Results

January-June 2011

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H1 11 Highlights

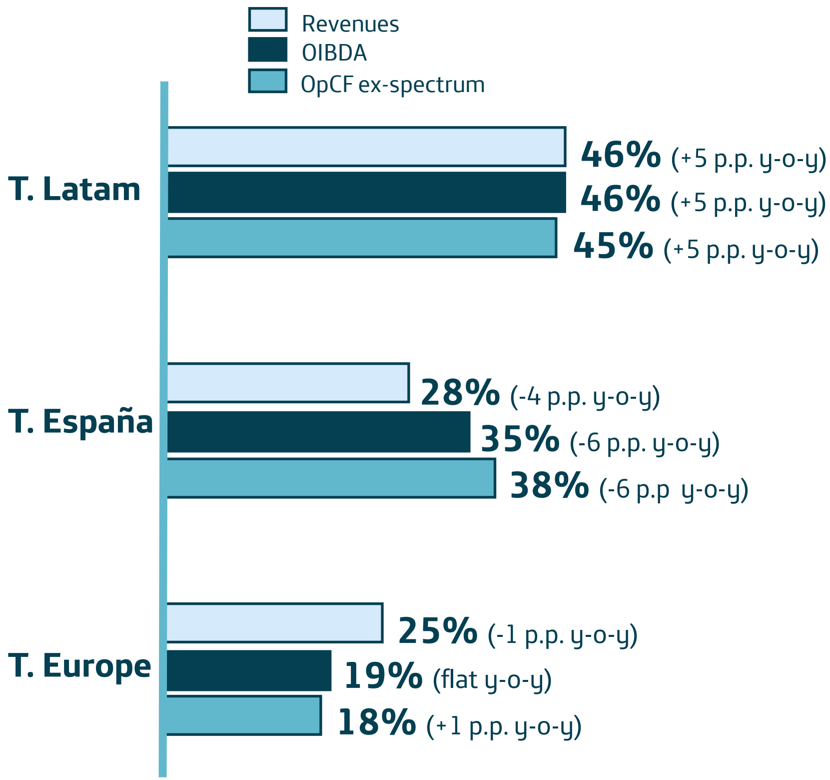
- **Performance consistent with FY 2011 guidance, outlook reiterated**
- **Strong revenue growth (+6.3%) amid challenging conditions & severe regulation**
  - T. Latam ex-Mexico revenue remains very robust (+20.9%)
  - Fast growth in mobile data revenues (+18.5%)
- **Retaining benchmark profitability, limited year-on-year erosion:**
  - Sequential OIBDA margin expansion to 37.1% in Q2 despite higher commercial activity
  - T. España's y-o-y OIBDA performance in Q2 unchanged from Q1
- **≈45% of revenues, OIBDA & OpCF came from T. Latam, driven by Brazil**
- **DPS targets reiterated**
- **Further progressing in cash generating initiatives, proving strong execution skills**
  - New Social Agreement in Spain, higher than expected synergies in Brazil, "Partnership Program"

All figures refer to H1 11 and y-o-y changes in reported terms.

Key financials

€ in millions	Jan-Jun 2011	Change y-o-y	Organic change
Revenues	30,886	+6.3%	+0.9%
OIBDA	11,304	+3.7%	-2.2%
OIBDA Margin	36.6%	-0.9 p.p.	-1.1 p.p.
Operating Income (OI)	6,348	-1.7%	-3.0%
Net income	3,162	-16.3%	
OpCF (OIBDA-CapEx)	7,466	-1.3%	-5.7%

Broad diversification (H1 11)

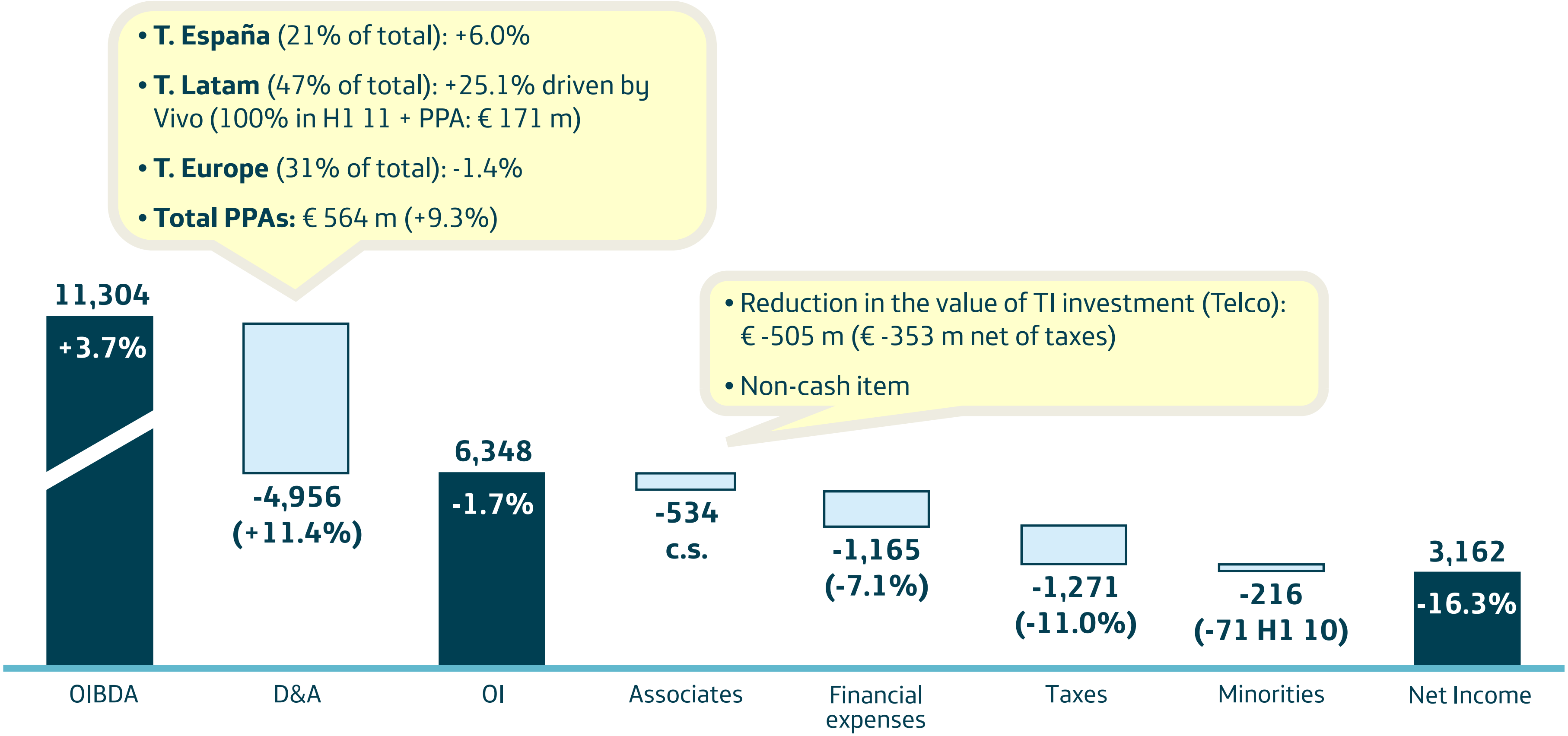


- **Growth in nominal rates is impacted mainly by the full consolidation of Vivo from Q4 10**
- **Solid performance leveraging diversification**

Organic growth: assumes constant average exchange rates as of H1 10 and excludes changes in the perimeter of consolidation and hyperinflation accounting in Venezuela. Further details included at the end of the document.

