

# Telefónica: Delivering sustainable growth

Frankfurt, May 27<sup>th</sup>, 2010

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This presentation includes certain non-GAAP (Generally Accepted Accounting Principles) financial measures which have not been subject to a financial audit for any period.

## **01 Industry: Is there growth in the Telecoms sector?**

## **02 Telefónica Group:**

- i. Will Telefónica maintain its differential growth profile?
- ii. Is your dividend policy sustainable?
- iii. What are your M&A ambitions?

## **03 T. España:**

- i. Macroeconomic situation
- ii. Revenue performance: is the worst over?
- iii. Competitive environment: is there a price war in Spain?
- iv. Commercial activity across businesses
- v. Are you under investing?

## **04 T. Latam:**

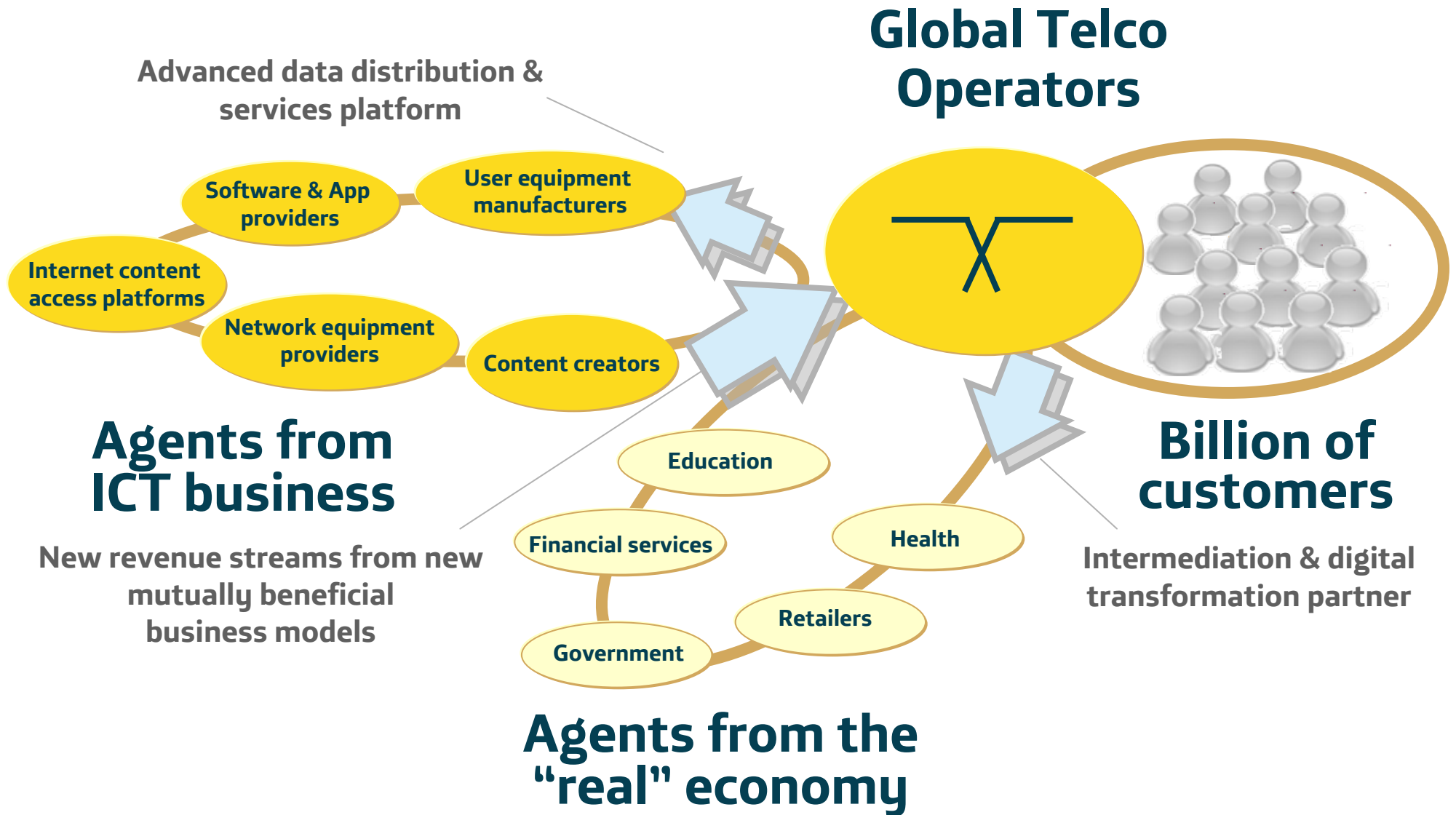
- i. Is the growth story in Latin America coming to its end?
- ii. How is Telesp performing?

## **05 T. Europe:**

- i. How are you going to deliver growth in UK and Germany?

## **06 Conclusions**

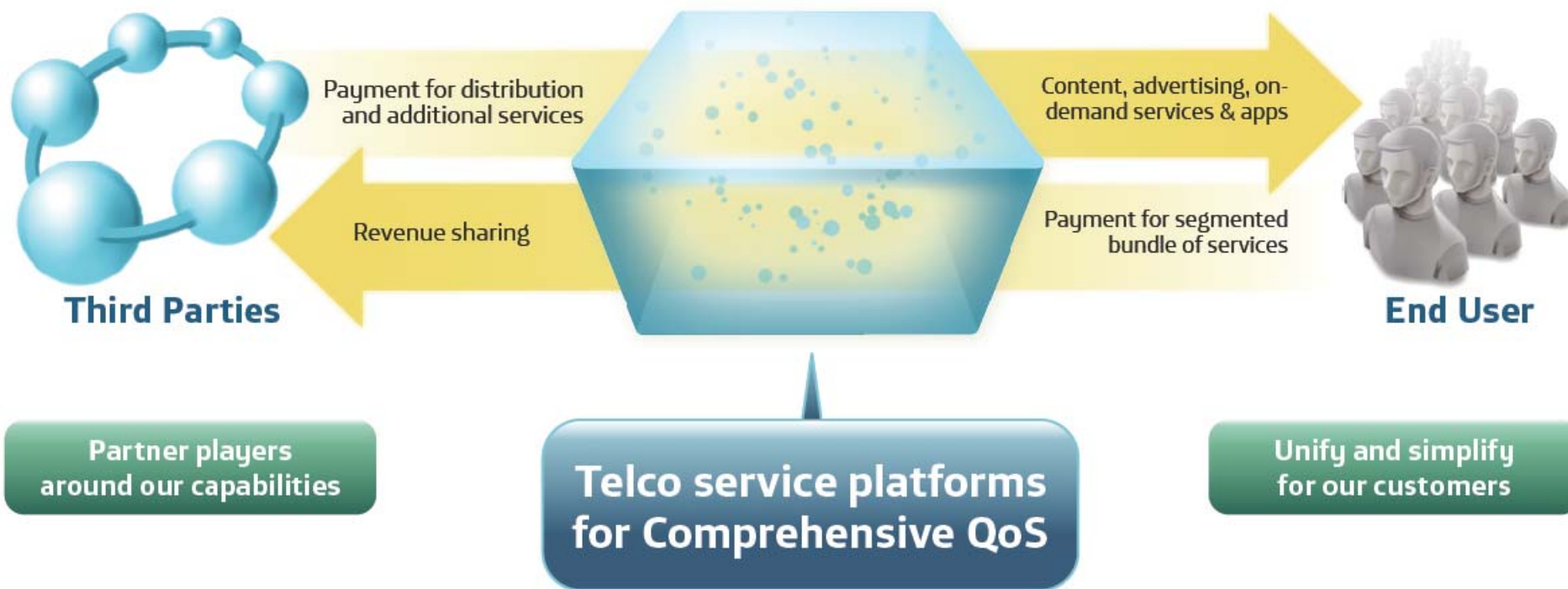
01 In the new digital world, advanced global operators are key to build new value proposals



# 01 Service platforms enable a new wave of revenues

## Beyond applications: Advanced platforms for quality service delivery

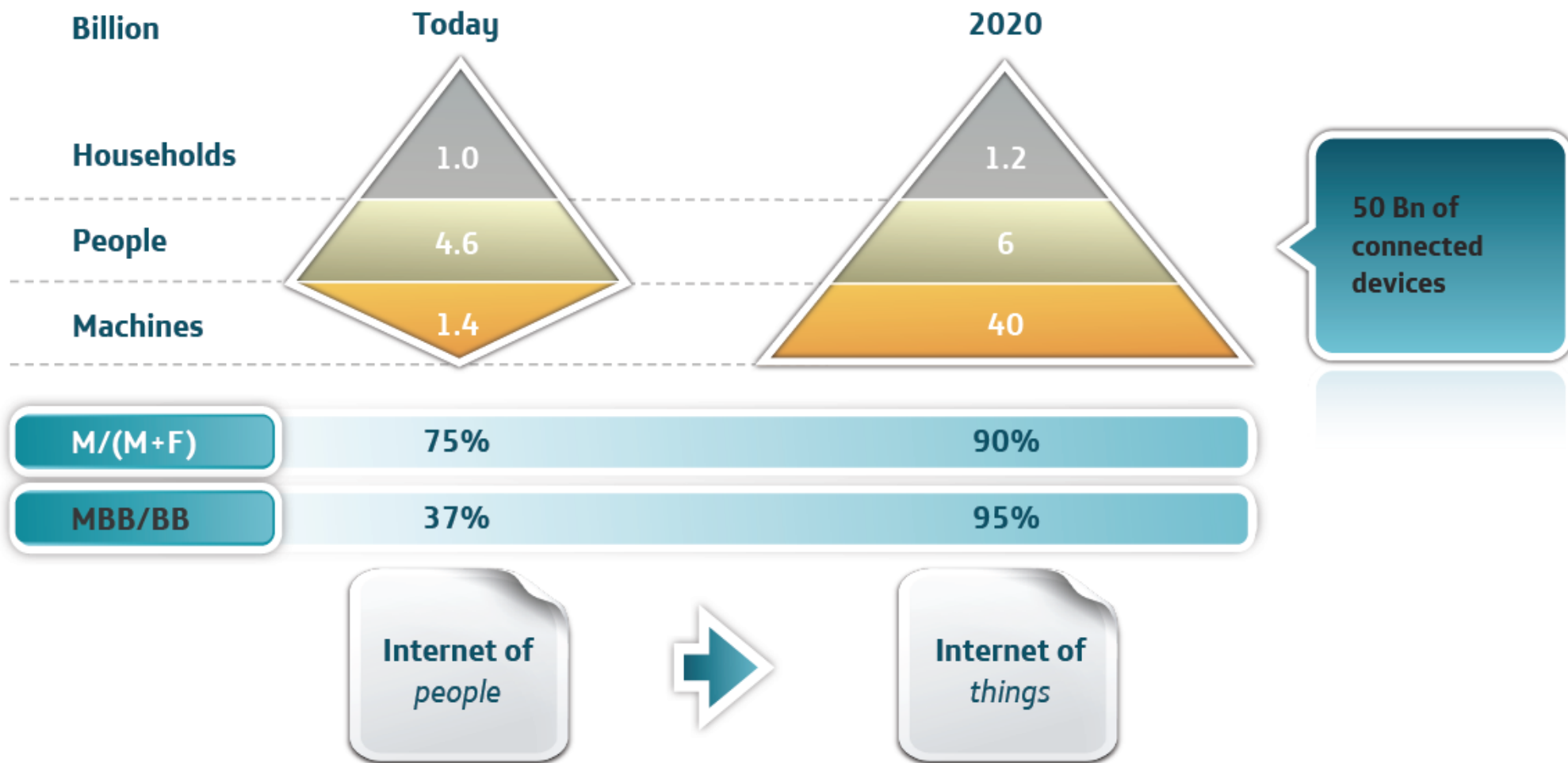
Adding comprehensive connectivity & service management



