postpay churn 4 p.p.** below last year
- **+2.2%** annual ARPU<sup>1</sup> increase, led by MoU and data ARPU growth

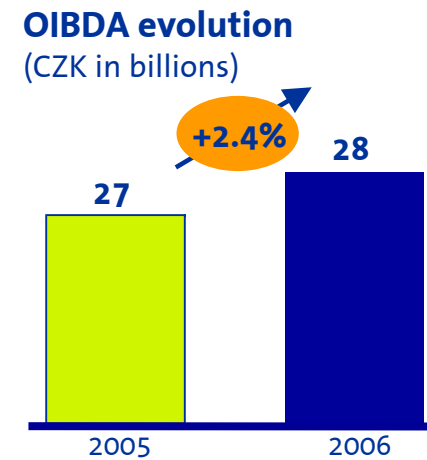
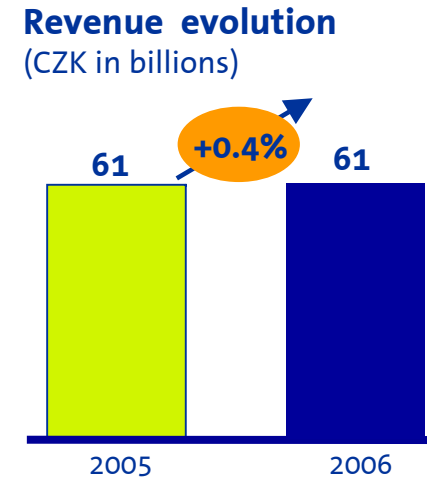
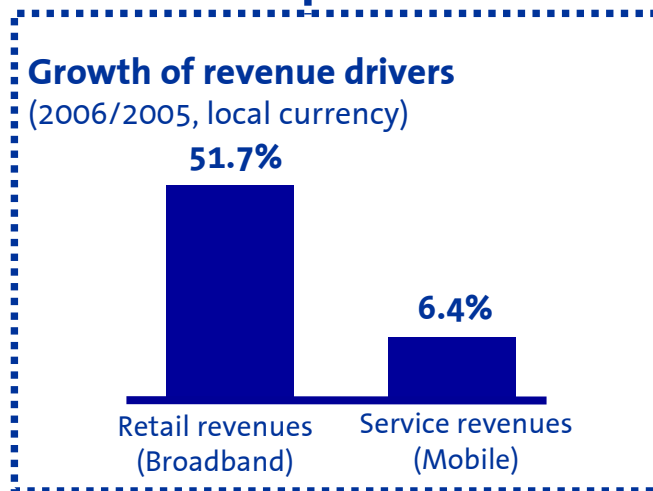
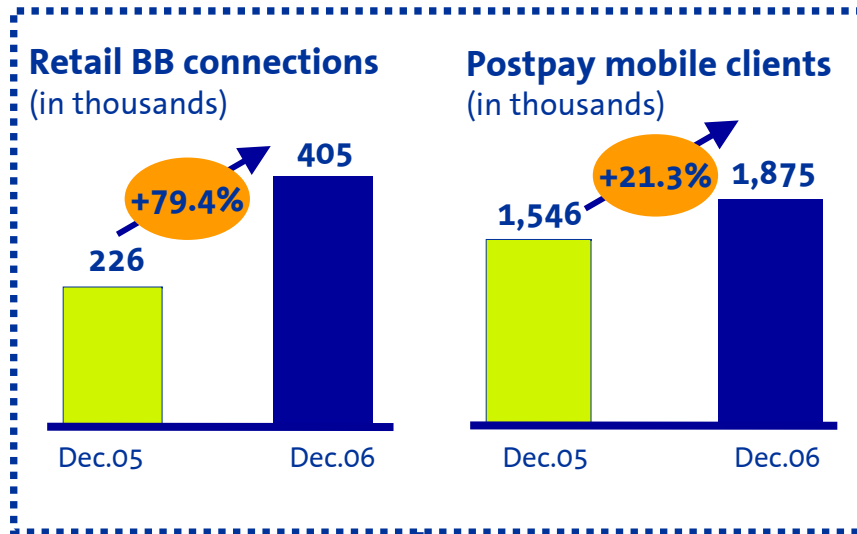


2006/2005 growth rates  
(€)



- **49%** of 4Q06 net adds on postpay
- **51%** of postpay net adds signed to Genion in 2006 (3.9 M clients end of Dec.06)
- **+4%** y-o-y growth in MoU in 2006
- Pressure on ARPU<sup>1</sup> (**-12.6%**), led by change in mix, MTR cuts and competition