Net income mainly affected by a non-recurrent effect

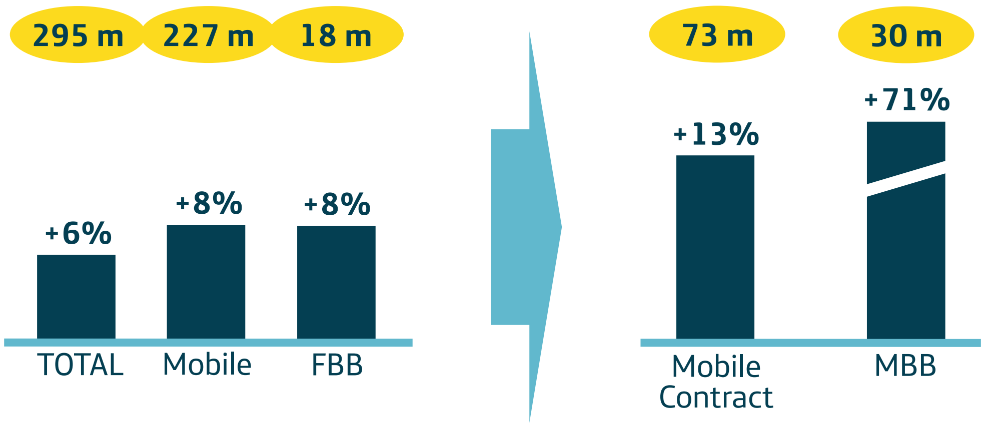
Jan-Jun 2011
€ in millions (y-o-y change)



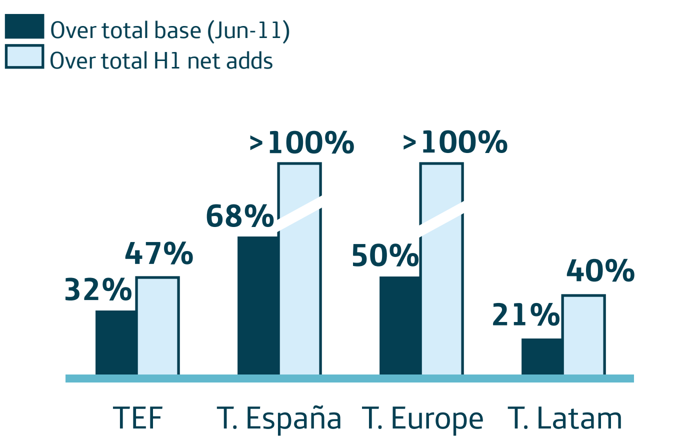
H1 11 EPS reached € 0.70 (€ 0.88 ex PPAs and Telco one-off)

Building consistent "value over volume" commercial strategy

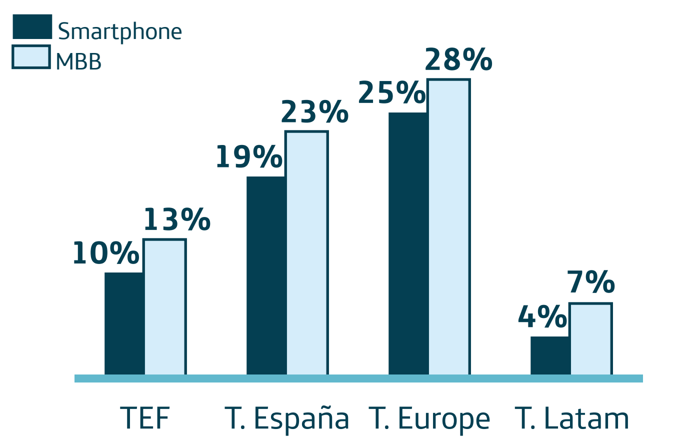
Accesses (Jun- 11 y-o-y)



Mobile contract base



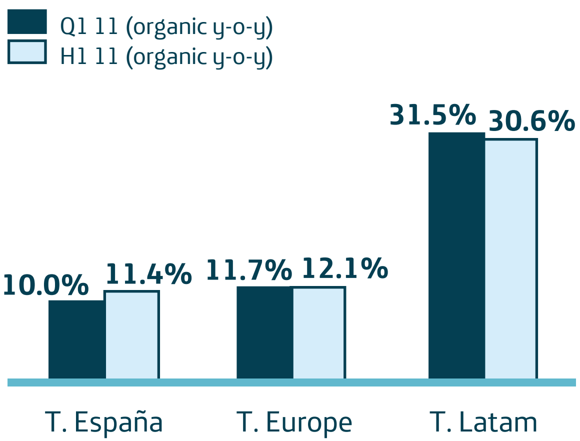
Data penetration (Jun- 11)



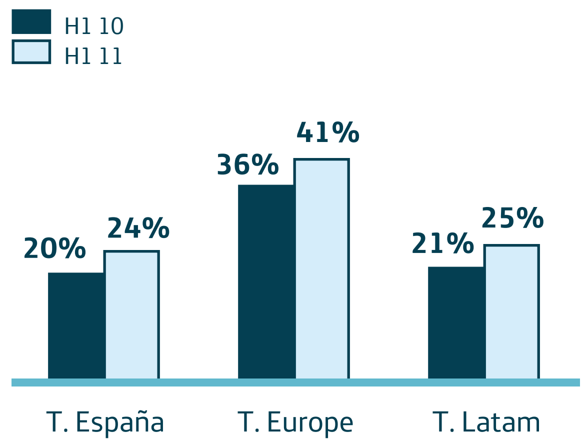
MBB penetration: MBB accesses (dongles and smartphones) with data attached rate/total mobile customer base.
Smartphone penetration: Smartphones with data attached rate/total mobile base excluding dongles and M2M.

Strong mobile data momentum, fast revenue growth

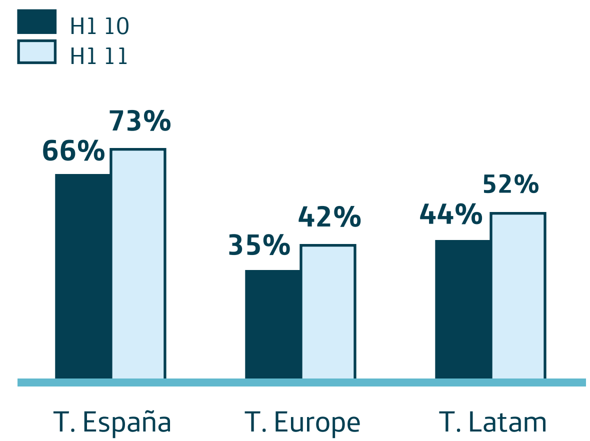
Mobile data revenue growth



Mobile data/MSR

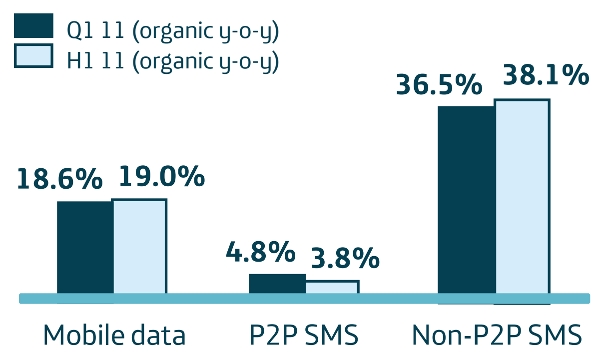


Non-P2P SMS/Mobile data revenue



- **Sustained strong revenue growth across regions leveraging increased MBB penetration and tiered pricing**
- **Mobile data revenue accounts for 30% of MSR (+4 p.p. vs. H1 10)**
- **Limited SMS cannibalization risk from new technologies on the back of:**
  - Right bundling plans (including voice, SMS and mobile data) and/or already high contribution from non-P2P SMS (i.e. Spain)

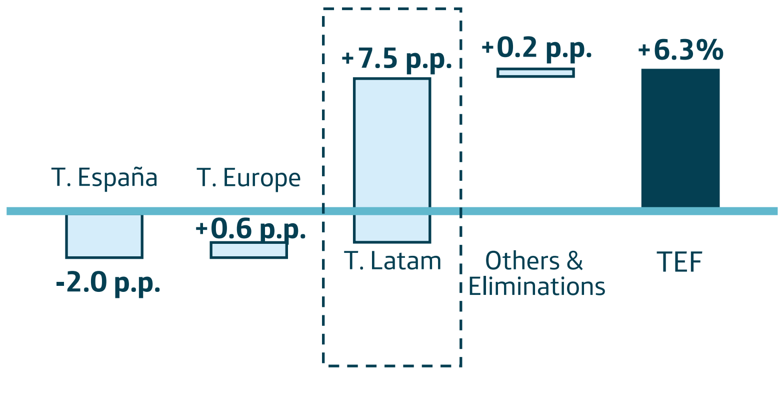
TEF mobile data revenue growth



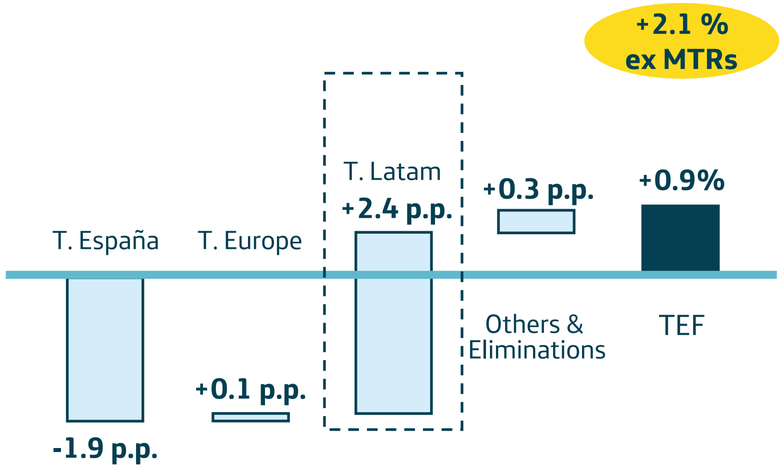
Aggregate figures for Group mobile service revenue, mobile data revenue, P2P SMS and non-P2P SMS data revenue.