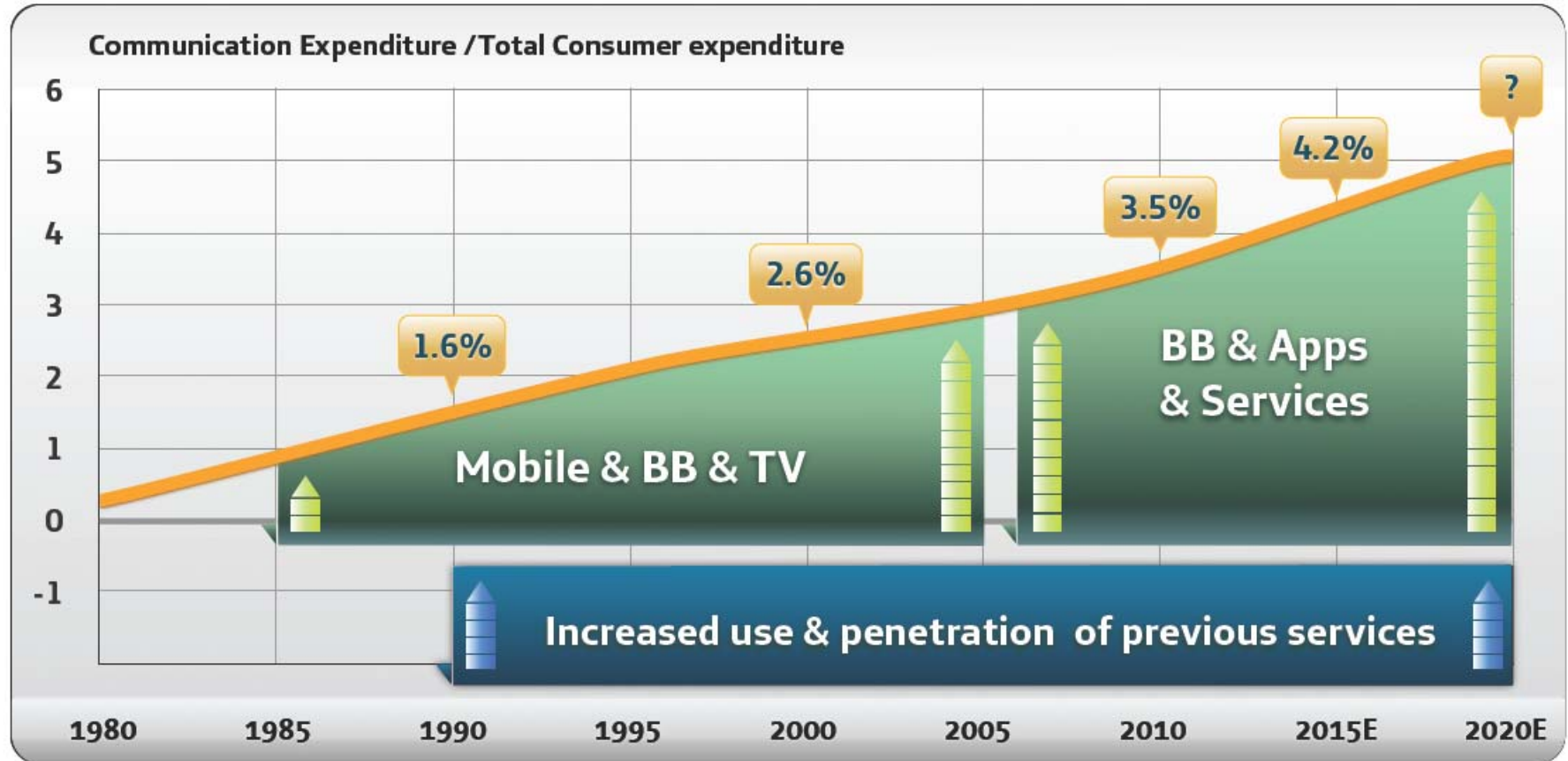
# 01 Our scale and value chain positioning places us as the partner choice in the new digital ecosystem to build high potential intersectorial alliances with every sector



# 01 Communication demand will keep growing

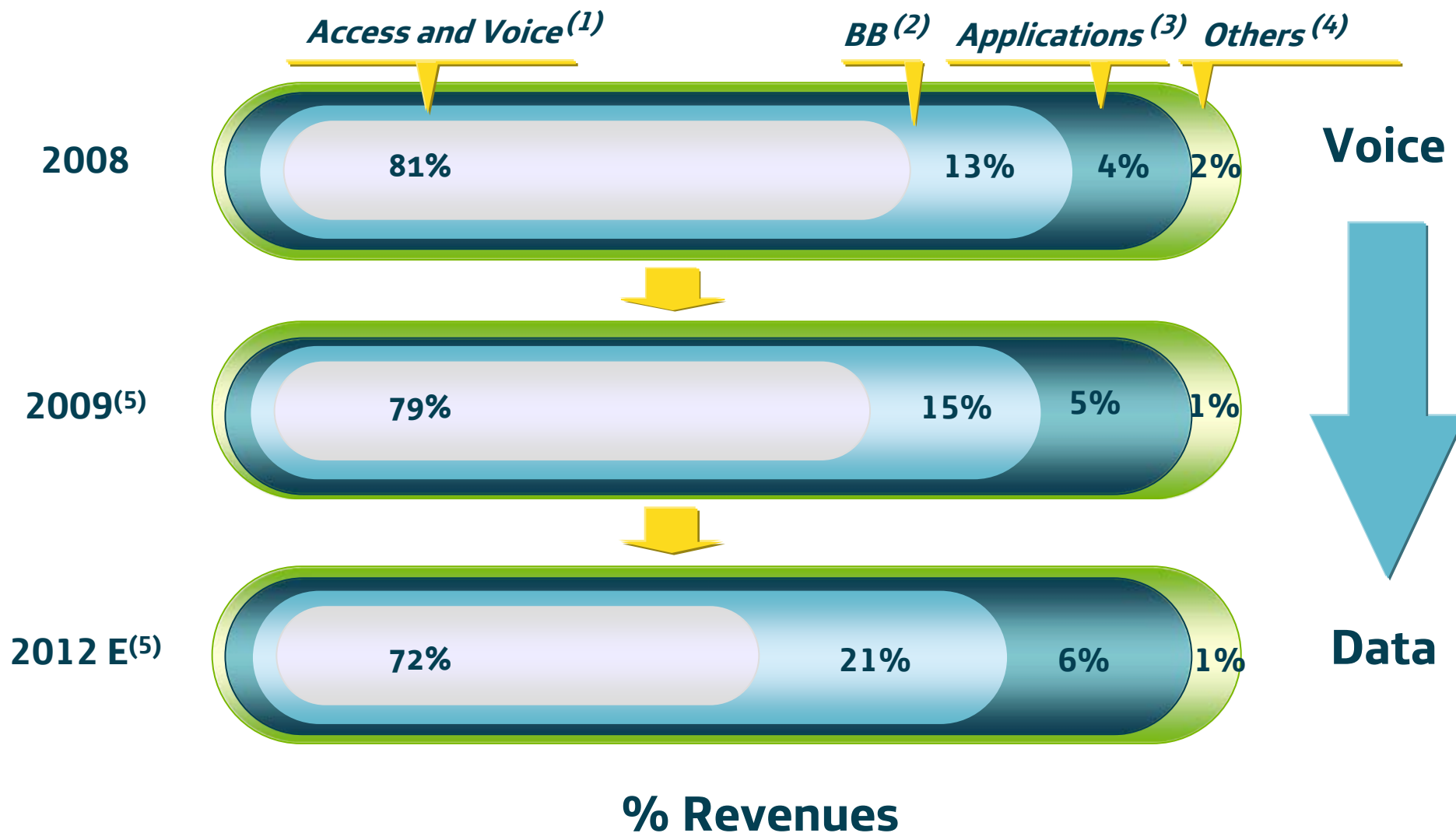


# 01 New digital applications and services will accelerate this trend, increasing ICT share in consumer's wallet





# 01 We see a larger business with a change of mix in Telefónica



(1) Access & Voice: Fixed and mobile access and voice (SMS included), fixed and mobile equipment, narrowband Internet and M2M revenue.

(2) BB connectivity (MBB & FBB). FFB connectivity: (DSL, FO, cable modem, ...), fixed data services, retail and wholesale and equipment. MBB connectivity: Big & Small Screen, mobile e-mail, and WAP browsing revenue.

(3) Apps and New Business: TV, ICT solutions, online advertising (e-Commerce, Terra), MBB VAS (Mobile content / Application downloaded), other FBB VAS, new growth sources and other digital content service revenue.

(4) Revenues from subsidiaries and other companies.

(5) Assuming constant exchange rates as of 2008 (average FX 08) and excludes changes in consolidation.

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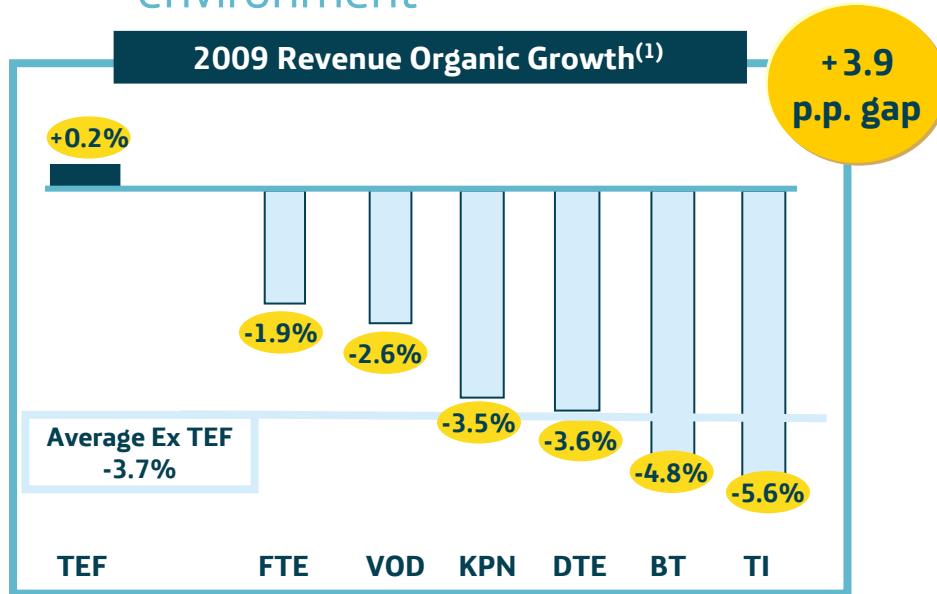
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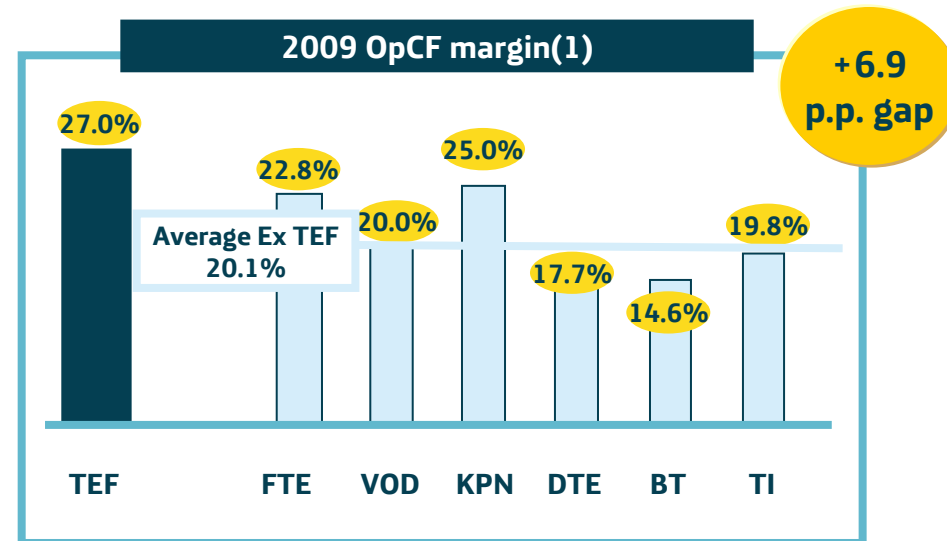
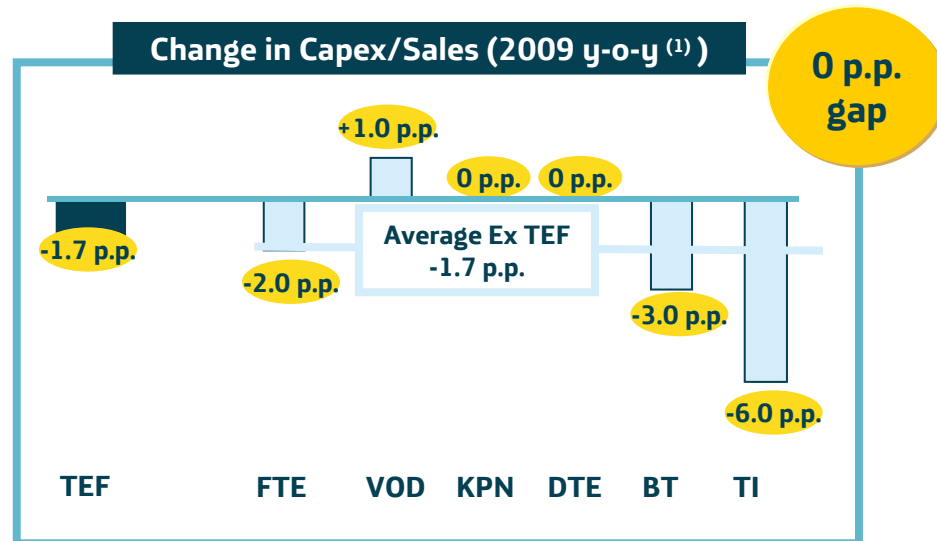
- i. How are you going to deliver growth in UK and Germany?