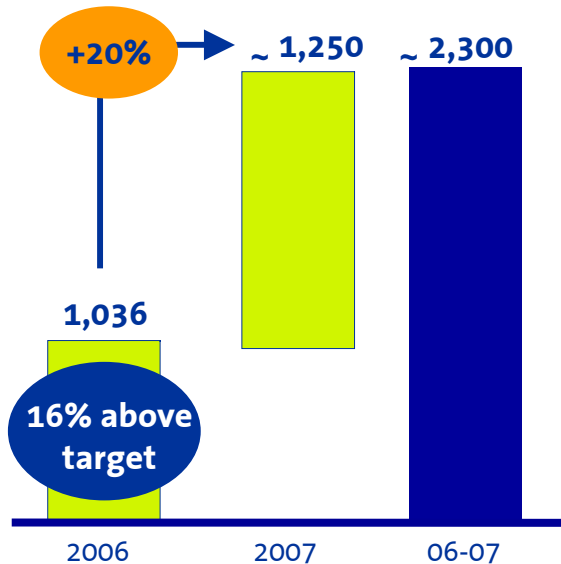
# ...and extracting value from the turn-around of fixed in the Czech Republic



**2006 margin at 45.8% (+0.9 p.p. y-o-y)**

# The benefits from a deeper integration are supporting operating performance

OpCF from synergies  
(€ in millions)



## 1 Keeping the focus on ongoing initiatives

- Regional management (Spain, Latam & Europe)
- Global projects (Infrastructure & Systems, Resources, & Business Development)
- Commercial Convergence (P&S and Channels)
- Integrated Network, Operations, IT, & Corporates
- Centralized purchasing

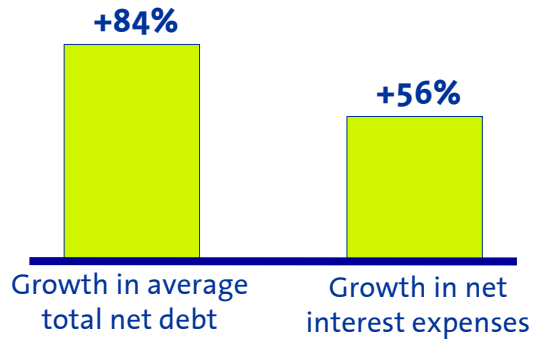


## 2 Working on new opportunities

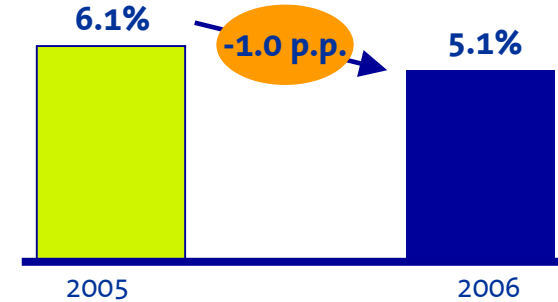
- ADSL+mobile in Europe
- IPTV/DTH in Latin America
- Mobile Data applications
- Digital Entertainment (PC, mobile, TV)

# Financial structure: de-leverage reaffirmed and active management of financial expenses

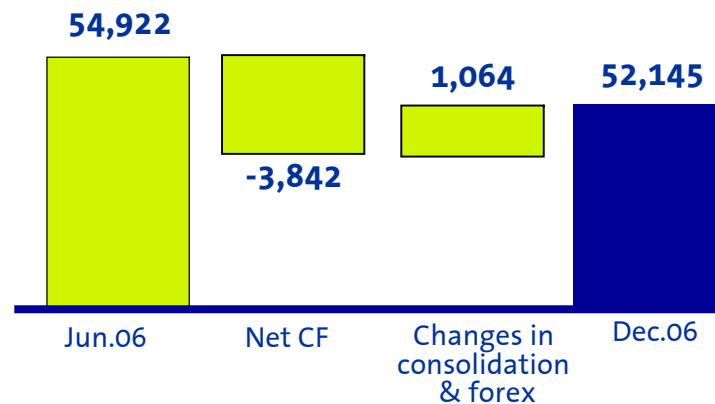
2006/2005 growth rates (€)