Increasingly capturing growth opportunities

Contribution to H1 11 revenue growth



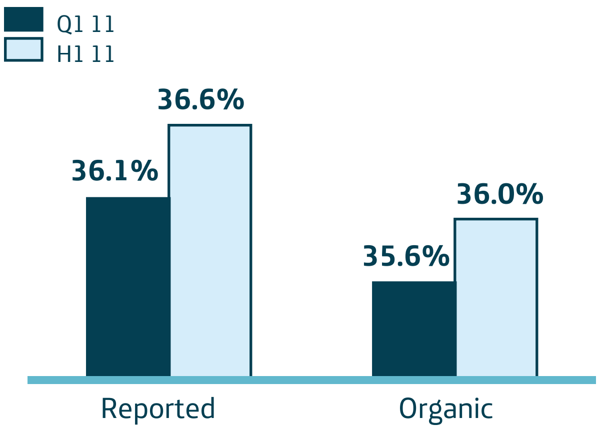
Contribution to H1 11 organic revenue growth



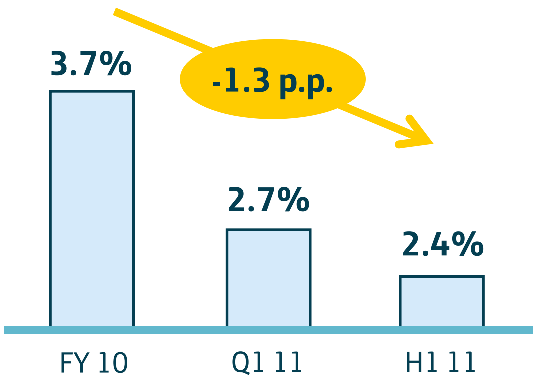
- **T. Latam boosts Telefónica growth**
- **Solid BB & Services Beyond Connectivity revenue (+20% y-o-y) reach 26% of total sales in H1 11, offsetting lower access & voice revenue**

Healthy profitability sustained

OIBDA margin



OpEx growth (y-o-y organic)



- **Sequential OIBDA margin improvement despite increased commercial activity**
- **Limited y-o-y margin erosion in H1 (≈1 p.p.) both in reported & organic terms**
- **Commercial investments in high value customers & MBB offset by strong cost efficiencies:**
  - Higher commercial costs (+2.9% organic y-o-y) & IT / Network costs (+6.5% organic y-o-y), linked to revenue growth
  - Interconnection costs down 2.3% due to MTRs cuts
- **Further benefits from integrated management, scale and scope (€ 230 m in H1 OIBDA from global projects)**

On track to meet full year outlook

	2011 Guidance	H1 11
Revenues	Up to 2%	0.9% ✓
OIBDA Margin	Upper 30s Limited erosion y-o-y	36.0% (-1.1 p.p) ✓
CapEx	€ ~ 9,000 m	€ 3,298 m ✓

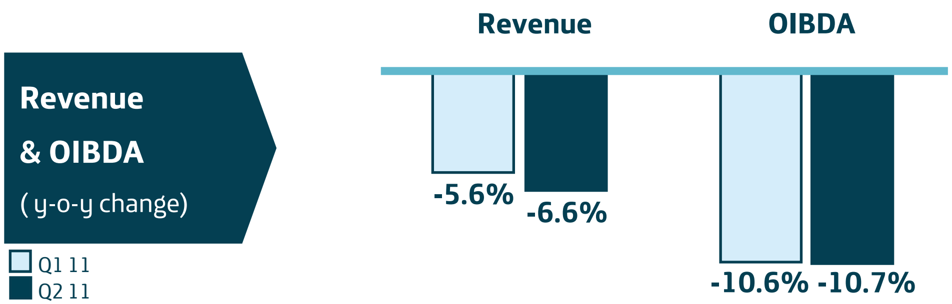
H2 11E

- Solid growth in Latin America despite MTR cuts in Mexico, fully capturing integration synergies in Brazil
- No further deterioration in OIBDA y-o-y change leveraging sale of non core assets in Spain, as announced in April (I. Conference: € 600 m cash-proceeds in FY 11-13E)
- Steady performance at T. Europe

Figures according to guidance criteria.

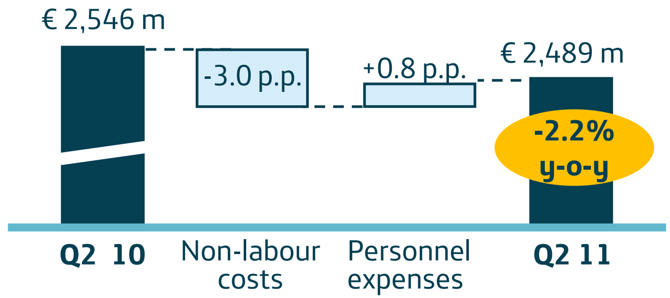
T. España: Contained OIBDA decline in a challenging environment

Revenue & OIBDA (y-o-y change)



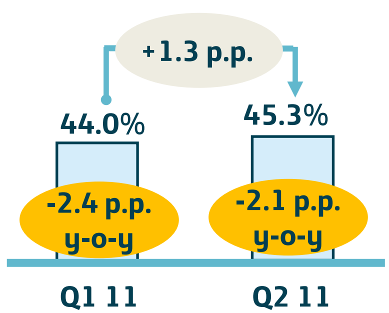
- **Revenue** impacted by volatile consumer trends amid weak confidence in a very competitive market
- **Focus on "value over volume"** led to lower gross additions but **better churn**
- **Contained sequential OIBDA y-o-y erosion**

OpEx



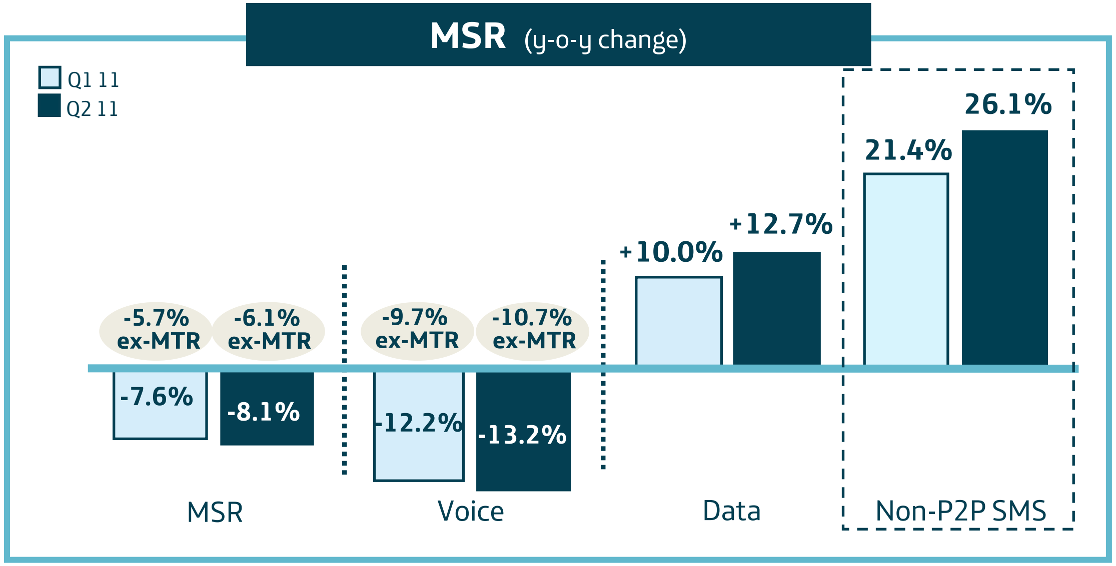
- **Flexibility to further reduce costs:**
  - 2.2% y-o-y drop in Q2 (-0.7% in Q1)
  - Labour costs rise driven by 2010 CPI
  - Commercial costs biased towards retention & MBB