## **06 Conclusions**

# 02 We have maintained our superior performance despite a very challenging environment

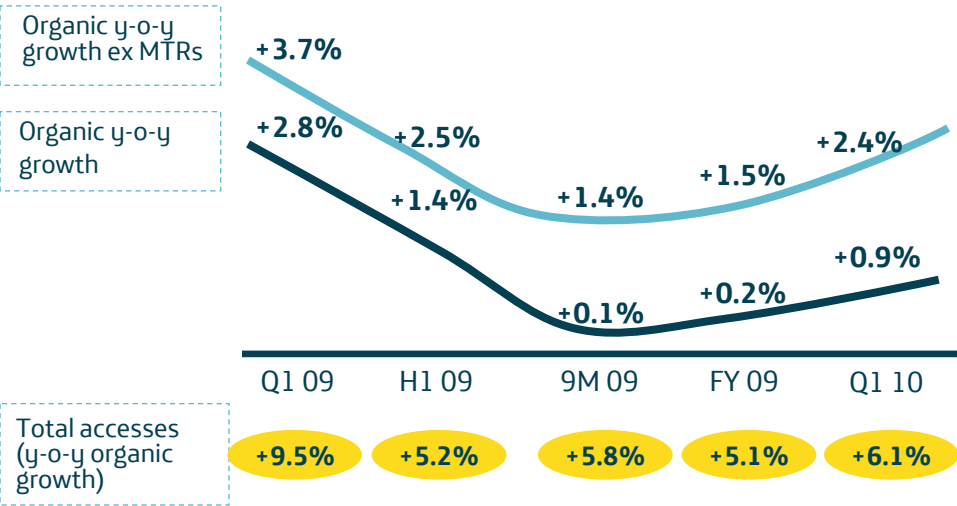


- Despite the adverse economic environment in Spain, we have maintained our growth gap vs. the sector...
- ... while maintaining our benchmark cash flow generation and keeping investment in future growth



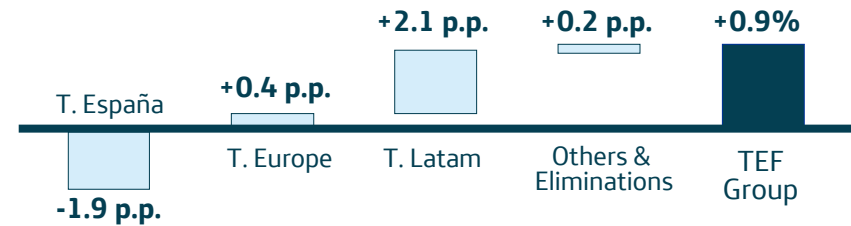
# 02 Distinctive top line performance

## Revenue growth acceleration for the 2<sup>nd</sup> quarter in a row

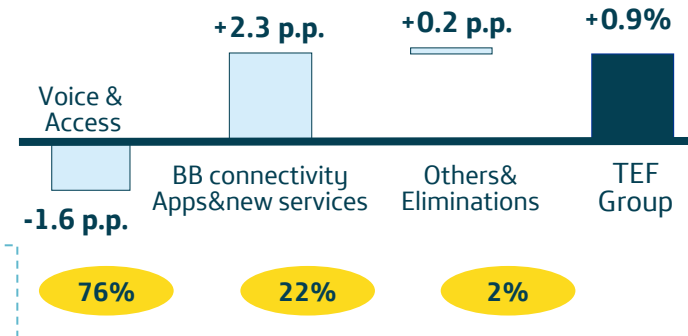


- **Top line growth drove superior OpCF:** € 3,923 m
- **Efficiency ratio improved 1.0 p.p. y-o-y to 74.5% in Q1 10**

## Q1 10 Revenue by region (contribution to organic growth y-o-y)



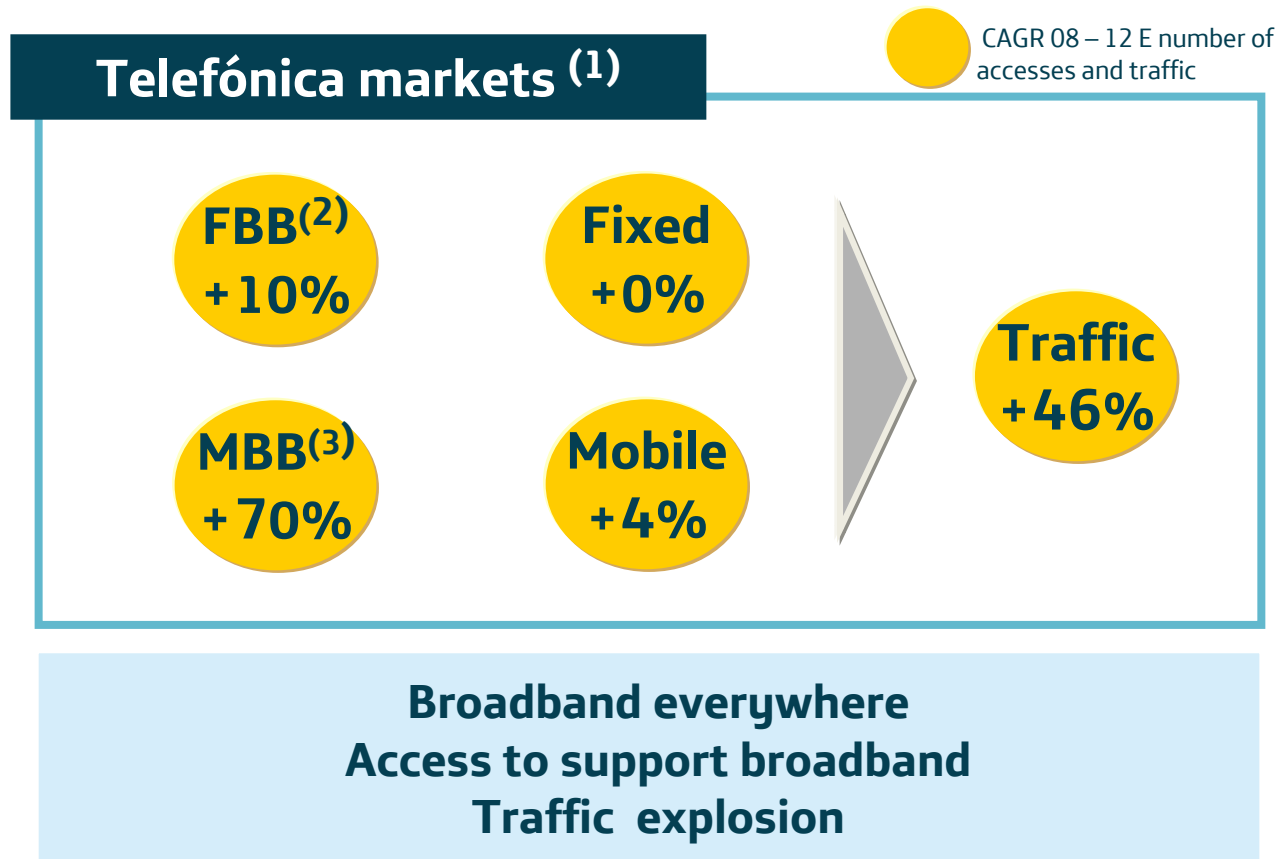
## Q1 10 Revenue by mix of services (contribution to organic growth y-o-y)



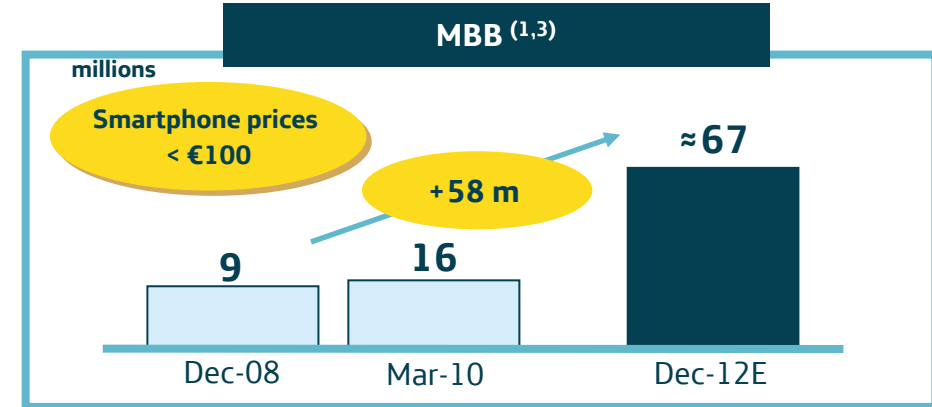
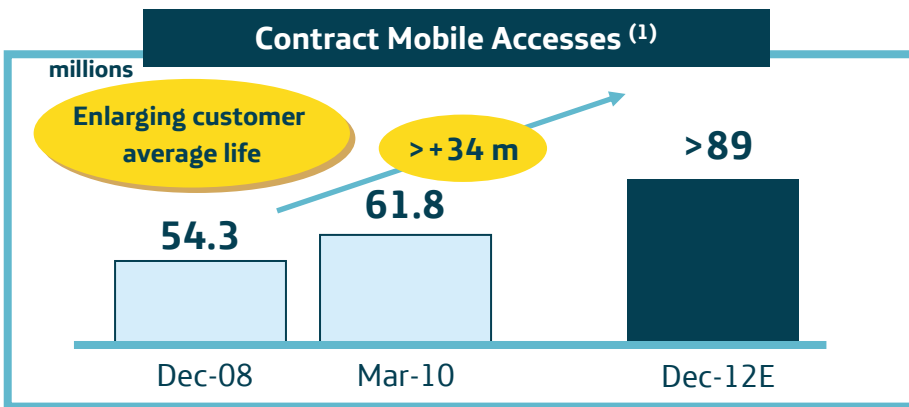
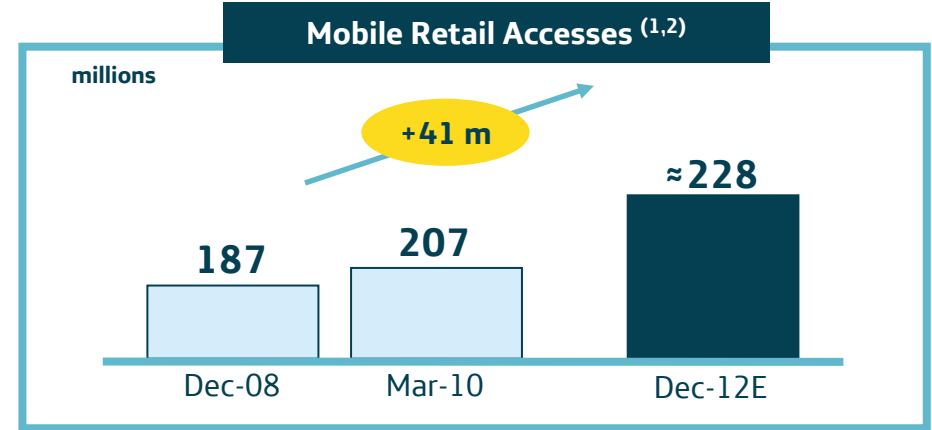
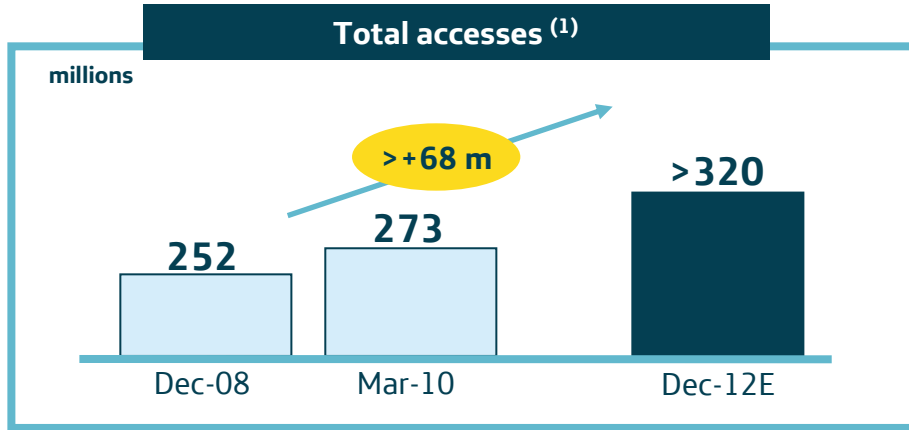
Weight over reported rev

## 02 We have already set the bases for future growth

- Geographical & Business **DIVERSIFICATION**
- Strong **GROWTH POTENTIAL** in our markets



