2012

Annual Report

The future is digital

Telefónica

Telefónica

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About this Report: first step towards an integrated reporting model

Telefónica has decided to take the first steps towards an integrated report with the present Annual Report 2012. To this end, strategic and operational aspects, and those of context, Corporate Governance and performance have all been incorporated into a single volume, together with other themes related to sustainability. In this way, any reader will be able to understand better how Telefónica is capable of creating and sustaining its value in the future through its business model.
The behavior of the market is also detailed, along with the most relevant financial and non-financial indicators of the Company. The report firstly shows the Management and Governance Bodies of Telefónica at the end of 2012, as well as the most important indicators of the Company for the 24 countries in which it is present. In addition, it offers Telefónica's perception of the most significant changes that the telecommunications sector is undergoing and how the Company handles the opportunities and risks inherent to these transformations. These are the keys to understanding its business model, working to convert the Company into a Digital Telco, as clearly as possible. And all this, through innovation and digital solutions, the talent of its professionals, the strength that its global scale bestows and the values of a great brand.

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Letter to shareholders_

César Alierta Izuel Chairman & CEO

Dear shareholder,

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

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

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

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

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

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

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

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

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

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

In parallel, in 2012 we undertook a profound transformation of our commercial model, "2012 was a key year in Telefónica's transformation, a year in which the decisions adopted and implemented already began to bear fruit"

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

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

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

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

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

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

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

316 million customers
reflect Company growth in 2012

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

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

4 Telefónica milestones in 2012

1 Transformation of the commercial model

In 2012 we undertook a profound transformation of our commercial model, changing our offering from a subsidy-focused model to a more sustainable approach based on distinctive quality and offerings

2 Simplification across the board

We made significant efforts to streamline processes and simplify our product base, a measure that is already generating sizeable savings and raising efficiency levels

3 Optimization of the investment management model

We optimized our investment management model, reallocating resources to the highest growth activities. From that perspective, in 2012 we decided to share networks and co-invest in some countries

4 Recover financial flexibility

We recovered our financial flexibility reducing debt significantly. Telefónica scaled down its debt more than any other telecoms operator worldwide.

Outstanding performance in financial flexibility

Financially speaking, 2012 was the year we recovered our financial flexibility, reducing debt significantly by upward of 5.0 billion euros. I can assure you that very few companies are in a position to lower their debt so drastically in a single year. In fact, in 2012 Telefónica scaled down its debt more than any other telecoms operator worldwide.

That extraordinary achievement was possible thanks to determined short-term measures, such as: proactive portfolio management; an active refinancing policy; and, as an exceptional, one-off measure, cancellation of the dividend for fiscal year 2012. A trying but necessary decision adopted by the Board of Directors in July 2012, it was the key to recovering financial flexibility. That favourable outcome was also the result of robust cash flows: in 2012 the Company generated a free cash flow of nearly 7.0 billion euros.

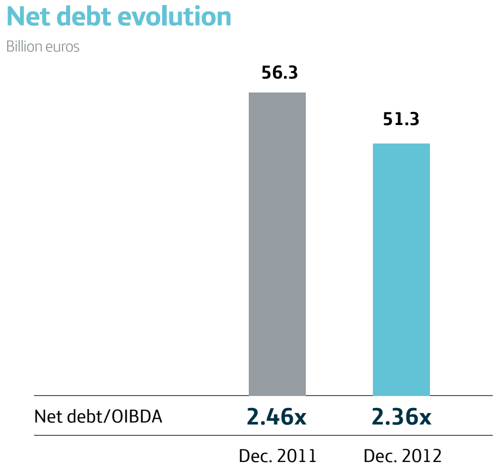
These measures led to a sizeable decline in financial leverage, stabilisation of our credit rating and a significant improvement in the Company's liquidity.

After the year's stringent adjustments, the Company is now in a position to resume shareholder remuneration in 2013, with a cash

Over 5 billion euros debt reduction

9.5 billion euros invested during 2012

Over 80% of investment in growth and transformation projects



dividend of 0.75 euros per share. The intention is to split this dividend into two payments: the first, at 0.35 euros per share, in November 2013 and the second for the remaining 0.40 euros per share in the second quarter of 2014. This proposal confirms our commitment to continue to reward our shareholders and translates into the ongoing payment of dividends year after year. In May 2012, for instance, Telefónica paid its shareholders a 2.8 billion-euro dividend on its 2011 earnings.

At the current share price (10.8 euros on 10 April 2013), the remuneration announced for 2013 constitutes a 6.9-per cent return. That is a higher dividend yield forecast for 2013 than offered by any of the other top 25 Information and Communication Technology companies by market capitalisation.

Becoming a genuine Digital Telco

Now I would like to share my vision with you on the situation prevailing on our market today, the period of fastest change ever in the history of our industry. Suffice to say by way of example that in 2012 mobile penetration reached 90 % worldwide, while the number of smartphone users grew by 42 %. That only 17 % of mobile customers have smartphones despite such a significant rise is an indication of the enormous growth potential to which we can look forward.

We are indisputably in the midst of a Digital Revolution that is driving profound change in our everyday lives, while the availability of increasingly smarter devices and the development of new digital solutions have become the key drivers of our industry's growth.

At Telefónica we are decidedly focusing on the digital world to capitalize on the opportunities already afforded by the digitisation of the economy. Telefónica Digital is playing an essential role in this process, furthering innovation to offer our customers optimal digital solutions. Some of its key initiatives include the development, in conjunction with Mozilla, of the HTML5-based Firefox open mobile operating system; the empowerment of machine to machine (M2M) solutions in different industries; the development of mobile payment options; the unconditional commitment to e-Health through the acquisition of Axismed in Brazil; and the active participation in innovation areas such as Big Data, Cybersecurity or Voice Recognition.

Nearly 7 billion euros
in free cash flow

Dividend of €0.75 per share

"At Telefónica we are working actively to position the Company as a major player in the digital world and turn it into a genuine 'Digital Telco'"

I can assure you that at Telefónica we are working actively to position the Company as a major player in the digital world and turn it into a genuine "Digital Telco". I am of the conviction that digital telcos such as Telefónica will continue to be the lead actors in the next stage ahead, whose foundations are being built over the investment effort made to deploy the latest generation networks.

Our social commitment

To conclude, I would like to devote a few words to our commitment to the comprehensive development of the societies where we operate, which materialises in three lines of work. First is our commitment to social and cultural action, channelled through Fundación Telefónica, to foster learning and pluralise knowledge by connecting people and institutions. Secondly, we are committed to entrepreneurship, innovation and support for youth through programmes such as Telefónica 'Think Big', 'Wayra', Amérigo, 'Campus Party' and 'Talentum', initiatives designed to back young entrepreneurs and identify ideas with high growth potential in the Information and Communication Technologies industry. Lastly, we are committed to corporate sustainability to ensure efficient social, economic and environmental risk management and pursue value creation in partnership with society.

I realise that 2012 was a difficult year, but together we are building a better future for the Company. I am confident that in 2013 we shall continue to harvest the fruit of the profound change undertaken, a venture that has enabled us to attain a position of privilege and leadership in the new wave of growth driven by the digitisation of the economy. Telefónica's present and especially Telefónica's future depend on its role as a Digital Telco leader.

Lastly, I wish to thank all of our shareholders for your support and for confiding in our company year after year. Both personally and on behalf of the Board of Directors, I can promise that we are going to continue to put all our enthusiasm and dedication into making Telefónica a leader in the new digital world.

Mobile penetration reached 90%
worldwide

42% growth
in smartphone users

Development of new digital solutions
has become a key driver of our industry's growth

MANAGEMENT AND GOVERNANCE BODIES

Board of Directors_

The Board of Directors of Telefónica answers to the needs of an international Company which operates globally to offer communication, information and entertainment solutions.

With the help of its committees, the Board of Directors carries out its activity in accordance with rules of Corporate Governance, mainly set down in the Articles of Association, in the Regulations of the General Meeting of Shareholders and in those of the Board of Directors.

It is the supervisory and controlling body for the Company's activity, with exclusive powers over general policies and strategies of the Group; among other matters, those related to Corporate Governance, Corporate Responsibility, compensation of Directors and Senior Executives, and remuneration of the shareholder fall within its remit.

As reinforcement for the Corporate Governance of the Company, the Board of Directors of Telefónica, S.A. has nine committees to which it delegates the examination and monitoring of areas of particular relevance.

Similarly, and in keeping with its Regulations, the Board delegates the ordinary management of the businesses to the executive bodies and management team of Telefónica.

The Company provides more detailed information about this matter in the Annual Corporate Governance Report and in the Report on the Compensation Policy of the Board of Directors. These documents can be consulted at:

http://www.telefonica.com/en/shareholders_investors/jsp/home/home.jsp

Access the full 2012 Annual Corporate Governance Report and Report on the Compensation Policy of the Board of Directors of Telefónica, S.A. via the QR code.

Composition of the Board of Directors and its Committees

	Type of Director	Executive Commission	Audit and Control	Nominating, Compensation and Corporate Governance	Human Resources, Corporate Reputation and Corporate Responsibility	Regulation	Service Quality and Customer Attention	International Affairs	Innovation	Strategy
Mr. César Alierta Izuel (Chairman)	Executive	●								
Mr. Isidro Fainé Casas (Vice-chairman)	Proprietary	●								
Mr. José María Abril Pérez (Vice-chairman)	Proprietary	●						●	●	
Mr. Julio Linares López (Chief Operating Officer)	Other external									
Mr. José María Álvarez-Pallete López	Executive	●								
Mr. José Fernando de Almansa Moreno-Barreda	Other external					●		●		●
Ms. Eva Castillo Sanz	Executive					●	●			●
Mr. Carlos Colomer Casellas	Independent	●	●	●			●		●	
Mr. Peter Erskine	Independent	●		●					●	●
Mr. Santiago Fernández Valbuena	Executive									
Mr. Alfonso Ferrari Herrero	Independent	●	●	●	●	●	●	●		●
Mr. Luiz Fernando Furlán	Independent							●		
Mr. Gonzalo Hinojosa Fernández de Angulo	Independent	●	●	●	●	●	●	●		●
Mr. Pablo Isla Álvarez de Tejera	Independent			●	●	●	●			
Mr. Antonio Massanell Lavilla	Proprietary		●		●		●		●	
Mr. Ignacio Moreno Martínez	Proprietary									
Mr. Francisco Javier de Paz Mancho	Independent	●			●	●		●		
Mr. Chang Xiaobing	Proprietary									
Mr. Ramiro Sánchez de Lerín García-Ovies (Non-director Secretary)										
Ms. María Luz Medrano Aranguren (Non-director Vice-secretary)										

Type of Director: ● Executive ● Proprietary ● Independent ○ Other external ● Committee members

GOVERNANCE AND MANAGEMENT BODIES

Board Members_

A solid governance body based on experience and diversity.

Mr. César Alierta Izuel

Executive Chairman

Holds a Law degree from the University of Zaragoza and an MBA from Columbia University.

Director of Telecom Italia, S.p.A., China Unicom (Hong Kong) Limited, and International Consolidated Airlines Group (IAG).

Member of the Columbia Business School Board of Overseers, and of the Social Board of the UNED (the Spanish national distance learning University).

He was the Chairman and founder of Beta Capital, Chairman of the Spanish Financial Analysts' Association, and Chairman of Tabacalera, S.A.

Mr. José María Abril Pérez

Vice-Chairman. Proprietary Director

Degree in Economics from the Commercial University of Deusto, and Professor at the same university.

Has been the Director-General of the Wholesale and Investment Banking Division, a Member of the Executive Committee of BBVA, S.A., and he is Director of Repsol, Iberia and Corporación IBV, as well as Vice-President of Bolsas y Mercados Españoles (BME).

Mr. José María Álvarez-Pallete López

Chief Operating Officer (COO)

Degree in Economics from the Complutense University of Madrid. Studied Economics at the Université Libre in Belgium. International Management Program (IMP) at the Instituto Panamericano de Desarrollo de Directivos (IPADE).

Currently, he works as COO, having held various posts at Telefónica Group since 1999.

He formerly worked for Arthur Young Auditores, Benito & Monjardín/ Kidder, Peabody & Co., and Cementos Portland (Cemex).

Ms. Eva Castillo Sanz

Executive Director

Degree in Economics, Law and Business from the Universidad Pontificia de Comillas (E-3), Madrid.

Chairman and CEO of Telefónica Europe, as well as Chairman of the Supervisory Board of Telefónica Czech Republic, a.s., and of Telefónica Deutschland Holding, AG; Bankia Director; and member of the Board of Trustees of the Comillas-ICAI Foundation.

She held various posts at Merrill Lynch until being appointed Head of Merrill Lynch Private Banking for Europe, Middle East and Africa (EMEA).

Mr. Isidro Fainé Casas

Vice-Chairman. Proprietary Director

Holder of a Doctorate in Economics. Diploma in Alta Dirección (Senior Management) from IESE Business School. ISMP in Business Administration from Harvard University. Financial Analyst and an Academic at the Royal Academy of Finance and Economics.

Chairman of Caja de Ahorros y Pensiones de Barcelona ("la Caixa"), of Caixabank, S.A., of Criteria Caixaholding, S.A. and of the Confederación Española de Cajas de Ahorros (the Spanish savings banks confederation); Vice-Chairman of Abertis Infraestructuras, S.A., and of AGBAR, Sociedad General de Aguas de Barcelona, S.A.; 2nd Vice-Chairman of Repsol, S.A. Additionally, he is a Director of Banco Português de Investimento, S.A. (BPI), and a non-executive director of The Bank of East Asia.

Mr. Julio Linares López

Vice-Chairman. 'Other external' Director

He holds a degree in Telecommunications Engineering and joined Telefónica's R&D Centre in May 1970, having held various positions within Telefónica Group S.A., one of them as Chief Operating Officer of Telefónica, S.A.

He is a member of the Board of Directors and the Executive Committee of Telecom Italia.

He is also a member of the Advisory Boards of Telefónica Europe, Telefónica Latinomérica and Telefónica Digital, and of the Social Council of the Complutense University of Madrid.

Mr. Fernando de Almansa Moreno-Barreda

'Other external' Director

Law degree from the University of Deusto (Bilbao).

He is a member of the Boards of Telefónica Brazil, S.A., and of Telefónica Móviles Mexico, S.A. de C.V. Furthermore, he is Deputy Director of Grupo Financiero BBVA Bancomer, S.A. de C.V. and of BBVA Bancomer, S.A.

Since 1974, he has occupied different positions within the Diplomatic Corps, until he was appointed Chief of the Royal Household, with ministerial rank, by His Majesty the King.

He currently is Private Director of His Majesty the King.

Mr. Carlos Colomer Casellas

Independent Director

Economics degree from the University of Barcelona and a degree in business administration from IESE Business School (Barcelona).

Chairman of The Colomer Group, Ahorro Bursátil, S.A. SICAV, of Inversiones Mobiliarias Urquiola, S.A. SICAV, and of Haugron Holdings, S.L.

Additionally, he is an Independent Director of Abertis Infraestructuras, S.A, and of Vueling Airlines, S.A.

Mr. Peter Erskine

Independent Director

Degree in Psychology from Liverpool University.

He is Chairman of Ladbrokes, plc and a member of the Advisory Board of Henley Management Centre.

He has worked at Polycell, Colgate Palmolive, the Mars Group, and UNITEL. He has also held various senior positions in BT Mobile until being appointed CEO and Chairman of O2, plc.

Mr. Santiago Fernández Valbuena

Executive Director

Ph.D. and Master in Economics from the Northeastern University of Boston , and degree in Economics from the Complutense University.

He is Executive Chairman of Telefónica Latinomérica. He was previously Director of Strategy, and Chief Financial Officer (CFO).

Before joining Telefónica, he worked as Director-General of Société Générale Valores, and as Stock Exchange Manager in Beta Capital.

Mr. Luiz Fernando Furlán

Independent Director

Degrees in Chemical Engineering from the Industrial Engineering Faculty of São Paulo, and in Business Administration from the University of Santana (Sao Paulo).

He is Chairman of the Board of Directors of the Amazon Sustainability Foundation, and a member of the Board of Directors of BRF-Brasil Foods, S.A., Telefónica Brazil, S.A., AGCO Corporation, and Amil Participações, S.A., and member of the Advisory/Consultative Boards of Panasonic (Japan), McLarty & Associates (USA), and Wal-Mart Stores Inc. (USA).

He was Minister of Development, Industry and Foreign Trade in the Government of Brazil, and Vice-Chairman of São Paulo Entrepreneurs' Association (FIESP).

Mr. Alfonso Ferrari Herrero

Independent Director

Doctorate in Industrial Engineering from the Polytechnic University of Madrid. MBA from Harvard University (USA).

He is Director of Telefónica Peru, S.A.A., and Deputy Director of Telefónica Chile, S.A.

He was Deputy of the Financial Manager of Hidroeléctrica del Cantábrico, S.A., Manager of Industrial Investments at Banco Urquijo, and Founder Member, Chairman and CEO of Beta Capital, S.A.

Mr. Gonzalo Hinojosa Fernández de Angulo

Independent Director

Doctorate in Industrial Engineering from the School of Industrial Engineering of Madrid.

He is a Director of Telefónica Peru, S.A.A.

He was General Manager, Chief Executive Officer and Chairman of Grupo Cortefiel, and has been a Director of Banco Central Hispano Americano, of Portland Valderribas, and of Altadis, S.A.

Mr. Pablo Isla Álvarez de Tejera

Independent Director

Degree in Law from the Complutense University of Madrid.

Member of the Body of State Lawyers, and first in his year. He is Chairman and Chief Executive Officer of Inditex, S.A.

He held various positions within the Ministry of Transportation, Tourism and Communications, as well as in the Directorate for State Legal Services, at Banco Popular, in the Ministry of Economic Affairs and Finance, and in the Altadis Group.

Mr. Antonio Massanell Lavilla

Proprietary Director

Degree in Economics and Business Studies from the University of Barcelona.

He is Director-General of CaixaBank. He also holds positions as Chairman of Barcelona Digital Centre Tecnológic, and as member of the Board of Directors of Boursorama, S.A., Beach & Golf Community, S.A., e-la Caixa, S.A., Caixa Capital Risc, S.G.E.C.R., S.A., Serveis Informatics "la Caixa", S.A., and SAREB. During his career, he has also been a director of various companies.

Mr. Ignacio Moreno Martínez

Proprietary Director

Degree in Economics and Business Studies from the University of Bilbao. Master's in Marketing and Commercial Management from the Instituto de Empresa Business School. MBA from INSEAD.

He is CEO of N+1 PRIVATE EQUITY and Non-Executive Chairman of Metrovacesa, S.A.

He has worked in Bank Vizcaya, Bank Santander de Negocios, Mercapital, Corporación Bancaria de España, S.A. (Argentaria), and Bank Bilbao Vizcaya Argentaria, S.A.

Mr. Chang Xiaobing

Proprietary Director

Professor of Engineering. Degree in Telecommunications Engineering from the Nanjing Institute of Posts and Telecommunications, MBA from Tsinghua University in 2001 and Doctorate in Business Administration from Hong Kong Polytechnic University.

He is Chairman of China United Telecommunications Corp., Executive Manager, Chairman and Chief Executive Officer of China Unicom Limited.

Mr. Javier de Paz Mancho

Independent Director

Diploma in Publicity and Information. Studies in Law. Senior Management Business Program of the IESE (University of Navarre).

He is Director of Telefónica Argentina, S.A. and of Telefónica Brazil, S.A., and member of the Executive Committee of the Council of Chambers of Commerce.

He has been Chairman of Atento Inversiones y Teleservicios, S.A.U., and Director of Tabacalera, S.A.

MANAGEMENT AND GOVERNANCE BODIES

Board of Directors' Committees_

Executive Commission

Duties. The Board of Directors, within the legal provisions in force, delegates all of its powers and duties, except those that cannot be so delegated for reasons of law, statute or regulation, to an Executive Commission. This commission provides the Board of Directors with greater operability and efficacy in the exercise of its duties, facilitating the necessary support through the work carried out, particularly inasmuch as it has fewer members than the Board and meets more frequently.

The relations between the two bodies are based on a principle of transparency, so that the Board is always fully informed of the decisions adopted by this committee. Thus, the Board of Directors is informed at each of its meetings of all the agreements adopted by the Executive Commission, with a summary of the Minutes of this commission's proceedings being distributed to each Director to that effect, the said agreements being then subject to ratification.

Composition	
Mr. César Alierta Izuel	Chairman
Mr. Isidro Fainé Casas	Vice-chairman
Mr. José María Abril Pérez	Vice-chairman
Mr. José María Álvarez-Pallete López	COO
Mr. Carlos Colomer Casellas	Member
Mr. Peter Erskine	Member
Mr. Alfonso Ferrari Herrero	Member
Mr. Gonzalo Hinojosa Fernández de Angulo	Member
Mr. Javier de Paz Mancho	Member
Mr. Ramiro Sánchez de Lerín García-Ovies	Secretary

Audit and Control Committee

Duties. Among other aspects, it works to support the Board of Directors in its duties of supervision, and assumes the following competencies: to report on questions raised by shareholders at GSM which fall within its purview; to propose the designation and terms for the hiring of the external Auditor; to supervise internal audit, and the preparation and submission of regulated financial information; and to propose the risk control and management policy.

Composition	Date of appointment
Mr. Carlos Colomer Casellas (Chairman)	24 April 2013
Mr. Antonio Massanell Lavilla	30 August 2000
Mr. Gonzalo Hinojosa Fernández de Angulo	26 June 2002
Mr. Alfonso Ferrari Herrero	27 February 2008

Nominating, Compensation and Corporate Governance Committee

Duties. Among other duties, it assumes the work of reporting, following standards of objectivity and conformity to the corporate interest, on proposals for appointment, re-election and removal of Directors and Senior Executive Officers of the Company and its subsidiaries, and of evaluating the qualifications, knowledge and experience required of candidates for vacant posts. It proposes to the Board of Directors, in the framework established by the Articles of Association, the extent and amount of the compensation, rights and remuneration of a financial nature, of the Chairman, the Executive Directors and the Senior Executive Officers of the Company, including the basic terms of their contracts, for purposes of contractual implementation thereof. It supervises compliance with the Company's internal rules of conduct and the corporate governance rules thereof in effect from time to time.

Composition	Date of appointment
Mr. Alfonso Ferrari Herrero (Chairman)	30 May 2001
Mr. Carlos Colomer Casellas	23 January 2008
Mr. Peter Erskine	27 February 2008
Mr. Gonzalo Hinojosa Fernández de Angulo	30 November 2005
Mr. Pablo Isla Álvarez de Tejera	26 June 2002

Human Resources, Corporate Reputation and Corporate Responsibility Committee

Duties. Among other obligations, it assumes the duties of: analyzing, reporting and proposing appropriate agreements related to staff policy; pushing forward the implementation of Company values; steering the development of the project of Corporate Reputation; advancing the verification of the Sustainability Report or of the balance of the intangible assets of the Group; ensuring the ethical and responsible behavior of Telefónica by raising awareness and implementation of the Business Principles in all the lines of operation and countries in which the Group operates.

Composition	Date of appointment
Mr. Javier de Paz Mancho (Chairman)	23 January 2008
Mr. Alfonso Ferrari Herrero	26 June 2002
Mr. Gonzalo Hinojosa Fernández de Angulo	5 July 2007
Mr. Pablo Isla Álvarez de Tejera	26 June 2002
Mr. Antonio Massanell Lavilla	22 July 1998

Regulation Committee

Duties. Among other work, it assumes the duties of: carrying out permanent monitoring of the main matters and themes of the regulatory order that affect the Telefónica Group at all times; providing a channel for communication and information between the Management Team and the Board of Directors in statutory matters and, when appropriate, bringing to the knowledge of the latter such matters deemed important or relevant to the Company or to any of the companies in the Group and on which it may be necessary or convenient to adopt a decision or establish a specific strategy.

Composition	Date of appointment
Mr. Gonzalo Hinojosa Fernández de Angulo (Chairman)	24 April 2013
Mr. Fernando de Almansa Moreno-Barreda	25 January 2006
Ms. Eva Castillo Sanz	16 December 2009
Mr. Alfonso Ferrari Herrero	5 July 2007
Mr. Pablo Isla Álvarez de Tejera	23 January 2008
Mr. Javier de Paz Mancho	23 January 2008

Service Quality and Customer Attention Committee

Duties. Among other aspects, it carries out examination, analysis and monitoring of the quality indexes of the principal services provided by the companies of Telefónica Group, and evaluates the levels of customer service by those companies.

Composition	Date of appointment
Mr. Antonio Massanell Lavilla (Chairman)	26 March 1999
Ms. Eva Castillo Sanz	16 December 2009
Mr. Carlos Colomer Casellas	26 June 2002
Mr. Alfonso Ferrari Herrero	16 December 2009
Mr. Gonzalo Hinojosa Fernández de Angulo	26 June 2002
Mr. Pablo Isla Álvarez de Tejera	25 April 2007

Strategy Committee

Duties. Among other duties, its principal function is to support the Board of Directors in its analysis and monitoring of the strategic policy of the Telefónica Group at an overall level.

Composition	Date of appointment
Mr. Peter Erskine (Chairman)	17 December 2008
Mr. Fernando de Almansa Moreno-Barreda	17 December 2008
Ms. Eva Castillo Sanz	17 December 2008
Mr. Alfonso Ferrari Herrero	23 June 2010
Mr. Gonzalo Hinojosa Fernández de Angulo	17 December 2008

International Affairs Committee

Duties. Among other subjects, its fundamental mission is to reinforce and bring to the attention of the Board of Directors those international matters which are relevant to the healthy development of Telefónica Group, paying particular attention to institutional relations in the countries in which subsidiaries of the Group operate. In addition, it analyzes questions of importance in international organizations and fora, and those of economic integration which may affect the Group; studies matters of regulation, competition and alliances, and; evaluates the programs and activity of the various Foundations of the Company and the resources deployed in support of its international social image and presence.

Composition	Date of appointment
Mr. José Fernando de Almansa Moreno-Barreda (Chairman)	28 May 2003
Mr. José María Abril Pérez	26 September 2007
Mr. Alfonso Ferrari Herrero	28 May 2003
Mr. Luiz Fernando Furlán	27 February 2008
Mr. Gonzalo Hinojosa Fernández de Angulo	28 February 2006
Mr. Javier de Paz Mancho	23 January 2008

Innovation Committee

Duties. Among other matters, its fundamental mission is to advise and provide support on all questions related to innovation, carrying out periodic analysis, study and monitoring of the innovation projects of the Company, formulating clear criteria and supporting efforts to guarantee a suitable fit for its implementation and development stages throughout Telefónica Group.

Composition	Date of appointment
Mr. Carlos Colomer Casellas (Chairman)	30 July 2008
Mr. José María Abril Pérez	18 May 2011
Mr. Peter Erskine	30 July 2008
Mr. Antonio Massanell Lavilla	30 July 2008

MANAGEMENT AND GOVERNANCE BODIES

Executive Commission_

Telefónica is led by a group of professionals who are responsive to the demands of the modern economy in an increasingly digital environment.

The organization is based around an Executive Commission of nine members, who make up the main management body. Their mission: to define strategy and monitor the performance of the businesses.

This Executive Committee is made up of the Executive Chairman, the Chief Operating Officer, the Head of Telefónica Digital, the Heads of the two regional organizations (Europe and Latin America), the Head of Global Resources, the Chief Financial and Corporate Development Officer, the General Secretary and Secretary of the Board, and the Director of Strategy and Alliances.

The Executive Commission is supported by a Transformation Committee, formed by the members of senior management most linked to the remodeling of the Company and by representatives of most of the countries.

Telefónica's Executive Commission normally meets twice a month, although special sessions are held when necessary

Chairman & CEO
César Alierta

General Secretary and Secretary of the Board
Ramiro Sánchez de Lerín

Chief Operating Officer (COO)
José María Álvarez-Pallete

Telefónica Digital
Matthew Key

Latin America
Santiago Fernández-Valbuena

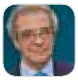
Finance & Corporate Development
Ángel Vilá

Strategy & Alliances
Eduardo Navarro

Europe
Eva Castillo

Global Resources
Guillermo Ansaldo

Executive Commission members

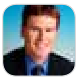


César Alierta*
Executive Chairman & CEO

J. M. Álvarez Pallete*
Chief Operating Officer (COO)

Eva Castillo*
Chairwoman Telefónica Europe

Santiago Fernández Valbuena*
Chairman Telefónica Latinoamérica



Matthew Key
Head of Telefónica Digital

He was appointed Director-General of Telefónica O2 Europe in November 2007. In 2005 he was designated a member of the Executive Committee of O2 UK. Before joining O2, he worked with Vodafone, where he was UK operations finance director for four years. Previously, he had held various executive posts in the financial departments of companies like Kingfisher, Coca-Cola, Schweppes and Grand Metropolitan. After Telefónica's acquisition of O2, he joined the Board of O2 as an Executive Director.

Guillermo Ansaldo
Head of the Global Resources operating unit

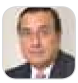
Graduate in Industrial Engineering from the Universidad de Buenos Aires. Master in Business Administration from Amos Tuck School of Business Administration, Dartmouth College. In 2000 he joined the Group as CEO of Telefónica in Argentina S.A. In 2005 he was named Chief Operating Officer of Telefónica Spain. Between 2007 and 2011, he was President of Telefónica Spain before becoming Head of the Telefónica Global Resources operating unit.

Ángel Vilá
Chief Financial and Corporate Development Officer

He graduated in Industrial Engineering from Universitat Politècnica de Catalunya and holds an MBA from Columbia University. After working with Citigroup, McKinsey&Company, Ferrovial and Planeta, he joined Telefónica Group in 1997. In 2000 he was appointed Director-General of Corporate Development. He is a member of the board of Telco SpA.

Eduardo Navarro de Carvalho
Director of Strategy and Alliances

Graduate in Metallurgical Engineering from the Universidad Federal de Minas Gerais, Brazil. In 1999 he joined Telefónica Group. He was Head of Strategic Planning and Regulation at Telefónica International. Between 1999 and 2005 he served as Vice-president of Corporate and Regulatory Strategy with Telefónica Group in Brazil, participating in the executive committees of several of the companies of Telefónica Group in Brazil. He worked as a Consultant with McKinsey&Company for five years (1994-1999).



D. Ramiro Sánchez de Lerín García-Ovies
General Secretary and Secretary of the Board

Began his professional career at Arthur Andersen. In 1982 he joined the State's team of attorneys at the Inland Revenue department in Madrid. Next stop was the Secretary of State's department for the European Community and then the Ministry of Foreign Affairs. He has also occupied, among others, the following posts: General Secretary, and Secretary of the Board, for Elosúa, S.A., Tabacalera, S.A., Altadis, S.A. and Xfera Móviles, S.A. Currently, he is also a member of the Board of Directors of Telco, SpA.

* The biographies not on this page feature on pp14-15, since the executives concerned form part of the Board of Directors.

2.0
Telefónica in 2012_

Telefónica in the world in 2012_

MEXICO
Revenue 1,742.5 M€*
Investment 427 M€*
Employees 3,024
Accesses** 20,326.9

GUATEMALA
Revenue 177.3 M€*
Investment 21.2 M€*
Employees 517
Accesses** 3,304.3

EL SALVADOR
Revenue 130.2 M€*
Investment 21.1 M€*
Employees 311
Accesses** 1,959.1

NICARAGUA
Revenue 153 M€*
Investment 22.9 M€*
Employees 398
Accesses** 2,367.2

COSTA RICA
Revenue 50.3 M€*
Investment 25.6 M€*
Employees 263
Accesses** 423.2

VENEZUELA
Revenue 3,388.5 M€*
Investment 463 M€*
Employees 7,022
Accesses** 11,664.6

PANAMA
Revenue 166.8 M€*
Investment 40 M€*
Employees 440
Accesses** 1,660.2

COLOMBIA
Revenue 1,778.6 M€*
Investment 352 M€*
Employees 3,452
Accesses** 14,126.1

ECUADOR
Revenue 473.4 M€*
Investment 85 M€*
Employees 1,328
Accesses** 5,019.6

PERU
Revenue 2,470 M€*
Investment 378 M€*
Employees 9,369
Accesses** 20,299.9

CHILE
Revenue 2,576.9 M€*
Investment 606 M€*
Employees 5,363
Accesses** 13,147

Present in 24 countries: Argentina, Brazil, Chile, China, Colombia, Costa Rica, Czech Republic, Ecuador,

62,356 M€ * joint revenues

9,458 M€* total investment

133,263 employees 95% of all contracts are permanent

And_

Telefónica reinforces its global scale with alliances and collaboration agreements. Through our strategic alliances with China Unicom and Telecom Italia, we reach 871 million customers.

* Million euros
** In thousands

El Salvador, Germany, Guatemala, Ireland, Italy, Mexico, Nicaragua, Panama, Peru, Puerto Rico, Slovakia, Spain, UK, Uruguay, USA and Venezuela

315.7 million accesses

1st European operator by revenue

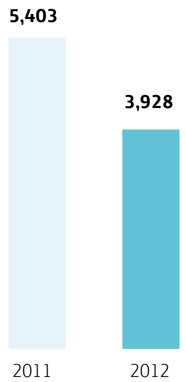
7th operator in the world by market capitalization

Telefónica in numbers (2012)_

Net profit

- 27.3%

Million euros



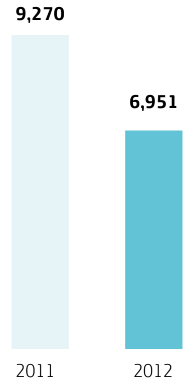
The behavior of net profit in 2012 compared to that of 2011 (-27.3%) was affected by various extraordinary impacts, which reduced this quantity by 2,536 million in the last year.

These include the value adjustment in the participation in Telecom Italia and Telefónica Ireland, and the effect of the devaluation of the Venezuelan bolívar. Without these effects, the consolidated net profit was 6,465 million euros.

Cash flow

- 25%

Million euros



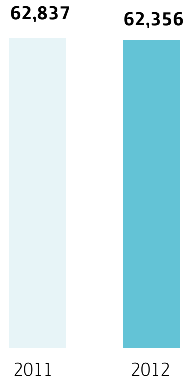
The free cash flow was 25.0% less than 2011, fundamentally as a result of lower generation of working capital and higher interest payments.

Nevertheless the financial flexibility has been increased and there is ample provision for the dividends promised for 2013.

Revenue

- 0.8%

Million euros



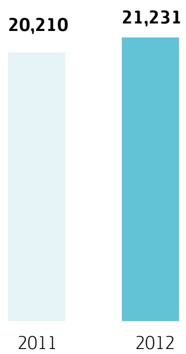
Revenue fell by 0.6% year-on-year (rise of 0.7% excluding the impact of regulation).

Noteworthy is the solid growth in mobile data revenue (+12.8% year-on-year) and the evolution of this in Latin America (+5.5%), which accelerated in the fourth quarter to grow by 7.5% organically.

OIBDA

+ 5.1%

Million euros

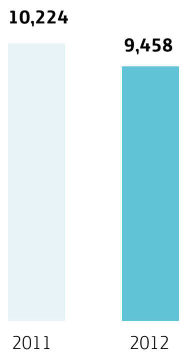


The consolidated OIBDA of Telefónica grew by 5.1% in reported terms to 21,231 million euros, which situated the OIBDA margin at 34% (+1.9pp).

Investment

- 7.5%

Million euros

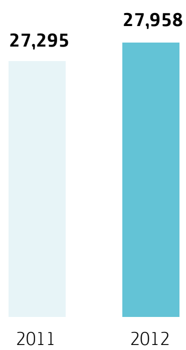


During the year, Telefónica allocated 14.2% of its revenue to investment (excluding investments made in spectrum). Of this, 81% was assigned to projects of growth and transformation.