OIBDA margin

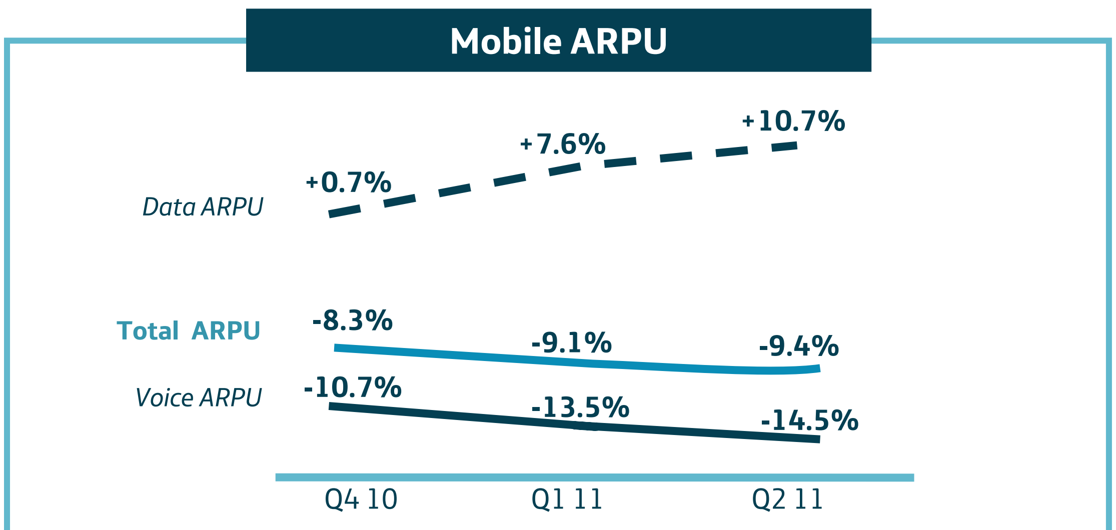


- **Sequential improvement in margin, limiting y-o-y erosion:**
  - 44.7% in H1 11 (-2.3 p.p. y-o-y)
- **CapEx** (+8.7% y-o-y) **focused on Total BB** to deliver top quality service

Sustained solid momentum in mobile data



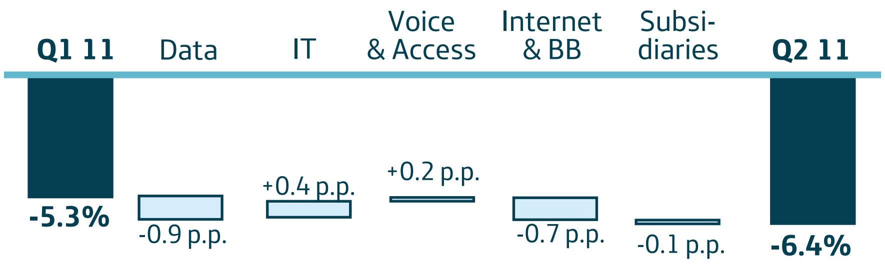
- **Decrease in voice revenues driven by lower outgoing ARPU and MTRs cuts**
- **Ramp-up in data revenue growth led by higher MBB adoption:**
  - MBB penetration up 7 p.p. y-o-y to 23%
  - Strong H1 non-P2P SMS accounting for 73% of data sales
- **Data revenues already 24% of MSR**



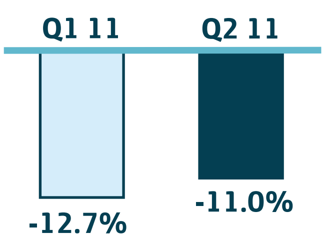
- **Voice ARPU** erosion impacted by usage optimisation, strong price competition and MTR declines
- **Outgoing voice ARPM decline eased** (-6.8% y-o-y in Q2 vs. -7.6% in Q1)
- **Solid Data ARPU** growth, ramping-up sequentially

Continued pressure in fixed line, more rational FBB market

Fixed Revenue (y-o-y change)



Retail FBB ARPU (y-o-y change)



- **Solid growth in IT continues at 14.6% y-o-y in H1 11**
- **Internet & BB revenue** driven by ARPU erosion and lower commercial activity:
  - Focus on value and fewer promotions led to lower gross adds
  - Improved churn on higher customer satisfaction
  - Solid leadership: 51% market share
  - More rational market post ULL price increases
- More than **65% of line losses offset by wholesale**

New Social Agreement will lead to higher flexibility and efficiency gains

Conditions

Workforce Reduction Plan

- Voluntary, universal and non discriminatory
- Agreed with unions & approved by labour authorities
- Up to 6,500 employees (27,896 headcount in June 2011)
- 3 years plan (2011-2013)
- Minimum age: 53 years
- 68% of salary until age of 61; 34% from 61 to 65
- Average cost /employee (€ 415 K[1]), including unemployment benefits covered by TEF

New Collective Agreement

- Covering 2011-2013
- Salaries linked to Company's OIBDA targets for the first time, rather than exclusively to CPI

Workforce Reduction Plan impacts

P&L

- **One-off cost to be recorded in H2 11:**
  - Current value of the cost of ERE (€2.7 bn before taxes[1]) to be booked as personnel expenses
- **Efficiency gains from recurrent savings in OpEx** (Personnel + G&A) in coming years

Cash-flow generation

- **Cash Flow positive since year 1:**
  - Savings in personnel expenses + G&A expenses > payments to pre-retirees – tax effect

Leverage

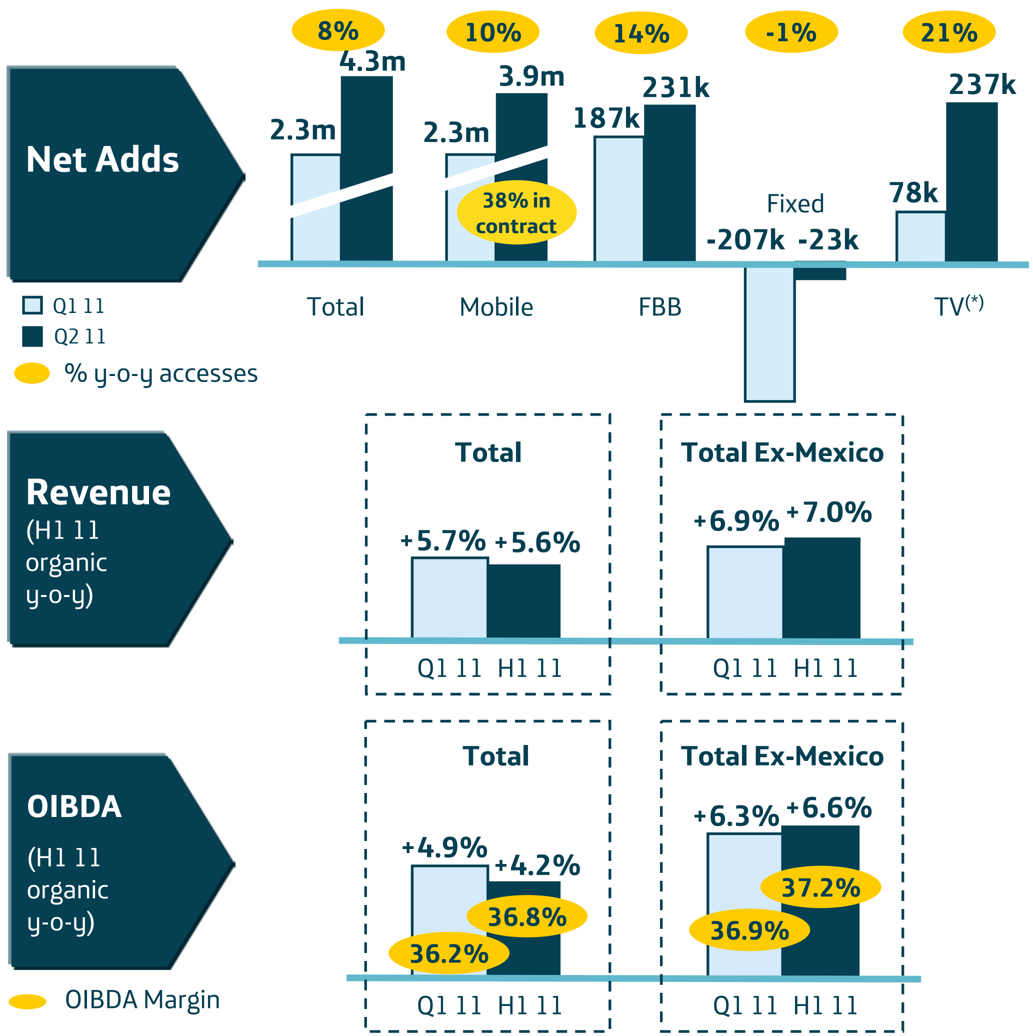
- Related liabilities (committed payments) to **gradually increase TEF leverage** as employees join the program