# 02 Growing our customer base & improving its quality

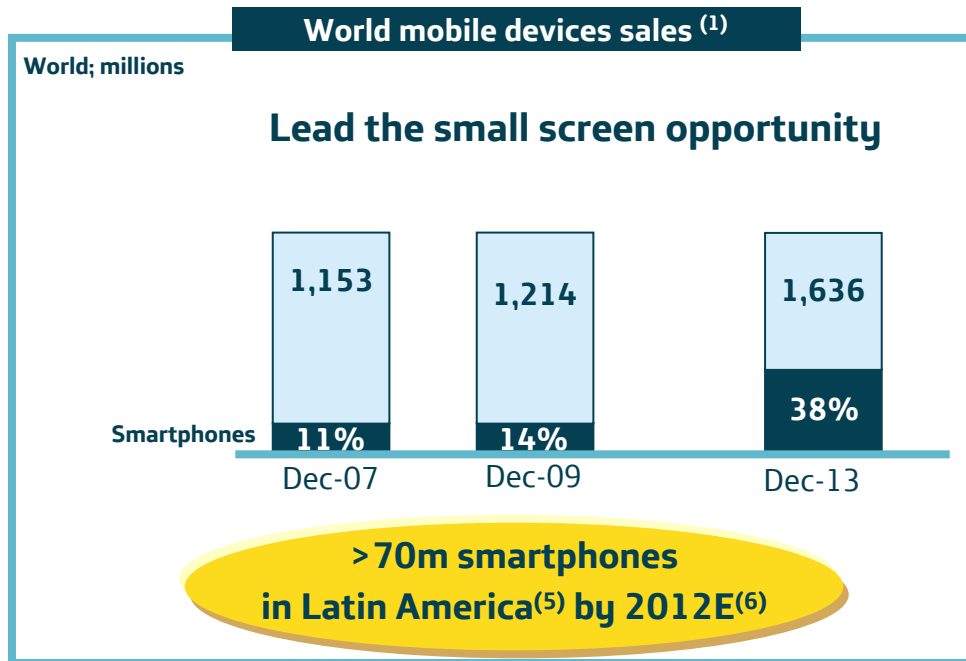
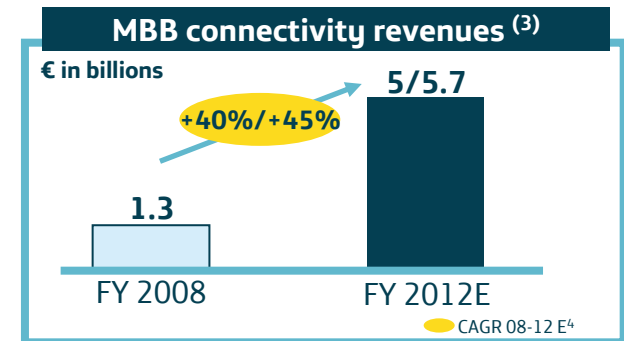
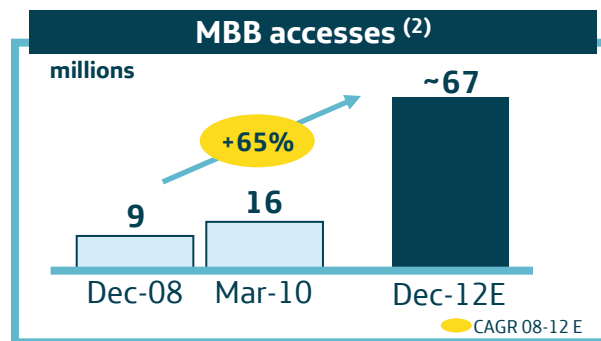
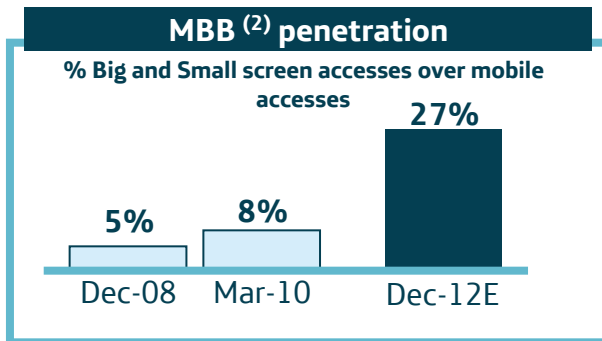


- +10 p.p. growth in the weight of contract customers by Dec-12E vs. Dec-08 (Telefónica Group)
- Contract ARPU<sup>(4)</sup> 4.5x prepay one in 2009, with better y-o-y evolution (Telefónica Group)

- MBB growth mainly driven by Smartphones
- ARPU of Smartphones in Spain 1.7x contract ARPU<sup>(4)</sup> in 2009

## Variation 08-12E

# 02 Massive MBB development (i)



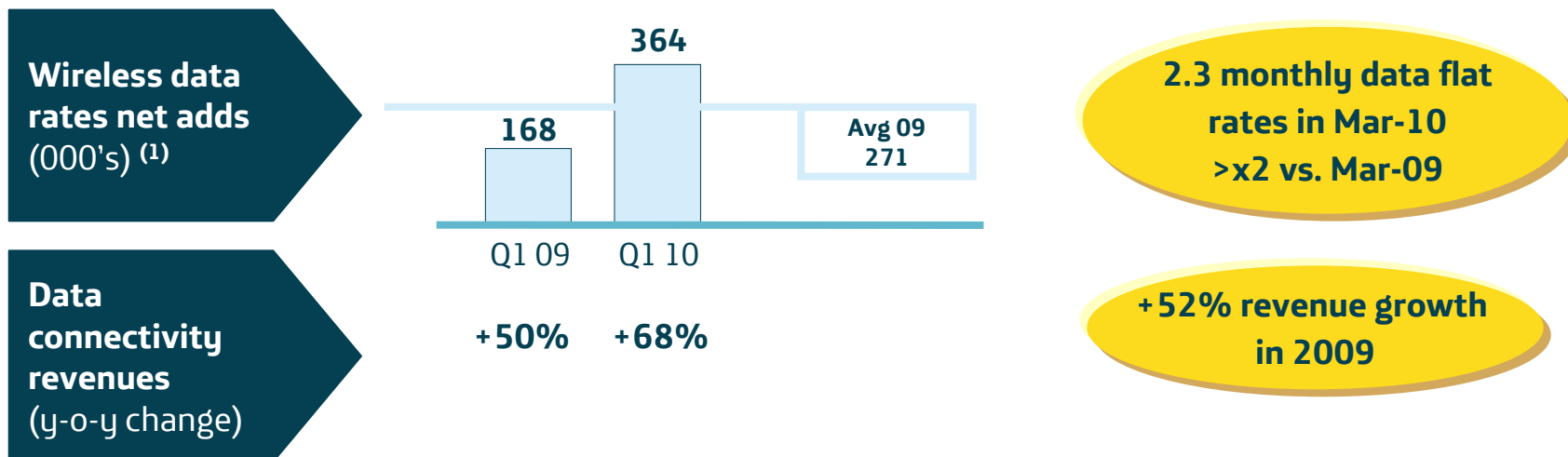
Competitive market pricing based on **tiered offers**, providing as much as possible on-demand:

- Bandwidth
  - QoS
  - Volume
  - Latency
  - Peak – offpeak ...
- XaaS (7)**

(1) Source: Gartner, "Forecast Mobile Devices World 2003-2013".  
 (2) MBB accesses: Including Big and Small Screen.  
 (3) MBB connectivity revenue: including Big and Small Screen, mobile email and WAP browsing revenues.  
 (4) Figures for guidance assume 2008 constant FX (average FX08) and exclude changes in consolidation.  
 (5) Smartphones includes High Tech.  
 (6) Telefónica estimates.  
 (7) XaaS: Everything as a service.

## 02 Massive MBB development (ii)

### ■ A reality even in a difficult environment: T. España



### ■ Tiered pricing in our markets: different customer needs, avoiding "all you can eat" tariffs

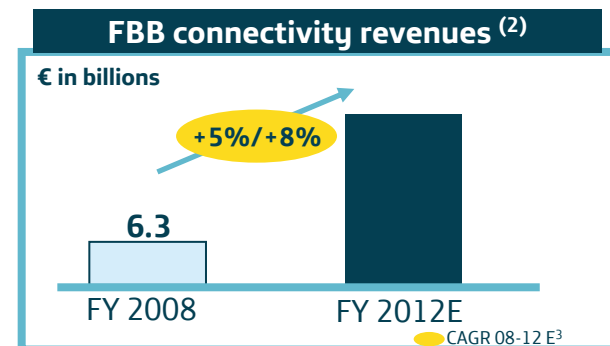
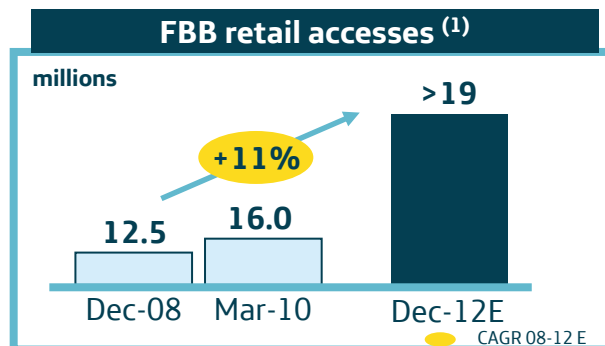
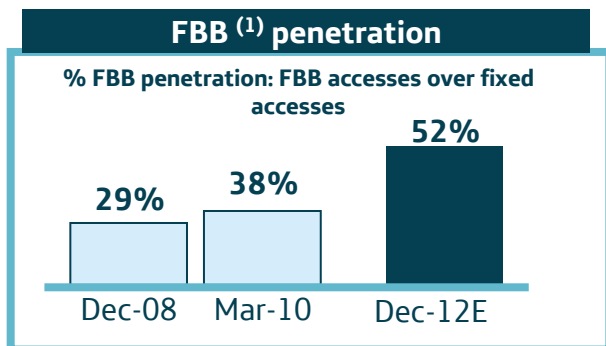
MEXICO (volume based)			SPAIN (Smartphone - traffic based profiles)			
Profiles	Allowance *	Price	Profiles	Max. down speed	Allowance*	Price
<b>Conecta</b>	300 Mb	x	<b>Int. Móvil (IM)</b>	1 Mbps	100 Mb	x
<b>Navega</b>	800 Mb	1.5 x	<b>IM Plus</b>	3 Mbps	200 Mb	1.5 x
<b>Descarga</b>	5 Gb	2.2 x	<b>IM Premium</b>	3 Mbps	1 Gb	2.5 x

*\*Fair usage policy rules applied. Additional modules are charged.*

*\*Unlimited volume. Download speed reduces to 64 Kbps when allowance volume reached. IM Plus and Premium includes unlimited access to Telefónica WiFi hotspots*



## 02 Further FBB expansion through DSL upgrade and selective FO deployment

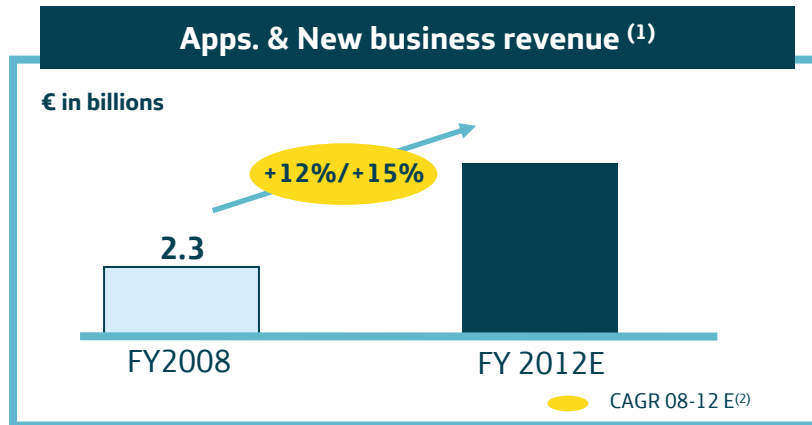


### DSL:

- Expand BB markets; low coverage areas and low income segments
- Tiered offer including Premium at high speed (>10 Mbps)
- **Selective FO** deployment (speed>25 Mbps)
- **Bundles across segments**

**Lines passed with  
> 25 Mbps in 2012  
> x9 vs. 2008**

## 02 Development of applications and new business



**Mobile Apps. Market  
from €6 bn to €17.5 bn  
in 2009-12(3)**

- **Mobile applications:** **>120m** Mobile applications downloaded in 2012E
- **Pay TV:** **>4.5m** Customers by 2012E vs. 2.3 m in December 2008
- **Digital Home** services
- **ICT solutions:** infrastructure alternatives, Cloud Computing, M2M, .....
- **New Business:** e-Finance, e-Health, e-Travel, e-Learning, e-Security, ...