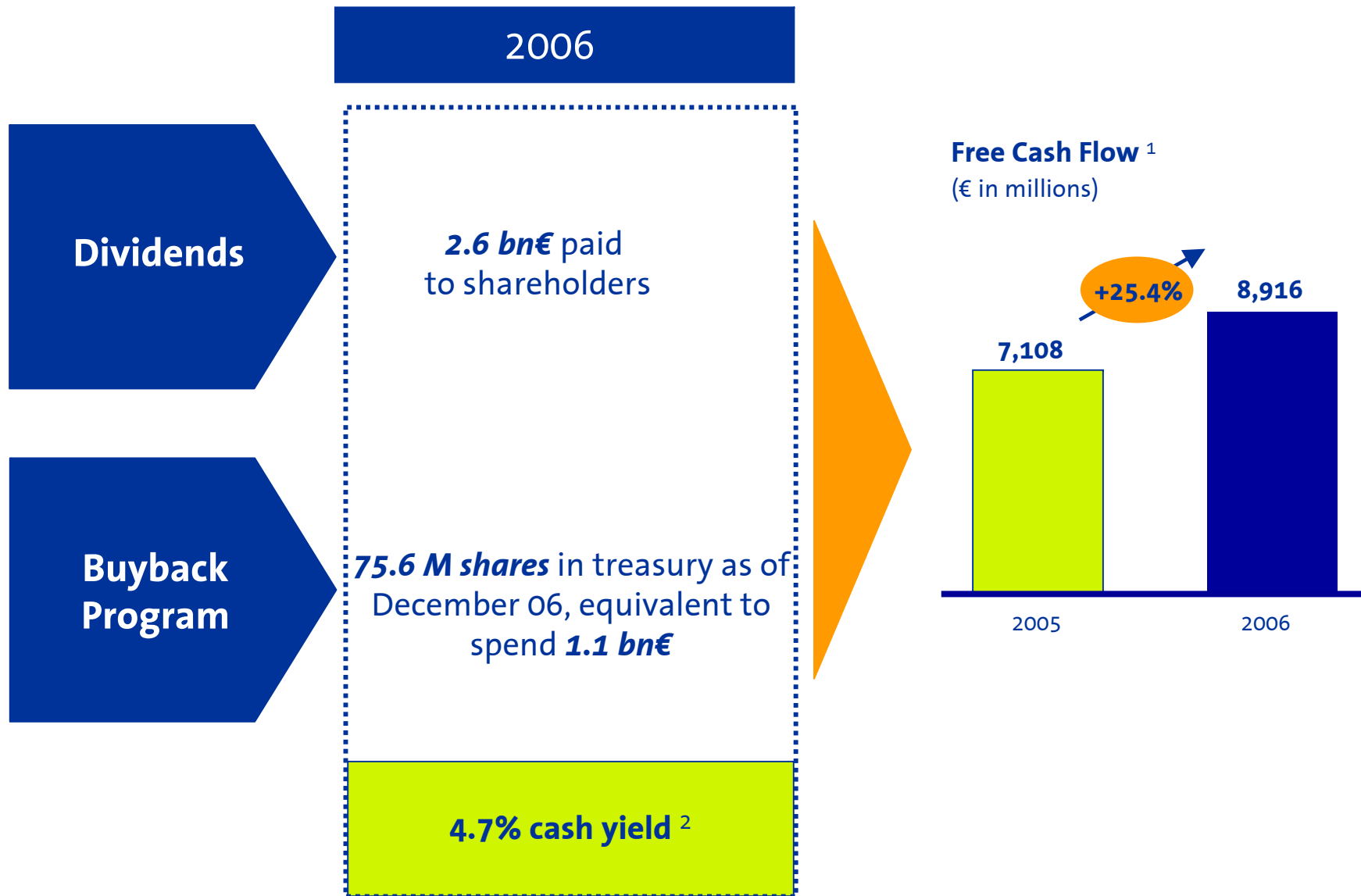
Evolution of Average Effective Debt Service Rate <sup>1</sup>



Net Debt (€ in millions)



# An attractive shareholder remuneration policy



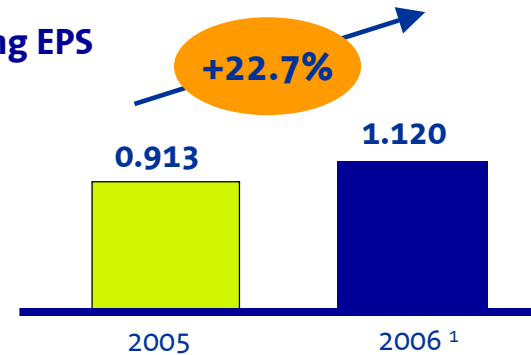
**TELEFONICA S.A.** Investor Relations (1) Available for shareholder remuneration, financial investments and debt reduction  
(2) Based on market capitalization as of 1/1/07 (79.3 bn€)

# A clear objective to grow returns while preserving financial discipline

## Shareholder remuneration

- **Double 2005 DPS (0.5€) by 2009**, in line with doubling 2005 EPS by 2009 (0.91€)
- Devote **2.7 Bn.€ to buyback** shares and cancel them by 2007

Underlying EPS  
(in €)



**1.6 Bn€ left to buy shares in 2007**

## Financial discipline

- **BBB+/Baa1** as rating floor & Net debt + commitments **below 2.5x OIBDA** in the medium term
- **<1.5 Bn.€** in net financial investments<sup>2</sup> in 07 & **no issuance of new shares** for M&A

Leverage ratio

(Net Debt & Commitments / OIBDA<sup>3</sup>)