Suppliers

+ 2.4%

Purchasing volume.
Million euros

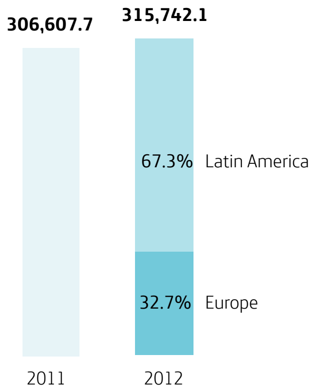


In 2012, Telefónica had about 20,000 contracted suppliers from 68 countries, of whom 85.6% are contracted at a local level. The purchasing volume was close to 28,000 million euros, which is 2.4% greater than the previous year.

Accesses

+ 3%

In millions



Telefónica closed the year with a customer base that grew 3% to reach 316 million accesses and with recovery in the commercial impetus in Europe.

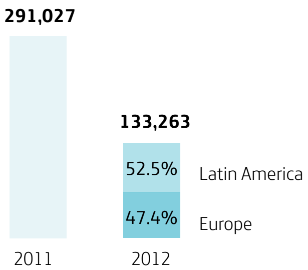
Mobile clients reached 247 million accesses at the end of 2012 (+4%), with a growth rate of +7% in the contract segment.

At the end of December, Telefónica had 52.8 million mobile broadband customers (+38%) and with 18.6 million end-user accesses of fixed broadband (+3%).

Employees

n.s.

Number of people



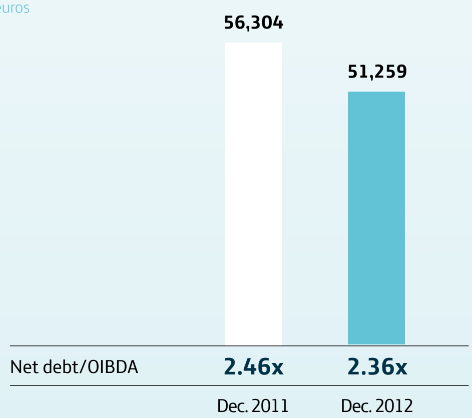
The number of workers at 31 December 2012 is affected by the **sale of Atento,** which had over 150,000 employees. If we exclude this effect, the total workforce is 4.1% less than in 2011 due to the restructuring processes that the Company is carrying out in various operations to improve the fit of the workforce to the new business requirements.

Latin America still has the greatest percentage of the Telefónica Group workforce, with 52.5%, while 47.4% are based in Europe. Telefónica continues to opt for sustainable work policies, so that 95% of its workforce have permanent work contracts.

Debt

-5,045

Million euros



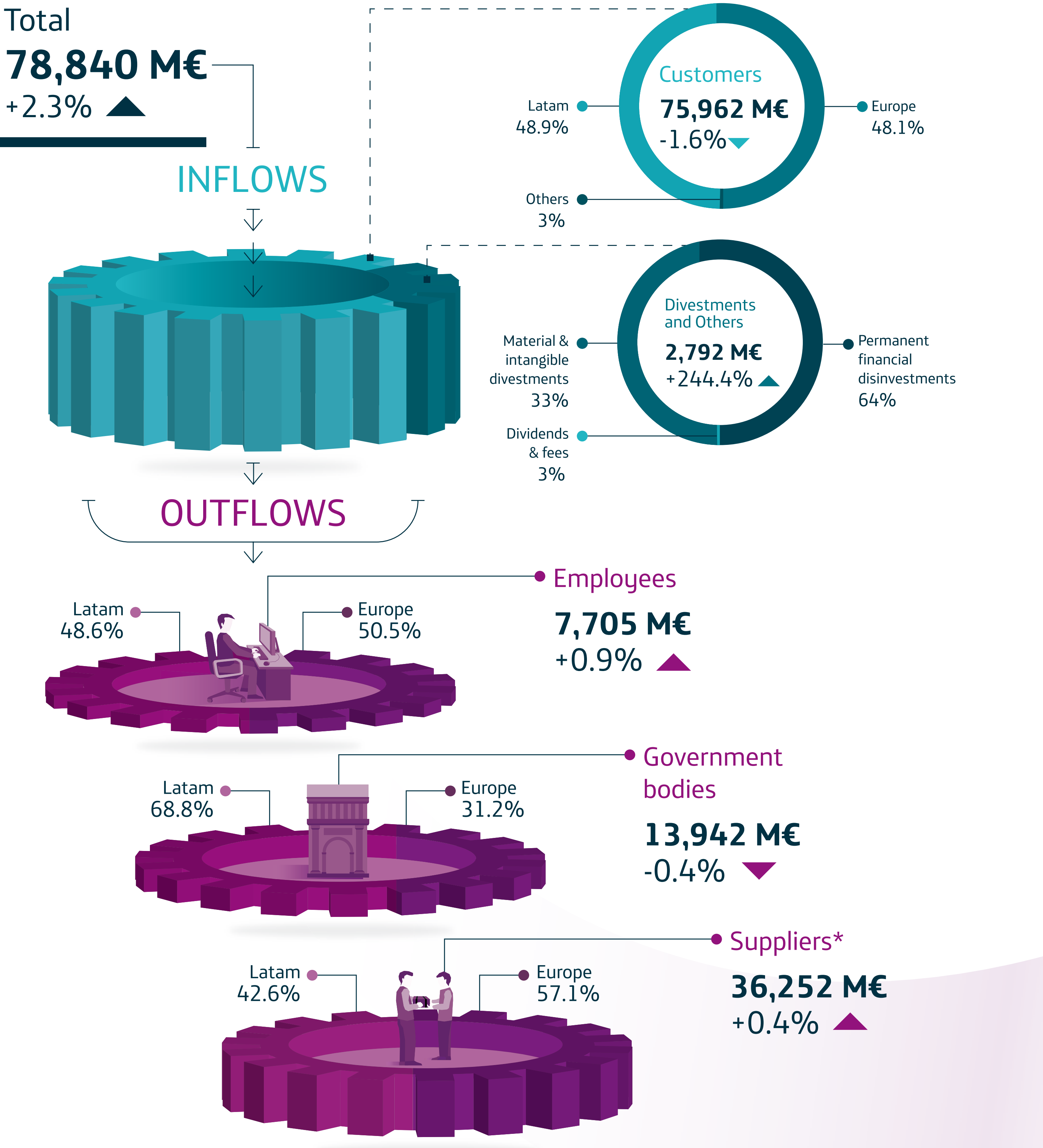
Between January and December, Telefónica reduced its net financial debt by more than 5,000 million euros to reach 51,259 million euros, which situates the ratio of net financial debt to OIBDA at 2.36 times.

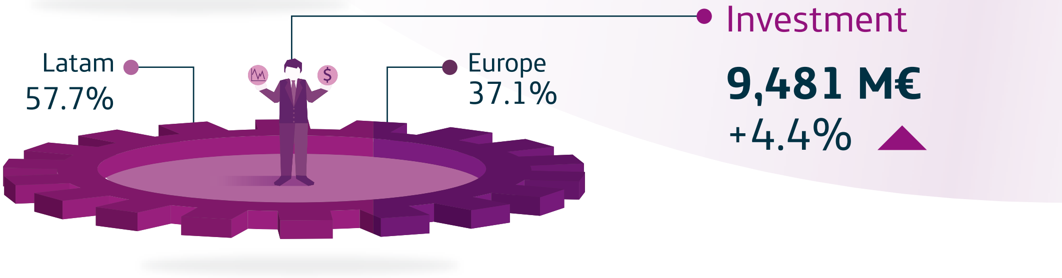
Moreover, thanks to an active financing policy (15,000 million euros between January and December), the debt maturity profile of Telefónica is now provided for until beyond 2014. All this is compatible with the investments in areas of greatest growth and in acquisition of spectrum.

Remuneration of shareholders

2012 underlying EPS (euros/share)

The evolution of the liquidity and the results throughout the year permit the renewal of the policy of remuneration of shareholders for 2013, with the distribution of a cash dividend of 0.75 euros per share.





Notes:
- All figures are expressed in millions of euros.
- The information in this graph has been calculated on a payments basis and it takes into account the audited accounting consolidation perimeter in Telefónica's financial statements.
- Employee salaries include social security payments.

(*) Includes interconnected suppliers.

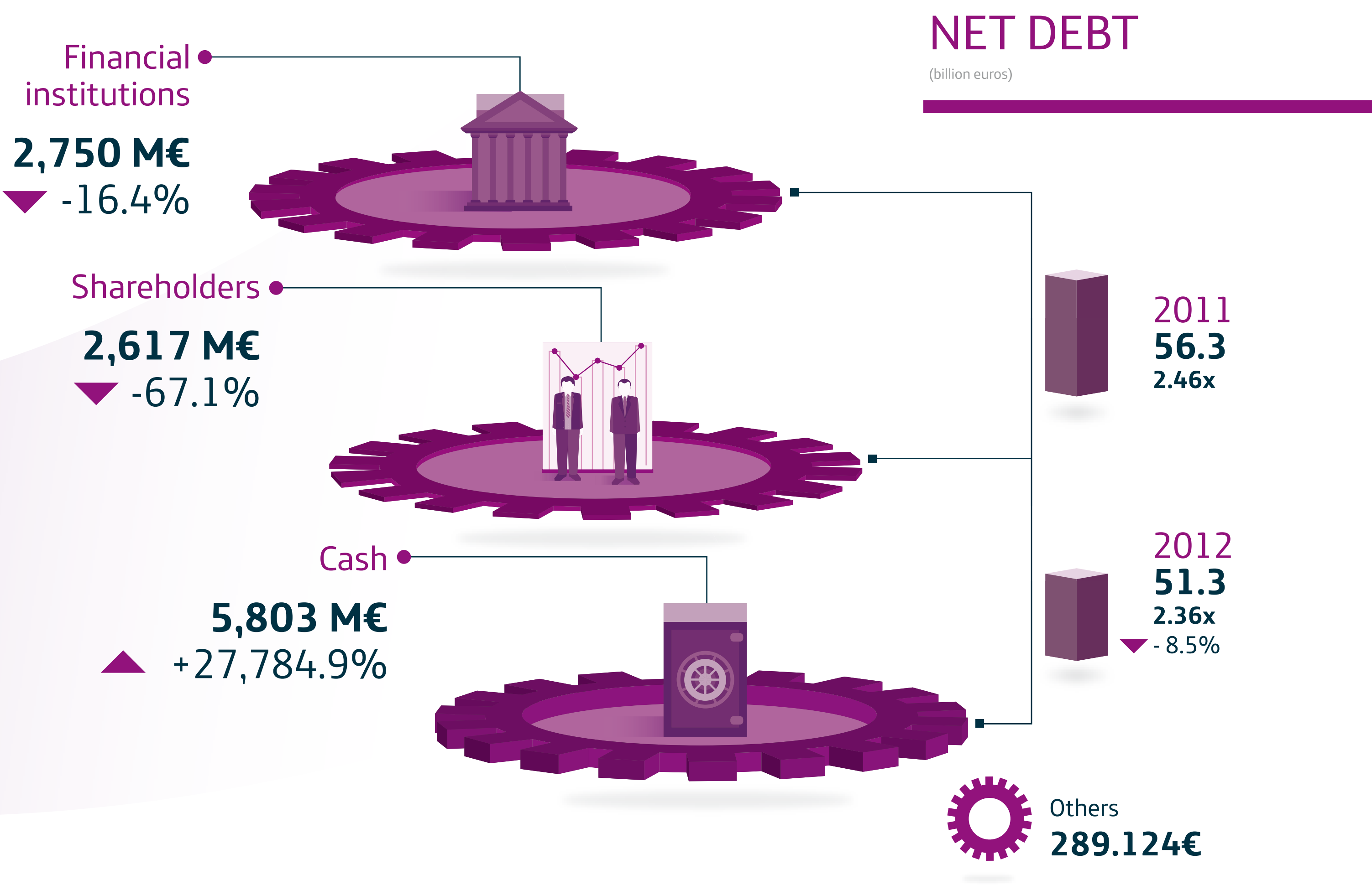
Telefónica in terms of economic impact: motor of progress_

The Company has shown a significant improvement in its financial flexibility thanks to asset management and cash generation.

In 2012, the total amount distributed by Telefónica increased by 0.9% to reach 78,840 million euros. Regarding inflows, it should be emphasized that an important part of this amount comes from permanent financial divestments in China Unicom and Atento. Both sales were commitments already announced by Telefónica to improve financial flexibility and ensure provision for the Company's commitments to its stakeholders in 2013. It should also be said that these divestments compensate for the fall in net revenues that has taken place in the period, mainly impacted by the complex environment for operations in Europe, exchange rates and regulation.

This financial flexibility has manifested itself in an important increase in the liquidity position of the Company, which reached 5,803 million euros at 31 December 2012 and reduced the ratio of net debt over OIBDA from 2.46x to 2.36x. In addition, it has managed to reduce the outflow towards financial institutions by improved debt management, which has allowed the effective rate of interest of the Company to be reduced from 5.50% to 5.37%.

Just as in the preceding year, there were notable divestments in non-strategic mobile infrastructures. These make up a series of initiatives carried out to optimize the use of capital and improve the energy efficiency of services to Telefónica's customers.



3.0

Towards a Digital Telco.

Objective: create value for everyone_

"The Digital revolution will change the world (it has already started to): the way of interacting with one another, of studying, learning, producing, taking care of ourselves... everything will be different! In such a future, the rules are not set. It is a great opportunity for our sector and for Telefónica to design the future that begins today."

José María Álvarez-Pallete
Chief Operating Officer, Telefónica

The opportunities of a sector in transformation_

Telecommunications are at the core of the digital revolution. The whole digital ecosystem revolves around them: devices, applications, content and operative systems. Without doubt, it is the telcos that make the Internet possible.

Demand for connectivity has grown fast, with a smartphone park of 17% of users worldwide, up 42% in 2012

We are going through radical changes. Mobility, broadband, and all the new digital services that become a reality thanks to them, are creating a new world, a digital world. In it, our children are digital natives. And us, digital immigrants that become dazzled with what is nowadays possible to do with just a mobile phone and a broadband connection.

The way in which we enjoy, learn, interact with others, and work keeps evolving. Thus, faster and ubiquitous accesses will be increasingly necessary in order to serve the strong connectivity demand that all forecasts point to; these are already visible through the service growth rates on land line and mobile data offered by the operators. A proof of this trend and potential is seen in the number of smartphones, showing a 42% increase in 2012, but which still only accounts for 17% of the users worldwide. There are already 1.1 billion smartphones and 2.4 billion internauts, and mobile Internet traffic exceeds that of PCs in countries like India. Nevertheless, beyond connectivity and data, a new way of thinking will be necessary, specially for the so-called digital emigrants, i.e. those people that still haven't made the most of all possibilities provided by the digital world.

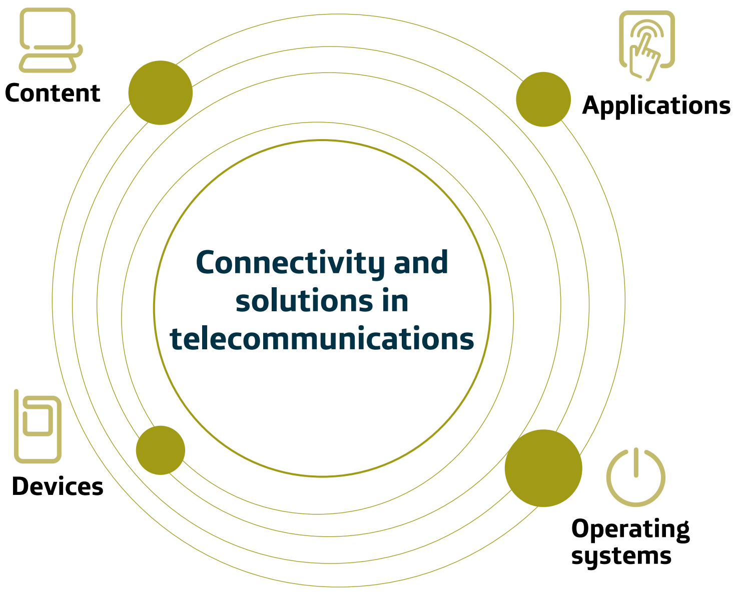
In order to give way to this new trend, new network capacities and intelligence are being developed, requiring a new technological framework for the infrastructures: the new generation networks. Some of the many opportunities that are already in place are fixed fiber accesses, fourth generation mobile networks, cloud computing, treatment of mass volumes of real-time data or machine-machine connections. Their impact is much greater than the simple renewal of the industry's services portfolio.

1.1 billion
smartphones worldwide

2.4 billion
internauts worldwide

In **2012**
the number of smartphones and tablets sold outnumbered PCs

Distribution of value created by Telefónica



And in this new world, what is the role of telecommunications? In simple terms, this industry makes the Internet possible. The telecommunications industry constitutes the backbone of the new digital ecosystem, which in turn is pushing forward industrial reinvention in all types of sectors. This is nowadays clear regarding distribution and contents, but other economic activities - such as financial services, health, education and public administration - are also progressing in their digitalization processes. Those mentioned alone represent 35% of the world's GDP. Beyond services, digital revolutions are also expected in primary and secondary sectors because of the impact of robotics, georeference, new materials or 3D printing.

Taking part as an ICT enabler in the new value chains represents an important opportunity for telecommunications, whose industry will have a determining role thanks to its networks, customer relations and third party platforms, recurrent direct revenues and multi-local presence. All these give the telecoms industry a distinct advantage over the other Internet agents, who are limited due to indirect business models based on advertisement, with a limited local adaptation and depending on the temporary tolerance of the users regarding their weaknesses on integration, stability, security, transparency or privacy.

We can speak of a new industrial revolution, a digital one, in which the operators are best placed in terms of the opportunities which they are opening up. In this sense, the intense internal competition among them has served as a stimulus for the industry in the development of characteristics such as anticipation and ability to adapt in timely fashion regarding technological changes, variations in consumer preferences or the economic, political and social reality; as well as regarding the urgency to increase the efficiency in operations, the accuracy in the deployment of infrastructure, the release of non-strategic assets and the efficiency regarding project development and execution. Those operators most advanced in their own transformation will be able to enjoy preferential access to the growth potential arising from the digital world and the digitalization of other sectors.

This is why Telefónica is evolving towards becoming a Digital Telco, to lead the new digital ecosystem and contribute in the redesign of the rules.

Towards a new positioning

Telefónica is participating in a transformation process in order to become a digital operator. The Group has played, and continues to play, a leading role within the telecommunications world and must hold that role in the new digital ecosystem, with an active participation in the development of, and debates over, the Internet.

The Company wants its customers to enjoy all possibilities provided by the digital world. Operators' telecommunications networks make the existence of the Internet possible, but Telefónica also aspires to a safe Internet, a trustworthy Internet, and an open Internet.

Concepts such as portability in digital life, interoperability of ecosystems, respectful and non-intrusive advertising, respect for the privacy policies, or security in communications are key issues in Internet.

All of them are related to the concepts of trust and freedom of choice for our users. Telefónica wants to help people understand, access and enjoy the best that the digital world has to offer. For this to be possible, trust is a key aspect, not only for the role that Telefónica wants to have in the digital world, but also for this world's sustainable development.

In this line, Telefónica wants users always to have options, and to be allowed to choose in this digital world. Under no circumstance should this new ecosystem be more closed off and provide less options to users than the ones they have been enjoying in the more traditional Web ecosystem.

Telefónica is already adopting a stand in all of them that aims to and must remain close to the concerns of Company customers.

A MODEL FOR CREATING VALUE

A structure for implementing the strategy_

Faced with a changing market, Telefónica believes in an integrated vision of its businesses, R&D and the digital world, with the customer always at the heart of its strategy.

Telefónica is an integrated and diversified telecommunications group that offers a wide range of features, principally in Europe and Latin America. The Company's activity is centered around services of fixed and mobile telephony, broadband, Internet, data traffic and pay TV, among others.

The presence of the Company in 24 countries, managed through regional structures, allows it to make use of the advantages of both its local positioning and its international scale. This robustness is reinforced by the opportunities presented by the agreements and participations entered into with China Unicom and Telecom Italia.

As a multinational telecommunications company which operates in regulated markets, Telefónica is subject to different laws and regulations in each of the jurisdictions in which it provides services. In this regard, it is expected that in Europe, the legal environment will continue to change as the common framework in force in the European Union is revised. Besides, in some countries, Telefónica could be faced with the pressure of regulatory initiatives in respect of rates and the reform of rights of use and allocation of spectrum. These questions are related to the quality of service and the regulatory treatment given to the deployment of the new broadband infrastructure.

In highly competitive markets, the Company starts out from a strong position, which will allow it to profit from emerging growth opportunities. In this way, Telefónica will be able to give impetus to broadband services, both mobile and fixed, or develop other additional ones based on connectivity, IT applications and systems, and adjacent businesses. The motive is clear: the Company wants to lead the telecoms sector and be ahead of the game, whatever trends may arise.

Business model

In order to establish itself as a telecoms operator of the digital world and grasp the opportunities that its structure and its industrial and strategic alliances present, in September 2011 Telefónica defined a new organizational structure. Its objective: to fortify its business model to make it more efficient and make the most of the synergies that arise from an integrated perspective on the businesses, processes and technologies, to direct itself even more towards the customer.

The Company model, which became fully operational in 2012, rests on four pillars:

- Digital
- Global Resources
- Latin America
- Europe

Telefónica's strong competitive position will allow it to profit from emerging growth opportunities

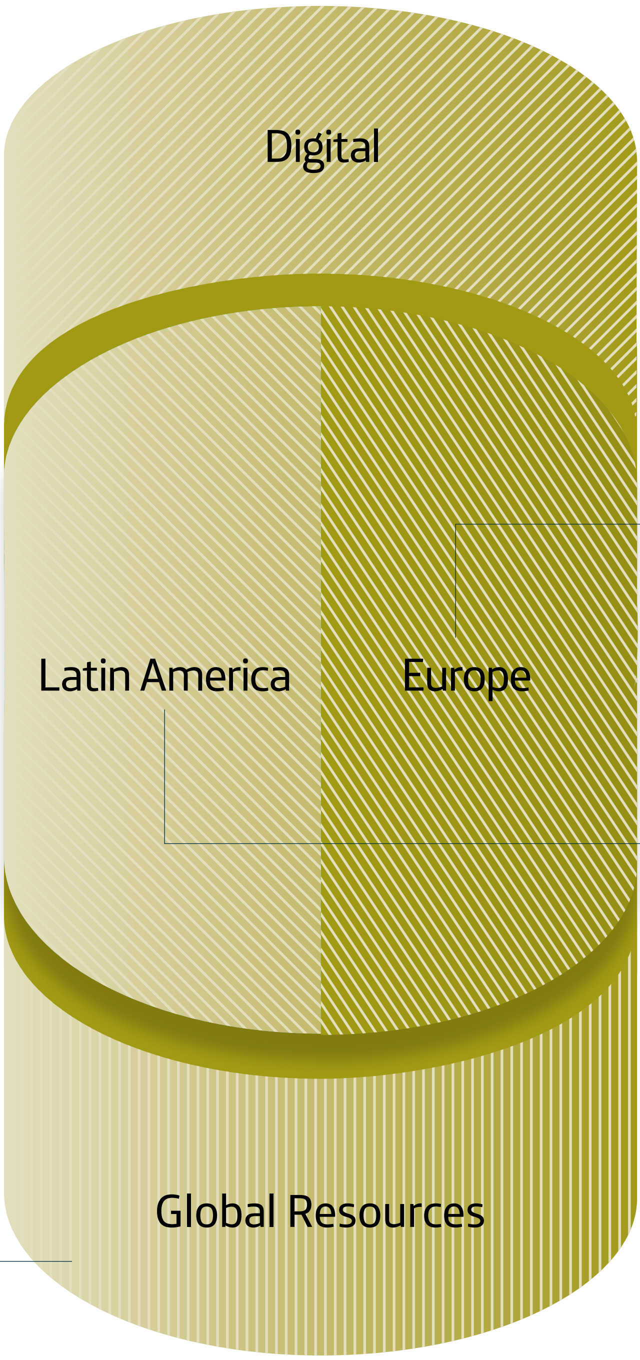
Digital

- To take advantage of all the growth opportunities of this environment.
- To accelerate innovation, broaden and strengthen the range of products and services.
- To maximize the advantages of Telefónica's customer base in a world which is ever more connected.

Global Resources

- The creation of the operating unit of Global Resources guarantees the profitability and sustainability of the businesses, taking advantage of the scale of the Company as well as accelerating the transformation towards a fully global model.
- The improvement of operational efficiency will be one of Telefónica's objectives. To achieve this, different local and regional initiatives will be implemented, such as network sharing agreements.

Organizational structure adapted to the business



Europe

- European customers will continue to occupy center stage in Company strategy and management priorities will focus on maintaining satisfaction. To this end, mobile broadband will be fomented strongly, complementing existing services with new products.

    - **In Spain,** in the second half of 2011, a strategy improving Company postioning and increasing efficiency was launched. Key changes have been made in the commercial and operational model, such as improvement in the value proposition and quality of service, elimination of subsidies for new clients and the launch of Movistar Fusión (a package including all domestic communications needs).

Latin America

- The strategy on the American continent is based on a model which leverages its growth and the economies of scale without losing sight of dealing with the customer locally. The mobile business will continue to play a fundamental part as a driver of growth. With this in mind, Telefónica will continue increasing the capacity and coverage of its networks, and tuning its distribution channel to increase the quality on offer. As for the fixed-line business, the availability of higher broadband speeds will be boosted and the range of packaged services will be extended. The intention is also to improve operational and commercial efficiency and seek new synergies to implement global, regional and local projects.

VALUE FOR SHAREHOLDERS

A company of nearly a million-and-a-half shareholders_

At 2012 year end, Telefonica was the seventh largest telecommunications company in the world in terms of stock market capitalization, the top integrated European operator and 18th in the Eurostoxx 50 ranking, which covers the largest companies of the Eurozone.

Telefónica is a company fully quoted on the Stock Exchange which has a total of 4,551,024,586 ordinary shares with nominal value of 1 euro, held by around one and a half million shareholders. The Company shares are quoted on the Spanish continuous market (within the select Ibex 35 index) and the four Spanish stock exchanges (Madrid, Barcelona, Bilbao and Valencia), as well as those of London (United Kingdom), New York (United States), Buenos Aires (Argentina)and Lima (Peru).

At the time of the call of the 2013 General Shareholders' Meeting, the Company had 1,463,746 shareholders distributed around the world. The most significant shareholders include BBVA (5.753%) and Caixa (5.596%).

2012 achievements

In 2012, Telefónica distributed 4,046 million euros in remuneration to its shareholders, an amount representing 58% of the cash flow generated in the reporting period and around 8% of the stock market capitalization of the Company at the end of that period. In should be noted that in mid-2012, due to the extremely harsh financial and economic context and external factors that aggravated possible financial risks, Telefónica decided to take definitive measures to mitigate these possible risks. In this regard, the Board of Directors decided at its meeting in July 2012, in accordance with the principle of prudent management and in the best interests of all of the stakeholders of Telefónica, as an exceptional and specific measure, to cancel the dividend and repurchase of shares for

€4,046m
used to remunerate the shareholders during 2012

1,463,746
shareholders at the time of the call of the General Meeting

70,286
calls dealt with by the Shareholders' Office

In 2012, Telefónica spent 4,046 million euros in remunerating its shareholders, a sum that exceeded the 2012 cash flow by 58%

2012 (including payments in cash and the scrip dividend of November 2012 and May 2013, respectively). In 2013, the Company has declared its intention to repay the dividend (0.75 Euros per share) in two parts: a first instalment (0.35 euros per share) in November 2013 and a final payment in the second half of 2014.

Shareholders' Office

Through the Shareholders' Office, Telefónica ensures transparent and smooth communications with its individual shareholders, facilitating the same information in time and form as the institutional shareholders. At the close of 2012, over 200,000 shareholders were registered at the Shareholders' Service Center who receive the Shareholder Card that identify them as such. The Company distributes among them the quarterly magazine, *Acción Telefónica*, a publication with financial references and news reports as well as information about exclusive campaigns that can be accessed. During 2012, we sent 593,798 copies directly to shareholders' homes.

The Telefónica Shareholders' Office has a free telephone number (900 111 004), through which it dealt with a total of 70,286 calls during 2012, with a monthly average of 5,857. For the period coinciding with the Annual General Meeting, the number of monthly calls went up to 20,690. Apart from these telephone consultations, the Shareholders' Office also answered more than 5,348 queries by email (accion.telefonica@telefonica.es) and by post.

VALUE FOR CUSTOMERS

The year the commercial offer was simplified_

In 2012, we transformed the commercial model from one centered on subsidies to another more sustainable, based on quality and differentiated from the competition.

Transparent communications and tariff simplification are essential, so that customers can see the competitiveness of products and services

Lines of progress

The basis of the Group's business is to offer value to its customers. This is why Telefónica is totally committed to the continual improvement of customer experience and the emotional link with the Company's brands. That is, to transform the Company into a global communications leader of the digital world.

To achieve this, Telefónica is fomenting a cultural shift which puts the customer at the heart of daily work, a fundamental maxim for all those who form part of the Company. This process is the fruit of the conviction that only by means of customer satisfaction and the building of solid relations of trust will it be possible to achieve the growth objectives which the Company has set itself.

Achievements 2012

At the close of 2012, total accesses had grown by 3% year-on-year to reach 315.7 million, with significant rises in the numbers of contract customers and for fixed and mobile broadband. Especially notable is the evolution of Telefónica accesses in Latin America (now 67% of the total), with an increase of 6% over December 2011.

Mobile accesses reached 247.3 million at the end of the last quarter, 4% more than in 2011. This is founded on sustained growth in the contract segment of the market (+7% year-on-year) now representing 33% of all mobile accesses. The net mobile gain in 2012 totals 12.1 million accesses (excluding the disconnection of 3.6 million inactive mobile accesses in Spain and Brazil) with the contract segment being 52%.

Mobile broadband accesses attained 52.8 million at December 2012; they increased by 38% year-on-year and make up 21% of all mobile accesses (up by more than 5pp with respect to the previous year). Also noteworthy was the strong commercial activity in smartphones during the year, with a net gain of 15.4 million in 2012 (over 20% year-on-year) and a penetration of 19% of the base of mobile accesses (over 6 percentage points up over the previous year). The fourth quarter is especially worth highlighting, with a net gain of 5.4 million, the largest in 2012 and 73% greater than in the third quarter. It is also important to point out the significant acceleration in the quarterly net gain of intelligent phones in Europe, fundamentally due to the commercial impulse recorded in Telefónica Spain.

Fixed accesses reached 40 million at the end of the fourth quarter in 2012, recording a net gain in the quarter of 181,000 accesses (-217,000 in Q3) and a smaller fall in interannual terms compared to September (-0,3% at Dec 2012 compared to -1,5% at September 2012).

Retail fixed broadband accesses were 18.6 million at the end of 2012, representing growth of 3% over December 2011, recording a net gain in the year of 530,000 accesses (+72,000 in the quarter). In the fourth quarter, it is notable that Telefónica Europe had a quarterly net gain for the first time since March 2011. This increase is due to the commercial impetus in fixed broadband recorded at Telefónica Spain. Retail fixed broadband accesses attained a penetration of 46% of all fixed-line accesses (+1.5 percentage points year-on-year).