**WAC**

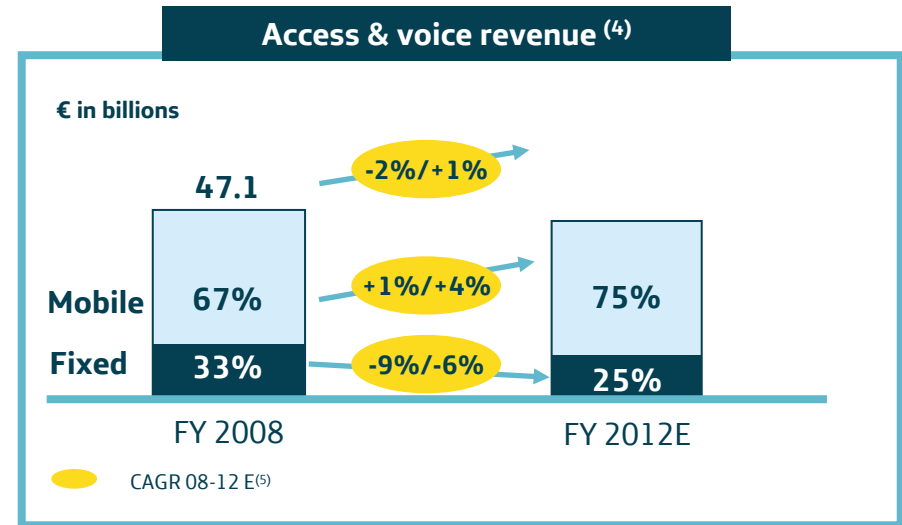
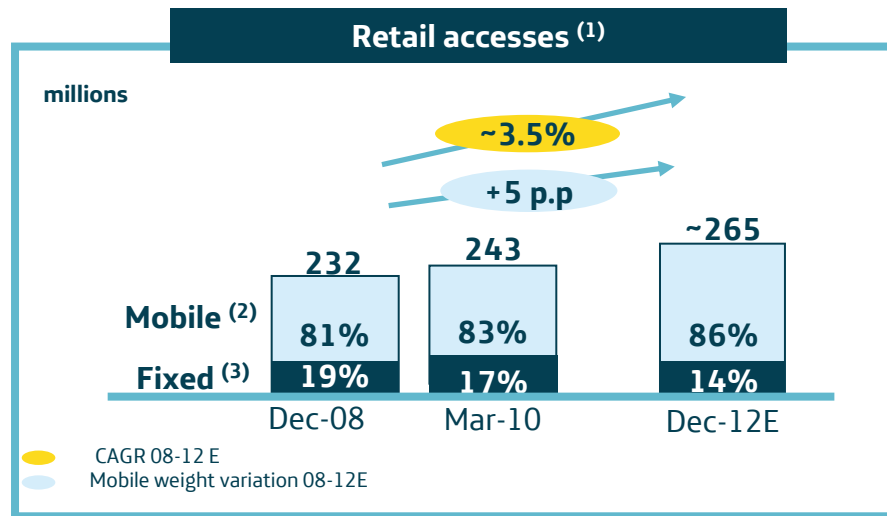
**Open platform**

**Over 30 telco players**

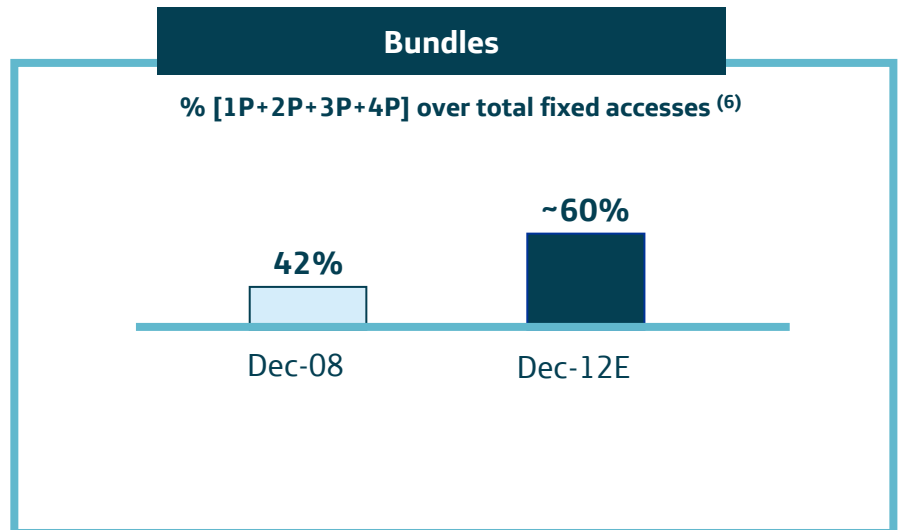
**4 global suppliers**

**3 Bn mobile customers**

# 02 Defense and growth of traditional business



- **Bundle access** with fixed and mobile voice to retain fixed voice only customers
- Capture **mobile penetration growth** opportunities (LatAm)
- Foster **prepay to contract migration**
- Innovative **tiered price plans**
- Increasing **loyalty**



(1) Morocco excluded in 2008 for comparison reasons.

(2) Mobile: Mobile voice accesses. M2M and small screen are included.

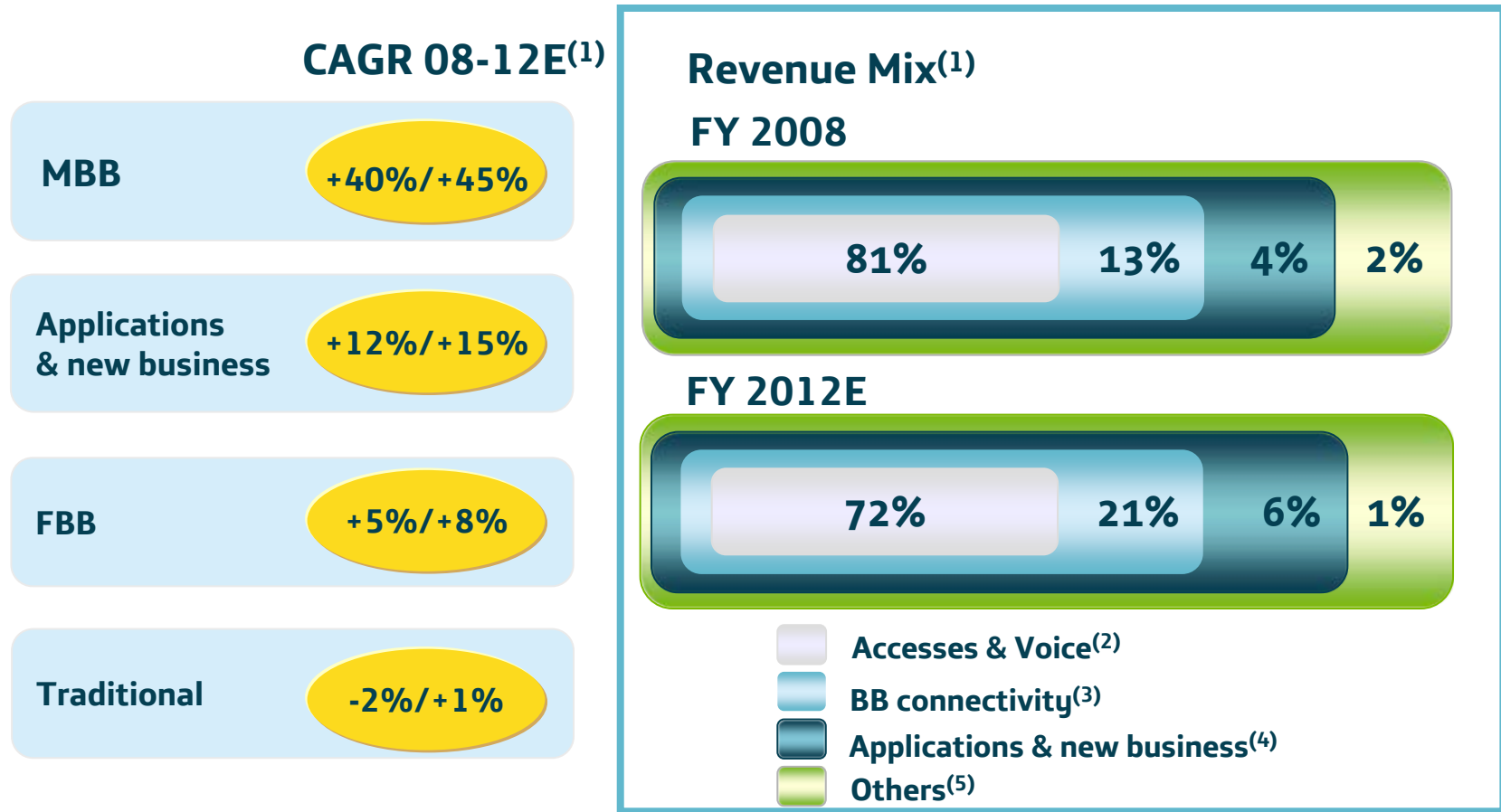
(3) Fixed: PSTN, Public Use Telephony, ISDN, Fixed wireless lines, self consumption, test and social interest lines, naked DSL, VOIP lines and narrowband internet accesses.

(4) Access & Voice: Fixed and mobile access & voice (SMS included), fixed & mobile equipment, narrowband internet and M2M revenue.

(5) Figures for guidance assume 2008 constant FX (average FX08) and exclude changes in consolidation.

(6) Ex-Public Use Telephony.

# 02 We will fully capture revenue growth potential in our markets



(1) Figures for guidance assume 2008 constant FX (average FX08) and exclude changes in consolidation.

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(5) Revenues from subsidiaries and other companies.

## 02 Medium term guidance will lead to a sustainable growth and an even lower risk profile

	2008 Adjusted <sup>(2)</sup>	CAGR 08-12E <sup>(2)</sup>
<b>Accesses</b> <sup>(1)</sup> (millions)	252	>320
<b>Revenues</b> € in millions	57,946	+1%/+4%
<b>OIBDA</b> € in millions	22,602	+2%/+4%
<b>OI</b> € in millions	13,556	+4%/+7%
<b>OpCF</b> € in millions	14,201	+5%/+7.5% Cumulative 09-12E >€64 bn
<b>CapEx</b> € in millions		~ € 30 bn Cumulative 09-12E

> € 40 bn  
Cumulative FCF <sup>(3)</sup>  
FY 2009-2012E

(1) Morocco Accesses excluded in 2008 for comparison reasons.

(2) 2008 adjusted figures for guidance exclude Sogecable gain (€143 m) and the application of provisions made in T.Europe in respect of potential contingences deriving from the past disposal of shareholding, one these risks has dissipated or had not materialized (€174m), includes 9 months of consolidation of Telemig in T.Latam. Figures for guidance assume 2008 constant FX (average FX in 2008) and exclude changes in consolidation. In terms of guidance calculation OIBDA exclude capital gains and losses from sale of companies and write-offs.

(3) Free Cash Flow available to remunerate Telefónica's shareholders, to protect solvency levels (financial debt & commitments), and to accommodate strategic flexibility. Figures assuming 2008 constant exchange rates (average exchange rates in 2008) and excluding changes in consolidation.

## 02 We have clear priorities for 2010

#1 Capturing top line growth prospects

- Reinvesting efficiency gains to foster revenue expansion
- Higher CapEx to support growth in customers & volumes

(€ in millions)

2009 Adjusted<sup>(1)</sup>

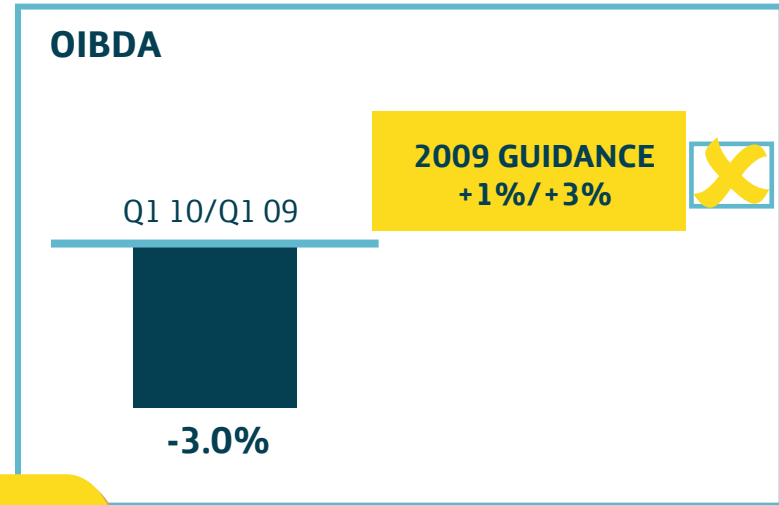
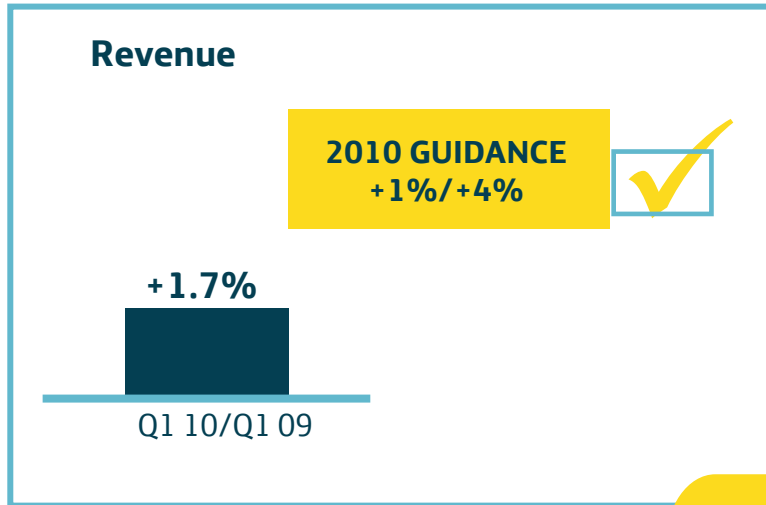
2010 Guidance<sup>(1)</sup>