Impacts not included in guidance

€ 1.4 bn of excess cash at end of Plan[1]

1. NPV.

T.Latam: Strong commercial momentum and robust profitability

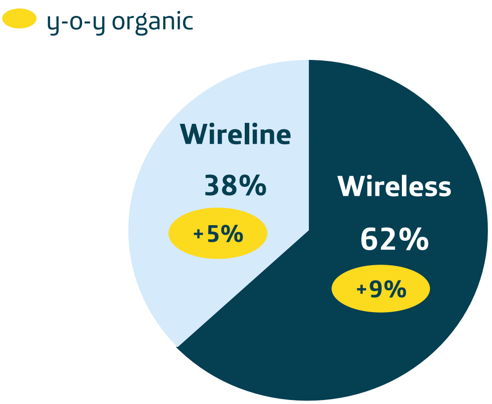


- **Strong commercial activity in Q2 11**
- **Solid top line growth:**
  - Brazilian revenues speeding up consistently
  - Southern Region keeps a solid pace
  - Weak financials in Mexico but improved commercial momentum
  - New regional initiatives dragging y-o-y growth. Focus on delivering results
- **Q-o-q OIBDA margin expansion** and limited y-o-y erosion (-0.5 p.p. organic) despite higher commercial activity

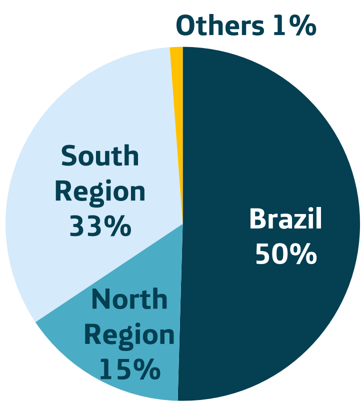
Organic growth: assumes average constant exchange rates as of H1 10 and excludes changes in the consolidation perimeter and hyperinflation accounting in Venezuela in both years. Further details included at the end of the document.
(*) Pay TV include 150 thousand accesses from TVA consolidation.

T.Latam: Data revenues drive growth across businesses

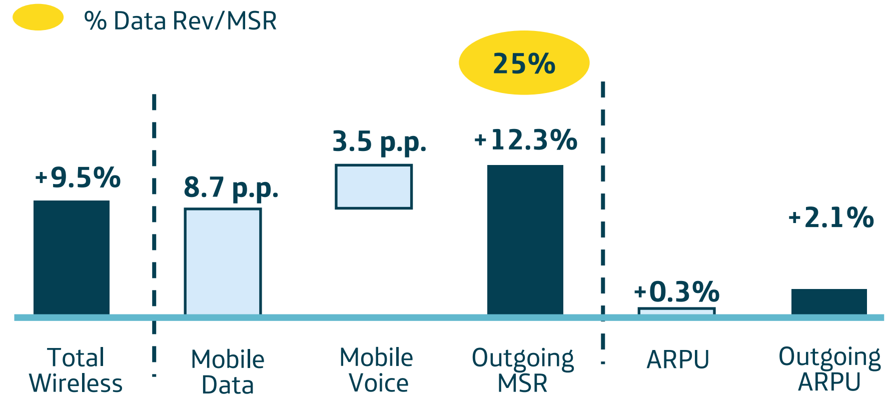
Revenue mix by business (H1 11)



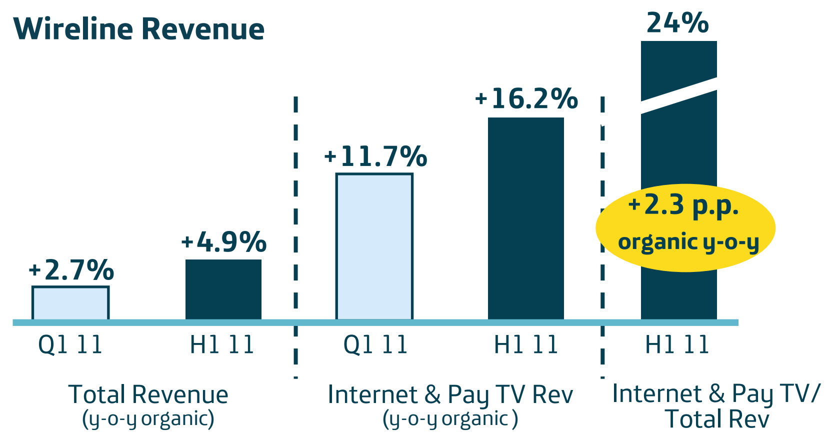
Revenue mix by region (H1 11)



Wireless Revenue (H1 11 y-o-y organic)



Wireline Revenue

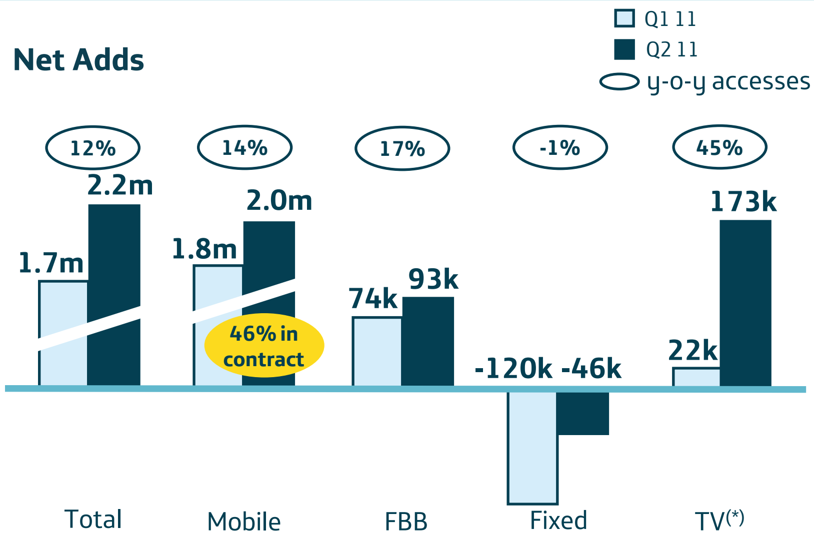


- **Double digit growth in outgoing MSR** led by data explosion and remaining opportunities in voice
- Focus on customer value drives **mobile ARPU growth**
- **Strong Internet & Pay TV revenue growth acceleration** boosts fixed revenue

Aggregated figures for Wireless and Wireline businesses.

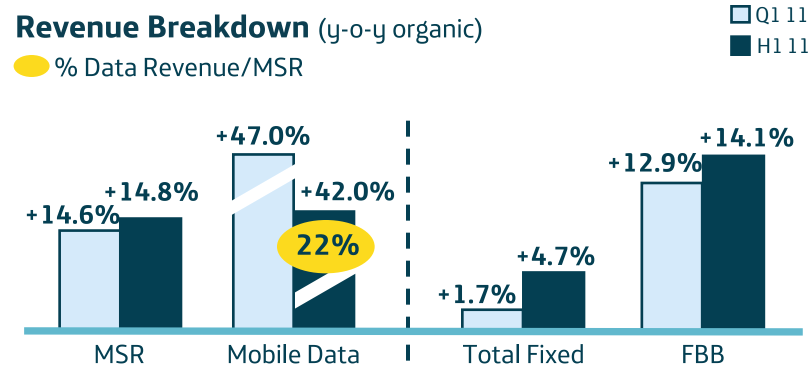
Brazil: Perfect balance, sequential growth with higher profitability

Net Adds

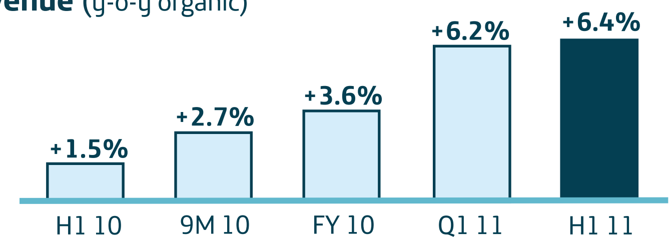


- **Strong commercial momentum, clear leadership**
- **Higher net adds in Q2 across services**
- **Sequential improvement in all financial metrics**
  - **Mobile data drives top line growth,** with ARPU expansion both q-o-q and y-o-y
  - Steady **acceleration in FBB revenue growth**
  - **Outstanding profitability;** further upside from synergies