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Country	Main achievements		Challenges 2013
	Qualitative	Quantitative	
Spain	• Introduction of a new commercial model for terminals based on fidelity and eliminating subsidies • Launch of Movistar Fusión, the best convergent product on the market • Growth in customer satisfaction index • Reduction in complaints and *churn*	**1.1 million** Fusión customers	• Acceleration of the quality transformation process and simplification aimed at lower cost and investment
United Kingdom	• Improvement in behavior of market in On&On tariffs for smartphones and for pre-pay in the Pay&Go rates • Preparation for the commercial launch of 4G services in 2013 with an infrastructure-sharing agreement with Vodafone • The Company was the one with the fewest complaints about its network	**Net gain in contracts 961,000** (+118% over the preceding year)	• To maintain the commercial impetus with proposals that lead the market while we offer real 4G network experience
Germany	• Strong commercial push • Success in monetizing mobile data • Investment focused on mobile LTE networks to face future growth and secure access to the VDSL platform	**The penetration of smartphones** rose by 6pp with respect to the preceding year, to reach **26%**	• To increase our mobile market share through use of our multibrand portfolio and to maintain a competitive network with the delivery of LTE to urban areas
Czech Republic and Slovakia	• Commercial drive in focussed areas despite the continual fierce competition • Growth in number of customers	**Total accesses: 9.3 million** (+4% compared to the previous year)	• Continued spotlight on efficiency to protect profitability
Ireland	• Growth in number of contract customers	**782,000 customers with contract** (+4% compared to the previous year)	• Move towards business stabilization

315.7
million
total accesses

247.3
million
mobile accesses

52.8
million mobile
broadband accesses

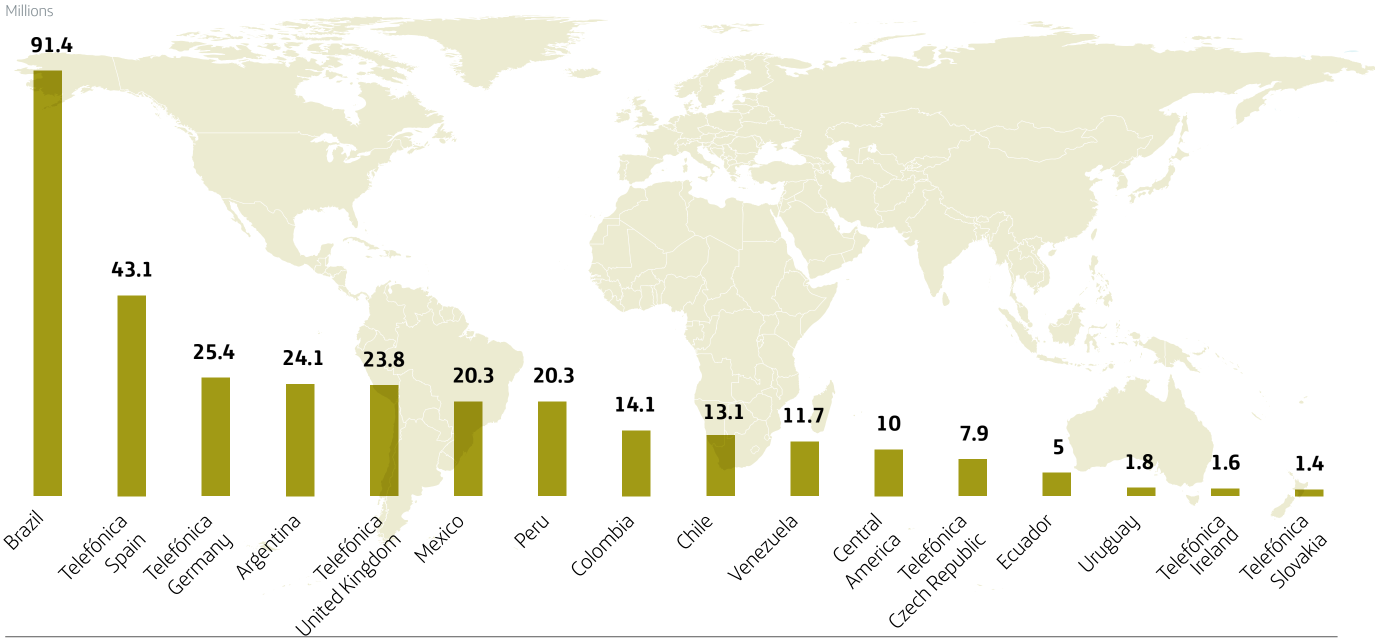
33%
of mobile accesses
are now contracts

Country	Main achievements		Challenges 2013
	Qualitative	Quantitative	
Argentina	• The network of specialized channels has been increased, with more than 50 new Relationship Points • A new portfolio of digital products was launched (SONORA, mobile, Wanda, Cloud services, etc.) • A daily data rate was launched to attract mass use of mobile broadband, with an offer segmented towards a younger public	• **24.1 million accesses,** with year-on-year growth of 5% • More than 85% of fixed accesses are as part of DUO or TRI packages • There was an increase of over 20pp in the Service Level of Technical Customer Service	• Improve the quality of the mobile network
Brazil	• The brand has been unified, boosting the Company's differential attributes and increasing the possibilities of connection • Convergence of customer service channels • The best rated operator in the AIF (service performance index) of Anatel (the country's regulator) in mobile telephony • Launch of the IPTV platform and acceleration of the use of fiber	• Integration of accounting systems for accesses of fixed line (10.6 million), mobile (76.1 million) and television (601,000 accesses) • Workforce growth of 4.9%: there are **91.4 million accesses and 80 million contracts per month** received by all service channels • **100,000 customers were attended**	• Focus on the change underway in the fixed business while keeping up the good performance of the mobile business, profiting from the quality of our offer
Central America	• Telefónica established itself as the mobile operator with the greatest customer growth in Central America • In all the operators of the region, the Company is leader in ISC (Index of Customer Satisfaction), outstanding even in Nicaragua and El Salvador, the best performance in Latin America	• The figure of **10 million customers was reached,** attaining year-on-year growth of 23% • Total **coverage was increased by 24%** and the 3G footprint rose by 46%	• Focus on getting to know the customer, and maintaining leadership in the ISC
Chile	• Development of the high-speed mobile and fixed broadband offer, both in VDSL technology and in optical fibre, and continuous improvement through service bundling • Launch of the new TV platform over IPTV • Change of the call center model with better prepared managers to improve resolution and satisfaction indicators	• The year closed with over **13 million accesses,** a year-on-year growth of 4% • Noteworthy are the **growth of the mobile operator by more than 5%** boosted by the increase in the pre-pay market and smartphones and the rise of 6% in broadband and 8% in television recorded by the fixed operator • The growth in the number of high-speed broadband customers is another highlight. At year's end, there were over **70,000 customers**	• Improvement in satisfaction and transformation into online company

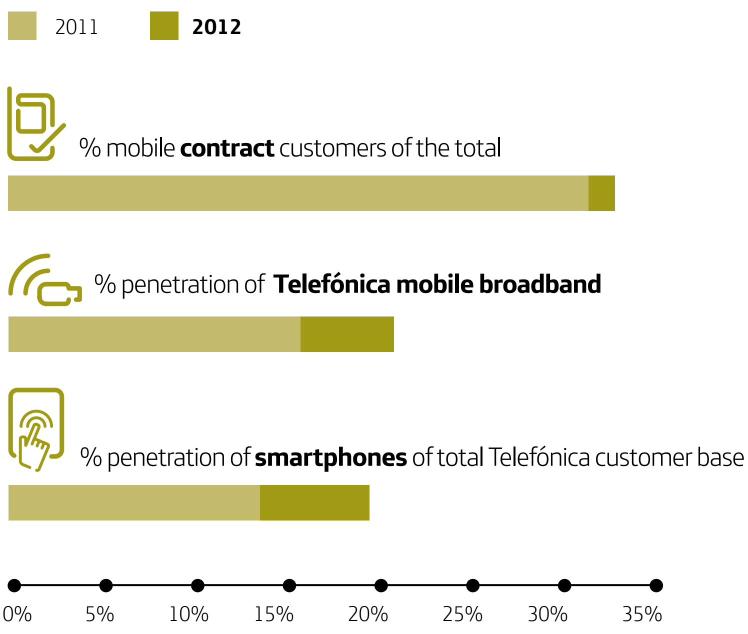
Country	Main achievements		Challenges 2013
	Qualitative	Quantitative	
Colombia	• Consolidation as the leading telecoms operator in the country with a convergent portfolio, commercialized under the single brand Movistar and capture of synergies produced by the fusion	• Handling of **14.1 million accesses,** with year-on-year growth of 3% • **Growth in the customer bases** for broadband (+15%), television (+12%) and post-pay (+10%)	• To capture the growth in the data market
Ecuador	• Substantial growth in the penetration of Small Screen (customers with data packages contracted). The proportion with a contract has gone from 31% to 37%, and the penetration of the pre-pay market doubled (from 3% to 6%) • Launch of the Mobile Sales Point channel to permit growth in pre-pay capture in areas like the coast, where participation in the market is low	• The year closed with over **5 million accesses,** a year-on-year growth of 11% over 2011 • Percentage of new contracts of "*Planes Smart*" (bundled voice + data), which went from 31% in 2011 to **56% in 2012** • **The number of contracts grew 12%** during 2012	• Maintenance of growth in the traditional business
Mexico	• Launch of the campaign "Prepago cero" (pre-pay zero), a landmark in the strategy of rate reduction within the "Todo Destino" (all destinations) plans • Launch of new data plans to develop the mobile broadband business, with the launch of LTE being a highlight • Operator with best network quality and fewest complaints • Highest customer satisfaction index in the industry	• Total accesses reached **20.3 million**	• Consolidation of the sales channel for the value segment • Simplification of processes
Peru	• Renewal of three mobile concessions for 18 years and 10 months • Consolidation of the integrated fixed-mobile organization, achieving management convergence with good results for the Company • Continuous improvement in data plans to foment the adoption of *smartphones*	• Handling of **20.3 million accesses** with year-on-year growth of 8%	• Leadership in the data market
Venezuela	• Focus on commercial campaigns to foment the adoption of mobile broadband and boost the penetration of smartphones • Boost digital services focused on television (DTH)	• Handling of **11.7 million accesses,** with year-on-year growth of 12% • Attainment of **3.2 million smartphones,** or a total of 33% of the customer base • The number of television customers (DTH) doubled, to reach **215,000**	• Maintain leadership in smartphones

Accesses by country

Millions



KPIs, mobile business



A look at the future

The optimal evolution of the fourth quarter of 2012 compared with the earlier ones offers certain grounds for optimism about the changes implemented in Telefónica's commercial model, which have transformed its offer from subsidy-centered to a more sustainable model based on quality and the development of differential offers that increase customer fidelity.

Telefónica is making progress in policies of Customer Intelligence, which lets it maintain distinct but fair prices and lets it focus on providing digital services that use its assets. Similarly, the Company is resolutely in favor of quality in its services, which makes it pay special attention to network quality, consumer experience, and makes it offer multi-channel communication to all its customers.

In the future, the levers of growth in revenues coming from customers will be in Latin America and the data market.

67%
of total customer base in Telefónica Latin America

4%
growth in mobile accesses with respect to 2011

40
million fixed accesses in 2012

78%
of all customers are mobile access (millions)

Challenges

Telefónica Group knows that fundamental for the customer are transparent communication and simplification of rates. To wit, that its users can assess the competitiveness of its products and services and their security and flexibility to be adapted to users' needs.

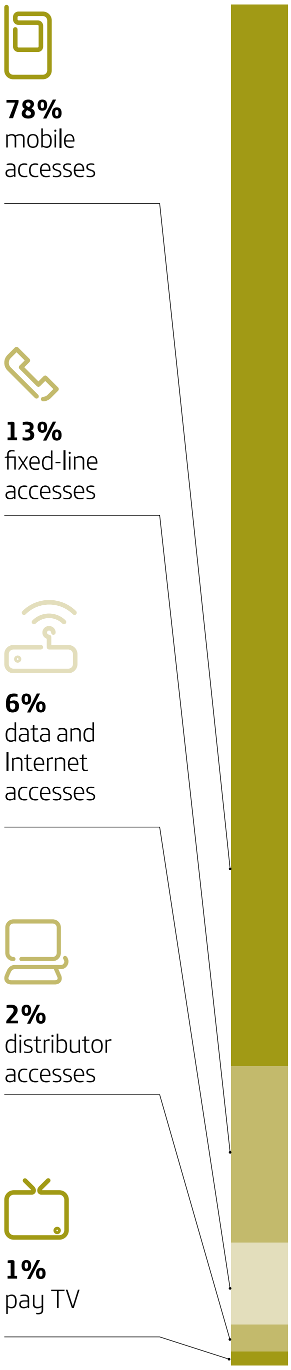
Telefónica has consolidated a collaborative and sharing work culture which has allowed it, in recent years, to swap best commercial practices and customer experiences, bringing them to all the countries where it is present.

For instance, the launch of Movistar Fusión at the end of 2012 has meant for Telefónica Spain an extremely important step on the path of centering its activity on the customer that it has taken. To achieve this, customer requirements and wishes were collected through a multitude of surveys and interviews. Movistar Fusión's USPs (unique selling points) are saving, transparency and simplicity. This is the first truly integrated offer on the Spanish market, with a single bill that includes fixed line, mobile, fixed and mobile broadband, and even television all in a single product. And for the first time, with line rental included in the price.

It is important to emphasize that products like Movistar Fusión, which the Company is backing strongly, contribute to a more sustainable customer relationship model. The motive is easy: they imply significant reductions both in the total cost to the customer and in churn, meaning that operational costs are reduced for the Company and its market share goes up.

On the other hand, the rates of economic growth and penetration in Latin America make clear that one of the critical factors in Telefónica's success will be its ability to lead the evolution of the mobile contract sector and of smartphones in the region.

Customers by type of access



3% year-on-year growth in total accesses	**12.1** million net gain in mobile accesses	**13%** of customers have fixed line	**2%** of customers are distributors

THE VALUE OF INNOVATION

Innovation as a lever for changing to the digital world_

The challenge of a changing and digital world requires unequivocable support for innovation in all divisions and as a way of doing business.

Telefónica's R&D&I activities impregnate all areas of the Company, so representing one of the biggest ICT innovation networks in the world

Fundamental plans

Telefónica is aware that technological innovation turns out to be key to achieving sustainable competitive advantages which permit the differentiation of the products it develops. So, R&D pervades all areas of the Company, both the transversal units (Telefónica Digital and Telefónica Global Resources), and the local operators. As for how it should be done, the Company considers that the way to ensure a differential advantage in its technological innovation activities is via R&D. This, combined with the acquisition of technology, represents an efficient manner of incorporating leading-edge products.

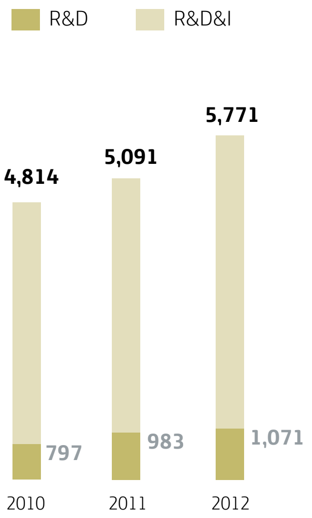
R&D activities take place by means of the work of Telefónica R&D and of a large variety of companies. Thus, we get one of the world's largest networks of innovation in the ICT sector. This model has permitted the opening of Telefónica's platforms to collaboration with third parties, backing new technology-based companies through venture capital initiatives and entering companies of technological interest.

2012 achievements

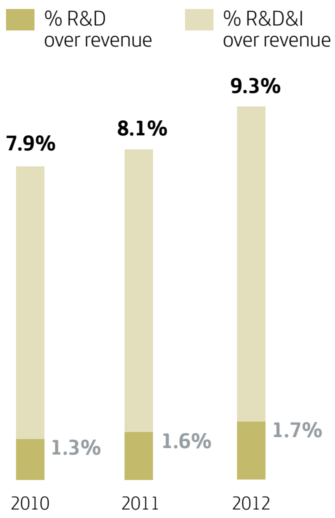
The Company celebrated this year the 25th anniversary of the founding of Telefónica R&D. And if this division was news in its day for being one of Europe's first private R&D centers, today it is news again for reaching a quarter of a century. During these years, Telefónica R&D has carried on adapting to the needs of the business and has joined the select band of companies investing more than one billion euros in R&D.

Performance evolution

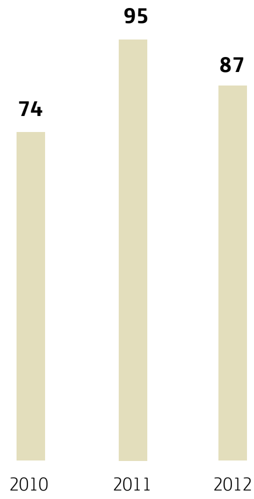
R&D&I investment
Million euros



Percentage of revenue



No. of patents



Currently, Telefónica has research centers in the United States, Israel, the United Kingdom, Brazil and Spain, where scientists and technologists of over 20 nationalities work.

For 2012, the following achievements should be highlighted:

- **TU Go.** This converts telephone service into an app which can be installed on whatever device is considered most appropriate.
- **Firefox OS.** Created with the intention of making intelligent telephones which use open web standards and where all functionality can be developed with HTML5 applications. It already has more than 2,500 developers.

'Wayra' is today one of the most important innovation projects in Telefónica. This is the link which connects startups to the Company. This initiative opens up great potential for distributing their ideas and projects in the markets where the Company is present (with over 300 million customers) and access to its vast network of partners and businesses all over the world. For Telefónica, this company accelerator is the perfect environment to identify talent and make it competitive as quickly as possible.

A large number of the projects that 'Wayra' advances are oriented towards strategic areas, from OTT applications or financial services to cloud computing. In 2012, Telefónica has fomented the work of 180 startups out of a total of 13,748 projects received.

A look at the future

Success in innovation should be founded on a global model which covers, as well as the execution of projects, tools which assist with talent management, encouragement of creativity, the generation of ecosystems based on business acceleration, the development of actions that bet on innovation, the protection and evaluation of the results, and the assessment and quantification of the return, among other values.

Telefónica has known how to adapt its Research, Development and Innovation model to take advantage of opportunities and respond to the needs of the business during the last 30 years. But in addition, the Company has not only moulded itself to this context but, by means of its developments, has helped to build the future.

When Telefónica R&D was created 25 years ago, the Group centered its activity on Spain and innovations were for mobiles and the Internet. Now, this division is at the technological vanguard and, with it, the Company is in a position to continue playing a central role in the development of new technologies for the future.

> Telefónica Digital has worked with Mozilla to develop the Firefox mobile operating system, based on HTML5

With ‘Wayra’, Telefónica offers startups access to its customers, partners and businesses

But, in this leading-edge work, Telefónica will not be playing alone - the Company enjoys the privilege of having one of the world’s largest innovation ecosystems.

Another bet on the future is Telefónica Digital, created to lead and promote the opportunities that this new world offers. Its next objective: to reach 5,000 million euros in 2015, a sum which would represent annual growth of around 20%. Within its areas of activity, the highlights include the development of the open mobile operating system Firefox based on HTML5 with Mozilla, the push for machine-to-machine (M2M) solutions in different sectors, putting the emphasis on efficiency (fleet management, insurance, control of electricity consumption, smart cities), the design of alternative mobile payment methods for the population of Latin America without access to banking, digital health solutions (eHealth) and the creation of Telefónica Dynamic Insights, a new global unit aimed at opening up new value creation opportunities in the area of Big Data.

Challenges

Although, like the majority of companies, Telefónica measures innovation through its R&D&I effort, the real key is to determine the return that this effort yields, as reflected in the development of new products, platforms, patents and other intangible technological assets. To correctly identify and generate this, the Company created the Telefónica Patent Office four years ago, a division which works closely with the inventors at Telefónica R&D.

As the basis of its business, Telefónica continues to believe that the customer is one of its principal sources of inspiration when defining new technological solutions and platforms. For this, the Company works by different routes. If we consider the early stages of the innovation process, one of the most critical units of Telefónica R&D is that of User Experience. Through this, the most innovative services are defined jointly with the customer. In parallel, initiatives are also undertaken in other business units of the Group which have direct interaction with end users. The idea is to use all this information as feedback for the creation cycle.

Beyond that innovation, at Telefónica the transversal activities with technological potential should increase the efficiency of the network and of its operations. Indeed, they have to support the transformation of telecommunications infrastructure so that it is lighter, more flexible and more configurable. So, by means of innovation in technology and network architecture, the capacity for adaptation of Telefónica to the ever-changing requirements of customers and digital services is boosted. In other words, innovation is put to work to build a much more digital company, a Digital Telco of the 21st century.

Research centers in **5** countries

180
startups fomented by 'Wayra'

25 years of Telefónica R&D

+5,771
million euros dedicated to R&D&I

Action lines	2012 successes	Targets	Challenges
Global R&D effort	**1,071 million** euros dedicated to R&D&I. Despite global economic difficulties, the figure reflects the upward trend of the Company in this area	• Keep up the effort in **research and development** to ensure products are differentiated and that the efficiency of processes increases due to own technologies	• Progress in identifying results obtained from R&D, justifying its **profitability** • **Maintain or increase the weight of R&D** as a percentage of the Company's investment effort
No. of new patents in the intangible assets portfolio	**87 new patents** generated by Telefónica R&D (of these, 54 have been registered by Telefónica Digital, 30 by Telefónica Global Resources and three by Telefónica España)	• Continue generating patents withinTelefónica Group, with a greater emphasis on **quality rather than quantity** • Emphasize the protection of products and technologies that, as new assets, cause Group value to increase	• Early identification of **new ideas** for patenting throughout the Group and management of other **intangible technological assets** beyond own patents
Acceleration of startups through 'Wayra'	**8.6 million** euros of outside financing for companies promoted by the 'Wayra' project	• Ensure that **startups** incubated in **'Wayra'** can in future raise more financing outside Telefónica as their acceleration periods come to an end	• Increase the influence of 'Wayra' in selecting startups in countries in which it operates • Foment development of **risk capital and business angels** in countries where Telefónica operates • Facilitate access to financing for 'Wayra' companies

THE VALUE OF BEING DIGITAL

Towards the digital economy_

Telefónica's digital products and services accelerate market growth through investment, collaborations and joint ventures.

Telefónica offers key digital solutions for the new financial services society, M2M communications, eHealth, advertising, video and media, security and cloud computing

Key pillars

Our goal is to transform Telefónica into a Digital Telco by creating new digital solutions to solve society's needs. In order to achieve this goal, Telefónica is committed to bringing to market new products and services. We cannot do this alone so we will partner with, invest in or potentially acquire other companies. These products and services are brought to market across seven key segments – financial services, M2M, eHealth, advertising, video and media, security and cloud computing.

2012 achievements

Telefónica's digital solutions, which have provided revenues of approximately €2.4bn to Telefónica, have been brought to market across seven key segments:

Financial services
The mobile phone is becoming more central to people's lives and has the potential to transform the way people carry money and pay for things. Telefónica believes that the mobile will become a gateway for a range of services ranging from credit & debit cards, money transfers, loyalty cards and that ultimately the mobile will replace the physical wallet. Telefónica aims to be a world leader in the provision of digital financial services through the mobile wallet.

It is also committed to working with a wide range of financial partners to grow the overall m-commerce ecosystem. An example of a financial service is MFS: a joint venture between Telefónica and MasterCard that will develop payment solutions using mobile telephony in Brazil. MFS's first product, set to launch in May 2013, will be a pre-paid account accessed via mobile phones alongside a MasterCard card, which will let consumers transfer cash to other people, make in-store purchases, top up their phones and carry out other financial transactions. The product will primarily focus on the payment requirements of Telefónica Vivo customers who do not have bank accounts, offering them financial inclusion. However, users who already have current accounts can also sign up for the service. Cash can be transferred onto pre-paid accounts at mobile phone refill stations, supermarkets and newspaper stands. Another example of a financial service is Direct-to-bill: Telefónica has signed global agreements with Facebook, Google, Microsoft and RIM to offer a simple and convenient way for customers to purchase goods, particularly virtual goods, via their mobile phones. Whether they are buying an app, mobile game or making an in-app purchase, Direct-to-bill enables the customer to simply charge the payment to their phone bill or prepaid credit, avoiding the need to use a credit card. Recent research from MACH found that over a third of European smartphone users have paid for applications via operator billing.

M2M

Machine-to-machine (M2M) communications are transforming all manner of industries across the world. After more than 100 years innovating in the way people communicate, Telefónica's bet for the forthcoming years is developing communications between things.

M2M communications are transforming industries, from utilities to transportation, providing more efficient, cheaper and more sustainable supply chains and operational processes, and enabling the creation of new business models.

Telefónica, as a leader in the telecommunications industry, wants to provide its customers with the best M2M solutions backed by its solid assets: global scale, wide portfolio of M2M value-added services and the best communications network. An example of a M2M service is "Pago como conduzco". Generali and Telefónica have partnered to create "Pago como conduzco" in Spain, a pioneering motor insurance policy that calculates the premium according to driving habits. It is aimed at customers of all kinds, although it especially benefits younger drivers with good driving habits. "Pago como conduzco" also has the potential to improve road safety. It provides suggestions based on the driving habits of the insured which could prove useful towards improving their driving.

eHealth

Governments around the world are grappling with growing healthcare costs, driven by ageing populations. Telefónica believes information and communications technologies have the potential to radically transform healthcare, providing both greater quality of care for patients and driving greater efficiencies for healthcare providers. From demand and access management through to remote patient management, mobile telecare and tele-consultation, Telefónica is able to provide innovative products and services to both healthcare providers and directly to end users.

An example of an eHealth service is Axismed. Telefónica has acquired a controlling stake in Axismed, Brazil's largest chronic care management company. The deal, which was concluded at the end of last year, will enable Telefónica Group to accelerate the development of a complete end-to-end service proposition in the fast growing Brazilian e-health market, targeting private healthcare providers, corporate customers as well as the 90 million Vivo customers in Brazil.

Advertising

The mobile advertising market is growing rapidly as brands increasingly realize the potential of mobile to deliver highly targeted and relevant marketing communications to customers. Through its advertising team,

Telefónica health services can improve the quality of patient care while offering increased efficiency

Telefónica's portfolio of cloud services covers all segments, from large entreprises and the public sector to SMEs and SOHO

Telefónica is able to leverage its strengths in this area, including global customer base, unparalleled customer knowledge and innovations in new advertising models.

Video & media

Telefónica is a leading provider of Pay TV and IPTV services across a number of countries in Latin America and Europe. In addition, its Content Delivery Network provides content owners with the ability to offer their customers the best viewing experience anywhere, anytime and on any device. An example of the video & media service is TokBox. Telefónica has acquired TokBox, the leading video communications platform. The acquisition of TokBox, based in San Francisco, builds on Telefónica's strategy of driving innovation in its core business of communications, with capabilities that will now extend beyond voice and messaging to live video. TokBox's OpenTok Video Platform enables the rapid development of live video-based communications services through the simple addition of video calling into websites and mobile applications. Telefónica will leverage TokBox's Platform to enhance the communication services it offers business and consumer customers, adding cross-platform Web-based video communications to its existing voice and messaging capabilities.

Security

Telefónica offers a range of managed security services for large corporations to ensure the integrity of traffic on their networks. This includes clean email and web security, and protection against denial-of-service attacks. For consumer customers, Telefónica is developing a number of products to protect mobile devices and PCs against viruses and malware, and to offer content filtering and child protection services.

Cloud computing

Telefónica has a portfolio of best-in-class cloud services covering all segments from Large Enterprise & Public Sector to SME & SOHO and the consumer market, and addressing different areas such as infrastructure services for supporting mission-critical business workloads, marketplaces for software as a service, personal cloud services and a totally innovative set of cloud services intended for smart devices. An example of a cloud service is Instant Servers: an Infrastructure-as-a-Service offering that delivers on-demand, high-performance cloud computing for developers, digital businesses and large enterprises. Customers benefit from the reassurance of a market-leading service-level agreement (SLA) of 99.996% per year backed by a financial

Product/business area	Update
Big Data/Telefónica Dynamic Insights	Smart Steps currently being trialed by customers in the UK
Financial services	• Wallet services live in UK (m-commerce, money messages), Germany (NFC, money messages) and Czech (NFC) • Wanda launched in Argentina and Peru/new CEO announced Providing Telefónica wallet for GSMA NFC showcase
Advertising	• Weve JV operational in the UK • Sprint global partnership • Taking O2 Media model to Brazil
eHealth	• Remote Patient Management trials in UK, Spain • Axismed acquisition in Brazil
Video	Global Video Platform launched in partnership with Microsoft. First deployments in Brazil, Spain and Chile
Carrier billing	• Global partnerships with Facebook, Google, RIM and Microsoft. Google Play integration live in Spain and Germany • BlueVia focusing on payments APIs – also combining Telenor payments APIs
TU Me	Approx 1m registered users
Cloud	• Instant Servers available globally (IaaS product) • Partnership with Feed Henry to provide one-stop shop for enterprises to create, manage and host their apps
M2M	• Pay-as-you-drive car insurance launched in Spain with Generali • Smart M2M management platform available in Spain and Brazil and soon to launch in Chile, Argentina and Czech Republic • Smart Metering Platform launched • Providing M2M services to General Motors' OnStar outside of US • Part of global M2M Alliance alongside KPN, DoCoMo, Rogers, Singtel, Telstra, Vimplecom and Etisalat

compensation in the event of non-compliance. Instant Servers also achieves lower operational costs allowing customers to serve more workloads per virtual machine when compared to other public cloud services. Customers are able to acquire, manage, monitor and control their virtual servers quickly and simply via the website at all times, and they only pay for the type of cloud services they require and the time they use them for. Instant Servers' cloud computing infrastructure is built on Joyent's cloud infrastructure, a high-performance cloud infrastructure that is the only solution specifically built to power real-time web, enterprise and mobile applications.

A look at the future

The world is going digital. Whether it is consumers looking for entertainment or to communicate, or companies trying to reach customers in different ways or make their businesses more effective, everyone and everything is going digital. Telefónica Digital's goal is to go beyond connectivity, transforming Telefónica into a Digital Telco by creating new digital solutions to solve society needs.

The digital revolution is being shaped by three trends:

- A surge in demand for digital services. Wherever they are, people want to be connected.
- Smartphones going mass market and increased availability of high-speed data networks.
- Companies in every industry using digital technology to transform how they do business (radically changing customer experience; operational processes; and business models).

This new reality presents great opportunities for industry, but also big challenges.

THE VALUE OF OUR PROFESSIONALS

A team for a future company_

The telecommunications market demands being agile, global, digital and leaders. This is why Telefónica has incorporated these qualities into all the systems for assessing the performance of its professionals.

Through the 'Talentum' program, Telefónica has incorporated over 1,500 young professionals in its project

Lines of progress

Telefónica works on various fronts to guarantee improvement of its workforce's productivity ratios. It does so in a complex macroeconomic context in a sector which is redefining the rules of the game in all areas (technological, structure of the competition, regulation, etc.)

This shifting reality necessitates that another of its priorities is the identification and development of its key capacities to continue being one of the leading telecoms operators of the sector. So, the employee talent management policies must ensure that the best professionals, the leaders of the future, are recruited and retained.

Internally, Telefónica promotes the idea that all its employees participate actively in transforming radically the way of working in the Company. To wit, building an organization more customer-centered, more agile, more global and more digital and therefore more leading.

Achievements 2012

Telefónica Europe launched the program 'Talentum' with the objective of incorporating young professionals in all regions. More than 1,500 workers joined the project in the year 2012.

As a key lever to strengthen the transformation of Telefónica, the new global performance model was launched, which in 2012 was applied to all the Company's managers. This scheme takes into consideration both the results obtained (the what), and the way they were achieved (the how, measured in terms of the Company's transforming behaviors: customer-centered, agile, global, digital and leader).

Telefónica's policies and plans in the area of human resources management continue to be aimed at improving the level of satisfaction and commitment of its employees. In 2012, it was 79% (2.5 percentage points more than the year before). Further, Telefónica was listed as one of the best multinationals in the ranking *Best Place to Work* 2012; the Company obtained 13th position.

1,500
incorporations thanks to the'Talentum' program

+2.5
percentage points in satisfaction of employees

A look at the future

For better results, people management systems at Telefónica consider the sociodemographic trends in each region in which it operates. So, the Company takes into account relevant aspects such as the presence of different generations at the same time (baby boomer, generation X and generation Y), the scarcity of talent, the globalized management of knowledge in the network, the impact of new technologies in the workplace (bring your own device, flexibility, permanent connectivity), etc.

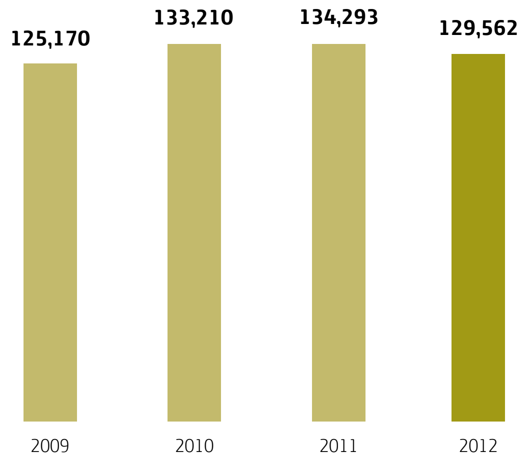
To ensure leadership in the new digital environment it will be key to have business capacities in the future. So, the Company is going to broaden the program 'Talentum', a project born in Telefónica Europe, to the rest of the Group. This initiative aims to attract professionals with ability, aptitudes, innovative spirit and new ideas (fresh thinking).

Likewise, the new conditions of the business and its environment demand faster adaptation, a more agile organization and simpler processes. This transformation has to be taken to heart by the employees of Telefónica Group. That implies new ways of working, cultural change, and managing to function with a simpler organization.

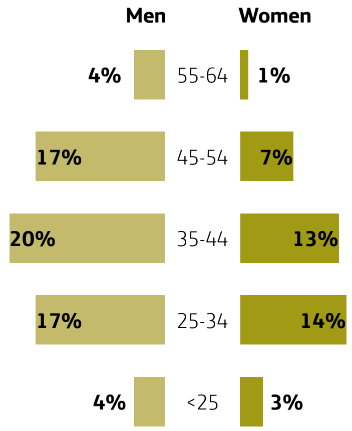
Moreover, the Company will drive forward internal mobility for its professionals to ensure diversity and satisfythe needs of new businesses and opportunities worldwide.

Evolution of the workforce without Atento

Number of employees



Age pyramid



Telefónica was listed as one of the best multinationals to work for in the *Best Place to Work* ranking

The development programs, especially those of Universitas Telefónica, will be at the service of the Company's transformation and the evolution of the leadership style of its executives.

Challenges

The speed of change forces the Company to adapt itself to it faster, at a pace which cannot be allowed to jeopardize quality or doing things right.

Only a committed team, aligned with the aspirations and values of the Company will allow it to adapt itself to the required transformations.

Another key factor for Telefónica in the next few years will be the management of critical capacities, and to know how to respond to an environment of uncertainty. Thus, the focus and the areas in which it will be necessary to be prepared in the near future will be mainly:

- Marketing
- Technology
- New businesses
- Digital profiles.

It will be fundamental in this task to find the right balance between internal development of capacities and their acquisition.

To obtain these abilities and know-how, Telefónica must be established as an employer of reference in the area of telecoms and digital businesses.

It will be vital to have as well-informed a workforce as possible to improve decision-taking more rapidly and effectively.

133,263
employees in total, fewer than in 2011 because of divestment of Atento

2,546
participants in 40 Universitas programs

Area of activity	Achievements 2012		Targets	Challenges
Boost productivity among the team of professionals	A workforce better **adjusted to the business**	**+2.7%** improvement in the hierarchical index	• Towards strategic planning of **resources** • Flatter organisations with **empowered employees** • To ensure management of change in the process of **simplification of the Company**	Manage different generations and cultures
Construction of capacities for the future	Launch in Europe of the **program 'Talentum'**	**+1,500** incorporations	• **Management of capacities critical** for the business • **Extend the initiative 'Talentum'** to the whole of Telefónica Group • Boost the **internal** mobility of talent	The scarcity of talent is becoming more intense in certain sectors and profiles
Acceleration of the transformation of the Company	New global performance model	**79%** level of satisfaction and commitment of employees • Telefónica, nº 13 in the ranking *Best Place to Work*	• Extend the model to **the whole workforce** of Telefónica • Evolution of the style of leadership, supported by **Universitas Telefónica** • The capacity for **rapid adaptation** to change, key for the process	Business environment very changeable and uncertain

Agenda

Transformation in HR

Achieve excellence in Human Resources

Support for the business

Boost employees' productivity

Build abilities for the future

Accelerate the transformation of Telefónica

19.4%
increase in ratio of women managers

over 3,000,000
hours of training

13th
company in the ranking of multinationals, *Best Place to Work*

THE VALUE OF BEING GLOBAL

A competitive scale_

Global Resources has played a vital role in the operational transformation of Telefónica. Its emphasis has been on homogenization, simplification of applications and the catalogue of devices, together with growing revenues in multinational businesses. All this has represented efficiency savings of over 1,000 million euros.

Seven big operational efficiency projects: Operations & Network, IT, Devices, Purchasing, Global Solutions, Global Services and Human Resource

Lines of progress

The model of Global Resources is based on optimization of the economies of scale of the Company, the quest for greater efficiency in its operational model and advancing its capacities in its global areas. To this end it is structured into seven main areas: Operations and Network, IT, Devices, Purchasing, Telefónica Global Solutions (TGS), Global Services and Human Resources.

In the area of Operations and Network, the focus is on increasing efficiency in digital transformation tools, developing capacities to allow turning Telefónica's networks into a differential element with respect to the competition.

The objective of the Information Technology (IT) area is to drive the Company to convert itself into a Digital Telco through the simplification of applications, excellence in production and the construction of three new data centers. All this is with the support of Telefónica Global Technology (TGT), an internal IT services company.

In the Purchasing area, the advantages of Telefónica's size are strengthened by global and strategic management, based on a matrix organizational structure. This system is administered according to a single set of rules, processes and systems, and strict guiding principles.

Telefónica Global Solutions, which is in charge of multinational businesses, distributors and roaming, manages relations with large multinational customers and carriers to improve their experience and consolidate the operational and commercial processes.

Area of activity	Achievements 2012	Targets	Challenges
Global network management and operations, which have made possible: • Maintenance of common requirements for purchasing new generation network technology • Sharing networks • Homogenized solutions and processes	**Over 20%** TCO savings from network shares in the United Kingdom (Beacon)	• Evolution towards all-IP networks • Strengthening network intelligence and boosting its virtualization • Pragmatism in network sharing	• Improvement in the efficiency of networks and operations • Transformation of the infrastructure of Telefónica in search of an entity more agile, flexible and configurable • Capacity to adapt the network to the rapidly changing needs of customers and digital services
Information technologies which drive Telefónica towards becoming a Digital Telco	**3** new data centers (ES, BR and MX), worldwide references for consolidation and cloud services **15%** reduction in applications and transformation in all operations	• Opportunity to explore the potential of Big Data, digital products and cloud services	• Simplification of the business in all its dimensions: products, policies and processes, while at the same time evolving the IT talent and culture, which will be key for attaining success in the digital world
To take advantage of the benefits of the Company's scale in mobile devices	**>80%** of the total spending on devices was negotiated globally **95%** of the value in **<100** references	• Continuous improvement in management capacities for the customer's life cycle • More balanced market, both in manufacturers and operating systems	• Promotion of a more user-friendly environment , which improves relations with customers • Concentration of relevant agents in the distinct market segments (tendency to duopoly) • Difficulty for new devices and operating systems to create a niche in the market
Global purchasing management	**42%** of the aggregate purchasing volume **Over 80%** of all contracts awarded are to local suppliers	Purchasing as generator of e2e sustainable value: • From specification to invoicing • Complete the end-to-end integration of purchasing systems	• Continue boosting collaboration with local suppliers • Telefónica as a key development driver in the countries where it is present
Exploitation of international businesses making use of the global power of Telefónica Global Solutions	Growth in businesses in double figures	Objective: **increase** business managed by 2015	• Optimism about our global position in contexts of rapid growth, such as Latin America
Generate efficiency for the support activities with services of excellent quality	**9.11/10** Customer Satisfaction Level	• Consolidation of the global model • Advances in efficiency through optimization of costs, extension of best practices and homogenization of processes	• Market of increasing activity due to the trend of externalization of non-core activities • Resistance to change • Internalization of activities • Adverse economic environment

Highlights of Network and Operations

- **643 M€** obtained from the sale of non-strategic assets such as masts
- **Reduction of prices** achieved relative to the previous list of mobile equipment in Latin America: **20%**
- **16 strategic projects** of transformation and efficiency in Network and Operations
- **29 patents** on network technology
- **51 technical contributions** to standards bodies on evolution of transport networks, intelligence, network virtualization and access technologies
- Synergies obtained with **Telecom Italia** in the network area

In 2012 over 80% of awards were to global suppliers

The Global Services division, for its part, has pursued the acceleration of the worldwide shared services model. The challenges are consistency, control of the processes and increasing efficiency, while at the same time reducing costs and new technologies are 100% exploited.