Revenue	56,407	+1%/+4%
OIBDA	22,344	+1%/+3%
CapEx	7,262	7,450/7,650

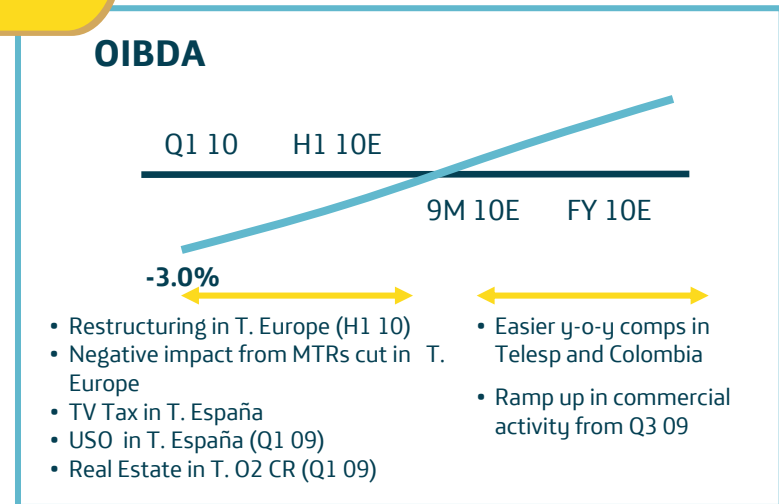
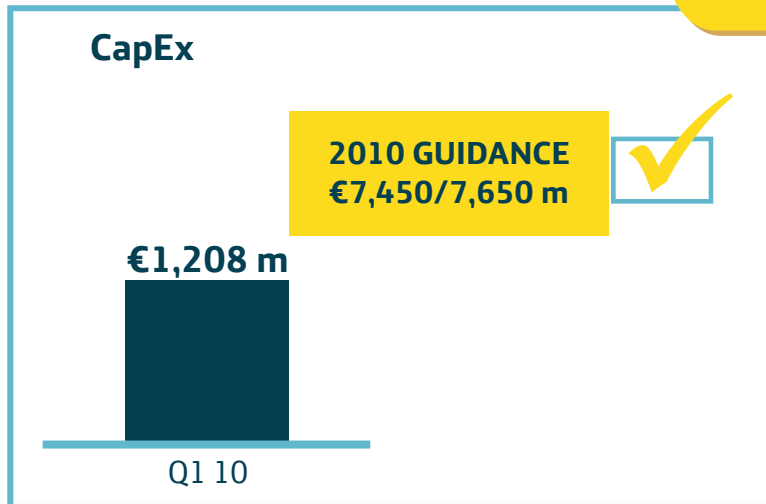
€2.10 EPS target confirmed

- On the back of the operating guidance provided, further efficiencies in taxes and financial costs and potential assets sales:
  - Interest expenses for 2010 are expected to be around 5.5%-5.75% (<6% guided in October 2009)
  - 2010 accrued tax rate is estimated at 25%-27% (vs. previous guidance of 27%-28%)
  - Continue to analyze value creation opportunities maintaining an active management of our non core asset portfolio

# 02 On track to meet 2010 guidance



**2010 EPS target confirmed (€ 2.1)**



## 02 We maintain our selective M&A approach

### M&A Priorities

- **Spectrum auctions in current markets to foster growth:**
  - Germany & Mexico in H1 2010
  - Potential awarding process in Spain along 2010
- **In-market consolidation:**
  - Offer for PT's stake in Brasilcel
  - Hansenet acquisition closed on February 16<sup>th</sup>
- **Increase shareholding in China Unicom to 10%**



### Continue capturing synergies from our Strategic Alliances



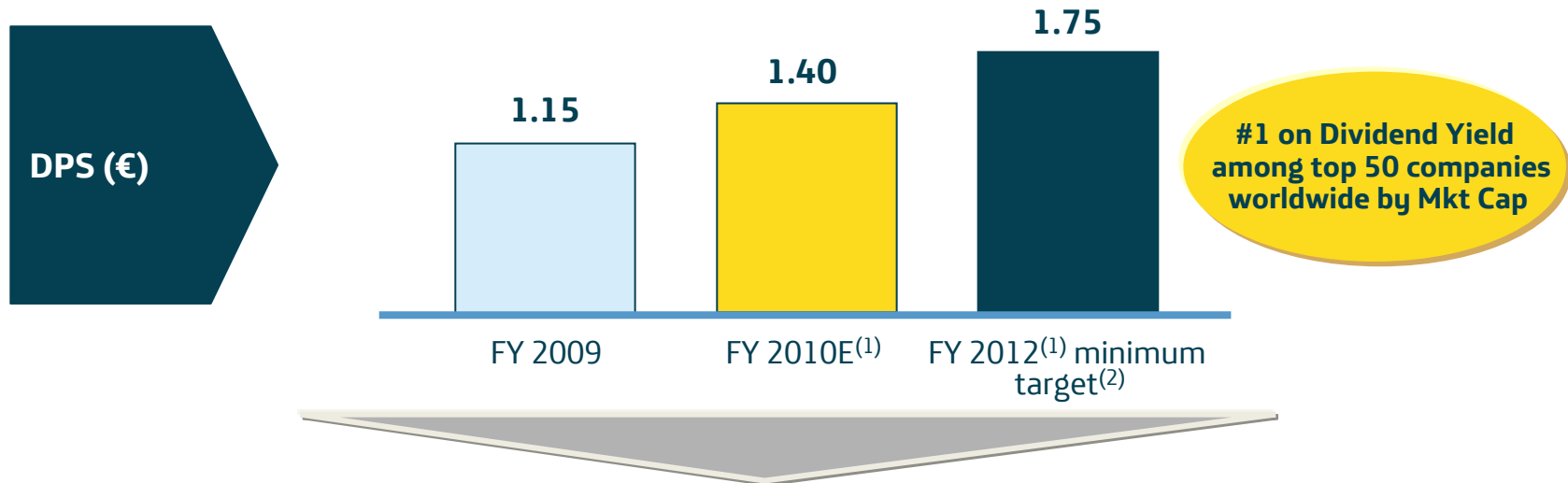
€740 m cash synergies<sup>(1)</sup> since Mar-08



- >670 million combined customer base<sup>(1)</sup>



## 02 Dividend commitments are supported by our FCF generation



- DPS targets reiterated
- Dividend is well covered
- No dependence on cash repatriation from any particular country in Latin America



**Tactical share buybacks to be considered for FCF excesses**

- 0.6% of capital held in treasury
- Derivatives on 150 m shares as of 31/12/09

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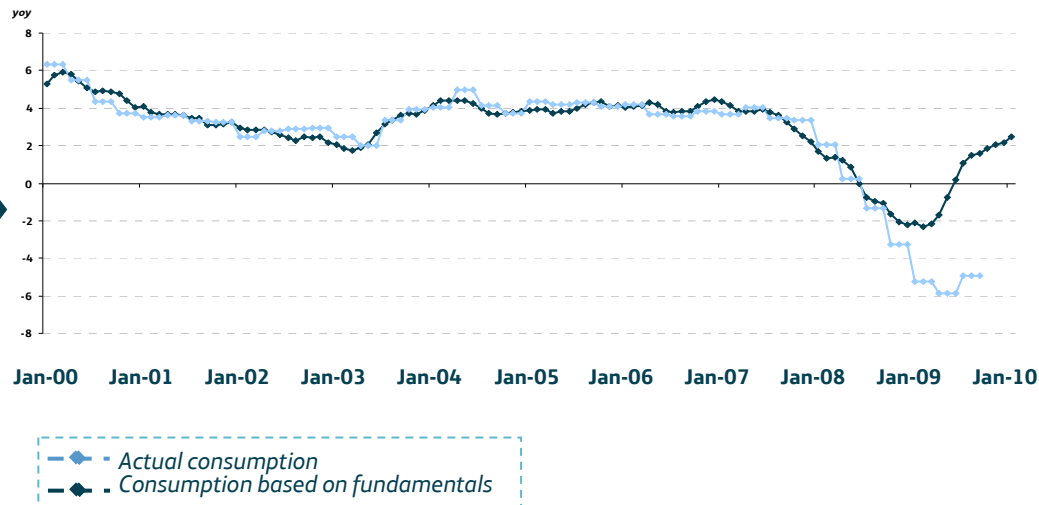
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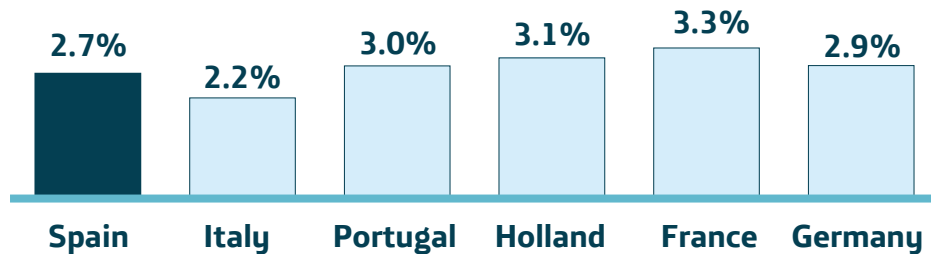
# 03 Macroeconomic situation

## Consumption growth (%)



**Spain: consumption growth far from fundamentals**

## Household consumption in communications (% of total spending) <sup>(2)</sup>



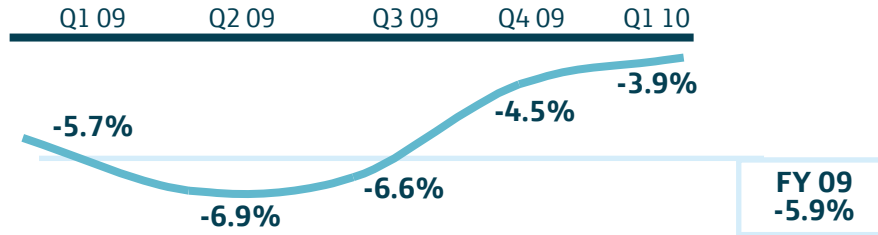
**Below the European average**

**Number of households:  
+226K in 2009**

# 03 T. España: continued top line recovery

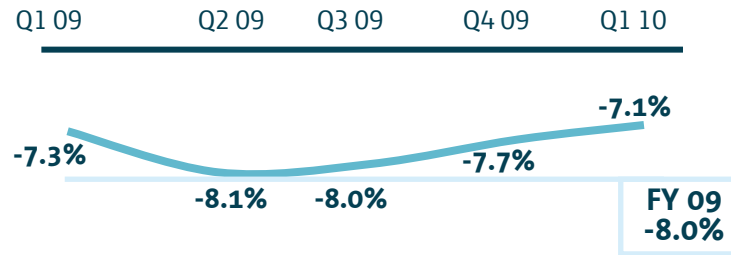
## Revenues

(comparable y-o-y change)



## Wireless

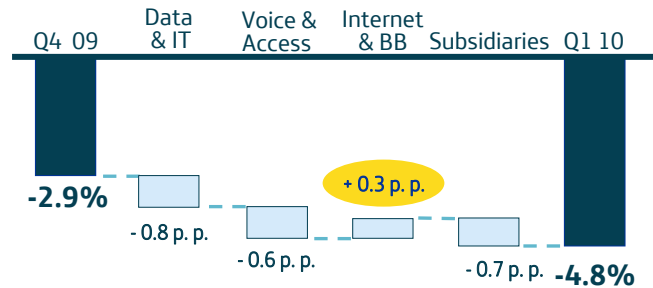
(Service revenues)