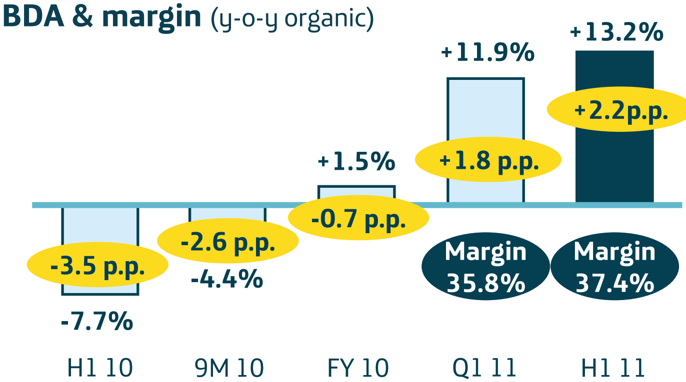
Revenue Breakdown (y-o-y organic)



Revenue (y-o-y organic)



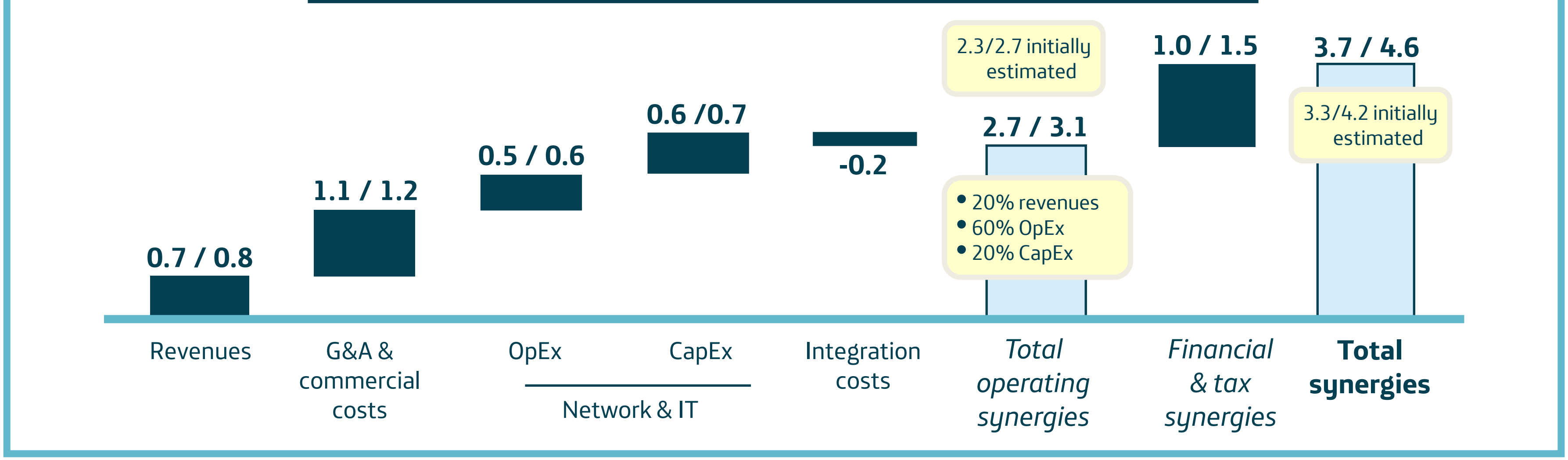
OIBDA & margin (y-o-y organic)



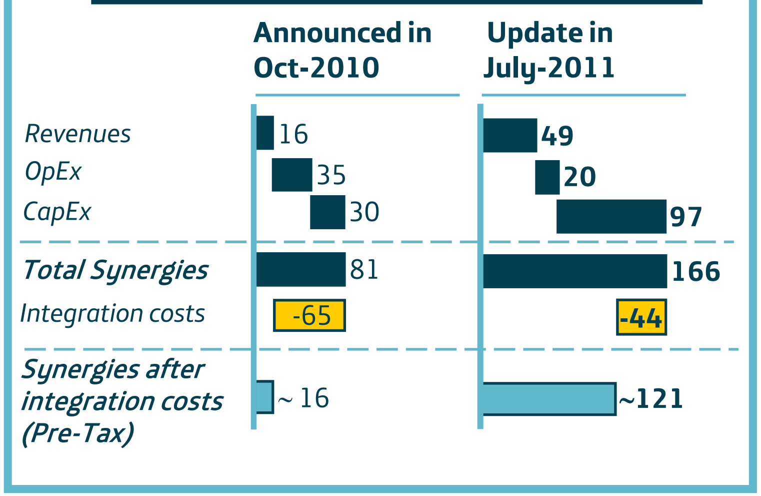
(*) Pay TV include 150 thousand accesses from TVA consolidation.

Brazil: operating synergies target upgraded by over 16%

TOTAL SYNERGIES NPV (€ in billions)



2011E operating synergies (€ in millions)



- **Outperforming initial targets from year 1**
- **Reinvesting CapEx synergies to reinforce our lead in 3G coverage, VAS and quality**
- **Run rate in line with previous estimates** (€ 400 m operating synergies from 2014E)
- **Corporate restructuring underway** to fully capture synergies potential

New synergies target from 2012 not included in guidance

Brazil: Faster than anticipated synergies execution path

LEVERS	Initiatives
Offer	▪ Integrated offer, mainly for Corporates and SMEs, leveraging cross-selling potential ▪ Fixed wireless inside & outside Sao Paulo, to offer fixed outside SP (new market) and complement copper network inside SP ▪ Reinforce LD service ("15") for mobile customers
Platforms & efficiency	▪ Processes rationalization to improve operating & tax efficiency (LD Code "15 "...) ▪ Common network & IT planning ▪ Traffic aggregation & common traffic management ▪ Network outside SP, specially backbone transmission ▪ Network core, architecture & topology ▪ IT functions, data centers and architecture ▪ Distribution channel optimization, focusing on new market trends ▪ Best-practices implementation in sell & attention processes
Customers	▪ Launch new products & services, maximising benefits from innovation both in fixed and mobile ▪ Reduce time-to market ▪ Brand integration

One single organization already in place

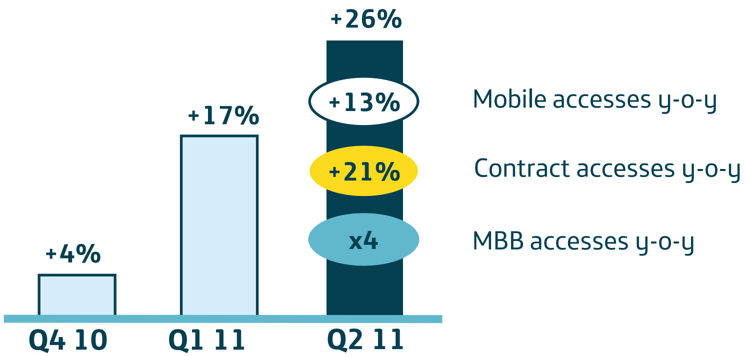
Innovation projects

- **1.7 m sold packages** Torpedo Message
- **240 k users (30d)** "Soletrando"
- **2.3 m users** Kantoo
- **2 m users** Ringer
- **> 7 m SMS** Mega Promo SMS
- **370 k users (30 d)** PTT
- **850 k co branded cards** Financial services
- **20 k users (1st week)** Security

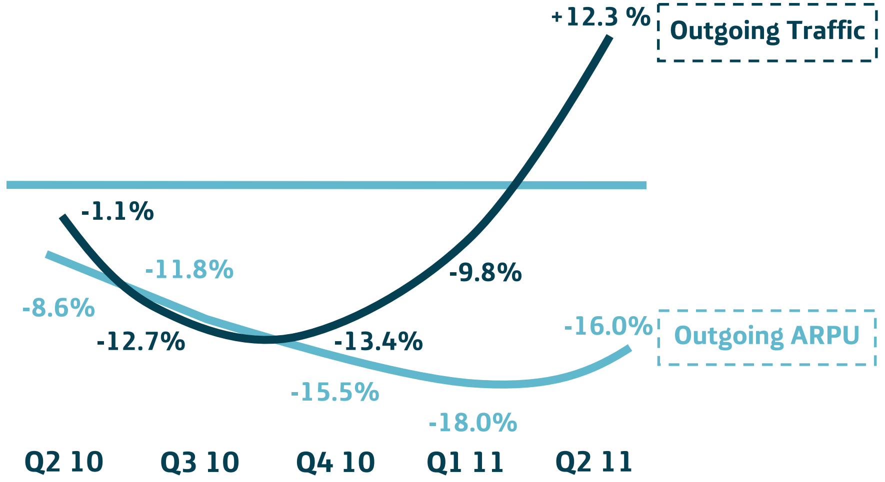
Outperforming peers in Brazil (operating & financial performance) + **Progressing faster than expected**

Mexico: improving operating KPIs, sharp MTRs cuts

Mobile gross adds (y-o-y change)



Outgoing Traffic & ARPU (y-o-y change)



Changes in termination rates

- **COFETEL approved cuts in MTRs, FTRs and transit rates**
- **<u>MTRs changes:</u>**
  - From 1.0 in 2010 to 0.3912 peso cents per min.
  - From rounding-up to the first minute to per second billing
  - Effective from January 1st, 2011 with the exception of Telmex/Telcel (from mid-May 2011[1])
  - H1 11 Impact: € -33 m in revenue and € -18 m in OIBDA

Impacts for Telefónica (€ millions)

	FY 2011E	FY 2012E
Revenue	-120/-130	-190/-210
OIBDA	-40/-50	-45/-55

- **Medium /Long term benefits**
- **Regulatory framework needs to evolve**

1. Telefónica reached an agreement with Telmex/Telcel for a MTR rate of 0.95 from January 2011. However, this agreement should be adjusted in accordance with the May resolution (0.3912).