2012 achievements

Telefónica Global Resources consolidated its operative model to help the Group to optimize the benefits of its global scale and obtain greater efficiencies and improvements in the time to market.

Initiatives in the area of Network and Operations have led to significant efficiencies. Some of these are:

- Consolidation of a global technical map for the deployment of new generation networks.
- Evolution of the transport network from a global perspective.
- Global definition of specifications for equipment in the customer's home.
- Network sharing In the UK, a joint proposal with Vodafone for sharing and deployment of the 2G, 3G and 4G mobile networks was made, as well as for the transmission network.
- Network operations efficiencies have been obtained through global homogenization of solutions and processes, the construction of mobile emplacements and the standardization of contracts of support, logistics, maintenance and repair of spare parts, as well as in reduced energy consumption.
- Common network intelligence solutions around the exposure (via APIs) of network capabilities and harmonization of service platforms.
- As regards innovation in this field, Telefónica R&D has been promoting the network virtualization ecosystem.

In 2012 the global IT area accelerated its transformation through simplification of applications (15% fewer), specifying a common systems architecture, and excellence in the production both of global services (SAP and email) and local ones. Especially noteworthy were the actions carried out

Global IT highlights

- **Reduction of 15% in applications** in 2012, 42 of them in Latin America
- Inauguration of **data centers (DCs) of worldwide prestige** in Madrid, Brazil and Mexico, on time and on budget
- **TIER IV certification** for the Alcalá DC, the largest in the world with these characteristics
- **GALA** (CRM for businesses), implemented in five new countries
- Improvement in the **satisfaction** of employees **(70.2%)**

Highlights in devices

- Use of the economies of scale: **>80%** of total spending on devices negotiated on a worldwide scale
- Global catalogue optimization: **95%** value of <100 references
- **Strategic focus** on remodeling the operating system map: proactive development of alternative ecosystems

during certain special events such as the London Olympics or the Christmas campaign. In addition, the production management model was changed to two clusters (Europe and Latin America). Furthermore, three new data centers were built, in Mexico, Brazil and Spain.

Another highlight was the formalization of TGT (Telefónica Global Technology) as an internal company of the Group for IT services: it has more than 1,000 employees and operates in four countries. Finally, it remains to underline the effort in redefining the team of the area, to which new talent was incorporated, while simultaneously reinforcing the existing capacities.

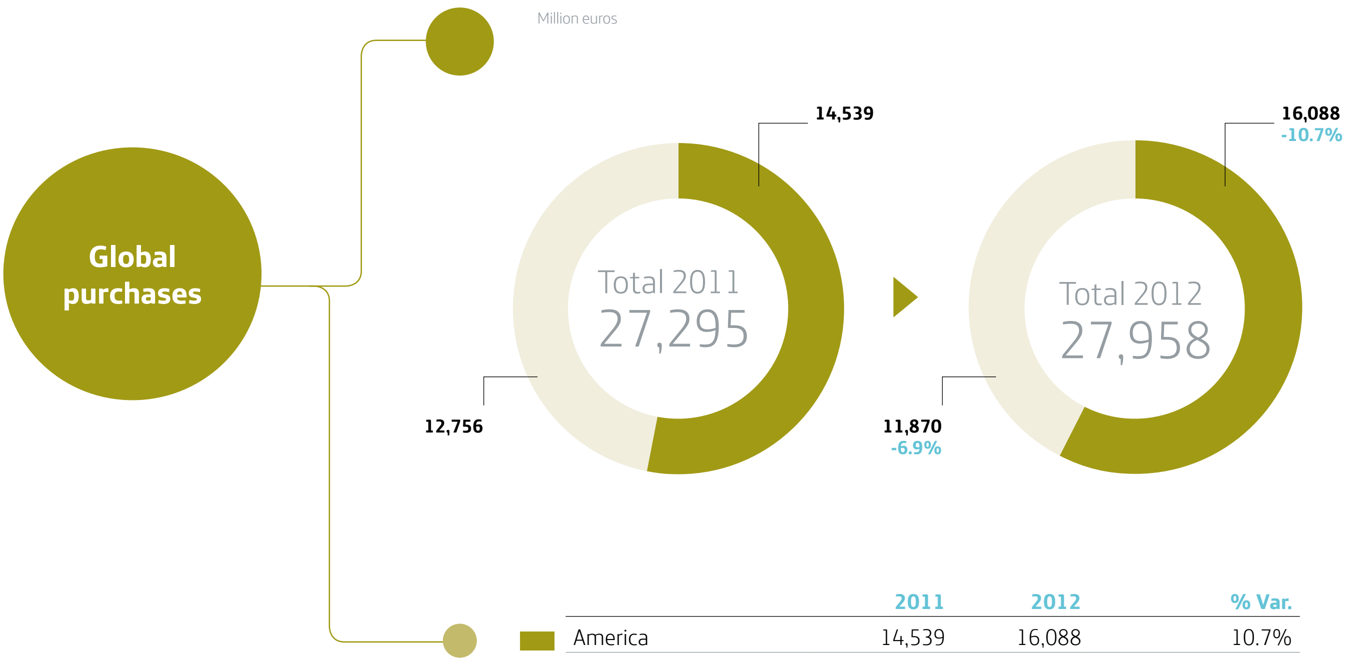
With respect to mobile devices, the value negotiated globally, concentrated in 100 references, rose by up to 80%. In this way, efficiency improved in every quarter. Moreover, joint work with all business units is being carried out so that Telefónica has a more balanced map of suppliers and operating systems.

The global Purchasing area, transversal to the whole Company, was centered on the 150 main negotiations (more than 50% of the purchasing volume) and on advancing cooperation with the distinct lines of business. So, TGS has been consolidated as the organization responsible for global negotiation processes, and new revenues have been generated for the Group through specialized services of efficient management of procurement. Indeed, a basis for developing an end-to-end purchasing model has been established, with special focus on global categories.

Telefónica Global Solutions increased annual sales by over 20% in the MNC sector, thanks to the large contracts obtained. Moreover, it has reinforced strategic alliances through agreements with Singtel, Softbank and Bouygues. In 2012, it also began to manage the CDN and roaming in Latin America, and offered the first standardized service of Global Managed Mobility and Global Managed WAN.

For the first time, the global satisfaction of Telefónica's multinational customers has been measured, permitting the design of more than 50 improvement plans. Telefónica Global Solutions is one of the major players at a global level in the IP and capacity business, and is already in Tier 1. Furthermore, in 2012 it increased the capacity of

Satisfaction studies among Telefónica's multinational customers have led to the design of more than 50 improvement plans



	2011	2012	% Var.
America	14,539	16,088	10.7%
Europe	12,756	11,870	-6.9%
Total Telefónica	**27,295**	**27,958**	**2.4%**

Awards per budget year, irrespective of management schedules, excluding purchase and sale of assets.

All Global Resources areas are seeking to collaborate in the transformation of the Company into a Digital Telco

the Panamerican submarine cable and reinforced the Central America zone with the laying of a new cable, the PCCS.

During the year, the area of Global Services, which includes Atento and tgestiona, advanced towards a global shared services model. It also made progress on initiatives to improve the supply and logistics chains. At the end of the year, Atento was sold for more than 1,000 million euros, a fact which contributed to the reduction of debt.

A look at the future

The current market situation conditions to a certain extent the way the Company will handle its businesses In the next few years. To the economic uncertainty, we should add the influence that legal and regulatory decisions have. For this, the focus of the distinct areas of Global Resources is oriented to help transform Telefónica into a Digital Telco.

From the perspective of Networks and Operations, of global scope, the trends indicate a progressive evolution towards infrastructure that is more agile, flexible and adaptable. So, as a Group, it is key to advance in the consolidation of technologies and network intelligence solutions and common network evolution models to use the advantages of the global scale, as well as design network sharing strategies. Besides, Telefónica should continue working on the determination of common models and processes which achieve economies of scale. It will also be highly pertinent to be able to carry out pilots of network virtualization technology in the operations of the Group.

To be transformed successfully into a Digital Telco, a critical feature is to have excellent IT services. In addition, to maintain a healthy IT costs/revenue ratio, the Global IT area deems it necessary to achieve an appropriate trade-off among the resources dedicated to production, growth and IT transformation. For all these reasons, Telefónica should persevere in the process of simplification, under a management model that concentrates production in hubs, reduces physical infrastructure and installations and has the best IT talent available.

Global Solutions milestones

Launch of **Managed WAN and Managed Mobility**

Customer satisfaction: 6.76 for multinationals and 7.22 for distributors

50 improvement plans for multinational customers

48 new agreements which reinforce the 'off-net' offer. Noteworthy are those referring to MPLS, Ethernet Internet Resale, Mobile Services and Telepresence, which fortify the **service coverage** in the world

24,000 million minutes of voice traffic transported on the network of Telefónica

PCCS, the new submarine cable in Central America

330 roaming agreements signed in 2012. A new roaming M2M market was created and new commercial agreements with third parties were formalized.

IP-Tier 1

45,000 km of optical fiber

More than **7,000 satellite stations**

Telefónica has signed the first agreement in Saudi Arabia to develop a **MVNO/E** business and a new catalogue of distributor services has been launched

Telefónica Global Solutions has a workforce of **1,400 professionals** who work in **40 countries** in America, Europe and Asia. In the last year, it has increased and reinforced its presence in these markets. The expansion of the office in France was a highlight.

The world of mobile devices is today dominated by a small number of firms who work both on terminals and operating systems. Thus, the Company stresses measures that lead to wider choice for its customers while promoting the incorporation of its applications into devices that should support its technologies (2G/3G/LTE). All this is done to tailor initiatives to Telefónica's commercial offering. The ultimate objective: contribute to the creation of a sustainable (and monetizable) business model around the proliferation of tablets and phablets (phone + tablet).

Regarding the business of large multinational customers, the challenge to the Company is to combine growth and efficiency while the global model of Telefónica Global Solutions is consolidated.

Telefónica operates in a global market of multinational customers and carriers which offers great opportunities for growth. So, it is possible to increase market share, firm up the presence of Telefónica in Europe and America and reinforce its capacities in Asia, and offer innovative solutions which have a positive effect on the experience and satisfaction of its customers. But, moreover, the Company wants to do this by leading the deployment of international infrastructure and the development of global platforms.

Finally, in regard to Global Services, Telefónica is looking at various initiatives for the transformation of its back office activities. The main challenges it faces are related to the consolidation of the model in practice. This area should extend the reach of its services to all geographies and types of business, coordinate the different lines of work to ensure their coherence with a medium-term vision and increase their profitability and efficiency. In other words, it should help the business to comply with its operational and financial commitments, maintaining the current levels of excellence in the quality of service.

While the global TGS model is being consolidated, the challenge is to combine growth and efficiency

THE VALUE OF THE BRANDS

A brand portfolio that creates value_

Telefónica combines efforts to build brands that are recognized, reliable and differential and can successfully compete in the modern, complex, digital environment.

Movistar, Vivo and O2 are considered among the world's biggest brands

Lines of progress

For Telefónica, brands are high value intangible assets for the business, because they associate the Company rationally and emotionally with its customers. For this reason, its strategy, resources and investment are focused on building strong and competitive firms.

The model that Telefónica follows endows an institutional role for the Telefónica masterbrand, which is responsible for leading the relations with employees, shareholders and investors, large clients and multinationals and institutional public suppliers in the general sense. In turn, Movistar, O2 and Vivo are the commercial brands and therefore, those that are related to the customers, each one in a different geography.

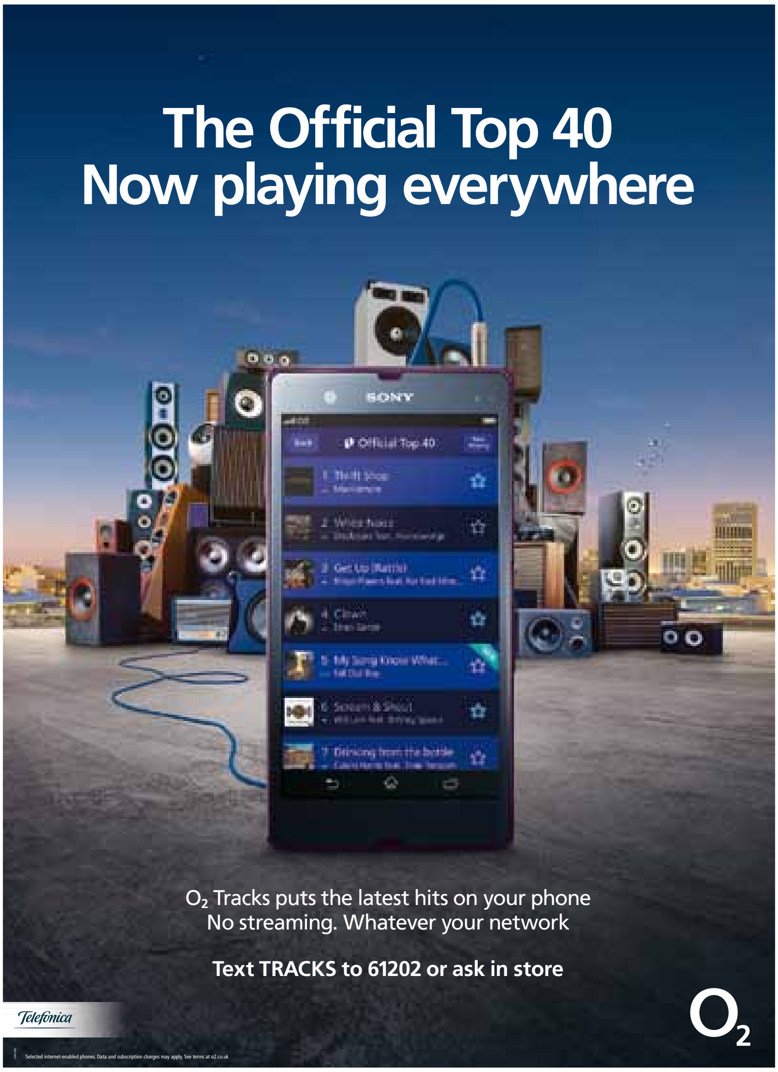
Movistar and O2 are considered to be among the 100 most important brands in the world. In addition, Telefónica has other independent brands for businesses or specific initiatives in the digital world (Tuenti, Terra, TU, etc.), for low-cost mobile phone operators (48, Fonic, Tuenti mobile, etc.) and innovation or accelerators of startups *(Wayra).*

2012 achievements

Telefónica has, under a fixed/mobile brand, integrated operations in Brazil, under the name of Vivo, and Colombia, under that of Movistar, consistently integrating the vision of the consumer.

In an increasingly global and digital world, to meet the needs of the clients - who are seeking to build relationships with global companies - Telefónica defined and approved the strategy of associating the Telefónica masterbrand with the commercial brands under a branded house structure so as to give them the attributes of solidity, leadership and innovation of a global company. Thus, Telefónica, with its logotype, supports all of the commercial communications of Movistar, O2 and Vivo. In this way, it helps the clients understand that they are interrelated: the products of a brand that has its own identity with one of the sector's most

The Telefónica logotype supports the communications of its commercial brands



Current map of Brand Architecture

Institutional brand

Telefónica

Commercial brands
Core business

movistar O2 vivo

Social commitment and innovation

Telefónica Fundación | Espacio Fundación Telefónica | think big | proniño | Atam | talentum | wayra | Amérigo | BlueVia

Other brands

Communications	Contents	Vertical	Services
acens, Fonic, Tu, tuenti, giffgaff, 48	terra, sonora	wanda, onthespot	Pleyade, Antares, fonditel, tgestiona

Elasticity of the Company's brands has enabled it to enter and compete in the digital world

important and soundest corporations. On the other hand, Telefónica thus obtains greater visibility and reinforces its image among investors, analysts and multinationals, which facilitates the launch of global offers, especially in the digital world.

The elasticity of the Telefónica brands and their innovation attributes have enabled the Group to enter and compete in the digital world with significant launches in financial services (Wallet), telemedicine and M2M, among others.

In addition, two independent low cost brands have been created to compete in the European youth segment: 48 and Tuenti mobile.

Brand perception

Movistar, O2 and Vivo are among the brands held in highest esteem by the clients. They have a good reputation: they are in first and second place amongst the highest valued in all of the markets where they are present.

O2 led the Digital Brand Champion ranking made by the WIWO (Wirtschaftwoche) from among the 60 most recognized firms in Germany.It assessed the digital relationship of the brand with its audiences and identity codes, as well as its innovation and digital leadership.

Telefónica has been recognized as the most admired non-American Telco by Fortune Most Admired Companies.

77,000
items reviewed in 2012 under Brand Guardian

1,480
items reviewed weekly to meet the brand requirements

93%
of marketing and advertising output carried the "on-brand" issue code

Spontaneous brand recognition

Total accumulated data, 2012

Top of mind (%)		Total mentions (%)	Ranking
19	Germany	66	2
36	Argentina	91	1
29	Brazil	75	1
34	Chile	84	1
26	Colombia	85	1
10	Costa Rica	88	2
39	Ecuador	98	2
27	El Salvador	98	1
25	Slovakia	90	2
38	Spain	94	1
29	Guatemala	99	1
30	United Kingdom	82	1
33	Ireland	94	2
30	Mexico	95	2
45	Nicaragua	99	1
41	Panama	98	2
60	Peru	94	2
36	Czech Republic	94	2
47	Uruguay	98	1
46	Venezuela	97	1

Data obtained from TPSM of Milward Brown, accumulated from the total for 2012. Mobile phone category.

Telefónica has taken up the challenge of offering its clients brands consistent with the Company's positioning

Brand management

Telefónica has consolidated the global process of Brand Guardian, which seeks the coherence and consistency of its brands. It is a question of achieving maximum recognition and relevance in its global, regional and local audiences. In 2012, this system has reviewed over 77,000 communication and marketing items, which has represented a weekly volume of 1,480. In other words, over 93% of the work that went through the system had an on-brand issue code.

Looking to the future

In an increasingly digital environment, with no geographical barriers and new competitors and clients who demand greater quality, service, simplicity and responsibility from the brands, Telefónica is facing the challenge of offering its users a brand experience consistent with the Company's positioning and values. To do this, it can count upon the latest technologies and full digitalization of its brands. Thanks to this, it is seen as communicating with the environment, selling its services, offering support and, finally, maintaining a two-way dialogue with all of its clients.

Challenges

- Achieve a greater bond between the commercial brands and the institutional support of Telefónica at the global level.
- Build brands closer to consumers.
- Design the brand management tools, Brand Guardian, Brand Room and training to facilitate knowledge of all of the brands.
- Extend the brands so as to offer digital services beyond connectivity.

VALUE FOR EVERYONE

Commitment to society_

Telefónica is committed to helping the development of the communities in which it operates.

Telefónica's investment in social projects reached 158 million euros, more than the year before

Telefónica is committed to improving people's lives and the economic and social development of the communities where it is present. To this end, the Company foments and develops values and projects capable of transforming ideas into responses to social needs. The idea is that the expected economic return also manifests itself in benefits for the whole community. This commitment is developed in three basic ways: through disability, social and cultural action, and supporting the young and entrepreneurs.

The Company is working for a digital society for everybody and seeks technological inclusion for the disabled, and to help young people by means of encouraging ideas. What stands out among Telefónica's activities is: fomenting ideas through the programs 'Wayra' and 'Campus Party'; helping youth through 'Talentum' and 'Think Big'; and from the perspective of integrating the disabled, the Ability Awards and the work of ATAM.

Commitment to disability

Within Telefónica's initiatives to support people with disability, the Ability Awards are especially noteworthy. The Awards seek to recognise those companies and institutions which develop sustainable business models and which include those with disabilities in their value creation chains, whether as employee, supplier and/or customer. Apart from this, we should underline the important efforts of ATAM, to which Telefónica contributed 14 million euros in 2012, and from which over 10,000 people benefited.

Social and cultural action

This year Telefónica contributed 158 million euros for projects directed at the young, childhood, education, social development and cultural activities related to the use of digital technologies. The role played by Fundación Telefónica in projects of education and commitment to childhood should also be highlighted.

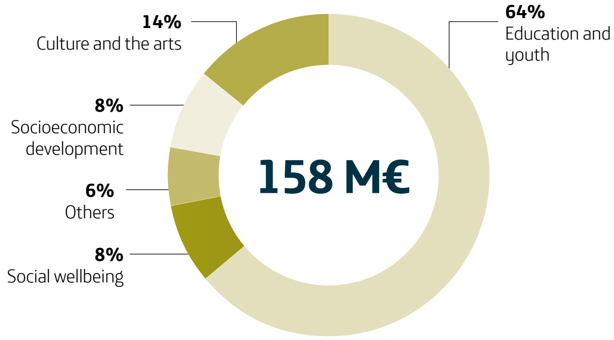
But in addition, Telefónica puts its human resources at the disposal of various social challenges and at the same time, offers its employees the chance to participate in this commitment with voluntary action. Along these lines, the Company promotes the development of the Telefónica Volunteers Program managed by Fundación Telefónica in collaboration with the areas of Corporate Responsibility, Human Resources and Communication. The objective: to promote social action and the collaboration of Telefónica's employees, forming an international network of professionals who carry out solidarity actions with social impact. During 2012, more than 24,000 staff members from 24 countries participated in some activity or campaign in the world. They dedicated 188,951 hours to 1,458 initiatives on three continents.

Over 337,000
children and adolescents attended by the program 'Proniño'

Over 188,951
hours of volunteer work by Company employees

Social action

Investment 2012

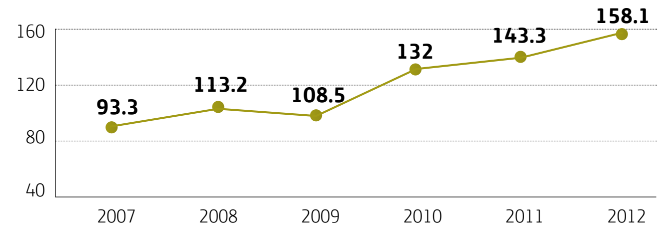


Investment by regions

42% Total Europe | **58%** Total Latin America

Evolution of investment

Millions of euros



Source: investment in social projects according to the LBG criteria.

With enterprise and the young

'Wayra' is the link between startups and Telefónica, offering entrepreneurs the potential of the markets in which Telefónica is present, with close to 316 million customers. It also provides them with access to its vast network of partners and businesses all over the world. Many of the projects which 'Wayra' accelerates fit with strategic areas key for Telefónica's business, such as OTT applications, financial services and cloud computing. in 2012, this initiative has given impetus to over 180 companies in which Telefónica has invested, so stimulating their capacity to create employment and undertake commercial activity.

'Campus Party', of which Telefónica is a key global member, is the world's largest technology festival, which combines innovation, creativity, science and digital entertainment. For seven days, thousands of campuseros live on-site in a unique environment where lectures, workshops, competitions and hackathons take place simultaneously. Editions of 'Campus Party' have been held in Spain and Latin America and it is planned to hold them soon in the United States and Europe.

'Talentum' is the project with which Telefónica seeks to drive young university talent and open doors for the coming generations to give them the tools and support necessary. Its principal objective is to encourage them to participate in the creation of a new European digital world. 'Talentum' *Universities* is a program of long-term grants which brings young graduates closer to the reality of business, by fomenting their integration into the labour market. For its part, 'Talentum Startups' is aimed at students in the later years of degree courses who want to improve society with technology. Telefónica supports them by means of grants. Through the distinct modes of 'Talentum' over 1,500 young professionals have been incorporated into one of the companies of Telefónica Europe.

'Think Big' is the Company's bet on young people between 13 and 25. This is an innovation and social enterprise program that operates in all countries where the Group is present. It has a double objective: on the one hand, it offers participants the chance to implement an idea which benefits their community, and on the other, it publicises the ideas and stories of these entrepreneurs to encourage others to take the reins of their future. More than 2,700 projects have already been financed. Participants receive face-to-face and online training, the support of a mentor, and a small sum of money. To put it another way: 'Think Big' seeks to facilitate things for those who present original initiatives aimed at modifying their daily context so as to become active agents of the so necessary social change.

The 'Proniño' program catered for over 337,000 children and teenagers in 2012

Over €14m
allocated to the social integration of people with disability

Over 2,700
young people's ideas financed through 'Think Big'

Over 180
new companies boosted by 'Wayra'

VALUE FOR EVERYONE

Sustainability, a tool for creating value_

Telefónica's Business Principles permit the generation of trust and make the Company more competitive. Corporate Sustainability is a business approach which aims to create long-term value through the efficient risk and opportunities management of issues related to economic, environmental and social development.

Telefónica builds its reputation by its Business Principles, gaining the confidence of its stakeholders and maximizing long term shareholder value and to society in general

Lines of progress

The creation of value by taking opportunities and the effective management of the risks inherent to economic, environmental and social development, is the focus of sustainability as a motor of responsible management and a lever of progress. For Telefónica, business transparency and managing integrity, as covered by its Business Principles, permit the generation of trust in the markets and between stakeholders and the Company. Sustainability can be taken as a synonym for competitiveness because it helps to reduce the risk premium, augments the value of the brand and differentiation for customers, improves the loyalty of employees, guarantees a stable Company project, and from society's point of view, cements its legitimacy to operate and permits sustainable development of the communities where the Company is present.

At Telefónica, projects are analysed from a triple perspective: growth in activity, increase in profitability and reduction of risk and impact for society.

2012 achievements

Within the 14 projects identified with impact in sustainability, it is worth noting the advances made in methodologies for identification and quantification of reputational risks stand out. In the area of the Group's Business Principles, their ratification at Telefónica Brazil should be mentioned.

As regards data protection and privacy, in 2012 a Privacy Task Force was formed, where all areas of the Company related directly or indirectly to this subject have a voice. Its objective: to devise a global privacy policy and strengthen Telefónica's positioning in this area.

In 2012, Telefónica carried out an evaluation of the impact of the Group in the area of human rights. Similarly, the Company signed the Guiding Principles of Privacy and Freedom of Expression of the ICT Sector and developed the *Methodological Guide to Identify and Evaluate Child Labour Risks.*

In the environmental field, in 2012 Telefónica positioned itself among the five leading

73,700
employees trained in the ethics code

19.4%
increased proportion of women managers in the Company

47%
more internal audits in the area of data protection

1,244
'in situ' audits of providers carried out

In top 5
leading telecoms companies in the CDP

Materiality matrix

1. Data protection and privacy
2. Good Internet use by children and youngsters
3. Electromagnetic fields
4. Green ICT
5. Code of conduct
6. Transparency
7. Quality of service
8. Supply chain
9. Diversity
10. Responsible marketing
11. Digital inclusion
12. Accessibility
13. Environmental management
14. Human rights

telecom companies in the world in the Carbon Disclosure Project (CDP). The Company also made important contributions to the work of the International Telecommunication Union (ITU) in the development of methodologies to measure the environmental impact of Green ICT services and ICT in cities. The advances we made in the energy efficiency field stood out, with over 35 projects introduced in 2012 and direct savings of 5 million euros, with 75% of the energy reduction target achieved. Telefónica also established a new objective in 2012 for reducing CO_2 emissions per customer by 30% a year by 2020.

In the social area, there were some important digital inclusion projects. The holding in Peru of the second edition of 'ConectaRSE para crecer', a competition to identify the best ICT initiatives in rural areas of the country, and the launch of Wanda, the Company created jointly with MasterCard to develop mobile payments in Latin America, illustrate the work of the Company in these areas. In a different area, the M-Inclusion project was launched, co-financed by the European Commission, to set up the first platform of social inclusion by means of mobile solutions in Europe and Latin America.

A look at the future

The European Commission published in April a proposal to amend the legislation on business reporting which would establish that companies of over 500 employees will be required to include relevant and material environmental, social, staff, corruption, diversity and human rights information in their annual reports. Apropos of this, Telefónica is convinced that companies that are transparent in their financial and non-financial communication are more efficient and generate greater competitiveness and more jobs.

Challenges

The objective of Telefónica's sustainability policy is its integration into the DNA of all its businesses, and to so keep a watch over all the reputational risks that might affect the Company. For this, the Company should advance in the implementation of the risk management methodology in all business units. Likewise, given the fundamental nature of the issues of privacy and data protection, communication and implementation of policies related to these questions are important. The Company should also continue working to position ICT at the heart of the solution to climate change and as a motor of eco-efficiency in the world. Its role is to contribute to actions of mitigation of and adaptation to climate change, and to support initiatives which foment competitiveness in cities and in strategic sectors of the economy using efficient communication networks and Green ICT solutions.

The Company wants to use Green ICT services to promote a low-carbon economy and encourage competitiveness

Access the full Corporate Sustainability Report via the QR code.

THE VALUE OF RISK MANAGEMENT

Security in the face of uncertainty_

Telefónica has a consistent, common methodology throughout the whole Group for how to deal with risks. This is an effective weapon with which it strengthens its commitment to suppliers and shareholders.

All risks are classified and subjected to a single management model

Risks are inherent to all businesses and business activities. The effective management of risks, as well as constituting a key component of internal control systems, contributes to meeting business objectives and the commitment of the organization to shareholders and customers.

For this, Telefónica has implemented a risk management system uniformly throughout the Group's main operations. It is designed so that those in charge in the Company, each in their area of responsibility, can carry out a timely identification, evaluation, response and follow-up of the risks.

The Company's model for dealing with risks is inspired by best market practice in this area and defines 60 types.

Classification of risks

Telefónica Group's business is conditioned both by factors exclusive to it and by those common to any company in the telecoms sector. Therefore, it is considered that the business, the financial situation and the results of the Company may be affected by certain significant risks and uncertainties which fall into four main categories:

- Business
- Operational
- Financial
- Global

Process of risk management

Identification → Evaluation → Response to the risk → Follow-up and reporting

Reporting workflow in risk management

Risks which impact on reputation

The Local and Corporate Reputation teams work together with those of Risk Management to identify and evaluate all those risks that might affect the reputation of the Company.

Principal risks identified

Business
- Country risk (investments in Latin America)
- Risk arising from the current world economic situation
- Strongly regulated markets
- Highly competitive markets subject to continuous tecnological evolution
- Limitations of spectrum

Operational
- Shortage of supplies from providers
- Risks associated with unforeseen network interruptions
- Risks related to the Internet

Financial
- Risk with interest and exchange rates
- Risk arising from dependence on sources of external finance
- Risks related to possible asset impairment

Global
- Radio frequency emissions and potential health risks

60 types
of risks catalogued

4 categories:
business, financial, operational and global

4.0

Performance indicators_

Table of performance indicators_

The following are Telefónica's main indicators in 2012, reflecting its triple bottom line results and the way the Company manages its business.

Financial

Economic efficiency in millions of euros		**2012**
Revenues	Sum of all income from sale of products and services, from financial and non-financial investments, and from the sale of tangible and intangible assets	62,356
Spending on suppliers	Spending on purchases and other third-party items	18,074
Value added	Operational margin: revenue less spending on suppliers	44,282
Remuneration of employees	Costs of remuneration of employees (includes wages, salaries and social security contributions)	8,569
Gross operating income	OIBDA	21,231
Financial costs	Value of interest accrued by external financing	-3,659
Remuneration of proprietors	Dividends to shareholders approved for the period	0
Corporate income tax	Tax on corporate income	-1,461
Economic contribution to the community	Contributions to social action (LBG)	158
Economic contribution to public administration	Total payments to public bodies (taxes, fees, VAT, social security, etc.)	13,806
RDI investment	Total investment allocated to research, development and innovation	5,771
Total investment	CapEx	9,458
Profitability	Net profit after taxes	3,928
Indebtedness	Net debt	51,259
Treasury shares	Book value of treasury (own) shares	506

Corporate governance

Good corporate governance		2012
Directors	Total number of directors	18
Independent directors	Number of independent directors	7
Directors in charge of Corporate Social Responsibility (CSR)	Number of independent directors with specific remit in the CSR area	4
Executive Committee	Number of directors with specific responsibility for the strategy of the Company	9
Audit committee	Number of directors with specific responsibility for economic and financial control	3
Appointments committee	Number of directors with specific remit in appointments	5
Board mettings	Number of meetings held by the Board in 2012	14
Remuneration of Board	Remuneration accrued by members of the Board during the year 2012	€ 47,898 th.
Gender diversity on the Board	Number of women Board members	1

Social

Human Capital		2012
Employees	Number of workers with contract at end of 2012	133,263
Gender diversity of employees	Number of women with contract at end of 2012	50,540
Management posts	Number of managers with contract at end of 2012	1,234
Gender diversity of management posts	Number of women managers with contract at end of 2012	239
Work stability	Number of employees with permanent contract at end of 2012	126,123
Staff rotation	% employees who leave the organization. The causes may be dismissal, resignation, retirement or demise while under contract. All workers are included, whatever their type of current contract.	19.3
Training of employees	Total number of hours of training received by the workers of the Company during the year	4,146,302
Social capital		
Payment of providers	Mean payment period of providers	75 days

Environmental

Energy efficiency and emissions		2012
Energy consumption	Total direct consumption of energy (renewable and non-renewable)	5,885 GJ
Fuel consumption in operations and by vehicle fleet	Direct consumption of fuel in operations and buildings [1]	1,712 TJ
Total greenhouse gas emissions	Sum of direct and indirect emissions, Scopes 1, 2 and 3	1,789,000 metric tons (t) CO_2eq
Water consumption	Total consumption of all types of water	5.6 million m^3
Waste management efficiency		
Waste generation	Total waste generated, dangerous and non-dangerous	30,410 t
Reuse of customers' waste electrical and electronic devices	Mobile phones of customers reused via managed programs	147 t
Waste reused	Waste reused following specific processes	147 t

1. Includes consumption of natural gas, diesel, petrol, LPG and ethanol in operations and by own vehicle fleet.

5.0

Appendices_

"In 2012, Telefónica initiated a deep transformation...

delivering progressive improvements quarter by quarter and allowing us to meet the guidance set at the beginning of the year.

This transformation approach targets the recovery of our differential growth profile, based on a sustainable top-line growth leveraged on our high diversification, with solid revenue growth in Latin America, mobile data and digital services.

Additionally, we have implemented bold actions in our commercial model, changing our propositions from a subsidy-based model towards a more sustainable model based on quality and differential offers, which increase customers' loyalty. In parallel, we are executing a simplification process across the board, leading to significant cost savings and increased efficiency, prioritising resources towards core and growth activities.

These actions resulted into a sequential improvement of organic revenue growth and a continued margin recovery which, in the fourth quarter, contributed to OIBDA year-on-year stabilisation and led to organic growth in the operating cash flow (+6.2% year-on-year).

With regards to the balance sheet, we closed the year with an outstanding improvement in financial flexibility thanks to a proactive portfolio management, a strong cash-flow generation and an on-going refinancing policy.

In 2013, we will further execute this transformation process, and we expect to recover our growth profile and further improve margin trends, while we continue to reduce our leverage."

César Alierta,
Executive Chairman

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January –December 2012

The financial information contained in this document has been prepared under International Financial Reporting Standards (IFRS), as adopted by the European Union, which do not differ for the purposes of the Telefónica Group, from IFRS as issued by the International Accounting Standards Board (IASB). This financial information is unaudited.

The English language translation of the consolidated financial statements originally issued in Spanish has been prepared solely for the convenience of English speaking readers. Despite all the efforts devoted to this translation, certain omissions or approximations may subsist. Telefónica, its representatives and employees decline all responsibility in this regard. In the event of a discrepancy, the Spanish-language version prevails

Access the full Financial Report via the QR code.