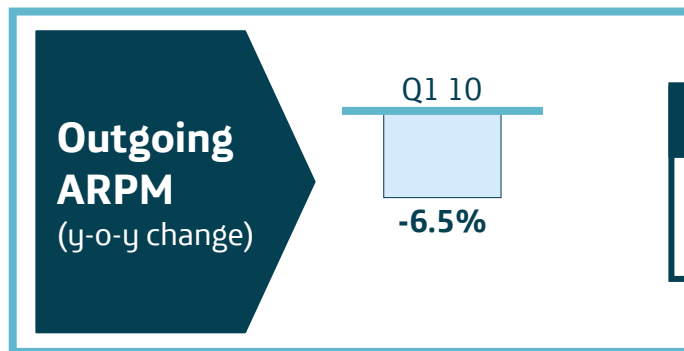
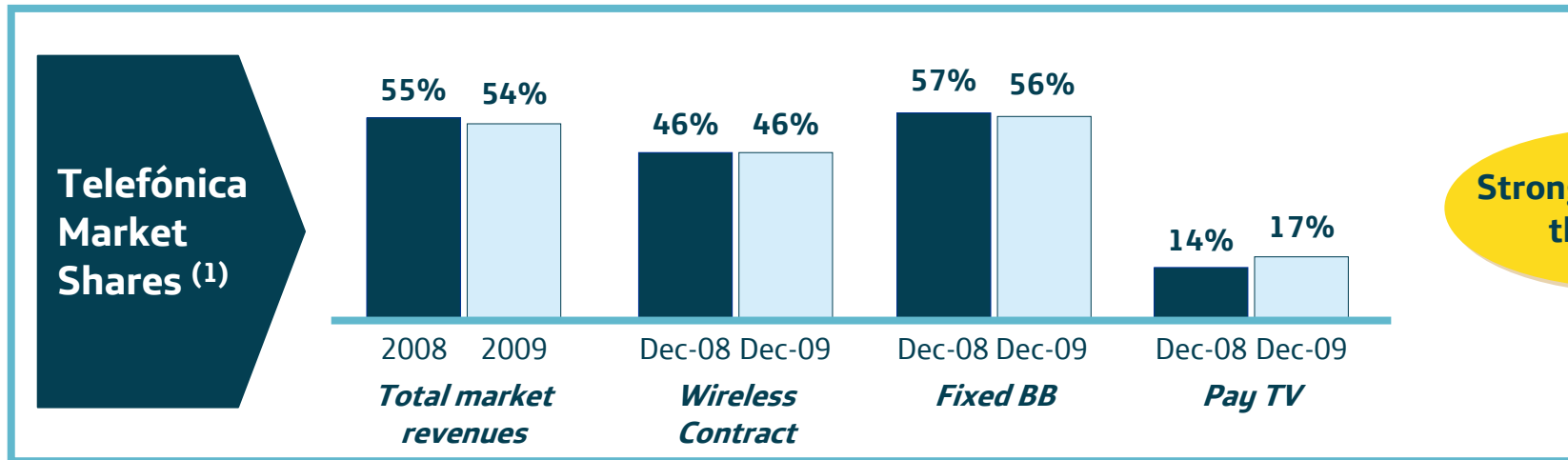
**Top line gradual recovery,**  
lowest revenue decline for  
the last five quarters

## Wireline

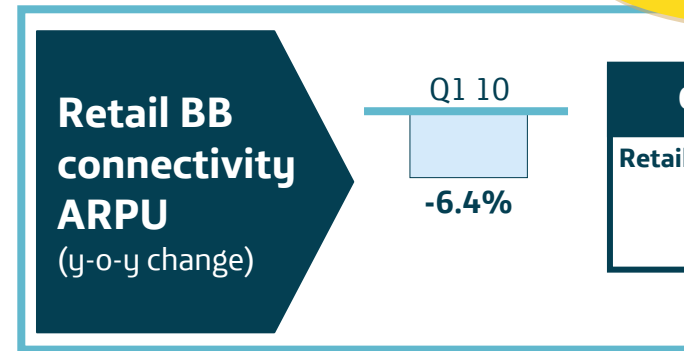
(comparable)



# 03 Competitive environment: is there a price war in Spain?



**Oct-07 ID target**  
Outgoing ARPM  
-5% / -7%  
CAGR 06-10 E

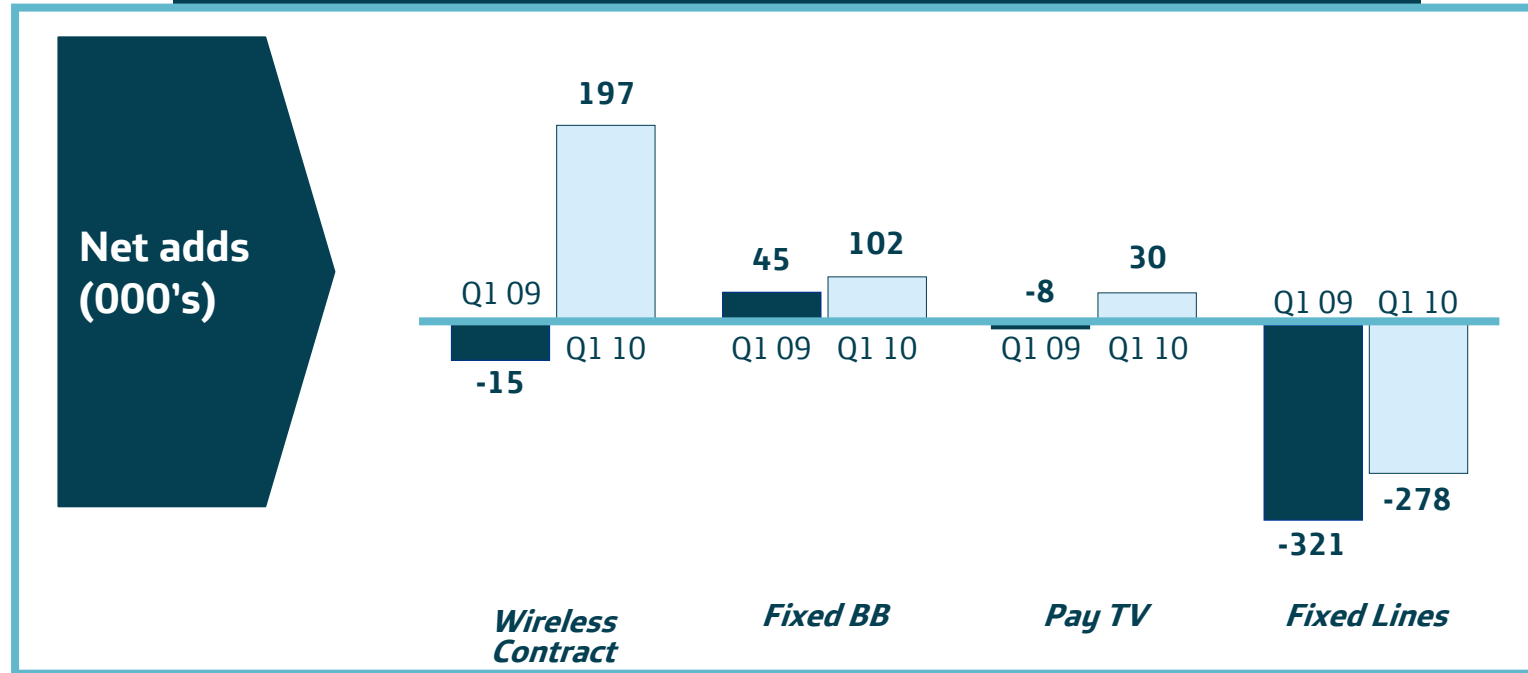


**Oct-07 ID target**  
Retail BB connectivity ARPU  
-4% / -7%  
CAGR 06-10 E

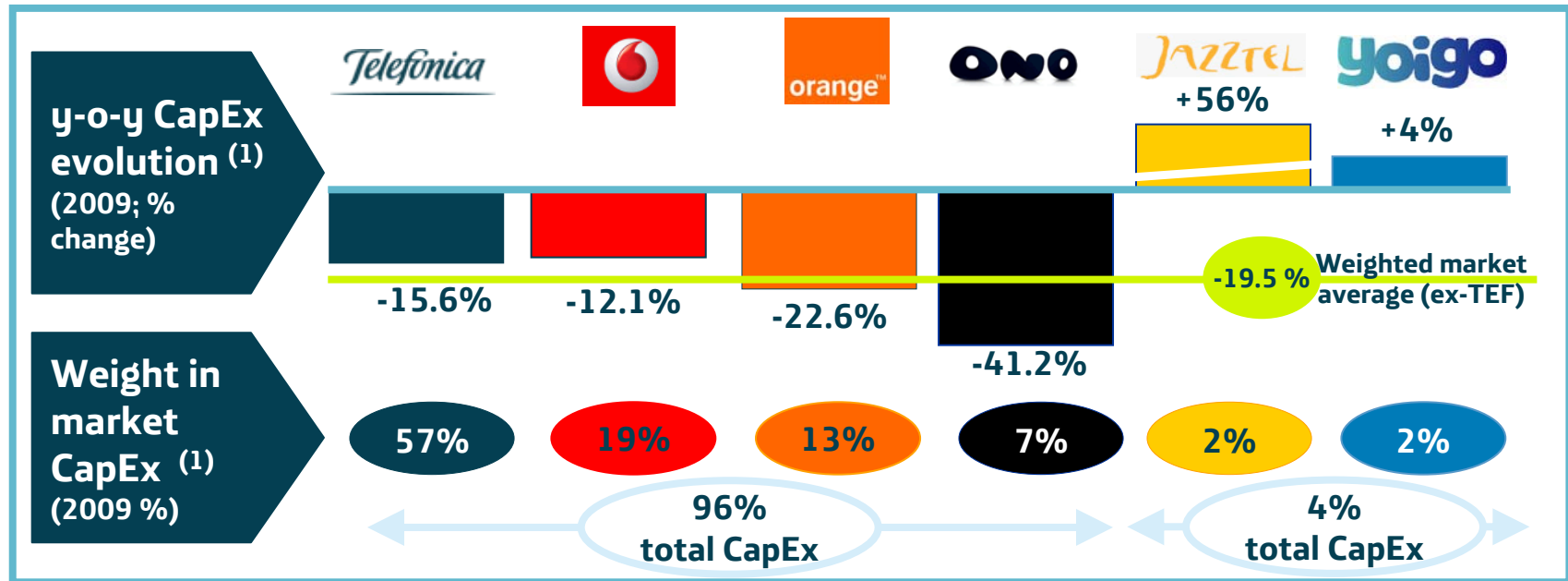
**Rational pricing environment**

# 03 Strong commercial activity across businesses

## Building foundations for future revenue growth



# 03 Are you under investing?



TEF ACHIEVING HIGHER EFFICIENCIES BASED ON

- Reduced prices on scale benefits
- Integrated player approach strategy
- Lower economic activity
- Lower eGSM investments
- Reduced Real Estate activity

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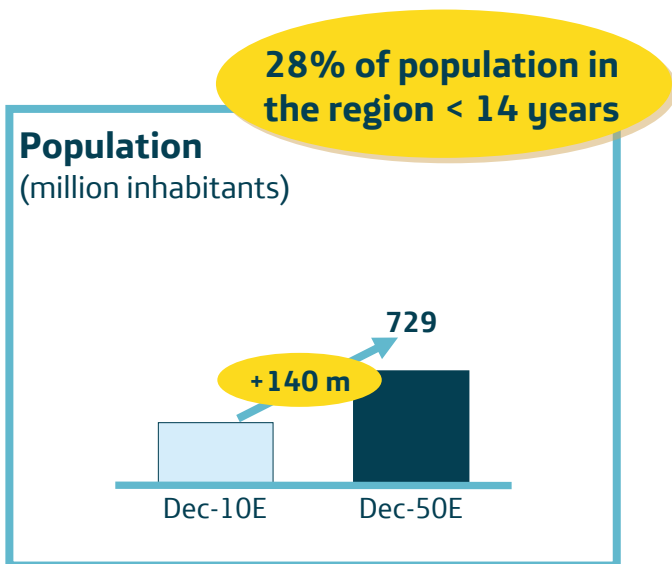
## **05 T. Europe:**

- i. How are you going to deliver growth in UK and Germany?

## **06 Conclusions**



## 04 Is LatAm growth potential exhausted?



### ■ Macroeconomic strength:

- >5% annual GDP growth in 2004-08, but -2.3% in 2009E
- >3.7% GDP growth in 2010E & 2011E

### ■ Structural social improvements in the growth period:

- **Unemployment reduced** from 11% to 7.5% since 2002
- **> 50 m people have left poverty** since 2000
- **Brazil: Middle & upper class ascent** even in the crisis period