Solid performance in other key operations

South Region

Contribution to TEF H1 Revenue

Argentina — 4.9%
- **Acceleration in double digit top line growth**
- **Strong net adds in mobile and FBB businesses in Q2,** stabilization of fixed telephony accesses

Chile — 3.7%
- **Steady growth in mobile and Pay TV accesses, enhanced performance in FBB**
- **Benchmark profitability,** OIBDA margin expansion y-o-y

Peru — 3.1%
- **Outstanding commercial activity in Q2** across businesses
- **Healthy top line and OIBDA margin evolution**

Colombia — 2.5%
- **Ramp-up in revenue and OIBDA growth** mainly due to steady improvement in mobile
- **Consistent accesses growth** on the back of positive mobile contract, FBB and Pay TV performance

North Region

Venezuela — 3.5%
- **Acceleration in top line growth** pushed by outgoing voice and data (+7.3% organic q-o-q)
- **Positive net adds in Q2 11 owing to a highly segmented commercial approach**
- **Robust OIBDA margin** (43.2%) despite higher commercial activity
- **Licence renewed in Q2 11 till 2022**

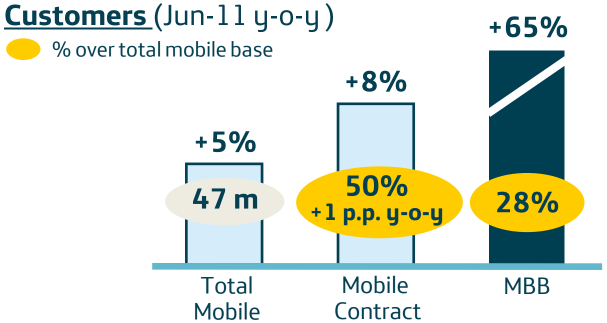
Growth rates in financials are given in local currency. In Venezuela, excludes also hyperinflation accounting in both years.

T.Europe: growing value from mobile data

Strong commercial performance focused on MBB

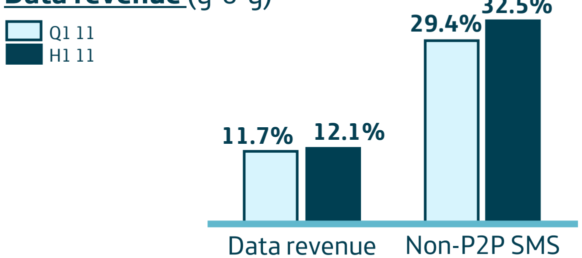
- **"Value over Volume" selective approach**
  - Solid contract net adds and stable churn y-o-y at 2.5%

Customers (Jun-11 y-o-y)



- **MBB penetration expansion leveraged on demand for tiered tariffs**
  - 78% of handsets sold in Q2 11 were smartphones
  - Still growing P2P SMS revenues (+0.9% y-o-y in H1 11)

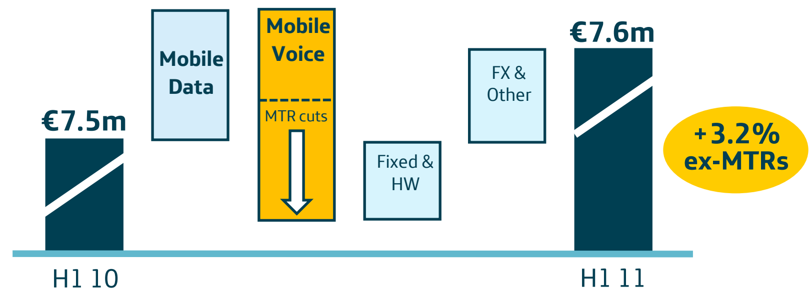
Data revenue (y-o-y)



Sound financial results

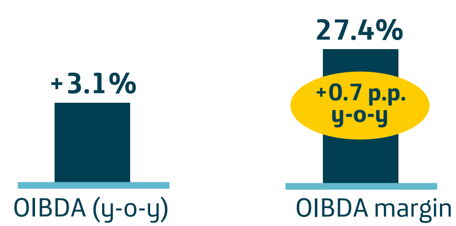
- **Top line driven by mobile data**
  - Mobile data accounts for 41% of MSR (+5 p.p. y-o-y)
  - Severe MTR cuts drag 3 p.p. of revenue growth

Revenue (y-o-y)



- **Sustained profitability, further building competitive advantages**
  - Increased investment in customer to drive future value
  - Continued overhead costs reduction from restructuring
  - Proactive cooperative approach (e.g. networks, platforms)

Profitability (H1 11)

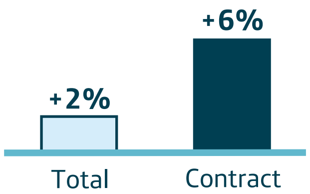


From January 1st, 2011 T.Europe also includes TIWS and TNA in its consolidation perimeter. Financial results have been restated accordingly from Q1 10.
All financial metrics following organic growth criteria: assumes constant exchange rates (average H1 10) and includes 6 months of HanseNet in H1 10.
Manx T. financial results and accesses are excluded from the organic growth calculation.

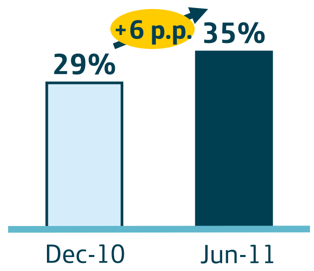
T. UK: driving a profitable MBB ecosystem

Focus on MBB

Mobile customers (Jun-11 y-o-y)

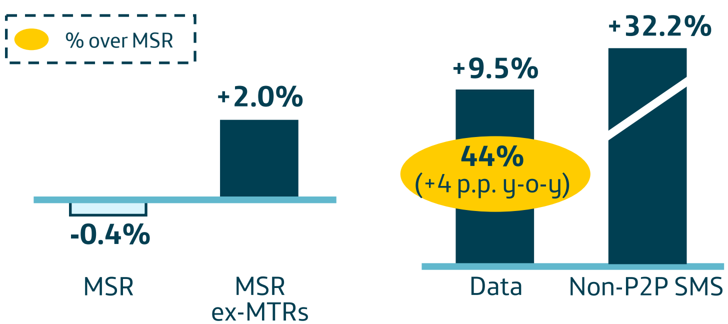


Smartphone penetration[1]



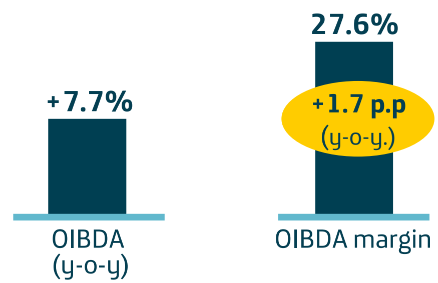
- **Limited commercial activity, sustained market leading contract churn**
- **Extracting value from increased MBB adoption**
  - ≈ 55% of contract smartphone users based on tiered data plans
  - Most customers taking £6-10 upper data tier on a wide choice of voice & SMS bundles
  - Negligible impact from IP voice and messaging Apps

Revenue (H1 11 y-o-y)



- **Non-P2P SMS data revenues partially offsetting regulation and usage optimisation**
  - Customer spend broadly stable q-o-q
  - MTR cuts dragging 4 p.p. in total Q2 revenue growth
  - Changes in commercial relationship model with some distributors impacting y-o-y performance

Profitability (H1 11)



- **OIBDA growth driven by lower activity and upgrades**
  - Business transformation already giving benefits
  - Q-o-q slowdown mainly affected by different MTR cuts timing from competitors (~8 p.p. in H1 11)

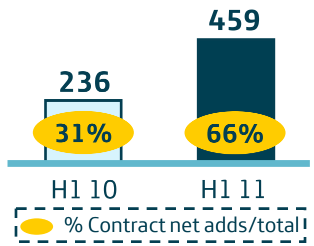
1. Smartphones with data attached rate/total mobile base excluding dongles and M2M.