Financial highlights

- **Stabilization of year-on-year OIBDA trend in the fourth quarter (-0.1% in organic terms), posting sequential growth and margin expansion for the third quarter in a row:**
  - Telefónica's fourth quarter OIBDA (5,449 million euros, negatively impacted in 527 million euros due to the impairment of Telefónica Ireland) increased 7.6% in underlying terms vs. the previous quarter (-1.4% year-on-year), reflecting the efficiencies and savings derived from the transformational initiatives and cost-reduction measures undertaken.
  - Underlying OIBDA margin for the fourth quarter was 37.0% (+2.0 p.p. vs. the previous quarter) significantly improving its year-on-year trend (+0.1 p.p. vs. 0.5 p.p. in the third quarter).
  - In 2012, underlying OIBDA totalled 21,741 million euros (-4.1% year-on-year), reflecting an outstanding improving trend throughout the year. Underlying OIBDA margin was 34.9%, 1.3 p.p. lower than in 2011.
- **Significant increase in operating cash flow (OIBDA-CapEx), which rose 6.2% year-on-year in organic terms in the fourth quarter.** In 2012 operating cash flow reached 12,870 million euros in underlying terms.
- **Substantial improvement in underlying EPS along 2012, that reached 1.44 euros in 2012 (0.87 euros in reported terms).** EPS in the fourth quarter grew 28.5% sequentially and remained virtually stable vs. the same period of 2011 (0.46 euros vs. 0.47 euros).
- Net income totalled 3,928 million euros, impacted by extraordinary impacts such as Telco impairment (-949 million euros), Telefónica Ireland impairment (-513 million euros) and the effect of the Venezuelan Bolivar devaluation (-417 million euros). **Net income excluding extraordinary impacts rose to 6,465 million euros.**
- **Free cash flow reached 6,951 million euros in 2012, thus 1.55 euros per share,** improving the Group financial flexibility and **allowing for an ample coverage of its dividend commitments for 2013.**
- **Outstanding improvement in financial flexibility, with a sharp reduction in net financial debt of 4,747 million euros in the fourth quarter (5,045 million euros for the full year):**
  - Net financial debt stood at 51,259 million euros at December 2012, implying a Net financial debt / OIBDA ratio of 2.36x.
  - The solid cash flow generation in the fourth quarter, coupled with an efficient and proactive management of the Company's asset portfolio, led to a 8.5% reduction in net financial debt compared with the end of September.
  - The proactive refinancing policy has enabled to raise around 15,000 million euros in 2012 (vs. more than 11,500 million euros in 2011) and covers debt maturities beyond 2014, eliminating refinancing risk.
- **Revenues totalled 62,356 million euros, and declined 0.8% year-on-year,** largely impacted by the challenging trading environment in Europe, forex and regulation. **Excluding regulatory impacts, revenues rose 0.7% thanks to the solid growth of mobile data and Telefónica Latinoamérica:**
  - In the fourth quarter, consolidated revenues' year-on-year organic trend improved compared to the previous quarter. Organic growth at T. Latinoamérica accelerated in the fourth quarter to 7.5% year-on-year (+6.7% in 2012), driven by the expansion of its high-value customer base with a growing weight of contract and smartphones.
  - Mobile data revenues continued to be the main growth driver in 2012, rising 12.8% year-on-year to account for more than 34% of consolidated mobile service revenues, on the back of the rapid expansion of non-SMS data revenues (57% of total data revenues). This growth is based on the strong increase in mobile broadband accesses to 52.8 million (+38% year-on-year).

- **In 2012, revenues and OIBDA at Telefónica Latinoamérica surpassed those at Telefónica Europe for the first time, highlighting the Company's high level of diversification:**

  - **Spanish OIBDA** improved significantly its trend in the fourth quarter (-3.0% year-on-year) to 1,710 million euros, thanks to the strong recovery in OIBDA margin (+5.5 p.p. year-on-year) to 47.2%. This, coupled with more efficient investment over the year, resulted in the first quarterly growth in operating cash flow since 2008 (+7.7% year-on-year in organic terms).

  - **Revenues in Brazil** accelerated in the fourth quarter (+2.9% year-on-year) driven by mobile revenues (+9.4% year-on-year), that account already for more than 65% of total revenues in the country. Fourth quarter OIBDA was 1,487 million euros, with a margin of 44.2%, impacted by the capital gains from the sale of non-strategic towers (269 million euros in the fourth quarter 2012 vs. 163 million euros in the fourth quarter 2011).

  - The pace of year-on-year decline in UK revenues improved significantly to -3.2% in the quarter, on the back of healthy growth in mobile service revenues, growing by 0.5% year-on-year excluding regulation. OIBDA reached 412 million euros in the quarter, maintaining its gradually improving trend (-8.7% year-on-year).

  - **Telefónica Germany** continued to improve its positioning in the German mobile market after increasing mobile service revenues by 4.8% in the fourth quarter 2012, excluding regulation. OIBDA reached 366 million euros in the quarter (+5.3% year-on-year) driven by revenue growth and continuing efficiency improvements.

- **Debt reduction is consistent with our strategy of prioritising investments on growth areas** and strengthening networks by acquiring spectrum.

- **The Company met its 2012 operating targets for revenues, OIBDA margin and CapEx/Sales.**

- **Telefónica announces its guidance for 2013 and reiterates the shareholder remuneration policy for 2013, of paying a cash dividend of 0.75 euros per share.**

  - Operating guidance (in organic terms[1]):
    - Revenue growth.
    - Lower OIBDA margin erosion than in 2012.
    - CapEx/Sales similar than in 2012.
  - Financial guidance:
    - Net financial debt < 47,000 million euros.

1. Guidance criteria 2013: 2013 guidance assumes constant exchange rates as of 2012 (average FX in 2012), excludes hyperinflationary accounting in Venezuela in both years and considers constant perimeter of consolidation. OIBDA level guidance for 2013 excludes write-offs, capital gains/losses from companies' disposals, towers sales and other significant exceptionals. CapEx excludes spectrum acquisition.

2012 adjusted bases exclude:

- Capital gains/losses from companies' disposals: Capital gains/losses from China Unicom, Atento, Hispasat and Rumbo and impairment of T. Ireland.
- Homogeneous perimeter: 2012 adjusted figures exclude results of Atento, Rumbo and small changes in T. Digital perimeter and homogeneous accounting treatment of Joint Ventures.
- Tower sales.
- Change in contractual commercial model for contract handsets in Chile.

2012 Bases for 2013 targets:

- Organic revenues 2012: 61,084 million euros.
- OIBDA margin erosion ex-towers: -1.4 percentage points.
- Organic CapEx/Sales ex-spectrum: 14.1%.

Selected financial data

Telefónica. Selected financial data

Unaudited figures (Euros in millions)	January - December		% Chg	
	2012	2011	Reported	Organic
Revenues	**62,356**	**62,837**	**(0.8)**	**(0.8)**
Telefónica Latinoamérica	30,520	28,941	5.5	6.7
Telefónica Europe	29,995	32,066	(6.5)	(7.8)
Other companies & eliminations	1,841	1,830	0.6	
OIBDA	**21,231**	**20,210**	**5.1**	**(3.9)**
Telefónica Latinoamérica	11,103	10,890	2.0	3.4
Telefónica Europe	10,244	9,278	10.4	(10.0)
Other companies & eliminations	(115)	42	c.s.	
OIBDA margin	**34.0%**	**32.2%**	**1.9 p.p.**	**(1.1 p.p.)**
Telefónica Latinoamérica	36.4%	37.6%	(1.3 p.p.)	(1.1 p.p.)
Telefónica Europe	34.2%	28.9%	5.2 p.p.	(0.9 p.p.)
Operating Income (OI)	**10,798**	**10,064**	**7.3**	**(8.7)**
Telefónica Latinoamérica	6,015	6,120	(1.7)	1.2
Telefónica Europe	5,233	4,197	24.7	(15.6)
Other companies & eliminations	(450)	(253)	78.1	
Net income	**3,928**	**5,403**	**(27.3)**	
Basic earnings per share (euros)	**0.87**	**1.18**	**(25.9)**	
CapEx	**9,458**	**10,224**	**(7.5)**	**0.3**
Telefónica Latinoamérica	5,455	5,260	3.7	4.5
Telefónica Europe	3,513	4,513	(22.2)	(9.0)
Other companies & eliminations	490	452	8.6	
OpCF (OIBDA-CapEx)	**11,773**	**9,986**	**17.9**	**(6.6)**
Telefónica Latinoamérica	5,648	5,630	0.3	2.6
Telefónica Europe	6,731	4,765	41.2	(10.4)
Other companies & eliminations	(605)	(409)	47.9	

Reconciliation included in the excel spreadsheets.

Notes:

- OIBDA and OI are presented before brand fees and management fees.
- OIBDA margin calculated as OIBDA over revenues.
- 2011 and 2012 reported figures include the hyperinflationary adjustments in Venezuela in both years.
- Other companies & eliminations include the results of Atento in 2012 until November 30th.
- CapEx includes 586 millon euros from the spectrum acquired in 2012: 5 millon euros in Nicaragua, 34 millon euros in Venezuela, 127 millon euros in Ireland and 420 millon euros in Brazil. In 2011 it includes 1,296 millon euros from the spectrum acquired: 842 million euros in Spain, 349 millon euros in Brazil, 68 millon euros in Costa Rica and 37 millon euros in Colombia.
- From January 1st, 2012, and due to the implementation of the new organization announced in September 2011, companies related to the digital world and global resources that were previously included in the consolidation perimeter of T.Latinoamérica (Terra, Medianetworks Perú, Wayra and the joint venture Wanda), T. España and T. Europe (TIWS, TNA, Jajah, Tuenti and Terra España) have been excluded from their consolidation perimeters and are included within "Other companies and eliminations". Additionally, from the beginning of the year, the perimeter of consolidation of T.Europe includes T.España. As a result, the results of T. Europe, T. Latinoamérica and "Other companies and eliminations" have been restated for the fiscal year 2011, to reflect the above mentioned new organization. As this is an intragroup change, Telefónica consolidated results for 2011 are not affected.
- Organic criteria: In financial terms, it assumes constant average exchange rates as of January-December 2011 and excludes changes in the perimeter of consolidation and hyperinflation accounting in Venezuela. The results of the Atento Group are included up to 30 November 2011 and those of Rumbo are included up to 31 October 2011. In OIBDA and OI terms, 2012 excludes the reduction in value made by the Telefónica Group on its investment in Telefónica Ireland (-527 million euros), the capital loss generated by the sale of China Unicom shares (-97 million euros), and the capital gains generated by the sale of the Atento Group (+61 million euros), Rumbo (+27 million euros) and the partial sale of Hispasat (+26 million euros). Excluded from OIBDA and OI in 2011 were the positive impact of the partial sale of Telefónica's economic exposure to Portugal Telecom (+184 million euros), and the provision for the redundancy program in Spain (-2,671 million euros). Telefónica's CapEx excludes spectrum investment and, in 2011, the Real Estate Efficiency Programme at T. España, and the real estate commitments in relation to the new Telefónica headquarters in Barcelona.

Telefónica Accesses

Telefónica. Accesses

Unaudited figures (thousands)	December		
	2012	2011	% Chg
Final Clients Accesses	310,010.8	301,311.8	2.9
Fixed telephony accesses (1) (2)	40,002.6	40,119.2	(0.3)
Internet and data accesses	19,402.6	19,134.2	1.4
Narrowband	653.2	909.2	(28.2)
Broadband (3)	18,596.2	18,066.3	2.9
Other (4)	153.1	158.7	(3.5)
Mobile accesses (5)	247,269.5	238,748.6	3.6
Prepay (6)	165,759,7	162,246.9	2.2
Contract (2) (7)	81,509.8	76,501.7	6.5
Pay TV	3,336.2	3,309.9	0.8
Wholesale Accesses	**5,731.3**	**5,296.0**	**8.2**
Unbundled loops	3,308.8	2,928.7	13.0
Shared ULL	183.5	205.0	(10.5)
Full ULL	3,125.3	2,723.7	14.7
Wholesale ADSL (8)	800.6	849.3	(5.7)
Other (9)	1,621.8	1,518.0	6.8
Total Accesses	**315,742.1**	**306,607.8**	**3.0**

Telefónica. Mobile Accesses

Unaudited figures (thousands)	December		
	2012	2011	% Chg
Prepay percentage (%)	67.0%	68.0%	(0.9 p.p.)
Contract percentage (%)	33.0%	32.0%	0.9 p.p.
MBB accesses ('000)	52,774.9	38,218.1	38.1%
MBB penetration (%)	21%	16%	5.3 p.p.
Smartphone penetration (%)	19%	13%	6.2 p.p.

Notes:

(1) PSTN (including Public Use Telephony) x1; ISDN Basic access x1; ISDN Primary access; 2/6 Access x30. Company's accesses for internal use and total fixed wireless included. Includes VoIP and Naked ADSL. Since the first quarter of 2012, fixed telephony accesses include 384 thousand VoIP customers in Germany and 65 thousand fixed lines in UK to homogenize these accesses to the criteria of Telefónica.

(2) Fixed telephony accesses include the reclassification in the fourth quarter of 2012 in Argentina of 157 thousand "fixed wireless" accesses previously recognized as mobile accesses of the contract segment.

(3) ADSL, satellite, optical fiber, cable modem and broadband circuits.

(4) Retail circuits other than broadband.

(5) First quarter of 2012 includes the disconnection of 2.0 million inactive accesses in Spain

(6) First quarter of 2012 includes the disconnection of 1.2 million inactive accesses in Spain. Additionally, 360 thousand inactive accesses were disconnected in Chile in the third quarter of 2011. In Brazil, 1.0 million inactive accesses were disconnected in the fourth quarter of 2011 and 1.6 million inactive accesses in the second quarter of 2012.

(7) First quarter of 2012 includes the disconnection of 800 thousand inactive accesses in Spain.

(8) Includes ULL rented by T. Germany and T.UK.

(9) Circuits for other operators. Includes Wholesale Line Rental (WLR) in Spain.

Consolidated results

2012 was a key year in Telefónica's transformation process. Various initiatives were introduced during the course of the year that will accelerate the restoring of the Company's growth differential. Telefónica Latinoamérica's revenues exceeded those of Telefónica Europe for the first time, remaining along with mobile data revenues as the main growth levers for the Group, with both registering an acceleration in their organic growth rates in the fourth quarter. Telefónica Europe regained strong commercial momentum in its main markets thanks to the success of the newly launched tariffs, particularly "Movistar Fusión" in Spain, which reflects a general improvement in the competitive position in the different markets.

Meanwhile, **for the third quarter in a row there was a sequential improvement in underlying OIBDA in absolute terms across all regions, and in the consolidated OIBDA margin, which returned to year-on-year growth in underlying terms**, on the back of the transformational initiatives and cost reduction measures undertaken in several areas.

In 2012 Global Resources consolidated its operating model and, through its global areas, consistently contributed to Telefónica's progress in optimising scale economies. As a result, it has obtained higher efficiencies, improvements in time to market and customer satisfaction, in addition to increased competitiveness in its multinational businesses.

The global initiatives oriented towards the simplification and standardisation of processes, applications and technologies, together with a rationalisation of rollouts and network sharing, have all allowed Telefónica to generate recurring savings and a better service quality. Thus, it has set the basis for accelerating our IT transformation, which will be supported on our new data centres (Mexico, Brazil and Spain).

In addition, the value traded globally in mobile devices has risen to 80%, focused on 100 references, thereby improving the efficiency obtained every quarter, and working towards a more balanced vendor map and an optimum swapability among references. It has also laid the foundations to develop an end to end sourcing model with emphasis on global categories. This model allows Telefónica to unify decision and award processes, guaranteeing savings and value creation sustainability.

Finally, the new organisation of Telefónica's multinational businesses has been strengthened, with leaner operations, reinforcing its global positioning and improving customer satisfaction. As a result, revenues from its multinational businesses increased 7% year-on-year, highlighting international services (+23% year-on-year).

During 2012, **we have also improved our CapEx efficiency by focusing on growth**, reallocating resources to higher-growth operations and services -such as the selective rollout of fibre and VDSL-, improving service quality and customer satisfaction, strengthening our networks via spectrum acquisition, and prioritising simplicity in order to best take advantage of shared investment.

At the same time, **there was a substantial improvement in financial flexibility at the end of 2012**, thanks to the three following cornerstones: firstly, a significant reduction in debt during the second half of the year, thanks to strong cash flow generation -this being due to a substantial improvement in OIBDA and an efficient working capital management- and proactive portfolio management; secondly, the fact that the Company's refinancing efforts throughout 2012 have led to the long-term refinancing of around 15,000 million euros, with a high level of diversification; and thirdly, the cancellation of the dividend corresponding to fiscal year 2012 has been a key determining factor for increasing the Company's liquidity and for facilitating market access. All these measures have led to significant reduction in financial leverage, credit rating stabilization and significant liquidity improvement.

During the fourth quarter of 2012, Telefónica advanced further with the transformation of the Company. **Telefónica Digital**, as part of its strategy to boost innovation and capture opportunities in the digital world, has made significant progress, including:

- As part of the venture capital initiative, **Telefónica Ventures** led the funding round for "Everything.me", an innovative dynamic HTML5-based platform for mobile applications, which is bringing about in smartphones a transition to the "dynamic" concept, offering services adapted to a particular time and location.
- At the same time, Telefónica continues to make progress with the development of **Firefox**, an HTML5-based Mozilla operating system, with first handsets to be launched in Brazil, Colombia, Spain and Venezuela during the summer of 2013.
- Telefónica launched "Instant Servers", the first global **cloud** service with the Telefónica brand name, which offers to corporate customers high-performance virtual servers optimized for corporate mobile applications.
- In Brazil, Telefónica and Mastercard presented MFS, a company that is to develop **mobile payment** solutions to meet the needs of Telefónica's customers that don't have bank accounts enabling them to make bank transfers, purchases and mobile top-ups among other financial transactions.
- T. Digital has bought TokBox, the leading platform for **video communication**, which enables the development of live video-based communication services via the simple incorporation of video calls into websites and mobile applications.
- **Wayra** successfully held its first "DemoDay Global" in Miami to present to international investors the advances made by 17 start-ups chosen from the more than 180 ventures so far accelerated. During the quarter Wayra incorporated new academies in Sao Paulo, Munich, Prague and Santiago de Chile, making a total of 13 academies around the world.

During the fourth quarter of 2012, Telefónica advanced further with the transformation of the Company.

The Company's total accesses rose 3% year-on-year, reaching 315.7 million at year end 2012

- Telefónica Digital and Microsoft signed a strategic agreement for the creation of a **Global Video Platform,** that offers television services both in managed networks (IPTV) and non-managed networks (over-the-top). During the quarter the service was launched in Brazil and Chile.

- Telefónica Digital created **Telefónica Dynamic Insights**, a new global business unit aimed at opening up the new value-creation opportunities offered by the so-called "big data" sector.

The Company's total **accesses** rose 3% year-on-year, reaching 315.7 million at year end 2012, with a significant rise in the number of contract accesses and fixed and mobile broadband accesses. Noteworthy was the 6% year-on-year increase in accesses at Telefónica Latinoamérica (67% of the total). In the fourth quarter, Telefónica Europe posted positive net additions on its total accesses, as a result of strong commercial momentum.

- **Mobile accesses** stood at 247.3 million at the end of the quarter, up 4% on 2011, driven by sustained growth in mobile contract accesses (+7% year-on-year), which now account for 33% of total mobile accesses. Mobile net additions in 2012 totalled 12.1 million accesses (excluding the disconnection of 3.6 million inactive mobile accesses in Spain and Brazil), with the contract segment accounting for 52%.

- The Company's **mobile broadband accesses** stood at 52.8 million in December 2012, maintaining a solid 38% year-on-year growth, and representing 21% of mobile accesses (+5 percentage points year-on-year). It is worth highlighting the strong commercial momentum in smartphones during the year, with net additions of 15.4 million in 2012 (+20% year-on-year) reaching a penetration rate of 19% over mobile accesses (+6 percentage points year-on-year), and particularly in the fourth quarter, with total net additions of 5.4 million (the best quarter of the year and a 73% higher than the third quarter). Particularly noteworthy was the significant acceleration of net smartphone additions in Europe in the fourth quarter, largely on the back of the commercial momentum of Telefónica España.

- **Fixed-line accesses** reached 40.0 million at the end of 2012, with net additions of 181 thousand during the fourth quarter (-217 thousand accesses in the third quarter) and with year-on-year deterioration slowing vs. September (-0.3% through to December compared with -1.5% to September).

- **Retail fixed broadband accesses** reached 18.6 million at the end of the year, a 3% increase vs. December 2011, with 530 thousand net additions during 2012 (+72 thousand in the fourth quarter). In the fourth quarter, Telefónica Europe showed net additions for the first time since March 2011, thanks to the commercial momentum on fixed broadband at Telefónica España. Retail fixed broadband accesses reached a penetration rate of 46% over total fixed accesses (+1.5 percentage points year-on-year).

It is important to note that Atento Group deconsolidated its results from Telefónica Group as of the end of November 2012 (following the disposal of the company during the fourth quarter of 2012), therefore affecting year-on-year comparisons of Telefónica's reported financial results.

Revenues in 2012 totalled 62,356 million euros, a 0.8% decrease vs. 2011, (-2.0% year-on-year in the fourth quarter), affected by adverse conditions in certain markets, both economic and those resulting from more intense competition, and the negative effect of regulation. Revenues increased 0.7% year-on-year in 2012, excluding the negative effect of regulation. Exchange rate fluctuations contributed 0.1 percentage points to growth and changes to the perimeter had a negative impact of 0.1 percentage points, meaning the decrease in organic terms was 0.8% for the full year. In the fourth quarter, the year-on-year decrease in organic terms was 0.7%, as exchange rate fluctuations had a negative impact of 0.9 percentage points and changes in the perimeter contributed negatively 0.4 percentage points to revenue growth.

The Company's high diversification remains a key differentiating factor in the current environment, as demonstrated by the revenue breakdown. By regions, Telefónica Latinoamérica's revenues in 2012 continued to show strong year-on-year growth in organic terms (+6.7%), accelerating in the fourth quarter vs. the third quarter (+7.5% vs. +6.4%), and they now account for 49% of consolidated revenues (+2.9 percentage points vs. the previous year), exceeding the revenues from Telefónica Europe (48% of total), which fell 6.5% year-on-year in reported terms. Telefónica España's contribution decreased to 24% of consolidated revenues.

By services, mobile data revenues remained as growth driver in 2012 (+12.8% year-on-year; +11.8% in organic terms), contributing more than 34% to mobile service revenues during the period (31% in 2011). Non-SMS mobile data revenues posted a significant increase (+24.1% year-on-year; +23.1% in organic terms), representing 57% of total mobile data revenues, 5 percentage points more than in 2011.

Consolidated **operating expenses** amounted to 42,343 million euros, 4.9% less than in 2011. The reported year-on-year comparison is affected by the provision for expenses related to the redundancy program in Spain booked in the third quarter of last year (2,671 million euros). The trend in expenses improved in the fourth quarter, with a 3.1% decrease year-on-year, thanks to the efficiency and cost cutting measures introduced. In organic terms, expenses increased by 1.1% year-on-year in 2012, an improvement of 1.1 percentage points compared with the first nine months of 2012, mainly due to lower commercial costs, principally in Spain, resulting from the new commercial model introduced as of the end of 2011.

- **Supplies** for full-year 2012 totalled 18,074 million euros, a 1.0% decrease in reported terms (-2.1% organic). In the fourth quarter of 2012, the decrease accelerated (-3.9% year-on-year in reported terms; -3.9% organic), reflecting lower mobile interconnection costs in all regions and lower handset upgrades in Spain and the UK.

- **Subcontract expenses** (13,487 million euros) rose by 3.6% year-on-year (+3.4% organic). Nevertheless, in the fourth quarter there was a change in trend and they fell on a year-on-year basis (-1.8% in reported

Telefónica Latinoamérica continued increasing its contribution to consolidated underlying OIBDA, accounting for 51%

terms; -2.4% organic), mainly due to the general reduction in commercial costs, especially those relating to fees and advertising expense.

- **Personnel costs** stood at 8,569 million euros, a 22.7% decrease vs. 2011, being the year-on-year comparison affected by the provision for the redundancy program in Spain mentioned above. In organic terms, this item increased 3.3% year-on-year (+1.3% in the fourth quarter), thanks to the important savings derived from the Company's redundancy programs, and despite the impact of inflation in some Latin American countries.

  The average headcount was 272,598 employees. Excluding Atento, which was sold in the fourth quarter, Telefónica's average workforce stood at 131,468 employees, 2,480 fewer than in 2011.

Gains on sales of fixed assets in 2012 stood at 782 million euros (-5.0% year-on-year) and at 493 million euros in the fourth quarter (-6.9% year-on-year). This heading in 2012 included mainly the following: i) the sale of non-strategic towers, with an impact on OIBDA of 643 million euros (354 million euros in the fourth quarter, mainly in Brazil, Mexico, Chile, Spain, and Peru); ii) the gain from the sale of applications in the second quarter (39 million euros; 18 million euros in Telefónica España); iii) the capital loss on the reduction of the stake in China Unicom (97 million euros in the third quarter); and iv) the capital gains from the fourth quarter disposals of Atento (61 million euros), Rumbo (27 million euros), and the partial sale of Hispasat (26 million euros). In 2011, this item totalled 823 million euros (530 million euros in the fourth quarter) and mainly included the positive effects of the partial reduction of our economic exposure to Portugal Telecom (184 million euros) and the sale of non-strategic towers (with an impact in OIBDA of 541 million euros; 467 million euros in the fourth quarter).

It is important to mention that OIBDA is affected by a value adjustment (-527 million euros) by the Telefónica Group in relation to Telefónica Ireland.

Operating income before depreciation and amortisation (OIBDA) amounted to 21,231 million euros, a 4.1% decrease in underlying terms, 1.0 percentage point less than the decrease registered during the first nine months of 2012 (-5.1%), with a sequential improvement in underlying OIBDA in all regions. In the fourth quarter, underlying OIBDA was virtually stable in year-on-year terms (-1.4%) at 5,862 million euros, confirming, for the third quarter in a row, a sequential quarterly improvement in OIBDA.

OIBDA margin at the end of 2012 stood at 34.0%, the year-on-year erosion being in line with the Company's forecasts (-1.3 percentage points in underlying terms). The sustained sequential improvement in the underlying OIBDA margin continued in the fourth quarter (37.0%, compared with 35.1% in the third quarter, 34.6% in the second quarter, and 32.8% in the first quarter).

Noteworthy, underlying OIBDA margin in the fourth quarter registered positive year-on-year growth (+0.1 percentage points compared with -0.5 percentage points in the third quarter, -1.9 in the second quarter, and -2.8 in the first quarter), reflecting the success of measures implemented to improve the Company's efficiency and despite the lower year-on-year contribution from tower sales. By region, Telefónica Latinoamérica continued increasing its contribution to consolidated underlying OIBDA, accounting for 51% (+3.2 percentage points vs. December 2011). Telefónica Europe accounted for slightly less than 50%, and Telefónica Spain's contribution fell to less than a third of the total (31%).

Depreciation and amortisation in 2012 (10,433 million euros) increased 2.8% year-on-year (+2.0% in organic terms) and 2.7% year-on-year in the fourth quarter, mainly due to the amortisation of the new spectrum acquired in Germany, Brazil, Colombia, Mexico and Venezuela, and the increase in fixed assets. The depreciation and amortisation charges arising from purchase price allocation processes amounted to 962 million euros in 2012 (-14.1% year-on-year).

In 2012, **operating income (OI)** totalled 10,798 million euros (-10.2% year-on-year in underlying terms), and particularly improved in the fourth quarter (-5.4% year-on-year in underlying terms).

Profit from associates amounted to -1,275 million euros (-635 million euros in 2011), mainly due to Telco, S.p.A.'s adjustments of the value of its investment in Telecom Italia, as well as to the recovery of all the operating synergies considered at the time of this investment, with both effects totalling -1,355 million euros in 2012 and -662 million euros in 2011. The figure for the fourth quarter was -789 million euros compared with -130 million euros for the same period the previous year, and was totally due to the above-mentioned value adjustment at Telco, S.p.A. It should be pointed out that these effects were non-cash impacts.

Net financial expenses for the full-year 2012 totalled 3,659 million euros, 24.4% more than in 2011. This is explained by two separate effects; on the one hand, by the increase in interest rate costs mainly due to a higher average debt in 2012 (+3.3% to 58,187 million euros), the widening of credit spreads, and the need to increase liquidity (with lower remuneration compared to the cost of debt) as a result of the financial market crisis; and, on the other hand, this is explained by greater negative exchange rate differences mainly due to the effect in the estimations of the Group as a result of the 32% decline in the estimated liquidation value of the Venezuelan Bolivar versus the US Dollar in 2013. Despite the increase in credit costs, the Company has managed to maintain the average cost of the Group's gross debt (excluding the cash position) at 4.7%. This implies an effective cost of debt of 5.37% over the last 12 months excluding exchange rate differences.

Cash Flow from operations reached 20,105 million euros in 2012 (-6.3% year-on-year), and 5,919 million euros in the fourth quarter.

Working capital generation over the twelve month period amounted to 772 million euros, driven by the working capital management measures implemented. This is lower than the 2011 figure (2,134 million euros), basically due to the following: the decrease in supplier financing, as a result of Spain's Insolvency Law; lower accruals resulting from the containment of investment in fixed assets; and the impact from differences among spectrum accruals and payments; and various other factors.

Interest payments totalled 2,867 million euros, 856 million euros more than in 2011. Out of this amount, approximately 308 million euros were non-recurrent effects, such as the payment of interests related to the restructuring of Colombian companies, payments to the tax authorities in Spain and Peru, and front-end fees related to financial operations signed. The remainder was mainly due to a higher average debt in 2012 and the increase in interest rates due to the negative evolution of financial markets.

Payment of taxes totalled 2,024 million euros in 2012, 65 million euros more than in 2011.

As a result, **Free Cash Flow** for full-year 2012 amounted to 6,951 million euros, 25.0% less than in 2011, mainly due to the lower generation of working capital and the higher interest payments mentioned above.

It is important to highlight that, following the Company's efforts to reduce debt, **net financial debt** decreased by 5,045 million euros in 2012, finishing the year at 51,259 million euros.

The lower debt compared to December 2011 was explained by a free cash flow figure for 2012 of 6,951 million euros and net financial divestments of 2,447 million euros, underlining the funds raised by the Initial Public Offering of the German subsidiary. Changes in the perimeter of consolidation and other impacts reduced debt by 669 million euros (including 1,499 million euros from the debt restructuring in Colombia, reduced by 830 million euros which reflects the increase in the present value of obligations due to fixed rate derivative transactions, accrued interest higher than payments, and other effects). Shareholder remuneration, although 51% lower than in 2011, increased financial debt by 3,561 million euros, payments due to commitments represented a cash outflow of 800 million euros, and exchange rate movements (mainly the appreciation of the Mexican peso, the Peruvian sol, and the Chilean peso against the dollar) led to an increase in financial debt of 662 million euros.

The **leverage ratio** for the past 12 months (net debt over OIBDA) stood at 2.36 times as of the end of December.

During 2012, Telefónica's **financing activity**, excluding short-term Commercial Paper Programmes activity, stood at around 15,000 million equivalent euros and has exceeded the amount raised in fiscal year 2011, improving significantly the Company's liquidity position.

The financing activity was focused on financing in advance debt maturing in 2012, and on smoothing the debt maturity profile for 2013 and 2014 at the Holding level. Therefore, the Company maintains a debt maturity profile that, along with cash flow generation expectations, is covered beyond 2014.

Net debt maturities for 2014 amount to 6,945 million euros, while for 2013 the cash and liquid assets position exceeds the gross maturities due in the year. The main financial operations included:

- In January, a loan facility with a Chinese financial entity was signed to finance telecom equipment purchases with a local supplier for an amount of 375 million US dollars.
- In February, Telefónica increased the 6 year euro bond last February 2011 through a private placement, for an amount of 120 million euros.
- In February, Telefónica issued a 6 year bond in the euro market for an amount of 1,500 million euros that experienced an excess of demand of over 6.5 times.

- In the month of February Telefónica signed a 3 year loan with a financial entity for an amount of 200 million euros.
- In March, Telefónica issued a bond in sterling pounds for an amount of 700 million and 8 year maturity, which was 3.8 times oversubscribed.
- Also in March, Telefónica issued a 5 year bond in Czech crowns through a private placement, for an amount of 1,250 million Czech crowns.
- It is worth highlighting, in the loan market, the refinancing signed in March with nearly 40 lenders for two tranches of the O2 syndicated loan maturing in December 2012 and December 2013 for approximately 3,400 million equivalent sterling pounds. On the one hand, Telefónica extended to December 2015 a total of approximately 1,300 million pounds of the 2,100 million sterling pounds maturing in December 2012. On the other hand, Telefónica extended to February 2017 the 2,100 million sterling pounds maturing in December 2013.
- In June, a 6-year 10,000 million Japanese yen bond was issued through a private placement.
- In August, a new loan facility with two Chinese financial entities was signed to finance telecom equipment purchases with a local supplier for an amount of 1,200 million US dollars.

During 2012, Telefónica's financing activity stood at around 15,000 million equivalent euros, improving significantly the Company's liquidity position

- In September, 1,000 million euros for a period of 5 years were raised through a 750 million euros bond that was above 9 times oversubscribed followed by a tap of 250 million euros.
- Also in September, Telefónica Czech Republic signed a 4 year term loan facility worth 3,000 million Czech crowns.
- In October, a 7 year bond issuance for an amount of 1,200 million euros was launched, more than 6.5 times oversubscribed.
- In November, as part of the refinancing of the preferred shares maturing in December 2012, a 10 year debenture issuance for an amount of 1,165 million euros was launched.
- In December, there was a debut Swiss franc issuance in two tranches, 6 years and 10 years, raising 250 million Swiss francs and 150 million Swiss francs respectively.

In January 2013, Telefónica issued a 10 year bond in the euro market for an amount of 1,500 million euros that was 6.5 times oversubscribed. More recently, in February, a refinancing has just been signed, with 23 banks, relating to the tranche of the Vivo syndicated loan maturing in July 2014, for an amount totalling 1,400 million euros. 700 million euros have been extended to July 2017 and 700 million euros to July 2018. Also in February, the Company has signed two operations to finance purchases from Canadian and Swedish suppliers, for 206 million euros and 1,001 million USD, respectively.

Telefónica S.A. and its holding companies have remained active during 2012 under the various Commercial Paper Programmes (Domestic and European), with an outstanding balance of nearly 1,100 million euros at the end of December.

Regarding Latin America, as of December 2012 Telefónica's subsidiaries have tapped the capital markets for an amount of approximately 2.900 million equivalent euros. The main financial operations closed during the year included:

Definitions

Organic growth:

In financial terms, it assumes constant average exchange rates as of January-December 2011 and excludes changes in the perimeter of consolidation and hyperinflation accounting in Venezuela.

The results of the Atento Group are included up to 30 November 2011 and those of Rumbo are included up to 31 October 2011. In OIBDA and OI terms, 2012 excludes the reduction in value made by the Telefónica Group on its investment in Telefónica Ireland (-527 million euros), the capital loss generated by the sale of China Unicom shares (-97 million euros), and the capital gains generated by the sale of the Atento Group (+61 million euros), Rumbo (+27 million euros) and the partial sale of Hispasat (+26 million euros).

Excluded from OIBDA and OI in 2011 were the positive impact of the partial sale of Telefónica's economic exposure to Portugal Telecom (+184 million euros), and the provision for the redundancy program in Spain (-2,671 million euros).

Telefónica's CapEx excludes spectrum investment and, in 2011, the Real Estate Efficiency Programme at T. España, and the real estate commitments in relation to the new Telefónica headquarters in Barcelona.

- In September, Telefónica Brazil completed a 5 year 2,000 million Brazilian reais debentures issue.
- Also, in September, Telefónica Colombia issued a 10 year US dollar debut offering for an amount of 750 million nearly 11 times oversubscribed.
- In October, Telefónica Chile issued a 10 year bond for 500 million US dollars which was over 10 times oversubscribed.

Telefónica maintains total undrawn committed credit lines for an amount of nearly 11,600 million euros, with around 9,500 million maturing in more than 12 months.

At the end of December 2012, bonds and debentures represented 68% of consolidated **financial debt** breakdown, while debt with financial institutions represented 32%.

Corporate income tax for 2012 totalled 1,461 million euros, which, over an income before taxes of 5,864 million euros, implied an effective tax rate of 24.9%, mainly due to the recognition of tax losses in several countries during the fourth quarter.