### ■ Countries > US\$ 10 thousand GDP per capita PPP<sup>(1)</sup> represent 75% of total

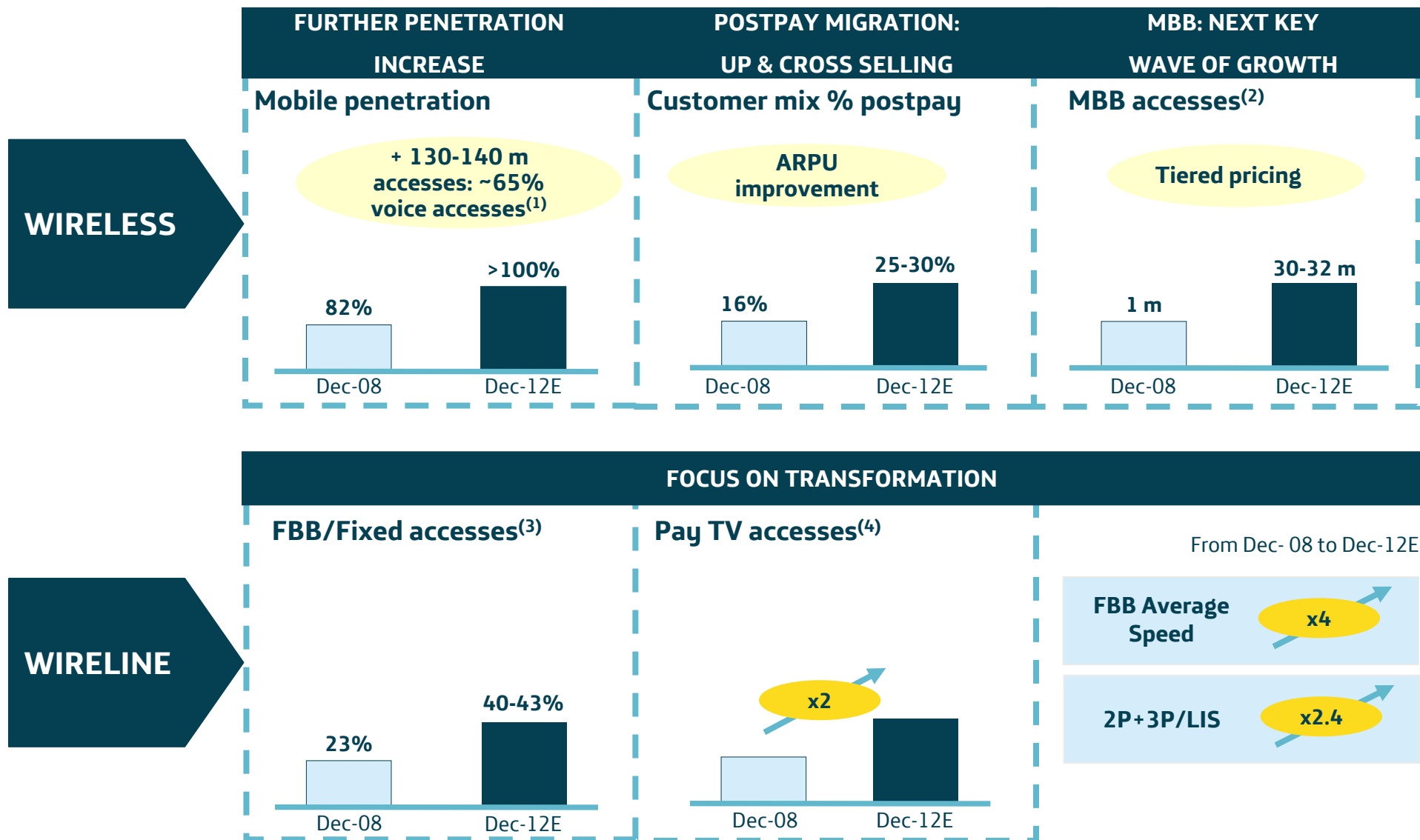
- >US\$780 bn<sup>(2)</sup> increase in **Private Consumption** from 90s to 2009E

### ■ 80% of Latam population is urban

- 5 of the biggest cities worldwide in Latam

**HUGE POTENTIAL FOR CONSUMPTION**

# 04 What are the growth opportunities in the region?



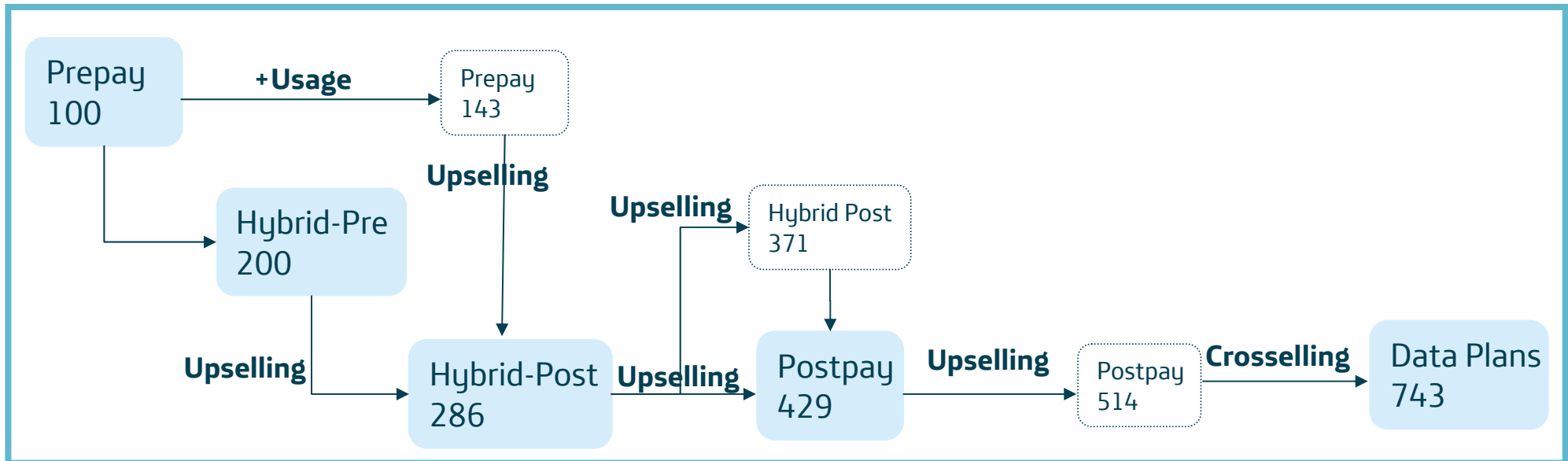
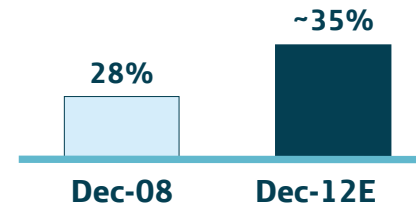
# 04 ARPU upside through up & cross selling in a more mature market

## EXAMPLE (1)

### Outgoing ARPU evolution in Chile, Jul-09 (Index)

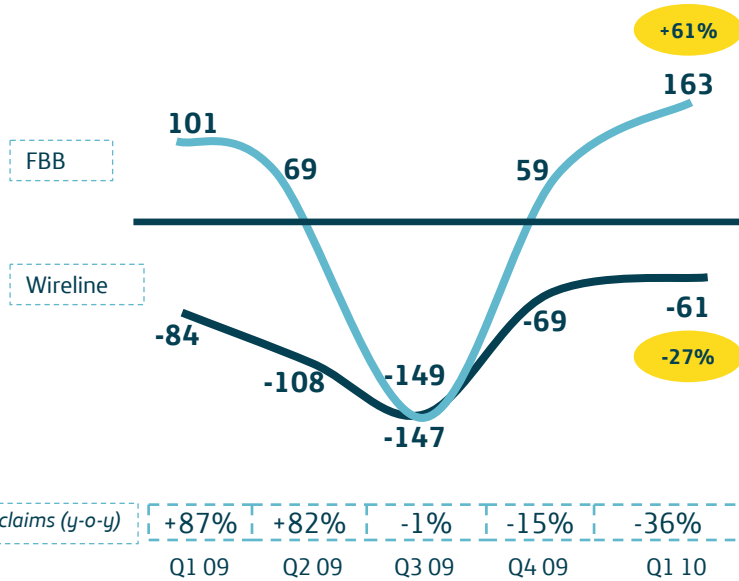
- 106% penetration
- Strong customer growth in the market
- Lowest churn in the region

#### Customer mix (% Postpau)



# 04 Telesp gradual recovery

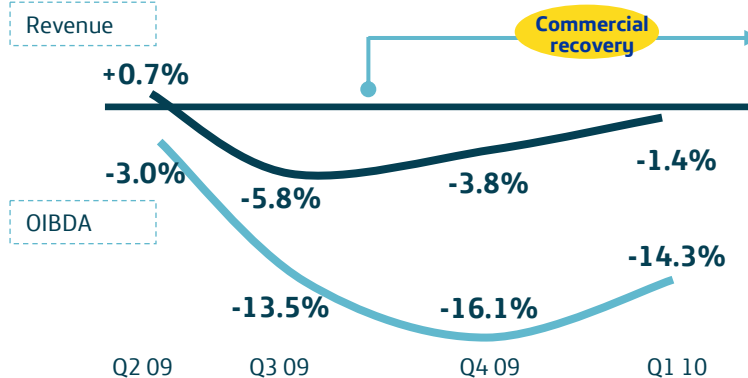
## Best Q1 in history for FBB



Net adds  
(000)

y-o-y growth

Financials  
(y-o-y in local  
currency)



### Gaining commercial momentum:

- Total accesses growth for the 1<sup>st</sup> time since Q3 08
- Limited activity in Jan-10 on heavy rains
- Positive fixed line net adds in March & April
- Strong BB churn reduction
- FBB net adds in Q1 10 is 2x FY 09 volume
- Close to 50% of Q1 10 net adds recorded in Mar-10
- Recovering market share
- Stable CapEx/sales: 13.5% last twelve months

- **Improving revenue trend** towards positive growth
- **Lower churn** levels should reduce commercial expenses going forward
- **OIBDA impacted by increased activity and heavy rains**

## **01 Industry: Is there growth in the Telecoms sector?**

## **02 Telefónica Group:**

- i. Will Telefónica maintain its differential growth profile?
- ii. Is your dividend policy sustainable?
- iii. What are your M&A ambitions?

## **03 T. España:**

- i. Macroeconomic situation
- ii. Revenue performance: is the worst over?
- iii. Competitive environment: is there a price war in Spain?
- iv. Commercial activity across businesses
- v. Are you under investing?

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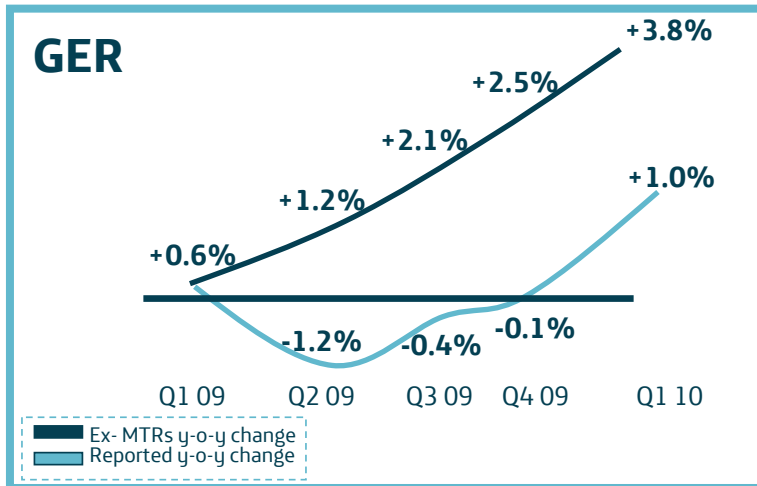
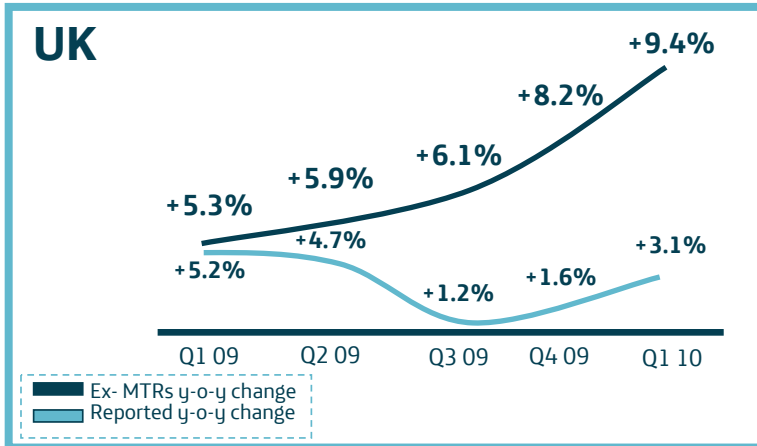
## **05 T. Europe:**

- i. How are you going to deliver growth in UK and Germany?

## **06 Conclusions**

# 05 How are you going to deliver growth in UK and Germany?

## Q1 10 Mobile Service Revenue Growth (y-o-y ; local currency)



### ■ Base expansion & Mobile internet driving growth

- Quality base improvement: 86% of Q1 mobile net adds in contract
- “Home of Smartphones”: over 7 m MBB in Q1, positively impacting ARPU & churn

### ■ UK: customer focus consistency, growing quality base

- Keeping customer experience & contract churn leadership
- Total ARPU up 2.7% y-o-y ex-MTR in local currency on higher contract and robust non-P2P SMS data growth
- Leveraging rational commercial and network investments for capacity. Investing for capacity: 1,500 additional BSs in 2010 and improved network management (e.g. disconnecting abusers of fair use policy, encourage uptake on WIFI, apps/services to notify customers)

### ■ Germany: challenger on P/S innovation and best-in-class network

- Quality and choice offer (“My Handy” & “O2o”)
- Setting the market context as the disruptive player (O2o, O2On)
- Already solid #3 position in MBB; spectrum in 800 MHz, 2.0 GHz and 2.6 GHz band already secured. Total investment: 1.38 billion euros
- Acquisition of Hansenet: enhanced integrated approach; cross-selling potential and reduce churn

## **01 Industry: Is there growth in the Telecoms sector?**

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## **06 Conclusions**

- **One of the best positioned players to take advantage of the growth industry**
- **Top quality performance in 2009 in a very challenging environment**
- **On track to meet 2010 positive guidance**
- **Very attractive medium term guidance reiterated**
- **Sector leading cash return. DPS targets confirmed**
- **Selective M&A policy maintained**



*Telefónica*

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