Growth rates in financials are given in local currency.

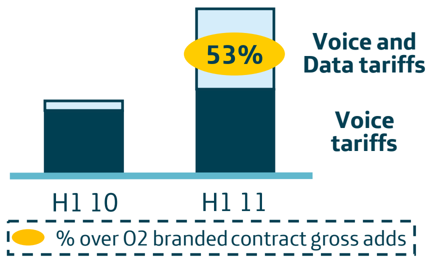
T. Germany: continued strong momentum in the market

Customer mobile KPIs

Contract Net Adds ('000)

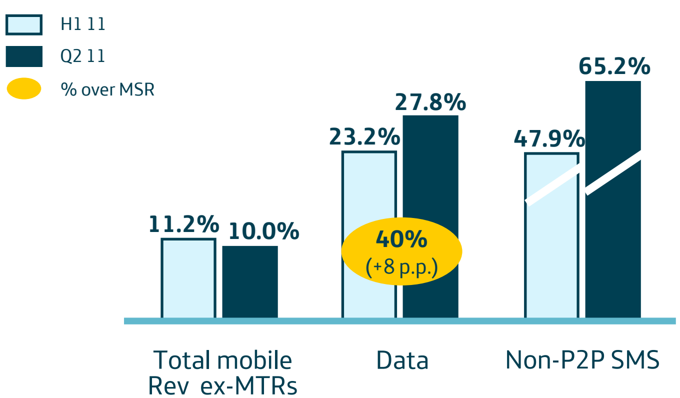


Contract gross adds



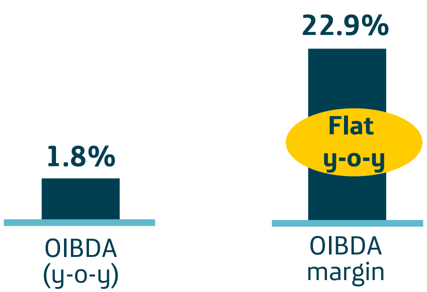
- **Improving momentum in the growing MBB market**
  - Contract churn trending down to 1.5% in Q2 11
  - Growing success of "O2 Blue" data tariff and "My Handy"
  - Momentum maintained despite targeted price increases
  - Solid performance in Business: SMEs/SoHo momentum; MNC contract win (Daimler)

Revenue (y-o-y)



- **MSR ex-MTRs accelerating to 7.2% in Q2 (+4.9% in Q1)**
  - Increased MBB penetration (23%; +3 p.p. vs. Dec-10)
  - Sustained prepay ARPU performance y-o-y

Profitability (H1 11)



- **Reinvesting efficiencies from restructuring and business integration on increased commercial activity around MBB**
- **LTE commercially launched in July**
  - Rural network roll-out in line with targets; leveraging existing 2G 900 MHz grid

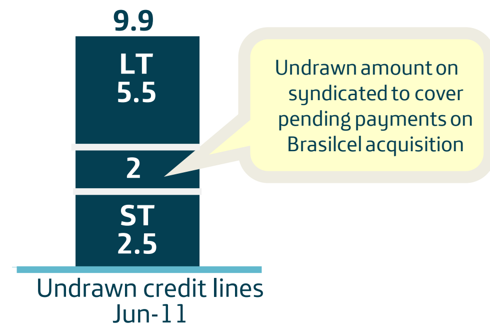
Growth rates in financials are given in organic terms .

Containing financial expenses despite debt increase

Contained Financial Expenses (€ in millions)

	H1 11
Net interest Expenses	-1,167
FX results	+2
Total Financial Results	**-1,165**
Total Average Net Debt	**55,828**
Effective cost	**4.21%**

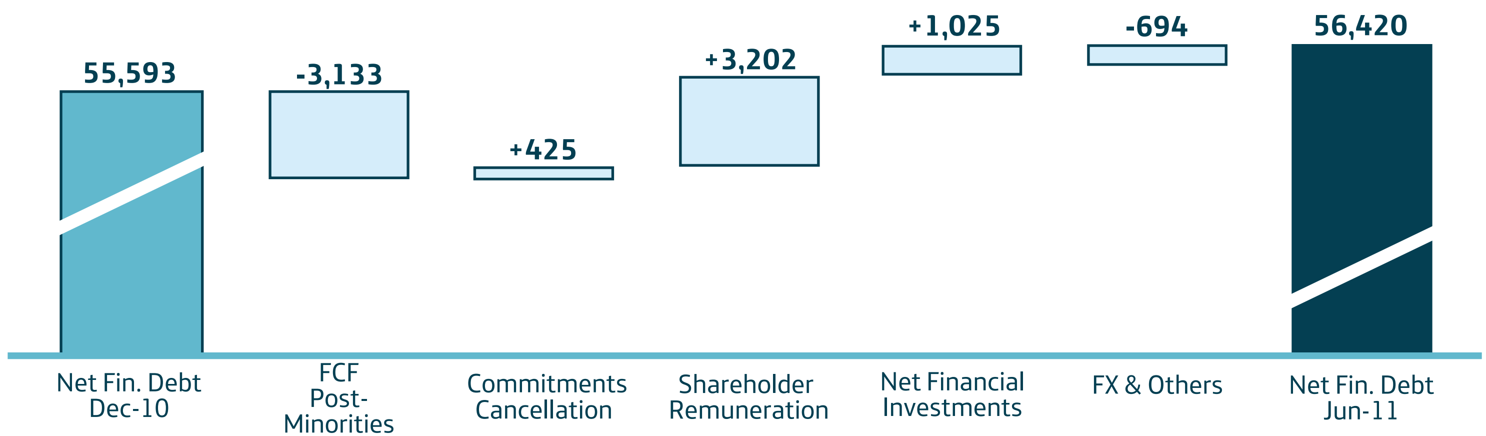
Solid liquidity position (€ in billions)



Net Financial Debt Evolution (€ in millions)

Total Net Debt + Commitments 2.50x OIBDA [1]

Total Net Debt + Commitments 2.56x OIBDA [2]



- **Leverage ratio including commitments at 2.56x:** excess debt over 2.50x would be offset by setting the working capital consumption within the target range (2011-2013E between 2% and 5% of OpCF)

1. FY 2010 OIBDA including 100% of Vivo's OIBDA, excluding results on the sale of fixed assets and the provision related to the Telefónica Foundation's social activities.
2. LTM OIBDA including 100% of Vivo's OIBDA, excluding results on the sale of fixed assets and the provision related to the Telefónica Foundation's social activities.

Conclusions

- **H1 11 performance consistent with FY 2011 guidance, outlook reiterated**
- **Very strong revenue growth & benchmark profitability despite challenging conditions & severe regulation**
- **Diversification and exposure to Latam, our key differential factor**
- **Fully capturing the mobile data opportunity**
- **Executing new cash-generating initiatives** (New Social Agreement in Spain, above-expectations synergies in Brazil, “Partnership Program”…)
- **Fully committed to dividend targets**

Organic growth: In financial terms, it assumes constant average exchange rates as of January-June 2010, and excludes changes in the perimeter of consolidation and hyperinflation accounting in Venezuela. Therefore, in January-June 2010 the consolidation of Vivo, HanseNet and Tuenti are included whereas the results of Manx Telecom are excluded. In OIBDA terms, in January-June 2011 the positive impact from the partial reduction of our economic exposure to Portugal Telecom is excluded, along with the impact of the capital gain from the sale of Manx Telecom booked in the second quarter of 2010. Results from the Costa Rica operation are excluded from the organic growth calculation. Telefónica's Capex excludes the Real Estate Efficiency Programme at T. España, the real estate commitments associated with Telefónica's new headquarters in Barcelona and investments in spectrum. In terms of accesses, changes in the consolidation perimeter are excluded and in terms of organic net adds customer disconnections made in the second quarter of 2010 are excluded. 2011 Financial results and accesses include from the second quarter of the year and retroactively from January 1st, 2011, the full consolidation of TVA, company that was already part of Telefónica's perimeter since the fourth quarter of 2007.