Profit attributable to minority interests dragged net income by 475 million euros in 2012, mainly due to the participation of minorities in net income of Telefónica Brazil, Telefónica Czech Republic and Telefónica Germany. The year-on-year change (-39.5%) is affected by the reversal of deferred tax liabilities recognised as part of the Vivo purchase price allocation in the amount of 1,288 million euros resulting from the tax benefit generated by some of the acquired assets.

As a result of the above items, **consolidated net income** in 2012 was 3,928 million euros (-27.3% year-on-year) and the basic earnings per share 0.87 euros (-25.9% year-on-year). In underlying terms, net income amounted to 6,465 million euros, a year-on-year decrease of 13.6%, while **basic earnings per share** was 1.44 euros (-11.9% year-on-year).

It is important to underline the significant improvement in the fourth quarter, in which net profit reached 2,051 million and 0.46 euros per share in underlying terms, showing strong sequential growth (+28.5% vs. the third quarter of 2012) and remaining virtually stable in year-on-year terms.

CapEx in 2012 reached 9,458 million euros, 7.5% less than in 2011. It is important to highlight that in 2012 this item included 586 million euros mainly relating to the cost of the spectrum in Brazil, Ireland, and Venezuela; while in 2011 it included spectrum investment in Spain, Brazil, Costa Rica, and Colombia, for a total of 1,296 million euros. In organic terms, CapEx rose 0.3% year-on-year. The Company continued to devote the bulk of its investments on growth and transformation projects (81% of total investment), fostering the expansion of high-speed broadband services, both fixed and mobile.

The CapEx to sales ratio (excluding spectrum) for 2012 stood at 14.2%, in line with 2011.

Consequently, **operating cash flow (OIBDA-CapEx)**, excluding spectrum, stood at 12,360 million euros in 2012 (+9.6% year-on-year; -6.6% in underlying terms). In the fourth quarter, operating cash flow rose 3.3% year-on-year in underlying terms.

Underlying growth:

Reported figures, excluding exceptional impacts and spectrum acquisition and excluding the impact from changes in the perimeter of consolidation.

The results of the Atento Group are included up to 30 November 2011 and those of Rumbo are included up to 31 October 2011. 2012 figures exclude the reduction in the value of the Telecom Italia investment and the recovery of all the operating synergies considered at the time of this investment (-1,355 million euros; -949 million euros net of taxes), and also PPAs (-1,073 million euros; -689 million euros net of taxes and minority interests), the reduction in value made by the Telefónica Group on its investment in Telefónica Ireland (-527 million euros; -513 million euros net of taxes), the effect of Venezuelan Bolivar devaluation (-438 million euros; -417 million euros net of taxes), the capital loss on the sale of China Unicom shares (-97 million euros; -45 million euros net of taxes), the capital gain on the sale of Atento Group (+61 million euros; +33 million euros net of taxes), the capital gain on the sale of Rumbo (+27 million euros; +24 million euros net of taxes) and the capital gain on the partial sale of Hispasat (+26 million euros; +19 million euros net of taxes). In 2011, results exclude the provision for the redundancy program in Spain (-2,671 million euros; -1,870 million euros net of taxes), the reversal of deferred tax liabilities at Vivo (+1,288 million euros; +952 million euros net of taxes and minority interests), value adjustments in relation to the stake in Telecom Italia and the operating synergies achieved (-662 million euros; -481 million euros net of taxes), the positive impact arising from the partial reduction of Telefónica's economic exposure to Portugal Telecom (+184 million euros), the difference in market value of the BBVA stake (-80 million euros; -56 million euros net of taxes), tax asset reassessment (-30 million euros) and also PPAs (-1,228 million euros before taxes; -790 million euros net of taxes and minority interests).

Financial Data

Telefónica. Consolidated income statement

Unaudited figures (Euros in millions)	January - December 2012	2011	% Chg
Revenues	**62.356**	**62.837**	**(0,8)**
Internal exp. capitalized in fixed assets	822	739	11,3
Operating expenses	(42.343)	(44.501)	(4,9)
Supplies	(18.074)	(18.256)	(1,0)
Personnel expenses	(8.569)	(11.080)	(22,7)
Subcontracts	(13.487)	(13.019)	3,6
Bad debt provisions	(777)	(818)	(5,1)
Taxes	(1.436)	(1.328)	8,1
Other net operating income (expense)	177	317	(44,0)
Gain (loss) on sale of fixed assets	782	823	(5,0)
Impairment of goodwill and other assets	(564)	(5)	n.s.
Operating income before D&A (OIBDA)	**21.231**	**20.210**	**5,1**
OIBDA Margin	**34,0%**	**32,2%**	**1,9 p.p.**
Depreciation and amortization	(10.433)	(10.146)	2,8
Operating income (OI)	**10.798**	**10.064**	**7,3**
Profit from associated companies	(1.275)	(635)	100,7
Net financial income (expense)	(3.659)	(2.941)	24,4
Income before taxes	**5.864**	**6.488**	**(9,6)**
Income taxes	(1.461)	(301)	n.s.
Income from continuing operations	**4.403**	**6.187**	**(28,8)**
Non-controlling interests	(475)	(784)	(39,5)
Net income	**3.928**	**5.403**	**(27,3)**
Weighted average number of ordinary shares outstanding during the period (millions)	**4.495,9**	**4.584**	**(1,9)**
Basic earnings per share (euros)	**0,87**	**1,18**	**(25,9)**

• **Notes:**

• For the basic earnings per share calculation purposes, the weighted average number of ordinary shares outstanding during the period have been obtained applying IAS rule 33 "Earnings per share". Thereby, the weighted average number of shares held as treasury stock during the period has not been taken into account as outstanding shares.

• In accordance with IAS 33, "Earnings per Share", the weighted average number of ordinary shares outstanding during the period have been restated for 2011 and 2012 to reflect the bonus share issue due to the scrip dividend. As a consequence basic earnings per share have also been restated.

• 2011 and 2012 reported figures include the hyperinflationary adjustments in Venezuela in both years.

• 2012 reported figures include the results of Atento until November 30th.

Telefónica. Guidance 2012

Unaudited figures (Euros in millions)	2012 January - December	2012 Guidance 2012	2011 Base
Revenues (% Chg Y o Y)	0,7%	≥ 0%	62.837
OIBDA Margin (% Chg Y o Y)	(1,3 p.p.)	Lower margin dedline than in 2011	(2,1 p.p.)
CapEx (ex-spectrum) / Sales	14,2%	Similar Capex / Sales as in 2011	14,2%
Net financial debt / OIBDA	2.36x	Net financial debt / OIBDA < 2,35	2,46x

• Guidance criteria2012: Assumes current exchange rates (2012 average FX of € 1: US$ 1.32; € 1: BRL 2.30; € 1: £ 0.85) and constant perimeter of consolidation. At the OIBDA A level, excludes write-offs, capital gains/losses from companies disposals and significant exceptionals. CapEx excludes spectrum licenses.

Telefónica. Reported vs. Underlying

Unaudited figures (Euros in millions)

	January - December			%	
	Jan-Dec 2012 Reported	Jan-Dec 2012 Underlying	Jan-Dec 2011 Underlying	Underlying Change y-o-y	Reported Change y-o-y
Revenues	**62.356**	**62.356**	**62.766**	**(0,7)**	**(0,8)**
OIBDA	**21.231**	**21.741**	**22.682**	**(4,1)**	**5,1**
OIBDA margin	**34,0%**	**34,9%**	**36,1%**	**(1,3 p.p.)**	**1,9 p.p.**
Operating Income (OI)	**10.798**	**12.270**	**13.660**	**(10,2)**	**7,3**
Net income	**3.928**	**6.465**	**7.485**	**(13,6)**	**(27,3)**
Basic earnings per share (euros)	**0,87**	**1,44**	**1,63**	**(11,9)**	**(25,9)**
OpCF (OIBDA-CapEx) ex-spectrum	**12.360**	**12.870**	**13.775**	**(6,6)**	**9,6**

Exceptional items	2012	2011
Reported Revenues	**62.356**	**62.837**
Rumbo		(3)
Atento		(68)
Underlying Revenues	**62.356**	**62.766**
Reported OIBDA	**21.231**	**20.210**
PT capital gain		(184)
Workforce restructuring plan in Spain		2.671
China Unicom capital loss	97	
Hispasat capital gain	(26)	
Rumbo	(27)	(1)
Atento	(61)	(15)
T. Ireland impairment	527	
Underlying OIBDA	**21.741**	**22.682**
Reported Net Income	**3.928**	**5.403**
PT capital gain		(184)
Telco write-down	949	481
Difference in market value of BBVA stake		56
PPAs	689	790
Workforce restructuring plan in Spain		1.870
China Unicom capital loss	45	
Hispasat capital gain	(19)	
Rumbo	(24)	(0)
Atento	(33)	(9)
T. Ireland impairment	513	
Deferred tax liability on Vivo acquisition		(952)
Tax asset reassessment		30
Venezuelan devaluation effect	417	
Underlying Net Income	**6.465**	**7.485**

• Underlying growth: Reported figures, excluding exceptional impacts and spectrum acquisition and excluding the impact from changes in the perimeter of consolidation. The results of the Atento Group are included up to 30 November 2011 and those of Rumbo are included up to 31 October 2011. 2012 figures exclude the reduction in the value of the Telecom Italia investment and the recovery of all the operating synergies considered at the time of this investment (-1,355 million euros; -949 million euros net of taxes), and also PPAs (-1,073 million euros; -689 million euros net of taxes and minority interests), the reduction in value made by the Telefónica Group on its investment in Telefónica Ireland (-527 million euros; -513 million euros net of taxes), the effect of Venezuelan Bolivar devaluation (-438 million euros; -417 million euros net of taxes), the capital loss on the sale of China Unicom shares (-97 million euros; -45 million euros net of taxes), the capital gain on the sale of Atento Group (+61 million euros; +33 million euros net of taxes), the capital gain on the sale of Rumbo (+27 million euros; +24 million euros net of taxes) and the capital gain on the partial sale of Hispasat (+26 million euros; +19 million euros net of taxes). In 2011, results exclude the provision for the redundancy program in Spain (-2,671 million euros; -1,870 million euros net of taxes), the reversal of deferred tax liabilities at Vivo (+1,288 million euros; +952 million euros net of taxes and minority interests), value adjustments in relation to the stake in Telecom Italia and the operating synergies achieved (-662 million euros; -481 million euros net of taxes), the positive impact arising from the partial reduction of Telefónica's economic exposure to Portugal Telecom (+184 million euros), the difference in market value of the BBVA stake (-80 million euros; -56 million euros net of taxes), tax asset reassessment (-30 million euros) and also PPAs (-1,228 million euros before taxes; -790 million euros net of taxes and minority interests).

Telefónica. Consolidated statement of financial position

Unaudited figures (Euros in millions)

	December 2012	December 2011	% Chg
Non-current assets	104.177	108.800	(4,2)
Intangible assets	22.078	24.064	(8,3)
Goodwill	27.963	29.107	(3,9)
Property, plant and equipment and Investment properties	35.022	35.469	(1,3)
Non-current financial assets and investments in associates	11.807	13.743	(14,1)
Deferred tax assets	7.308	6.417	13,9
Current assets	25.596	20.823	22,9
Inventories	1.188	1.164	2,1
Trade and other receivables	10.711	11.331	(5,5)
Current tax receivable	1.828	1.567	16,7
Current financial assets	1.872	2.625	(28,7)
Cash and cash equivalents	9.847	4.135	138,1
Non-current assets classified as held for sale	150	1	n.s.
Total Assets = Total Equity and Liabilities	**129.773**	**129.623**	**0,1**
Equity	27.661	27.383	1,0
Equity attributable to equity holders of the parent	20.461	21.636	(5,4)
Non-controlling interests	7.200	5.747	25,3
Non-current liabilities	70.601	69.662	1,3
Non-current financial debt	56.608	55.659	1,7
Deferred tax liabilities	4.788	4.739	1,0
Non-current provisions	7.064	7.172	(1,5)
Other non-current liabilities	2.141	2.092	2,3
Current liabilities	31.511	32.579	(3,3)
Current financial debt	10.245	10.652	(3,8)
Trade and other payables	9.407	9.406	0,0
Current tax payables	2.522	2.568	(1,8)
Current provisions and other liabilities	9.333	9.953	(6,2)
Financial Data			
Net Financial Debt (1)	51.259	56.304	(9,0)

1. Figures in million euros.Net financial debt in December 2012 includes: Non current interest-bearing debt + Other non-current payables (1,639) + Current interest-bearing debt + Other current payables (145) - non-current financial assets and investments in associates (5,605) - trade and other receivables (54) - current financial assets (1,872) - cash and cash equivalents.

- **Note:**
  2011 and 2012 reported figures include the hyperinflationary adjustments in Venezuela in both years.

Telefónica. Free cash flow and change in debt

Unaudited figures (Euros in millions)

		January - December		
		2012	2011	% Chg
I	**Cash flows from operations**	**20.105**	**21.466**	**(6,3)**
II	Net interest payment [1]	(2.867)	(2.011)	
III	Payment for income tax	(2.024)	(1.959)	
A=I+II+III	**Net cash provided by operating activities**	**15.214**	**17.496**	**(13,0)**
B	Payment for investment in fixed and intangible assets [2]	(8.578)	(8.304)	
C=A+B	**Net free cash flow after CapEx**	**6.636**	**9.192**	**(27,8)**
D	Net Cash received from sale of Real Estate	36	30	
E	Net payment for financial investment [3]	2.412	(3.590)	
F	Net payment for operations with minority shareholers and treasury stock [4]	(4.046)	(7.966)	
G=C+D+E+F	**Free cash flow after dividends**	**5.037**	**(2.334)**	**c.s.**
H	Effects of exchange rate changes on net financial debt	662	(37)	
I	Effects on net financial debt of changes in consolid. and others	(669)	(1.587)	
J	Net financial debt at beginning of period	56.304	55.593	
K=J-G+H+I	**Net financial debt at end of period**	**51.259**	**56.304**	**(9,0)**

(1) Including cash received from dividends paid by subsidiaries that are not fully consolidated.
(2) In 2012 it includes 632 million euros for the spectrum payments: 396 in Spain, 126 in Ireland, 42 in Brazil, 23 in Colombia, 7 in Mexico, 4 in Nicaragua and 34 in Venezuela. In 2011 it includes 891 million euros for the spectrum payments: 441 in Spain, 349 in Brazil, 3 in Colombia, 26 in Mexico, 3 in Nicaragua and 69 in Costa Rica.
(3) Includes charges amounting to 1,429 million euros from the IPO of the German subsidiary.
(4) Dividends paid by Telefónica S.A., operations with treasury stock and operations with minority shareholders from subsidiaries that are fully consolidated.
- Note: 2011 and 2012 reported figures include the hyperinflationary adjustments in Venezuela in both years.

Telefónica. Reconciliations of cash flow and oibda minus Capex

Unaudited figures (Euros in millions)

	January - December		
	2012	2011	% Chg
OIBDA	**21.231**	**20.210**	**5,1**
- CapEx accrued during the period	(9.458)	(10.224)	
- Payments related to cancellation of commitments	(800)	(807)	
- Net interest payment	(2.867)	(2.011)	
- Payment for tax	(2.024)	(1.959)	
- Gain (Loss) on sale of fixed assets and impairment of goodwill and other assets [1]	(218)	1.848	
- Investment in working cap. and other deferred income and expenses	772	2.134	
= Net Free Cash Flow after CapEx	**6.636**	**9.192**	**(27,8)**
+ Net Cash received from sale of Real Estate	36	30	
- Net payment for financial investment	2.412	(3.590)	
- Net payment for operations with minority shareholders and treasury stock	(4.046)	(7.966)	
= Free Cash Flow after dividends	**5.037**	**(2.334)**	**c.s.**

Unaudited figures (Euros in millions)

	January - December		
	2012	2011	% Chg
Net free Cash Flow after CapEx	**6.636**	**9.192**	**(27,8)**
+ Payments related to cacellation of commitments	800	807	
- Opertaions with minority shareholders	(485)	(728)	
= Free Cash Flow	**6.951**	**9.270**	**(25,0)**
Weighted average number of ordinary shares outstanding during the period (millions)	4.496	4.584	
= Free Cash Flow per share (euros)	**1,55**	**2,02**	**(23,5)**

(1) In 2011, it includes 2,671 million euros from the workforce provision related to the Redundancy Program approved in Spain.
Notes:
- The concept "Free Cash Flow" reflects the amount of cash flow avaible to remunerate Telefónica S.A. Shareholders, to protect solvency levels (financial debt and commitments), and to accomodate strategic flexibility.
- 2011 and 2012 reported figures include the hyperinflationary adjustments in Venezuela in both years.
- CapEx includes 586 millon euros from the spectrum acquired in 2012: 5 millon euros in Nicaragua, 34 millon euros in Venezuela, 127 millon euros in Ireland and 420 millon euros in Brazil. In 2011 it includes 1,296 millon euros from the spectrum acquired: 842 millon euros in Spain, 349 millon euros in Brazil, 68 millon euros in Costa Rica and 37 millon euros in Colombia.

Telefónica. Net financial debt plus commitments

Unaudited figures (Euros in millions)		December 2012
	Long -term debt (1)	58.247
	Short term debt including current maturities (2)	10.390
	Cash and cash equivalents	(9.847)
	Short and Long -term financial investments (3)	(7.531)
A	**Net Financial Debt**	**51.259**
	Gross commitments related to workforce reduction (4)	4.321
	Value of associated Long -term assets (5)	(928)
	Taxes receivable (6)	(1.357)
B	**Net commitments related to workforce reduction**	**2.035**
A + B	**Total Debt + Commitments**	**53.295**
	Net Financial Debt / OIBDA (7)	**2.36x**
	Total Net Debt + Commitments / OIBDA (8)	**2.54x**

(1) Includes "Non current interest-bearing debt" and 1,639 million euros of "Other non-current payables".
(2) Includes "Current interest-bearing debt" and 145 million euros of "Other current payables".
(3) Includes 1,872 million euros of "Current financial assets", 5,605 million euros of "Non-current financial assets and investments in associates" and 54million euros of "trade and other receivables" from Rent to Rent operations of T. España.
(4) Mainly in Spain. This amount is detailed in the captions "Long-term provisions" and "Short-term provisions and other liabilities" of the Statement of Financial Position, 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".
(5) Amount included in the caption "Non-current financial assets and investments in associates" of the Statement of Financial Position. Mostly related to investments in fixed income securities and long-term deposits that cover the materialization of technical reserves of the Group insurance companies.
(6) Net present value of tax benefits arising from the future payments related to actual workforce reduction commitments.
(7) Calculated based on the last 12 months OIBDA.
(8) Calculated based on the last 12 months OIBDA excluding results on the sale of fixed assets.
- **Note:** 2012 reported figures include the hyperinflationary adjustments in Venezuela.

Telefónica. Debt struture by currency

Unaudited figures	December 2012				
	EUR	LATAM	GBP	CZK	USD
Debt structure by currency	80%	10%	5%	3%	2%

Telefónica. Credit Ratings

	Long -Term	Short-Term	Perspective	Date of last rating change
Moody's[1]	Baa2	P-2	Negative	10-18-12
JCR[2]	A-	-	Negative	01 -23-13
S&P[1]	BBB	A-2	Negative	12 -20-12
Fitch[1]	BBB+	F-2	Negative	06 -08-12

(1) The rating is issued by a credit rating agency established in the EU and registered under Regulation (EC) 1060/2009.
(2) The rating is issued by a third country credit rating agency that is certified in accordance with Regulation (EC) 1060/2009.

Telefónica Exchanges Rates Applied

	P&L and CapEx (1)		Statement of Financial Position (2)	
	Jan - Dec 2012	Jan - Dec 2011	December 2012	December 2011
USA (US Dollar/Euro)	1,285	1,391	1,319	1,294
United Kingdom (Sterling /Euro)	0,811	0,868	0,816	0,835
Argentina (Argentinean Peso/Euro)	5,838	5,743	6,489	5,569
Brazil (Brazilian Real/Euro)	2,502	2,325	2,696	2,427
Czech Republic (Czech Crown/Euro)	25,142	24,591	25,140	25,800
Chile (Chilean Peso/Euro)	624,590	672,246	633,260	671,795
Colombia (Colombian Peso/Euro)	2.308,536	2.568,667	2.333,004	2.513,662
Costa Rica (Colon/Euro)	652,742	710,732	678,426	670,691
Guatemala (Quetzal/Euro)	10,062	10,831	10,426	10,106
Mexico (Mexican Peso/Euro)	16,898	17,252	17,107	18,047
Nicaragua (Cordoba/Euro)	30,255	31,185	31,831	29,726
Peru (Peruvian Nuevo Sol/Euro)	3,387	3,828	3,362	3,489
Uruguay (Uruguayan Peso/Euro)	26,054	26,835	25,595	25,746
Venezuela (Bolivar Fuerte/Euro) 3	5,673	5,564	5,673	5,564

(1) These exchange rates are used to convert the P&L and CapEx accounts of Telefónica foreign subsidiaries from local currency to euros.
(2) Exchange rates as of 12/31/12 and 12/31/11.
(3) After considering Venezuela as an hyperinflationary country, P&L and CapEx from the operations in the country are to be accounted at the closing exchange rate Bolivar Fuerte/Euro.

Results by regional business units

Telefónica Latinoamérica [1]

In 2012, Telefónica Latinoamérica registered a solid performance, reinforcing its growth profile with a gradual improvement in efficiency levels driven by the strategic focus on maximising customer value.

Telefónica managed a total of 212 million **accesses** in the region at the end of December 2012, 6% higher year-on-year. It should be highlighted that this growth reflects the strong commercial activity in the mobile business, mainly due to the mobile broadband growth, the positive trend of the fixed broadband and pay TV businesses, and the consolidation during the second half of the year of the stronger performance from traditional fixed accesses, which posted positive net additions for the second consecutive quarter.

Main trends in the **mobile business** include the following:

- Estimated penetration in Latin America was 116% (+7 percentage points year-on-year).
- **Mobile accesses** reached 176.6 million with a year-on-year increase of 6%, despite the disconnection of inactive prepay mobile customers in Brazil (1.6 million accesses in the second quarter) and the application of more restrictive criteria for both gross additions and disconnections in several countries in the region.
- **Contract accesses** doubled the growth rate of mobile accesses and increased 12% year-on-year, enabling Telefónica to maintain its regional leadership in this segment, with 39.5 million accesses. Contract accesses now account for 22% of total mobile accesses, and the performance of this segment (+1 percentage point year-on-year) reflects the strategic focus on capturing value customers.
- Similarly, **mobile broadband accesses** posted a strong growth (+68% year-on-year), and stood at 27.3 million accesses by the end of the year, reaching a penetration of 15% of the mobile accesses base, thanks to the strong growth in smartphones, which represent 13% of accesses and almost double the accesses base as of December 2011, with net additions during the year of 10.7 million customers.
- **Net additions** reached 11.9 million in 2012 (excluding the disconnections mentioned previously) and 1.4 million accesses in the quarter, of which 1.2 million are in the contract segment. This trend reflects the significant year-on-year growth of gross additions in 2012 (+10% year-on-year), mainly in high-value customers, and a churn increase, which stood at 3.2% for the full year (+0.4 percentage points year-on-year), affected by the application of a more restrictive criteria for prepay disconnections mentioned above.
- **Traffic** grew by 16% year-on-year in 2012 and by 18% in the quarter in homogeneous terms (excluding the tariff change from minutes to seconds applied from the first quarter of 2012 in Mexico), reflecting the higher level of activity of the customer base.
- **ARPU** decreased slightly (-0.2% year-on-year) despite the negative impact derived from the reduction of mobile termination rates. Thus, outgoing ARPU increased by 3.1% year-on-year (+4.4% in the quarter), reflecting the Company focus on maximizing customer value.

Highlights in the **fixed business** include the following:

- The Company's **accesses** reached 35.3 million at the end of 2012, with a year-on-year growth of 2%.
- **Accesses in traditional business** totalled 24.2 million with a year-on-year increase of 1%, after consolidating during the quarter the positive trend in net additions (280 thousand accesses vs. 14 thousand in the third quarter and 193 thousand in the full-year). This growth is mainly due to the launch of convergent services and the increased penetration of the service using Fixed Wireless technology, and it includes the reclassification in the fourth quarter of 2012 of 157 thousand Fixed Wireless accesses previously recognised as contract mobile accesses in Argentina.
- **Broadband accesses** amounted to 8.4 million, up 7% year-on-year, with net additions of 586 thousand in the year (76 thousand during the quarter).
- **Pay TV accesses** reached 2.4 million, growing by 7% year-on-year, and with net additions of 169 thousand accesses in the year, with an improvement in the quarter (73 thousand in the fourth quarter; 34 thousand in the third quarter; 25 thousand in the second quarter).
- The continued focus on bundling and broadband is reflected in the fact that 75% of fixed accesses signed up for some form of bundled offer (+2 percentage points year-on-year), while 88% of broadband accesses are also under 2P/3P offers.

Telefónica Latinoamérica's **revenues** amounted to 30,520 million euros in 2012, with a 5.5% year-on-year growth in reported terms (+4.2% in the quarter), and 6.7% in organic terms, with a solid acceleration in the quarter to 7.5%. Excluding the negative impact of regulation, organic revenues rose 8.3% year-on-year in 2012, with the growth rate accelerating in the last quarter (+9.1% year-on-year).

This trend was driven by the good performance of **mobile service revenues** (+11.4% in the year; +10.2% in the quarter

1. Organic growth: In financial terms, it assumes constant average exchange rates as of January-December 2011, and excludes hyperinflation accounting in Venezuela. In 2011, it excludes from OIBDA the positive impact of the partial sale of our stake in Portugal Telecom (+35 million euros). CapEx excludes investments in spectrum

in organic terms), despite the negative impact from regulation (-2.0 percentage points in the year-on-year growth, both for the full year and for the fourth quarter), and the better trend in the quarter registered in the fixed business (-2.5% year-on-year in organic terms in the fourth quarter; -3.7% in the third quarter).

Mobile broadband business remained a key growth driver, as reflected in **mobile data revenue**, with a year-on-year increase of 24.1% (+21.5% in the quarter), now accounting for 29% of mobile service revenues (+3 percentage points year-on-year). Connectivity revenues increase bolstered the growth in non-SMS data revenues, which rose 32.9% in the year and 34.2% in the fourth quarter, now accounting for 57% of data revenues (+4 percentage points year-on-year).

Operating expenses amounted to 20,305 million euros in 2012, up 6.5% year-on-year (+7.8% in organic terms), following a slowdown in the fourth quarter (+5.5% in organic terms).

- **Supply costs** reached 7,670 million euros for the full year, posting a year-on-year increase of 2.8% (+3.4% in organic terms; +4.4% in the quarter), mainly due to the increased number of gross additions with a higher contribution of smartphone sales and costs associated with the providers of digital, data, and content services. On the other hand, it is also worth highlighting the increased cost of leasing sites for the rolling-out and sale of towers.

- **Subcontract expenses** amounted to 8,259 million euros, increasing by 6.8% year-on-year (+8.7% in organic terms). Nevertheless, slower growth in the fourth quarter was consolidated (+2.3% year-on-year in organic terms), as a result of ongoing cost efficiency measures implemented during the year and also the commercial activity, which was more comparable in year-on-year terms in the second half of the year.

- **Personnel expenses** stood at 2,908 million euros and increased by 13.5% year-on-year (+14.2% in organic terms), after growing 14.8% in the quarter, mainly due to the negative impact that inflation had on higher costs in certain countries of the region, and despite the restructuring efforts carried out along the year.

OIBDA reached 11,103 million euros in 2012, with a year-on-year increase of 2.0% and 3.4% in organic terms), with an acceleration in the year-on-year growth in the fourth quarter to 4.7% in organic terms (+1.6% reported). Thus, OIBDA margin registered a significant sequential improvement and stood at 36.4% for the year (40.3% in the fourth quarter), with a year-on-year decrease of 1.3 percentage points in the year and 1.0 percentage points in the quarter.

It should be highlighted that in these periods both OIBDA and OIBDA margin include the sale of non-strategic towers: 583 million euros in 2012 versus 541 million euros in 2011 (338 million euros in the fourth quarter of 2012 versus 467 million euros in the fourth quarter of 2011).

In addition, OIBDA in 2012 was negatively affected by a number of factors that impacted various countries in the first half of 2012 (integration costs, rebranding and provision reversal in Brazil, service interruption in Argentina, retroactive impact of new labour laws in Venezuela, etc.), reducing OIBDA by 42 million euros. Moreover, from the fourth quarter of 2012 OIBDA is affected by the change in the accounting treatment of handset revenues and costs following the contractual change in the commercial model used for marketing contract mobile handsets, with a negative impact in the quarter of 22 million euros.

CapEx in 2012 rose 3.7% year-on-year (+4.5% in organic terms), reaching 5,455 million euros, mainly devoted to the continued improvement of the network in order to provide innovative and benchmark services in the region in terms of quality. Investment during the year includes spectrum in several countries in the region for a total amount of 459 million euros: in Brazil (420 million euros in the fourth quarter), Venezuela (34 million euros in the third quarter), Chile (0.4 million euros also in the third quarter) and Nicaragua (5 million euros in the first quarter). Spectrum investments in 2011 totalled 454 million euros coming from spectrum acquired in Colombia (37 million euros in in the fourth quarter), Brazil (349 million euros in the second quarter) and Costa Rica (68 million euros in the second quarter).

Thus, **operating cash flow (OIBDA-CapEx)** stood at 5,648 million euros in 2012, up 2.6% in organic terms (+0.3% reported).

Telefónica managed a total of 212 million accesses in Latinoamerica at the end of December 2012

Brasil (year-on-year changes in organic terms)

Telefónica Brasil ended 2012 as market leader, increasing its contribution in high value segments and products and maintaining its solid position in both coverage and network quality and brand image.

Especially noteworthy over the year was the launch of new commercial propositions both in the mobile segment, with ongoing repositioning of plans aimed at increasing penetration of data services and voice traffic, and in the fixed business with the launch of convergent services and the deployment outside Sao Paulo of Fixed Wireless technology, which is now available in the country's largest metropolitan areas. In television, the fourth-quarter highlights were the launch in October of the new platform for IPTV service and the introduction of the OTT "Vivo Play" service in December. In fixed broadband, a new landmark in the market was also established with the launch of the 200 Mb service via the fibre optic network.

Furthermore, during 2012 the Company has successfully expanded its leadership in terms of customer satisfaction in the mobile business and significantly improving its position in the fixed business, which was reinforced following the rebranding in April 2012.

The Company managed 91.4 million **accesses** at the end of December, a solid year-on-year increase of 5% despite the disconnection of 1.6 million inactive prepay accesses in the second quarter and the application of more restrictive criteria for the reporting of prepay customers.

Mobile business performance highlights:

- Penetration in Brazil stood at 133% (+8 percentage points year-on-year).
- **Market share** stood at 29.1% (-0.5 percentage points year-on-year) and at 36.9% in the contract segment, up 0.3 percentage points year-on-year and stable compared with the previous quarter thanks to the strategic focus on higher value segments.
- **Mobile accesses** stood at 76.1 million (+6% year-on-year), mainly driven by the contract segment (+17% year-on-year), which accounts for 25% of mobile accesses (+2 percentage points year-on-year). Particularly noteworthy was the strong growth of **mobile broadband accesses** (+67% year-on-year), which accounted for 16% of mobile accesses (+6 percentage points year-on-year) on the back of the strong growth in smartphones with data plans attached, which doubled year-on-year and account for 12% of mobile accesses.
- **Net additions** totalled 6.2 million accesses in 2012 (excluding the disconnection of 1.6 million inactive prepay accesses in the second quarter), after posting a net loss of 0.7 million accesses in the fourth quarter associated with low value customers and as a result of the application of more restrictive criteria for the reporting of prepay customers. Net contract additions stood at 0.8 million in the quarter (2.7 million in the year), with the Company's share of net additions in the market at 37.4% in the quarter. Also noteworthy is the strong performance of gross additions (+8.2% year-on-year), which partially offset by the abovementioned disconnections was resulting in a higher churn rate (3.5% in 2012). Contract **churn** positive trend stood out and continued to improve quarter-on-quarter and stood at 1.4% in the last quarter of 2012 (1.5% in the year).
- **Traffic** maintained a positive trend, and grew by 27% in 2012 (+28% in the quarter), reflecting the strong take-up of tariff plans launched over the year. Top-ups also posted a good performance, growing 20% year-on-year in 2012.
- **ARPU** maintained year-on-year growth trend of recent quarters (+7.4% compared with the previous quarter), driven by the strong performance of both data and voice. Year-on-year ARPU trend improved in the fourth quarter (-3.7%) with ARPU down 6.4% in 2012. Outgoing ARPU posted positive year-on-year growth in the quarter for the first time in 2012 (+0.3%) thanks to the improvement in the prepay and contract segment, reducing the year-on-year decline to 2.5% in 2012.

Regarding commercial activity at the **fixed business** as of December 2012, the main highlights were:

- **Traditional accesses** stood at 10.6 million (-3% year-on-year), stabilizing its pace of decline thanks to the launch of convergent services and the rollout of Fixed Wireless technology outside the Sao Paulo area.
- **Retail Broadband accesses** totalled 3.7 million (+3% year-on-year), with 100 thousand net additions over the year (-20 thousand accesses in the quarter) in a backdrop of higher competitive intensity. Fixed broadband accesses accounted for 35% of the Company's fixed traditional accesses, a year-on-year increase of 2 percentage points.

  Ultra-broadband accesses through fibre continued to grow, reaching 112 thousand accesses at the end of 2012, twice the number registered in 2011, while penetration increased steadily over the more than 1 million homes passed.
- **Pay TV accesses** stood at 601 thousand (-14% year-on-year), impacted by the MMDS technology accesses loss associated with the future return of the licence. As a result of the Company's strategic focus on the commercial repositioning of this service, in October the new IPTV service via a new platform for high-speed fibre technology was launched while the OTT " Vivo Play" service with multi-device access was launched on 20 December.

Revenues in 2012 amounted to 13,618 million euros (+2.3% year-on-year), with growth accelerating in the quarter (+2.9%). The mobile business continued to post strong growth in the fourth quarter, while the trend in fixed business revenues continued to improve vs. previous quarters.

It is important to note that 2012 revenues are affected by mobile termination rate cuts (VUM; -13.7%) from 24 February and by the reduction in the retail fixed-mobile tariff (VC; -10.4%). Excluding these effects, revenues would have grown by 4.2% year-on-year in 2012, with growth accelerating to 4.7% year-on-year in the quarter.

Mobile revenues in 2012 stood at 8,573 million euros, up 9.4% year-on-year in 2012 and in the quarter.

- **Mobile service revenues** increased by 9.7% in the year and by 5.9% in the quarter despite the excellent performance of service revenues in the fourth quarter of 2011, reflecting the successful launch of the "Vivo Sempre" plan in the second half of the year and of the new contract plan portfolio in the last quarter of the year 2011. Excluding the impact of the reduction in mobile termination rates, mobile service revenues would have grown by 12.1% year-on-year (+8.1% in the quarter) thanks to the strong performance of voice and data revenues.

Data revenues advanced 19.7% year-on-year in 2012 and accounted for 26% of service revenues (+2 percentage points year-on-year). Non-SMS data revenues accounted for 62% of the total data revenues thanks to the strong performance of the mobile broadband business.

- **Revenues from handset sales** rose by 3.6% in the year as a result of the robust growth in the quarter (+112.8%) thanks to the Company's focus on high value customers, the increased weight of smartphone sales and the different commercial model for small and medium enterprises.

Fixed revenues stood at 5,045 million euros in 2012 (-7.8% year-on-year) and continued to improve sequentially (-7.5% in the fourth quarter; -8.5% in the third quarter; -11.0% in the second quarter). Year-on-year performance was affected by the decline in the fixed-mobile retail tariff, which deducted 1.3 percentage points (-1.4 percentage points in the quarter) to year-on-year growth. Breakdown by component:

- **Voice and access revenues** (-11.2% in 2012; -10.5% in the quarter) reflected the abovementioned cut in fixed-mobile retail tariffs (-9.2% in 2012 and -8.4% in the quarter excluding this effect) and the mobile business substitution effect.

- **Broadband and new services revenues** remained virtually stable in 2012 (-0.6% year-on-year), affected by the intense competition in the fixed broadband and Pay TV businesses and the stabilisation of data and IT revenues, though their performance improved year-on-year in the quarter (-1.0% compared with -2.0% in the third quarter and -8.8% in the second quarter).

Operating expenses increased 2.7% year-on-year, with continued growth deceleration in the quarter (3.2% year-on-year in September) mainly due to mobile termination rate cuts and the steady decline in personnel expenses associated with the headcount restructuring programme carried out in the first quarter of 2012. On the other hand, other cost year-on-year growth also slowed down despite continued high commercial activity associated with value customers. In 2012 expenses reflect the impact of rebranding and the costs associated with the integration of businesses, including the abovementioned workforce restructuring expenses in the first quarter of the year and the reversal of a provision in the second quarter, with a net positive impact of 11 million euros in the year.

Moreover, OIBDA in 2012 included 445 million euros from the sale of non-strategic towers (269 million euros in the fourth quarter) compared with 186 million euros in 2011 (163 million euros in the fourth quarter). Also worth noting is the net negative impact of mobile termination rate cuts and the reduction of fixed-mobile retail tariffs on OIBDA, which had a -1.4 percentage point impact on year-on-year growth.

Thus, **OIBDA** in 2012 stood at 5,161 million euros, a year-on-year increase of 5.5%, with strong growth posted in the last quarter (+15.4% year-on-year). The OIBDA margin posted an impressive improvement in the final quarter (44.2%) and stood at 37.9% in the full year (+1.1 percentage points year-on-year).

CapEx amounted to 2,444 million euros (+2.9% year-on-year excluding the investment in spectrum). Note that investment in the quarter includes 420 million euros associated with the acquisition of spectrum licences following the 4G spectrum award process and the provision of rural coverage in certain areas of the country carried out in the second quarter of 2012. Investment over the year was mainly driven by the mobile network expansion aimed at securing strong data and access growth and increasing the weight of higher speed accesses in the fixed broadband service.

Operating cash flow (OIBDA-CapEx) in 2012 amounted to 2,717 million euros, up 7.3% year-on-year, excluding the investment in spectrum, on the back of the Company's better operational performance.

Telefónica Brasil ended 2012 as market leader, improving its solid position in both coverage and network quality and Brand image

Argentina (year-on-year changes in local currency)

Telefónica Argentina maintained its market leadership in 2012, with a portfolio of benchmark services via integrated bundled fixed and mobile broadband offers and value added services, with a segmented approach enabling it to meet customers' different needs.

In the last quarter, it is worth highlighting the launch of a daily data proposition, the aim of which is to popularise the use of mobile broadband through a segmented approach for the younger market, which has shown high demand since its launch.

In addition, it is important to highlight that the Company's economic results in 2012 were negatively impacted by the compensation to customers associated with the software fault in the equipment which manages signaling in Movistar's national network, which affected the service during some hours on April, 2. Moreover, the severe weather conditions that affected the western area of Buenos Aires on April, 4 had also a further negative impact on results. On the other side, part of this impact was offset by the compensation received from insurers during the last quarter.

The Company managed 24.1 million **accesses** at the close of 2012, up 5% year-on-year.

Operating highlights at the **mobile business** in 2012 were:

- The estimated penetration rate in the market stood at 145% (+7 percentage points year-on-year).
- The Company's **mobile accesses** stood at 17.6 million (+5% year-on-year), after registering a net gain in the fourth quarter of 308 thousand accesses in the fourth quarter and 837 thousand for the full year, a 36% increase on 2011, thereby consolidating the improvement seen in activity levels over the last few quarters. Furthermore, this quarter includes the reclassification of 157 thousand contract mobile accesses as Fixed Wireless accesses, to be considered as traditional fixed-line accesses as of this quarter.
- **Churn** in 2012 stood at 2.7%, slightly up on the previous year (2.6% in 2011), mainly driven by the disconnection of low-value accesses in the prepay segment. Contract churn continued its positive performance, and remained as a regional benchmark.
- **Traffic** increased by 13% year-on-year in 2012, following a strong acceleration in the fourth quarter (+23% year-on-year) on the back of the increased customer base and the higher prepay usage.
- **ARPU** posted a positive performance, increasing by 14.6% year-on-year in 2012 (+13.4% in the fourth quarter) due to the progressive uptake of data services and growth in voice traffic.

Regarding commercial activity at the **fixed business** the main highlights were:

- **Traditional fixed accesses** stood at 4.8 million, a 3% rise on the previous year, thanks to the successful re-launching during the year of the strategy under Fixed Wireless technology business and also service bundling. Thus, 75.3% of accesses now include some type of service bundle.
- **Retail broadband accesses** totalled 1.7 million, up 9% year-on-year, and with 33 thousand net additions in the fourth quarter (141 thousand accesses in the year).

Revenues reached 3,697 million euros in 2012, up 18.4% year-on-year, with growth accelerating in the last quarter (+19.7% year-on-year).

Mobile service revenues totalled 2,431 million euros, a year-on-year rise of 21.2% (+23.2% in the quarter).

- **Mobile service revenues** posted a significant growth acceleration to 19.0% year-on-year (+19.7% in the quarter), reflecting the high level of usage. Data revenues were the main growth driver, advancing by 33.5% year-on-year in 2012 (+33.2% in the quarter) and already accounting for 44% of service revenues (+5 percentage points year-on-year).
- The strong level of commercial activity during the final quarter led to an acceleration of the year-on-year growth in **handset revenue**s (+47.4% in the year; +64.8% in the quarter).

Fixed revenues totalled 1,390 million euros in 2012, with growth accelerating to 14.2% year-on-year (+14.7% in the quarter.)

- **Voice and access revenues** increased by 5.7% year-on-year in 2012 (+5.6% in the quarter), thanks to the positive result of the voice services bundling strategy and accesses stability.
- Particularly noteworthy is the strong increase in **broadband and new services revenues** (+26.5% year-on-year; +26.7% in the quarter), which reflect the solid growth of internet and content revenues, and of data, IT and capacity rental revenues.

Operating expenses totalled 2,632 million euros and increased by 27.4% year-on-year (+26.8% year-on-year to September 2012). In 2012 expenses were affected by higher commercial costs due to the increased commercial activity and the costs related to the better customer care service. Operating expenses were also impacted by higher prices, which particularly impacted subcontract expenses and personnel expenses.

Full-year **OIBDA** amounted to 1,076 million euros, a year-on-year rise of 0.8%, following the significant improvement in the fourth quarter (+9.0% year-on-year). OIBDA margin for the full year stood at 28.5%, following the improvement in the last quarter (31.4% versus 25.9% in the third quarter).

CapEx reached 519 million euros for the full year, a year-on-year increase of 17.5%, reflecting the focus on strengthening the leadership in quality, especially in fixed and mobile broadband services.

Operating cash flow (OIBDA-CapEx) amounted to 557 million euros for 2012, a 10.9% decrease over 2011.

Chile (year-on-year changes in local currency)

Telefónica continues to lead the Chilean telecommunications market, strengthening its competitive advantage based on a differentiated integrated services offer in a highly competitive environment. Commercial activity in 2012 was affected by the nationwide introduction in January of mobile number portability and its gradual implementation in the fixed business, reaching nationwide scope in the third quarter.

Also noteworthy throughout 2012 was the development of mobile broadband and fixed ultra-broadband offer, through VDSL and fibre optic technology, as well as the ongoing improvement of the Company's offering through service bundling. The new IPTV platform for TV service was launched in the fourth quarter.

Thus, Telefónica managed a total of 13.1 million **accesses** in Chile at the end of 2012, with a year-on-year increase of 4%.

The main highlights of the operating performance in the **mobile business** include:

- Estimated penetration of the Chilean mobile market stood at 149% (+8 percentage points year-on-year).
- The Company's **mobile accesses** stood at 10 million at the end of the year, up 5% year-on-year, after registering net additions of 290 thousand accesses in the quarter (+492 thousand accesses in the full year).
- **Mobile broadband** accesses reached 1.5 million (+38% year-on-year) and accounted for 15% of total accesses (+4 percentage points year-on-year), driven mainly by strong growth of smartphones, which doubled accesses as of 2011.
- **Churn** stood at 2.3% in the year (2.0% in 2011) as a result of the introduction of number portability in the market.
- **Traffic** increased by 7% year-on-year (+9% year-on-year in the quarter) mainly driven by the higher usage in prepay segment.
- **ARPU** decreased by 3.9% year-on-year (-6.3% in the quarter), impacted by higher competitive intensity.

Regarding commercial activity in **fixed business**, highlights were:

- **Traditional accesses** stood at 1.7 million (-6% versus 2011), highlighting the strong churn contention which stood at the lowest level in the last seven quarters and allowed the improvement in net accesses loss (-20 thousand accesses; -90 thousand at the end of September) despite the gradual introduction of fixed number portability.
- **Retail broadband accesses** totalled 932 thousand (+6% year-on-year), after posting net additions of 54 thousand accesses compared with 57 thousand in 2011.
- **Pay TV accesses** stood at 424 thousand, growing by 8% year-on-year, with net additions of 16 thousand accesses in the fourth quarter (+17 thousand at the end of September 2012) after reducing churn in the last quarter of the year.

Revenues totalled 2,569 million euros in 2012, a year-on-year increase of 3.3% (+3.9% in the quarter).

Mobile revenues stood at 1,559 million euros with a year-on-year growth of 3.6% (+3.9% in the quarter).

- **Mobile service revenues** increased by 3.5% year-on-year in 2012 (+2.7% in the quarter), underpinned by access growth and the contribution of data revenues (+3.0% in the year; +2.8% in the quarter), despite being negatively affected in the year by the impact of regulatory change in the treatment of Premium SMS. Non-SMS revenues accounted for 74% of data revenues (+1 percentage point year-on-year) due to the higher penetration of mobile broadband services.
- **Revenues from handset sales** were affected in the quarter by a contractual change which requires total contract handset sales to be recorded on the profit and losses account and not as CapEx (an impact of 10 million euros on revenues). Handset sales in the full year increased by 4.6% (+13.9% in the quarter).

Revenues from the **fixed business** reached 1,113 million euros in 2012 (-0.3% year-on-year; +0.1% in the quarter).

- **Broadband and new services revenues** accounted for 52% of fixed business revenues (+5 percentage points year-on-year) and grew by 10.9% year-on-year (+8.5% in the quarter), reflecting the growth coming from internet, TV and content revenues along with the increase from data, IT and capacity rental revenues.
- **Voice and access** revenues decreased by 9.9% year-on-year (-7.8% in the quarter) due to the net accesses loss amid a more mature market environment.

Operating expenses grew by 8.7% in 2012 (+10.0% year-on-year in the first nine months), affected in the fourth quarter by supply cost associated with all mobile devices gross adds new accounted as operating expense (increasing operating expenses by 32 million euros) and higher commercial activity in the mobile business, resulting in higher supply, content and interconnection expenses. These impacts are partly offset by the efficiency measures implemented over the year, which are reflected in all cost areas.

Thus, **OIBDA** totalled 1,033 million euros in 2012 (-7.3% year-on-year; -10.0% in the quarter), with an OIBDA margin at 40.2% in the full year and at 39.7% in the fourth quarter (-4.6 percentage points and -6.1 percentage points year-on-year respectively).

It is important to note that the year-on-year OIBDA comparison was affected by the sale of non-strategic towers both in 2012 (32 million euros; 31 million euros in the fourth quarter) and in 2011 (50 million euros in the year and 39 million euros in tit he

Both in Argentina and Chile, the Company retained its leadership in the telecoms market

fourth quarter). Also, from the fourth quarter of 2012 OIBDA was negatively affected by a contractual change affecting the treatment of contract additions with an impact of 22 million euros in both the fourth quarter and the full year.

CapEx stood at 606 million euros in 2012, with a year-on-year increase of 6.5%, mainly related to the development and improvement of the quality of fixed and mobile broadband services and reduced by 32 million euros as a result of the contractual change on contract handset sales abovementioned.

Operating cash flow (OIBDA-CapEx) amounted to 427 million euros in 2012, a 21.7% decrease on 2011.

Peru (year-on-year changes in local currency)

In 2012, Telefónica reinforced its leadership in the Peruvian market, leveraged on the advantages of its integrated services offer.

During the year, the Company's commercial offer focused on bundled offers in fixed business and on mobile broadband, with continued improvement of data plans to boost smartphone adoption.

At the end of December, Telefónica Peru managed 20.3 million **accesses**, with a year-on-year increase of 8%.

Highlights of the operating performance of the **mobile business** include:

- The estimated penetration rate in the mobile market stood at 85% (+9 percentage points year-on-year).
- The Company's **mobile accesses** totalled 15.2 million, with a year-on-year growth of 9%, which continued to be driven by the positive performance of the contract segment, which increased 25% and now accounts for 24% of total accesses (+3 percentage points year-on-year).
- **Net additions** amounted to 1.2 million accesses in 2012 and 399 thousand accesses in the fourth quarter, despite the application from the third quarter, of more restrictive accounting criteria on prepay customers. It should also be noted the positive trend of net additions in the contract segment, which stood at 224 thousand accesses in the quarter and 723 thousand in 2012.
- **Mobile broadband accesses** continued to show strong year-on-year growth, tripling the figure registered in December 2011, reaching a penetration of 8% of the total base (+5 percentage points year-on-year in 2012).
- **Churn** in 2012 and in the fourth quarter stood at 3.6%, unchanged from the first nine months of 2012 and the third quarter of the year.
- **Traffic** grew 23% year-on-year in 2012 (+17% in the quarter) and continued to be driven by the good performance in outgoing traffic (+24% year-on-year in 2012, +18% year-on-year in the quarter).
- **ARPU** decreased 1.7% year-on-year over the twelve months of the year (-0.1% in the fourth quarter), affected mainly by the change in the fixed-mobile tariff and the interconnection tariff reduction applied in October 2011. Thus, outgoing ARPU registered solid growth and rose 2.8% in the year (+4.4% in the quarter).

Regarding commercial activity in the **fixed business**, it is worth highlighting the growth across all the services as a result of the integrated offer:

- **Traditional accesses** at the end of December 2012 stood at 2.9 million, up 1% year-on-year, and with net additions of 35 thousand accesses in the year.

In 2012 Telefónica strengthened its leadership in Peru; and in Colombia it took a giant leap forward by merging with Colombia Telecomunicaciones

- **Retail broadband accesses** totalled 1.3 million, up 18% year-on-year, after registering 198 thousand net additions in the year (+30 thousand accesses in the fourth quarter).
- **Pay TV accesses** stood at 902 thousand at the end of December, a year-on-year increase of 13% and net additions of 103 thousand in the year (+17 thousand accesses in the fourth quarter).

Revenues in 2012 amounted to 2,400 million euros, a year-on-year increase of 4.6% (+3.2% in the quarter), despite adverse regulatory impacts which affected fixed-mobile calls (due to the change of call ownership and also to a decrease in the regulated retail rate) and the mobile interconnection rate cuts in October 2011 and 2012. Excluding these impacts, revenues would have increased strongly by 8.1% year-on-year in 2012 (+7.1% in the fourth quarter).

Mobile revenues reached 1,314 million euros in the year, a year-on-year growth of 6.9% (+4.1% in the quarter):

- **Mobile service revenues** posted a good performance, increasing by 8.6% year-on-year in the year (+5.3% in the quarter), despite the negative impact of the regulatory changes mentioned above. Excluding these effects, growth would have been 13.3% year-on-year in 2012 (+10.3% in the fourth quarter).

  Mobile data revenues continued delivering a solid performance, with year-on-year growth of 44.8% (+59.3% in the quarter), already accounting for 18% of service revenues (+4 percentage points year-on-year), with strong growth in non-SMS data revenues (+51.5% year-on-year; +72.5% in the quarter), representing 67% of mobile data revenues (+3 percentage points year-on-year).

Revenues from **fixed business** stood at 1,226 million euros in 2012, a 1.5% increase year-on-year, with a significant acceleration for the second quarter in a row (+2.9% year-on-year):

- **Broadband and new services revenues** remained the growth engine, with a year-on-year increase of 12.9% in the year (+12.7% in the fourth quarter), and represent 60% of fixed revenues, thanks to the solid performances of revenues from Internet, TV, content and business services.
- **Voice and access revenues** fell 12.3% year-on-year in 2012 (-10% in the quarter), affected by the regulatory changes (-6.7% year-on-year in the year and -3.1% in the fourth quarter, excluding these factors).

Operating expenses registered a better trend than in previous quarters, with an increase of 4.7% in the year to 1,559 million euros (+8.7% year-on-year in January-September 2012) due mainly to higher commercial costs driven by the increased commercial activity relating to higher-value customers, as well as higher taxes related to the canon for the usage of radioelectric spectrum, and higher personnel expenses related to the participation of employees. It should be noted the decrease of interconnection costs due to mobile termination rate cuts and the change on fixed-mobile call ownership.

OIBDA stood at 909 million in 2012 and grew 7.1% year-on-year (+23.3% year-on-year in the fourth quarter), leaving OIBDA margin at 37.9% for the year (+0.9 percentage year-on-year) and at 41.6% in the quarter (+6.6 percentage points year-on-year). It should be noted that 2012 included the sale of non-strategic towers for 23 million euros (3 million euros in the fourth quarter), while 2011 included 2 million euros in the fourth quarter.

CapEx amounted to 378 million euros, a year-on-year rise of 10.8%, with investment during the year focused on network deployment for broadband, both fixed and mobile, and new services.

As a result, **operating cash flow (OIBDA-CapEx)** in the year amounted to 531 million euros, a year-on-year growth of 4.6%.

Colombia (year-on-year changes in local currency)

The year 2012 has meant a significant milestone in the development of Telefónica's operations in Colombia after Telefónica Móviles Colombia, S.A. and Colombia Telecomunicaciones S.A. completed their merger at the end of June, bolstering the Company's position in the country's telecommunications market.

Thus, after having brought all its services together in the second quarter of the year under the Movistar brand, Telefónica reinforced the integrated marketing of products by bundling fixed and mobile services over the last two quarters of the year and continuing to focus on high-value customers.

Telefónica in Colombia managed 14.1 million **accesses** at the end of 2012, up 3% year-on-year.

The main highlights of the operating performance of the **mobile business** include:

- The estimated mobile penetration rate in the market stood at 116% (+6 percentage points year-on-year).
- The Company's **mobile accesses** stood at 11.7 million, up 3% year-on-year, led by the positive performance of the contract segment (+10% year-on-year).
- **Net additions** in the year totalled 313 thousand accesses, with a net loss in the quarter of 301 thousand accesses associated with the disconnection of low-value prepay customers offsetting the positive performance of gross additions (+20% year-on-year in 2012; +4% in the fourth quarter). Also noteworthy is the positive performance of the contract segment, with net additions of 264 thousand customers in the year (69 thousand in the quarter).
- **Churn** stood at 3.8% in 2012, up 1.0 percentage points year-on-year, as a result of the abovementioned disconnection of low-value customers.
- **Traffic** managed in the quarter rose 3% year-on-year, improving the trend compared to previous quarters (-1% year-on-year in the year).
- **ARPU** decreased by 9.7% year-on-year in 2012 (-5.0% year-on-year in the fourth quarter), impacted by mobile termination rate cuts.

Regarding commercial activity in the **fixed business** the main highlights were as follows:

- **Traditional fixed accesses** stood at 1.4 million (-4% year-on-year), with a net loss of 60 thousand accesses in 2012 (11 thousand in the quarter), though there was a notable improvement in the churn of the year (-0.4 percentage points year-on-year).
- **Retail broadband accesses** reached 705 thousand, with year-on-year growth accelerating for the third quarter in a row to 15% after registering 27 thousand net additions in the last quarter (93 thousand in the year). The churn rate improved by 0.8 percentage points year-on-year in 2012.
- **Pay TV accesses** totalled 285 thousand, up 12% year-on-year, with net additions of 13 thousand accesses in the quarter (30 thousand in the year), as a consequence of the Company's focus on repositioning

its offer as a differential aspect of its bundling strategy. Churn also showed a strong reduction of 0.4 percentage points in the year.

Revenues in 2012 totalled 1,765 million euros, up 1.6% year-on-year (-0.4% in the quarter).

Mobile revenues in 2012 stood at 1,069 million euros, up 6.1% year-on-year (+3.7% in the quarter):

- **Mobile service revenues** (+6.3% year-on-year; +3.9% in the quarter) were affected by a lower ARPU and the reduction in mobile termination rates. Excluding this impact, mobile service revenues would have grown by 8.6% year-on-year in 2012 (+7.5% in the quarter).

- **Data revenues** posted year-on-year growth of 15.2% in 2012 (+4.5% year-on-year in the quarter) despite the change in the marketing strategy for Premium SMS, and already account for 24% of service revenues (+2 percentage points year-on-year). Non-SMS revenues accounted for 89% of data revenues (+3 percentage points year-on-year).

Fixed revenues totalled 695 million euros (-4.7% year-on-year; -6.3% in the fourth quarter).

- **Broadband and new service revenues**, which together accounted for 51% of total revenues, grew by 2.5% year-on-year in 2012, fuelled by the growth in internet and content revenues. In the fourth quarter revenues fell by 2.5% year-on-year, affected by the seasonality of corporate projects.

- **Voice and access revenues** posted a year-on-year decrease of 10.9% as of December (-9.8% year-on-year in the fourth quarter), due to a lower number of accesses, the highly competitive environment and the reduction in termination rates.

Operating expenses totalled 1,206 million euros in 2012, a decrease of 2.2% year-on-year, continuing the cost reduction trend registered as of September 2012 thanks to the efficiency measures applied by the Company, which were mainly reflected in lower personnel and subcontract expenses. Supply costs also fell year-on-year due to the reduction in termination rates.

OIBDA stood at 607 million euros in 2012, up 1.0% year-on-year (-4.0% in the quarter) with an OIBDA margin of 34.4% (-0.2 percentage points year-on-year) and of 37.3% in the quarter (-1.4 percentage points). The year-on-year comparison was affected by the recognition of the sale of non-strategic towers in 2011 and 2012 (2 million euros in the third quarter of 2012; 25 million euros as of December 2011 and 9 million euros in the fourth quarter of last year).

CapEx fell by 22.0% year-on-year in 2012 and stood at 352 million euros at the end of 2012 (-14.1% excluding spectrum investment).

Thus, **operating cash flow (OIBDA-CapEx)** amounted to 256 million euros at the end of 2012, up 70.0% year-on-year, reflecting the Company's higher efficiency following the integration of fixed and mobile businesses (+33.3% excluding spectrum investment).

Mexico (year-on-year changes in local currency)

In a rapid-growth environment in the Mexican market, Telefónica has been pro-active, reinforcing its commercial position with products and services focused on innovation.

It should be highlighted in the fourth quarter the launch of the "Prepago Cero" campaign, which offers calls to any fixed or mobile operator in Mexico, the U.S., and Canada for 0.85 Pesos/minute; an offer that represents a new milestone in the tariff reduction strategy within the "all-destination" tariff plans which are currently being marketed following the sharp reduction in termination rates during the first half of 2011. It is also worth to note the launch of new data plans to develop the mobile broadband business. Another highlight was the launching of LTE during the fourth quarter with Movistar being the first operator in Mexico to offer this service. All this demonstrated the Company's strategic focus on innovation and quality of service.

It should also be noted that in the second half of 2012 the agreement on national roaming with Iusacell came into effect, significantly reinforcing the coverage and capacity of the services that both companies provide.

Highlights of the business's operating performance include:

- The estimated mobile penetration in the market stood at 88% at the end of December 2012 (+5 percentage points year-on-year).

- Telefónica's **total accesses** in the country stood at 20.3 million (-1% year-on-year).

- **Mobile accesses** totalled 19.2 million, down 3% year-on-year, following the change of criteria adopted in the third quarter of 2011 aimed at improving the quality and customer base value, which is reflected in the positive performance of ARPU. It should be noted that after registering a net loss of customers for the fifth quarter in a row, in the fourth quarter of 2012 there were positive net additions of 91 thousand accesses, 49 thousand of which were contract customers.

- **Mobile broadband accesses** more than doubled those in 2011, fuelled by the strong growth of smartphones, which rose at the same pace, reaching a penetration of 10% over total mobile accesses (+6 percentage points year-on-year), thereby reflecting the rapid rollout of the 3G network and the Company's commercial repositioning in the data business.

- The **churn** rate stood at 3.1% in 2012 (+0.2 percentage points year-on-year), affected by the more restrictive criteria in the accounting of accesses.

- **ARPU** continued the growth trend begun in the second quarter, and rose 3.4% year-on-year in 2012 (+3.2% in the fourth quarter). Outgoing ARPU rose 8.0% year-on-year in the year (+5.0% in the quarter).

Revenues in 2012 totalled 1,596 million euros, a 0.4% increase year-on-year for the full year (+3.5% year-on-year in the quarter). Also noteworthy is the improvement in mobile service revenues (+2.7% in the quarter; flat in 2012), which included the revenues relating to the agreement reached with Iusacell, above mentioned. Excluding the impact of the reduction on termination rates, service revenues rose 4.5% year-on-year in 2012 (+5.6% in the quarter).

Data revenues rose 15.0% year-on-year in 2012 and fell 0.5% in the final quarter, heavily affected by the 54% reduction in SMS termination rates introduced in September. Data revenues accounted for 33% of mobile service revenues (+4 percentage points year-on-year). Non-SMS data revenues grew by 61.8% year-on-year (+42.3% in the quarter) and already account for 39% of data revenues (+11 percentage points year-on-year).

Operating expenses improved their trend compared to previous quarters, posting a year-on-year decrease of 1.3% in the year (-5.0% in the quarter), due mainly to lower supplies derived from the reduction in termination rates.

OIBDA in 2012 reflected cost containment efforts and stood at 432 million euros (-26.1% year-on-year; -53.9% in the quarter), with OIBDA margin at 27.0% for the twelve months and 31.4% in the quarter, being remarkable the gradual improvement in margin throughout the year, thanks to increased commercial efficiency as well as the efficiencies generated by the agreement with Iusacell.

It should be noted that OIBDA and OIBDA margin year-on-year performance were affected by the sale of non-strategic towers both in 2012 (35 million euros in the quarter; 77 million euros in the year) and 2011 (217 million euros in the fourth quarter; and 240 million euros in the year).

CapEx amounted to 427 million euros in 2012 (-11.3% year-on-year) and was mainly devoted to investment in the distribution channel and points of sale along with the increase of capacity and coverage in 2G and 3G networks, and also the deployment of LTE mentioned above. As a result, **operating cash flow (OIBDA-CapEx)** amounted to 5 million euros in 2012.

Venezuela (year-on-year changes in organic terms)

In 2012 Telefónica continued to offer a benchmark portfolio of services, strengthening its leadership position via a strategy aimed at satisfying customer needs by maximising customer value, service quality, innovation and ongoing improvement in tariff plans. As a result, operating and financial performance improved throughout the twelve months. During the year the focus remained on commercial campaigns to promote the adoption of mobile broadband fostering smartphones' penetration in the customer base.

Highlights of the operating performance of the business include:

- Estimated penetration at the end of 2012 in the Venezuelan mobile market was 110% (+12 percentage points year-on-year).
- Telefónica managed a total of 11.7 million **accesses** in Venezuela at the end of December, with a year-on-year increase of 12%.
- **Mobile accesses** totalled 10.5 million, accelerating their year-on-year growth to 12% after registering net additions of 1.1 million accesses in 2012 (vs. -76 thousand in 2011), reflecting a strong acceleration in the fourth quarter, reaching net additions of 458 thousand accesses (+138% year-on-year).
- **Mobile broadband accesses** posted significant year-on-year growth of 43% in 2012, driven by the strong increase in smartphones, which grew by 58% year-on-year and reached a penetration of 31% of total mobile accesses (+9 percentage points year-on-year).
- **Churn** stood at 2.1% in 2012, down 0.7 percentage points year-on-year, and reached 2.0% in the quarter (-0.6 percentage points year-on-year). The contract churn rate stood at 0.8% at the end of 2012 (-0.2 percentage points year-on-year) and remained a market benchmark.
- **Traffic** continued to show solid year-on-year growth, increasing by 13% in 2012 (+21% in the quarter).
- **ARPU** increased by 17.4% year-on-year in 2012 (+15.3% in the quarter), mainly driven by growth in data.

Revenues in 2012 totalled 3,338 million euros, accelerating their year-on-year growth one more quarter to 28.1% (+31.1% in the quarter). This trend reflected the positive performance of **mobile service revenues**, which increased by 25.6% year-on-year (+29.0% in the quarter), boosted by the larger customer base and ARPU growth. Excluding the impact of lower mobile termination rates, service revenues grew by 26.9% year-on-year in 2012 (+31.5% in the quarter).

Data revenues posted significant growth of 37.4% year-on-year (+41.1% in the fourth quarter) to account for 39% of mobile service revenues (+3 percentage points year-on-year). Non-SMS data revenues advanced by 77.8% year-on-year and accounted for 53% of data revenues (+12 percentage points year-on-year).

Operating expenses increased by 26.5% year-on-year in 2012 (+28.9% in September 2012), mainly impacted by the increase in personnel expenses following the reform of the labour law and the higher commercial costs related to the increased commercial activity in the year. In addition, the widespread price increases resulted in higher personnel expenses and increased subcontracting costs.

OIBDA totalled 1,500 million euros in 2012, with year-on-year growth accelerating to 30.0% after increasing by 41.6% in the fourth quarter. The OIBDA margin stood at 44.9% in 2012 and at 46.3% in the fourth quarter (+1.2 percentage points and +3.4 percentage points year-on-year respectively), as a result of the continuous focus on increasing efficiency.

CapEx in 2012 amounted to 463 million euros, increasing by 21.3% year-on-year excluding spectrum investments, and was mainly devoted to increasing capacity and 3G coverage, the distribution channel, points of sale and call centres. As a result, operating cash flow (OIBDA-CapEx) was 1,037 million euros (+33.6% year-on-year excluding spectrum investments).

Telefónica Latinoamérica. Accesses

Unaudited figures (thousands)	2011 December	2012 December	% Chg
Final Clients Accesses	200,760.5	211,908.0	5.6
Fixed telephony accesses (1)(2)	23,960.7	24,153.3	0.8
Internet and data accesses	8,244.2	8,732.5	5.9
Narrowband	304.6	209.1	(31.4)
Broadband (3)	7,828.9	8,415.3	7.5
Other (4)	110.6	108.0	(2.3)
Mobile accesses	166,297.9	176,595.4	6.2
Prepay (5)	131,087.2	137,141.5	4.6
Contract (2)	35,210.7	39,453.9	12.1
Pay TV	2,257.7	2,426.8	7.5
Wholesale Accesses	50.9	47.0	(7.5)
Total Accesses T. Latam	**200,811.3**	**211,955.1**	**5.5**
Terra accesses	641.7	604.7	(5.8)
Total Accesses in Latin America	**201,453.0**	**212,559.8**	**5.5**

Telefónica Latinoamérica. Mobile Accesses

Unaudited figures (thousands)	2011 December	2012 December	% Chg
Prepay percentage (%)	78.8%	77.7%	(1.2 p.p.)
Contract percentage (%)	21.2%	22.3%	1.2 p.p.
MBB accesses ('000)	16,283.3	27,275.8	67.5
MBB penetration (%)	10%	15%	5.7 p.p.
Smartphone penetration (%)	7%	13%	6.0 p.p.

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

(2) Fixed telephony accesses include the reclassification in the fourth quarter of 2012 in Argentina of 157 thousand "fixed wireless" accesses previously recognized as mobile accesses of the contract segment.

(3) Includes ADSL, optical fiber, cable modem and broadband circuits.

(4) Retail circuits other than broadband.

(5) 360 thousand inactive accesses were disconnected in Chile in the third quarter of 2011. In Brazil, 1.0 million inactive accesses were disconnected in the fourth quarter of 2011 and 1.6 million inactive accesses in the second quarter of 2012.

Telefónica Latinoamérica. Consolidated Income Statement

Unaudited figures (Euros in millions)

	2012	2011	% Chg
Revenues	**30,520**	**28,941**	**5.5**
Internal exp. capitalized in fixed assets	171	156	9.5
Operating expenses	(20,305)	(19,068)	6.5
Supplies	(7,670)	(7,459)	2.8
Personnel expenses	(2,908)	(2,563)	13.5
Subcontracts	(8,259)	(7,730)	6.8
Bad debt provision	(489)	(496)	(1.3)
Taxes	(978)	(821)	19.2
Other net operating income (expense)	139	257	(45.8)
Gain (loss) on sale of fixed assets	574	605	(5.1)
Impairment of goodwill and other assets	2	(1)	c.s.
Operating income before D&A (OIBDA)	**11,103**	**10,890**	**2.0**
OIBDA Margin	**36.4%**	**37.6%**	**(1.3 p.p.)**
Depreciation and amortization	(5,088)	(4,770)	6.7
Operating income (OI)	**6,015**	**6,120**	**(1.7)**

Notes:

- OIBDA and OI before management and brand fees.
- 2011 and 2012 reported figures include the hyperinflationary adjustments in Venezuela.
- From January 1st, 2012, and due to the implementation of the new organization announced in September 2011, companies related to the digital world that were previously included in the consolidation perimeter of T. Latinoamérica (Terra, Medianetworks Perú, Wayra and the joint venture Wanda) have been excluded from the consolidation perimeter and are included within ""Other companies and eliminations"". As a result, the results of T. Latinoamérica and ""Other companies and eliminations"" have been restated for the fiscal year 2011, to reflect the above mentioned new organization. As this is an intragroup change, Telefónica consolidated results for 2011 are not affected.

Telefónica Latinoamérica. Accesses by country (I)

Unaudited figures (Thousands)	2011 December	2012 December	% Chg
Brazil			
Final Clients Accesses	87,172.1	91,345.4	4.8
Fixed telephony accesses (1)	10,977.4	10,642.7	(3.0)
Internet and data accesses	3,942.6	3,964.3	0.6
Narrowband	214.5	137.9	(35.7)
Broadband (2)	3,648.0	3,748.4	2.8
Other (3)	80.0	78.1	(2.5)
Mobile accesses	71,553.6	76,137.3	6.4
Prepay (4)	55,438.1	57,335.1	3.4
Contract	16,115.5	18,802.2	16.7
Pay TV	698.6	601.2	(13.9)
Wholesale Accesses	28.0	24.4	(13.0)
Total Accesses	**87,200.1**	**91,369.8**	**4.8**
Argentina			
Final Clients Accesses	23,008.4	24,121.9	4.8
Fixed telephony accesses (1)	4,611.0	4,762.4	3.3
Fixed wireless (5)	38.2	234.6	n.s.
Internet and data accesses	1,630.7	1,755.5	7.7
Narrowband	35.7	19.3	(46.0)
Broadband (2)	1,595.1	1,736.3	8.9
Mobile accesses	0.0	0.0	
Prepay	16,766.7	17,604.0	5.0
Contract (5)	10,581.3	11,000.0	4.0
Wholesale Accesses	6,185.4	6,604.0	6.8
Total Accesses	13.9	14.1	1.2
Total Accesos	**23,022.3**	**24,136.0**	**4.8**
Chile			
Final Clients Accesses	12,674.4	13,142.1	3.7
Fixed telephony accesses (1)	1,848.1	1,737.9	(6.0)
Internet and data accesses	887.4	940.1	5.9
Narrowband	5.8	5.5	(5.2)
Broadband (2)	878.1	932.0	6.1
Other (3)	3.5	2.5	(27.0)
Mobile accesses	9,548.1	10,040.1	5.2
Prepay	6,732.7	7,385.0	9.7
Contract	2,815.4	2,655.1	(5.7)
Pay TV	390.8	424.0	8.5
Wholesale Accesses	5.2	4.9	(5.9)
Total Accesses	**12,679.6**	**13,147.0**	**3.7**

(1) PSTN (including Public Use Telephony) x1; ISDN Basic access x1; ISDN Primary access, 2/6 Access x30. Company's accesses for internal use included. Total "fixed wireless" accesses included.
(2) Includes ADSL, optical fiber, cable modem and broadband circuits.
(3) Retail circuits other than broadband.
(4) In Brazil, 1.0 million inactive accesses were disconnected in the fourth quarter of 2011 and 1.6 million inactive accesses in the second quarter of 2012.
(5) Includes the reclassification in the fourth quarter of 2012 in Argentina of 157 thousand "fixed wireless" accesses previously recognized as mobile accesses of the contract segment.

Telefónica Latinoamérica. Accesses by country (II)

Unaudited figures (Thousands)	2011 December	2012 December	% Chg
Perú			
Final Clients Accesses	18,766.1	20,299.5	8.2
Fixed telephony accesses (1)	2,848.4	2,883.4	1.2
Fixed wireless (2)	444.6	580.3	30.5
Internet and data accesses	1,120.4	1,317.6	17.6
Narrowband	9.4	8.2	(12.8)
Broadband (3)	1,090.6	1,288.3	18.1
Other (4)	20.4	21.0	3.1
Mobile accesses	13,998.3	15,196.9	8.6
Prepay	11,079.6	11,555.3	4.3
Contract	2,918.7	3,641.6	24.8
Pay TV	799.0	901.6	12.8
Wholesale Accesses	0.4	0.4	(8.0)
Total Accesses	**18,766.6**	**20,299.9**	**8.2**
Colombia			
Final Clients Accesses	13,746.9	14,122.8	2.7
Fixed telephony accesses (1)	1,480.6	1,420.4	(4.1)
Internet and data accesses	620.3	714.0	15.1
Narrowband	7.9	8.5	7.5
Broadband (3)	612.3	705.4	15.2
Mobile accesses	11,391.1	11,703.6	2.7
Prepay	8,626.8	8,675.2	0.6
Contract	2,764.2	3,028.8	9.6
Pay TV	255.0	284.8	11.7
Wholesale Accesses	3.3	3.3	0.0
Total Accesses	**13,750.2**	**14,126.1**	**2.7**
México			
Mobile accesses	19,742.4	19,168.0	(2.9)
Prepay	18,149.8	17,668.3	(2.7)
Contract	1,592.6	1,499.7	(5.8)
Fixed wireless	745.3	1,158.9	55.5
Total Accesses	**20,487.7**	**20,326.9**	**(0.8)**
Venezuela			
Mobile accesses	9,438.7	10,549.0	11.8
Prepay	8,570.9	9,514.8	11.0
Contract	867.8	1,034.3	19.2
Fixed wireless	883.4	900.3	1.9
Pay TV	114.3	215.3	88.3
Total Accesses	**10,436.4**	**11,664.6**	**11.8**

(1) PSTN (including Public Use Telephony) x1; ISDN Basic access x1; ISDN Primary access, 2/6 Access x30. Company's accesses for internal use included. Total "fixed wireless" accesses included.
(2) From January 1st, 2012 it includes Public Use Telephony from the fixed wireless technology.
(3) Includes ADSL, optical fiber, cable modem and broadband circuits.
(4) Retail circuits other than broadband.

Telefónica Latinoamérica. Accesses by country (III)

Unaudited figures (Thousands)	2011 December	2012 December	% Chg.
Central America [1]			
Fixed telephony accesses [2]	530.1	600.4	13.3
Fixed Wireless	340.9	440.2	29.1
Internet and data accesses	3.0	3.0	0.2
Broadband [3]	1.8	1.6	(10.8)
Other [4]	1.2	1.4	15.7
Mobile accesses	7,562.5	9,380.2	24.0
Prepay	6,850.7	8,545.4	24.7
Contract	711.8	834.8	17.3
Total Accesses	**8,095.6**	**9,983.7**	**23.3**
Ecuador			
Mobile accesses	4,477.5	4,972.8	11.1
Prepay	3,756.5	4,169.5	11.0
Contract	721.0	803.3	11.4
Fixed Wireless	36.4	46.9	28.7
Total Accesses	**4,513.9**	**5,019.6**	**11.2**
Uruguay			
Mobile accesses	1,819.0	1,843.5	1.3
Prepay	1,300.8	1,292.9	(0.6)
Contract	518.2	550.6	6.2
Total Accesses	**1,819.0**	**1,843.5**	**1.3**

(1) Includes Guatemala, Panama, El Salvador, Nicaragua and, from Q4 11, Costa Rica.
(2) PSTN (including Public Use Telephony) x1; ISDN Basic access x1; ISDN Primary access, 2/6 Access x30. Company's accesses for internal use included. Total "fixed wireless" accesses included.
(3) Includes ADSL, optical fiber, cable modem and broadband circuits.
(4) Retail circuits other than broadband.

Telefónica Latinoamérica. Selected financial data by country (I)

Unaudited figures (Euros in millions)	2012	2011	% Chg	% Var. M Local
Brazil [1] [2]				
Revenues	13,618	14,326	(4.9)	2.3
Wireless Business [2]	8,573	8,437	1.6	9.4
Wireless service revenues	8,167	8,014	1.9	9.7
Wireless data revenues	2,130	1,916	11.2	19.7
Handset revenues	407	423	(3.8)	3.6
Wireline Business [2]	5,045	5,890	(14.4)	(7.8)
FBB and new services [3]	1,742	1,885	(7.6)	(0.6)
Voice & access revenues	3,254	3,946	(17.5)	(11.2)
Others	49	58	(15.9)	(9.4)
OIBDA	5,161	5,302	(2.7)	4.8
OIBDA margin	37.9%	37.0%	0.9 p.p.	
CapEx [1]	2,444	2,468	(1.0)	6.6
OpCF (OIBDA-CapEx) [1]	2,717	2,834	(4.1)	3.2
Argentina				
Revenues	3,697	3,174	16.5	18.4
Wireless Business	2,431	2,039	19.2	21.2
Wireless service revenues	2,200	1,880	17.0	19.0
Wireless data revenues	968	737	31.3	33.5
Handset revenues	231	159	45.0	47.4
Wireline Business	1,390	1,237	12.3	14.2
FBB and new services [3]	640	514	24.4	26.5
Voice & access revenues	706	679	3.9	5.7
Others	44	43	2.1	3.8
OIBDA	1,076	1,085	(0.8)	0.8
OIBDA margin [4]	28.5%	33.4%	(4.8 p.p.)	
CapEx	519	449	15.6	17.5
OpCF (OIBDA-CapEx)	557	636	(12.4)	(10.9)
Chile				
Revenues	2,569	2,310	11.2	3.3
Wireless Business	1,559	1,399	11.5	3.6
Wireless service revenues	1,429	1,283	11.4	3.5
Wireless data revenues	272	245	10.9	3.0
Handset revenues	130	116	12.6	4.6
Wireline Business	1,113	1,037	7.3	(0.3)
FBB and new services [3]	577	484	19.4	10.9
Voice & access revenues	507	522	(3.0)	(9.9)
Others	29	31	(7.5)	(14.1)
OIBDA	1,033	1,035	(0.2)	(7.3)
OIBDA margin	40.2%	44.8%	(4.6 p.p.)	
CapEx	606	529	14.6	6.5
OpCF (OIBDA-CapEx)	427	507	(15.7)	(21.7)

Notes:

- OIBDA is presented before management and brand fees.
- From January 1st, 2012, and due to the implementation of the new organization announced in September 2011, companies related to the digital world and global resources that were previously included in the consolidation perimeter of T. Latinoamérica (Terra, Medianetworks Perú, Wayra and the joint venture Wanda) have been excluded from the consolidation perimeter and are included within "Other companies and eliminations". As a result, the results of T. Latinoamérica and "Other companies and eliminations" have been restated for the fiscal year 2011, to reflect the above mentioned new organization.

(1) 2011 results 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. CapEx includes 349 million euros from the acquisition of spectrum in the second quarter of 2011 and 420 million euros from the acquisition of spectrum in the fourth quarter of 2012.

(2) 2011 figures have been reclassified according to a proforma criteria regarding the ownership of the licenses and "inter-company" eliminations.

(3) Includes FBB connectivity services (retail and wholesale), including value added services, TV services, ICT revenues and other services over connectivity.

(4) Margin over revenues includes fixed to mobile interconnection.

Telefónica Latinoamérica. Selected financial data by country (II)

Unaudited figures (Euros in millions)	2012	2011	% Chg	% Var. M Local
Peru				
Revenues	2,400	2,030	18.2	4.6
Wireless Business (1)	1,314	1,088	20.8	6.9
Wireless service revenues (1)	1,164	948	22.7	8.6
Wireless data revenues	206	126	63.7	44.8
Handset revenues	151	139	8.0	(4.4)
Wireline Business	1,226	1,069	14.7	1.5
FBB and new services (3)	738	578	27.6	12.9
Voice & access revenues	463	467	(0.8)	(12.3)
Others	24	23	4.0	(8.0)
OIBDA	909	751	21.0	7.1
OIBDA margin	37.9%	37.0%	0.9 p.p.	
CapEx	378	302	25.2	10.8
OpCF (OIBDA-CapEx)	531	449	18.2	4.6
Colombia				
Revenues	1,765	1,561	13.0	1.6
Wireless Business (2)	1,069	906	18.1	6.1
Wireless service revenues	994	841	18.3	6.3
Wireless data revenues	242	189	28.2	15.2
Handset revenues	75	65	15.6	3.9
Wireline Business (2)	695	656	6.1	(4.7)
FBB and new services (3)	355	312	14.1	2.5
Voice & access revenues	338	341	(0.9)	(10.9)
Others	2	3	(39.5)	(45.6)
OIBDA	607	540	12.4	1.0
OIBDA margin	34.4%	34.6%	(0.2 p.p.)	
CapEx (4)	352	405	(13.2)	(22.0)
OpCF (OIBDA-CapEx) (4)	256	135	89.2	70.0
México (T. Móviles Mexico)				
Revenues	1,596	1,557	2.5	0.4
Service revenues	1,416	1,387	2.1	(0.0)
Data revenues	469	399	17.4	15.0
Handset revenues	180	170	5.8	3.7
OIBDA	432	572	(24.6)	(26.1)
OIBDA margin	27.0%	36.7%	(9.7 p.p.)	
CapEx	427	471	(9.4)	(11.3)
OpCF (OIBDA-CapEx)	5	101	(95.2)	(95.3)

Notes:

- OIBDA is presented before management and brand fees.
- From January 1st, 2012, and due to the implementation of the new organization announced in September 2011, companies related to the digital world and global resources that were previously included in the consolidation perimeter of T. Latinoamérica (Terra, Medianetworks Perú, Wayra and the joint venture Wanda) have been excluded from the consolidation perimeter and are included within "Other companies and eliminations". As a result, the results of T. Latinoamérica and "Other companies and eliminations" have been restated for the fiscal year 2011, to reflect the above mentioned new organization.

(1) Includes earnings from fixed wireless..

(2) 2011 and 2012 figures have been reclassified according to a proforma criteria regarding the integration of the fixed and mobile businesses.

(3) Includes FBB connectivity services (retail and wholesale), including value added services, TV services, ICT revenues and other services over connectivity.

(4) CapEx includes 37 million euros from the spectrum acquired in the fourth quarter of 2011.

Telefónica Latinoamérica. Selected financial data by country (III)

Unaudited figures (Euros in millions)	2012	2011	% Chg	% Var. M Local
Venezuela (T. Móviles Venezuela) (1)				
Revenues	3,338	2,688	24.2	28.1
Service revenues	2,972	2,435	22.0	25.6
Data revenues (2)	1,051	780	34.7	37.4
Handset revenues	366	252	45.1	49.3
OIBDA	1,500	1,177	27.5	30.0
OIBDA margin	44.9%	43.8%	1.2 p.p.	
CapEx (3)	463	372	24.5	31.2
OpCF (OIBDA-CapEx) (3)	1,037	805	28.8	29.5
Central America (4)				
Revenues	672	543	23.8	15.8
Service revenues	609	499	22.0	14.2
Data revenues	139	96	45.1	36.5
Handset revenues	62	43	44.1	34.2
OIBDA	140	165	(15.3)	(20.1)
OIBDA margin	20.9%	30.5%	(9.6 p.p.)	
CapEx (5)	131	176	(25.5)	(30.6)
OpCF (OIBDA-CapEx) (5)	9	(10)	c.s.	c.s.
Ecuador (T. Móviles Ecuador)				
Revenues	491	408	20.3	11.1
Service revenues	443	364	21.7	12.4
Data revenues	135	100	35.0	24.7
Handset revenues	48	44	8.6	0.4
OIBDA	176	137	28.5	18.7
OIBDA margin	35.9%	33.6%	2.3 p.p.	
CapEx	85	58	45.8	34.7
OpCF (OIBDA-CapEx)	91	79	15.7	6.8
Uruguay (T. Móviles Uruguay)				
Revenues	254	228	11.2	7.9
Service revenues	243	219	10.8	7.6
Data revenues	89	79	13.2	9.9
Handset revenues	11	9	20.6	17.1
OIBDA	114	104	8.8	5.7
OIBDA margin	44.8%	45.7%	(1.0 p.p.)	
CapEx	28	23	22.5	18.9
OpCF (OIBDA-CapEx)	86	82	5.0	2.0

Notes:

- OIBDA is presented before management and brand fees.
- From January 1st, 2012, and due to the implementation of the new organization announced in September 2011, companies related to the digital world and global resources that were previously included in the consolidation perimeter of T. Latinoamérica (Terra, Medianetworks Perú, Wayra and the joint venture Wanda) have been excluded from the consolidation perimeter and are included within "Other companies and eliminations". As a result, the results of T. Latinoamérica and "Other companies and eliminations" have been restated for the fiscal year 2011, to reflect the above mentioned new organization.

(1) Reported figures include the hyperinflationary adjustments in Venezuela in both years.

(2) Data revenues do not include hyperinflationary adjustments.

(3) CapEx includes 34 million euros from the spectrum acquired in Venezuela in the third quarter of 2012.

(4) Includes Guatemala, Panama, El Salvador, Nicaragua and, from Q4 11, Costa Rica.

(5) CapEx includes 5 million euros from the spectrum acquired in Nicaragua in the first quarter of 2012 and 68 million euros in Costa Rica in the second quarter of 2011.

Results by regional business units

Telefónica Europe [1]

Telefónica Europe's operations gained the right commercial traction and increased efficiency in 2012, laying foundations for future growth. This performance reflects the success of the new commercial propositions and the transformation initiatives put in place throughout the year, focused on improving the allocation of resources, strategic costs and areas of investment. In addition, the retention focus has served to drive a solid churn performance and improve the quality of customer service.

In the fourth quarter it should be highlighted the commercial momentum improvement, particularly in Spain on the back of the 'Movistar Fusión' launch in October, with continued solid trading in the rest of the European operations, focused on smartphone adoption and data tariffs.

All these allowed Telefónica Europe's performance to stabilise along 2012 amid a difficult trading environment, being worth mentioning that the fourth quarter showed improving trends in its financial results, as illustrated by the sequential improvement in the year-on-year change at OIBDA and margin level. This performance reflects the delivery of operating cost reductions in a number of areas despite continued revenue pressure, driven by usage optimisation amid a challenging economic backdrop, strong competition, mobile termination and roaming rates cuts and new roaming commercial propositions.

Telefónica Europe's **total customer base** reached 103.2 million accesses at the end of 2012 (-2% year-on-year), impacted by the disconnection of 2.0 million mobile accesses in Spain in the first quarter of 2012.

In the **mobile business** it should be highlighted that:

- The **mobile customer base** totalled 70.7 million (-2% year-on-year), with an increased weight of contract customers, which account for 60% of the base at the end of the year (+3 percentage points year-on-year). Total net additions in the quarter stood at 247 thousand accesses (2.2 times higher than the previous quarter) as a result of the improved performance of the contract segment. Net contract additions strongly accelerated in the quarter, increasing 58% sequentially to amount to 419 thousand accesses reflecting a sustained strong momentum despite a lower volume of handset upgrades (-22% year-on-year in the fourth quarter vs -12% in the third quarter).

- **Mobile broadband accesses** maintained a very positive evolution to stand at 25.5 million, with a solid 16% year-on-year growth. In the fourth quarter it should be highlighted that mobile broadband net additions more than doubled compared to the previous quarter (2.6 times) driven by the successful "Movistar Fusion" offer in Spain. Smartphone adoption increased sharply to reach 35% at the end of December (+8 percentage points year-on-year; +3 percentage points quarter-on-quarter) with mobile broadband growing to account for 36% of the mobile base (+6 percentage points year-on-year). Smartphones represented a 80% share of total handset sales in both the fourth quarter and 2012.

Regarding **fixed telephony business** in 2012, the highlights were:

- **Retail fixed telephony accesses** declined 2% year-on-year to 15.8 million as of December 2012.

- **Retail fixed broadband accesses** stood at 9.6 million accesses at the end of the fourth quarter of 2012 (-1% year-on-year), with net additions turning positive in the quarter (66 thousand).

- **Pay TV accesses** fell by 14% year-on-year to 0.9 million at the end of 2012.

Revenues reached 29,995 million euros in 2012 and decreased by 6.5% year-on-year (-7.8% in organic terms) after posting a 6.7% year-on-year decline in the fourth quarter (-8.1% organic).

Mobile data revenues increased 5.8% year-on-year in the year to December 2012 (+2.7% in organic terms) and 3.5% in the fourth quarter (+0.7% organic), affected by higher mobile broadband accesses and the higher weight of flat data tariffs, to represent 41% of mobile service revenues (+5 percentage points year-on-year). Data revenues continue to be driven by non-SMS data revenues, which grew 18.6% year-on-year in the year (+15.7% in organic terms) and 15.5% in the fourth quarter (+12.9% organic). As a result, non-SMS data revenues to December account for 58% of total data revenues (+6 percentage points year-on-year).

The continuous focus on increasing efficiencies led to lower **operating expenses** (19,777 million euros in 2012) decreasing 15.5% year-on-year (-6.7% in organic terms), showing a better performance in the fourth quarter (-10.9% year-on-year; -12.5% organic). It should be noted that the reported year-on-year change is affected by the booking of the provision for the workforce restructuring plan in Telefónica España (2,591 million euros) in the third quarter of 2011. Operating expenses breakdown as follows:

- **Supplies** decreased 4.6% year-on-year in 2012 to 9,821 million euros (-6.9% in organic terms), mainly driven by lower interconnection costs, and, to a lesser extent, lower supplies, due to the new commercial strategy of subsidies in Spain. In the fourth quarter the decline accelerated (-9.2% year-on-year; -11.3% organic) owing to the lower volume of handset upgrades.

- **Personnel expenses** amounted to 3,497 million euros in the year, a decline of 45.4% compared with 2011 (-16.2% in the fourth quarter), mainly due to the provision included in Spain mentioned above. In

(1) Organic growth: In financial terms it assumes constant average January–December 2011 exchange rates and excludes changes in the perimeter of consolidation, the revision in the value of T. Ireland in the fourth quarter of 2012 and the provision for the redundancy program in Spain in the third quarter of 2011. CapEx excludes investment in spectrum.

organic terms, personnel expenses decreased by 8.9% year-on-year in 2012 and a significant 16.4% in the quarter, mainly on the back of the incremental savings related to the restructuring plan in Spain and positively affected in the quarter by an impact (94 million euros) due to a change in the pension scheme in the UK.

- **Subcontract expenses** totalled 5,844 million euros in the year (-2.6% reported; -4.1% in organic terms), reflecting the higher commercial efficiency delivered by the leaner business model. In the fourth quarter subcontract expenses declined 14.1% year-on-year in organic terms, primarily due to incremental commercial cost savings.

OIBDA in 2012 stood at 10,244 million euros affected in the fourth quarter of 2012 by a negative impact of 527 million euros mainly due to the revision in the value of goodwill of Telefónica Ireland and by the positive 94 million euros impact booked in personnel expenses above mentioned. It should be reminded that the provision for the workforce restructuring plan in Spain was recognised in the third quarter of 2011.

OIBDA year-on-year decline in organic terms has been reduced consistently quarter-on-quarter to 10.0% year-on-year in 2012, reflecting the incremental savings stemming from the set of initiatives to enhance efficiency put in place across operations. In the fourth quarter it should be noted that OIBDA posted a lower year-on-year decline (-0.8% year-on-year in organic terms) and OIBDA margin improved to 37.7% (+2.8 p.p. year-on-year organic).

As a consequence, OIBDA margin in 2012 stood at 35.9%, declining 0.9 percentage points year-on-year in organic terms.

CapEx amounted to 3,513 million euros in 2012, a decline of 22.2% year-on-year, affected by the acquisition of spectrum in Spain (842 million euros in 2011) and in Ireland (127 million euros in 2012). CapEx decreased by 9.0% compared with 2011 in organic terms as a result of the Company's focus on areas which deliver the most value to customers and reflecting higher commercial and investment efficiency. This has allowed Telefónica Europe to devote higher resources to growth services such as 3G and 4G mobile networks as well as fibre networks.

Operating cash flow (OIBDA-CapEx) reached 6,731 million euros in the year (+41.2% reported; -10.4% in organic terms).

Telefónica España

Telefónica España's results in 2012 reflect visible progresses from the transformation journey started in the second half of 2011, that has allowed the Company to improve its competitive position in the market and increased its business model efficiency, amid a challenging macroeconomic environment and increasingly intense competition.

This strategy has supposed the introduction of bold changes in the company's commercial and operating model, starting with the improvement in the value proposal and service quality at the end of 2011, with the launch of the new tariffs portfolio, which reached a high penetration of the customer base at the end of this year. This process continued in March 2012 with the introduction of the new commercial model for handsets, focused on customer loyalty and the removal of acquisition subsidies. This translated into significant commercial cost savings along with those obtained from efficiency gains, including lower personnel expenses, among others. Last October, the company moved another step forward in its transformation process with the launch of "Movistar Fusión", the best convergent offer on the market, which is completely aligned with customer requirements and covers all the home's communication needs in a simple offer at a highly competitive price including differential services such as fibre and TV content.

All these measures were already bearing fruits in 2012, increasing customer satisfaction and reducing claims and churn, a key factor behind the improvement in commercial activity.

As a result, OIBDA improved significantly its pace of decline in in the fourth quarter (-3.0% year-on-year) being worth to highlight the OIBDA margin enhancement of 5.5 percentage points compared to the fourth quarter 2011, to reach 47.2%. This growth is explained by the new commercial model, the simplification and reduction in the operating cost base and the optimisation of resources, with a clear focus on average margin per customer management.

Personnel costs were 3,497 million for the year, a decrease of 45.4% with respect to 2011

It is also worth to highlight that despite the strong boost of fibre rollout, total investment in 2012 declined compared with 2011, thanks to enhanced efficiency resulting from quality increase and churn reduction, systems rationalisation and prioritization of new services development.

All these factors impacted positively on **operating cash flow** (-8.5% year-on-year in 2012, stripping out the impact of the provision for the restructuring plan and spectrum in 2011, vs -15.9% in 2011), which rose year-on-year in the fourth quarter (+7.7%), the first quarter to post year-on-year growth since the fourth quarter of 2008.

At the same time, Telefónica España's fourth quarter of 2012 results reflect the commercial success of "Movistar Fusión", which in just three months has reached 1.1 million customers, changing the competitive landscape of a market currently shaped by the promotion of convergent solutions, and highlighting its potential both to capture new customers and to encourage existing ones to adopt new services. As such, 30% of "Movistar Fusión" customers have brought new mobile or fixed broadband services. It should be noted the progressive improvement new customers acquisition and and upselling throughout the quarter.

The launch of "Movistar Fusión" reversed the trend in the company's commercial activity, fostering value services growth. As a result, Telefónica led the growth of the fixed broadband market in the quarter, recording the highest quarterly net additions in the last four years and doubling net additions of fibre customers compared with the previous quarter while at the same time improving smartphone adoption.

At the end of December 2012, Telefónica España managed a total of 43.1 million **accesses** (-8% year-on-year) affected by the disconnection of 2.0 million inactive mobile accesses in the first quarter of the year.

Operating highlights at the **fixed business** are as follows:

- **Retail fixed telephony accesses** stood at 11.7 million, down 5% year-on-year, with a net loss of 48 thousand accesses in the fourth quarter. This is the smallest loss in the last five years, 75% lower compared to the same quarter last year and 73% lower than in the third quarter.

- **Retail fixed broadband accesses** amounted to 5.7 million, growing 2% year-on-year. Growth resumed in the fourth quarter of 2012 following the launch of "Movistar Fusión", with net additions of 130 thousand accesses, the highest since the second quarter of 2008. This means that just one quarter after the launch of "Movistar Fusión" the company has regained virtually all the broadband accesses lost since the start of 2011. Churn in the quarter stood at 1.9% (-0.3 percentage points year-on-year). At the end of 2012, 80% of residential customers were already either enjoying the new tariffs launched in September 2011 or had signed up for "Movistar Fusión".

  In addition, there was sharp acceleration in fibre net additions (66 thousand accesses) which more than doubled compared with the previous quarter (and increased by 78% compared with the fourth quarter of 2011), bringing the number of connected households to 312 thousand, which accounts for 14% of passed households (2.2 million homes, more than double the figure in December 2011). It is worth to highlight that these customers have higher ARPU and a lower churn compared with ADSL customers.

- **Pay TV accesses** stood at 711 thousand at the end of December 2012 (-15% year-on-year). Performance in the quarter (-49 thousand accesses) was affected by the review of prices and the VAT increase applied to the service since September. Nonetheless, gross additions surpassed the third quarter figure and remained stable over the year. In December 2012, "Movistar Imagenio" strengthened and simplified its choices for lovers of film and TV series ("Ocio", €12), sport ("Deportes", € 20) and a more wide-ranging offering ("Familiar" €29.90), with the customer able to select any of these three options when signing up for "Movistar Fusión TV".

- **Wholesale accesses** amounted to 4.4 million (+9% year-on-year), fuelled by growth in unbundled loops (+15% year-on-year).

Highlights at the **wireless business:**

- The company's **mobile accesses** stood at 20.5 million (-15% year-on-year), affected by the disconnections of inactive accesses in the first quarter, with the contract segment representing 75% of the total. The accesses performance in the fourth quarter (-429 thousand) was mainly due to a higher loss of prepay lines, in a declining market and amid increased competition with aggressive price offers and handset subsidies from some operators. Moreover, net additions continued to be affected by the ongoing migration of USB modems to integrated multidevice tariffs.

  Nonetheless, in the fourth quarter net customer losses due to portability was reduced by 29% sequentially, in particular in the contract segment (-44%), thanks to the sharp growth in gross additions (1.8 times higher than in the previous quarter) fuelled by the success of "Movistar Fusión", even though no handset subsidy is included.

  Meanwhile, total gross additions grew 19% quarter-on-quarter while **churn** stood at 1.9% in 2012 (-0.6 percentage points year-on-year in comparable terms) and at 2.1% in the quarter, affected by the contraction of the market and the high intense competition. Contract churn stood at 1.6% in 2012 (-0.1 percentage points year-on-year) and at 1.8% in the fourth quarter, whilst 66% of contract mobile customers in the residential segment are now taking advantage of the new tariffs launched in the second half of 2011 or of "Movistar Fusión".

- **Mobile broadband accesses** grew by 9% year-on-year to 7.7 million. In the fourth quarter net additions strongly accelerated (532 thousand accesses compared with 25 thousand in the previous quarter), reflecting the strong growth in smartphones (707 thousand in the quarter, 178 thousand in the third quarter) boosted by "Movistar Fusión". On the other hand, smartphone sales were 81% of total handset sales in the quarter and 80% in 2012, leaving penetration of the mobile access base at 39% (+13 percentage points year-on-year).

- **Traffic** declined by 9% year-on-year (-10% in the quarter), reflecting lower customer usage in an environment of private consumption contraction.

- **ARPU** in 2012 fell by 14.9% year-on-year in comparable terms, reflecting lower usage by customers, the lower prices in the new tariff portfolio and the mobile interconnection rates cuts (with a 14.5% reduction since April 16th and an additional cut of 7.6% since October 16th). ARPU fell by 15.4% year-on-year in the quarter, posting a smaller decline than in the third quarter (-16.1%), due to the anniversary of the launch of the new tariffs in the fourth quarter of 2011 and despite the decline in ARPU explained by the repositioning of customers in "Movistar Fusión".

  In comparable terms, **voice ARPU** in 2012 declined by 20.0% year-on-year (-19.5% in the quarter) and **data ARPU** fell by 0.4%, accounting for 31% of total ARPU, despite the growth in connectivity revenues which did not offset the lower SMS revenue. The worse performance of data ARPU in the fourth quarter (-5.3% year-on-year) is mainly driven by the migration of USB modems to multidevice tariffs and the ongoing decline of SMS revenues.

Revenues were 14,985 million euros in 2012, 13.2% down year on year

Revenues amounted to 14,985 million euros in 2012 (-13.2% year-on-year), primarily reflecting the performance of accesses and the lower ARPU across services in an adverse macroeconomic and competitive environment. In the fourth quarter the pace of year-on-year decline (-14.3%) eased compared with the third quarter (-15.3%) thanks to the improved mobile revenue performance.

Fixed line revenues (9,541 million euros in 2012) declined by 10.2% year-on-year and by 12.1% in the fourth quarter. Breakdown by component:

- **Access and voice revenues** (4,628 million euros) fell 13.8% year-on-year (-15.5% in the quarter). Access revenues (1,939 million euros) declined by 9.3% year-on-year (-9.1% in the quarter), primarily driven by the loss of accesses. The fourth quarter of 2012 includes the booking of 31 million euros revenues of Universal Service (35 million euros in the same quarter of 2011). Meanwhile, voice revenues (2,689 million euros) fell by 16.7% compared with 2011 (-20.0% year-on-year in the quarter) due to the growing weight of flat rates and traffic bundles.

- **Broadband and new service revenues** stood at 4,431 million euros and fell by 4.9% year-on-year (-4.8% in the fourth quarter). Retail revenues (1,838 million euros) fell by 13.8% (-12.9% in the quarter), reflecting the performance of effective broadband ARPU (28.0 euros), which fell by 12.2% year-on-year (-12.4% in the quarter), impacted by the migration of customers to the new tariffs. Wholesale revenues (592 million euros) increased by 10.1% in 2012 (+2.8% in the quarter).

  Data revenues in January-December of 2012 (1,383 million euros) remained stable year-on-year (+3.1% in the final quarter) while IT service revenues (612 million euros) posted a 2.4% year-on-year growth (-2.3% in the quarter) due to the seasonality of projects.

Mobile business revenues amounted to 6,453 million euros in 2012 (-16.6% year-on-year). In the fourth quarter they fell by 17.8%, largely due to a decline in revenues from handset sales (-37.4%). Nonetheless, the pace of year-on-year decline eased compared with the previous quarter (-19.8%). Breakdown by components is as follows:

- **Mobile service revenues** (5,442 million euros) fell by 16.8% compared to December 2011, mainly driven by pressure from ARPU performance and the cuts in mobile termination rates (April and October) and roaming rates (July). The sequential pace of decline slowed in the fourth quarter (-13.5% year-on-year versus -17.1% in the third quarter) mainly thanks to the positive impact of the lower level of handset upgrades in the quarter (-43.3% year-on-year vs. -32.1% in the third quarter), as upgrades are recognized as lower revenues (loyalty programme). Excluding the aforementioned regulatory effects, service revenues fell by 15.0% year-on-year in 2012 (-11.8% in the quarter). Breakdown by component:

  - **Customer revenues** in 2012 (4,759 million euros) fell by 16.3% year-on-year, mainly due to lower ARPU. In the fourth quarter the year-on-year decline eased to 14.1%, mainly as a result of the abovementioned impact of the loyalty programme.

    Mobile data revenues (1,602 million euros) declined by 4.6% year-on-year vs. January- December 2011 (-11.1% in the quarter), despite the sustained growth in non-SMS revenues (+8.2% year-on-year), which already account for 85% of data revenues (+10 percentage points year-on-year). The performance of these revenues is mainly explained by lower SMS revenues, the larger weight of data flat rate tariffs, boosted in the quarter by “Movistar Fusión”, and the migration of customers from USB modems to more attractive multidevice propositions. It should also be noted that data revenues are still affected by the change in the marketing strategy for Premium SMS since November 2011 (Premium SMS revenues declined by 70% year-on-year in 2012).

  - **Interconnection revenues** (469 million euros) fell by 28.0% in the year (-28.8% in the quarter), affected by the mobile termination rate cuts and lower traffic. Roaming-in revenues (108 million euros) fell by 11.8% year-on-year (-8.1% in the quarter), affected by lower traffic and the new roaming tariffs.

- **Revenues from handset sales** amounted to 1,011 million euros in the year (-15.7% year-on-year). In the quarter they declined by 37.4% year-on-year, in line with previous quarter, due to the lower handset sales associated with the change in the company's commercial model.

Operating expenses stood at 8,513 million euros in January-December 2012, a year-on-year decrease of 32.3%, affected by the recognition in the third quarter of 2011 of the provision for the restructuring plan, which amounted to 2,591 million euros. Excluding this effect, expenses would have fallen by 14.8% year-on-year in 2012, with the pace of decline improving significantly in the fourth quarter (-21.7% year-on-year), reflecting the ongoing efforts to contain all cost areas.

Breakdown by component:

- **Supply costs** stood at 3,264 million euros in 2012 and dropped by 16.9% year-on-year, mainly due to lower mobile interconnection costs. In the fourth quarter, these costs fell by 24.7% year-on-year, reflecting the lower expense on mobile equipment since the introduction of the new commercial model. **Subcontracting expenses** amounted to 2,559 million euros, down 14.5% year-on-year and showed a significant improvement in the fourth quarter (-29.3% in the quarter; -11.6% in the third quarter) due to lower costs of subsidies and commissions.

  Both items reflect the savings in **commercial expenses** (-19.0% year-on-year; -33.1% in the quarter), stemming from the new commercial model and the company's strategy to improve quality and customer satisfaction.

- **Personnel expenses** (2,233 million euros) declined 56.1% year-on-year, affected by the restructuring provision recognised in the third quarter of 2011 (2,591 million euros). Excluding this impact, personnel expenses would have fallen by 10.7% in the year (-12.6% in the quarter) reflecting the savings from the restructuring plan (257 million euros through December). Telefónica España had 31,192 employees at the end of December (-7.4% year-on-year).

- **Taxes** fell by 13.5% year-on-year in 2012, while bad debt provisions accounted for 0.7% of revenues in 2012.

As a result, **OIBDA** in 2012 amounted to 6,830 million euros, compared with 5,095 million euros in 2011. Excluding the provision for the restructuring plan above mentioned, OIBDA would have declined by 11.1% year-on-year, while the OIBDA margin stood at 45.6%, recording a 1.1 percentage points year-on-year improvement.

OIBDAi the fourth quarter of 2012 (1,710 million euros) posted a marked improvement in its pace of decline (-3.0% year-on-year) compared to the previous three months (-13.4% year-on-year excluding the impact of the restructuring plan provision in 2011) and prior quarters. Meanwhile, the OIBDA margin widened by 5.5 percentage points compared with the fourth quarter of 2011 to 47.2%.

It should be noted that the year-on-year OIBDA performance in reported terms in 2012 was affected by: i) the booking of the provision for the restructuring plan (2,591 million euros in the third quarter of 2011); ii) the impact of the Universal Service (9 million euros in the fourth quarter of 2012 and 13 million euros in the fourth quarter of 2011); iii) the sale of non-strategic assets (60 million euros in 2012 and 16 million euros in the fourth quarter; 73 million euros in 2011 and 40 million euros in the fourth quarter) and iv) capital gains from the sale of application rights in 2012 (18 million euros in the second quarter of 2012). Thus, these factors had in the fourth quarter a negative impact on the OIBDA year-on-year change (25 million euros in the fourth quarter of 2012 compared with 52 million euros in the fourth quarter of 2011).

CapEx stood at 1,692 million euros in 2012, down 18.3% year-on-year excluding the impact of the acquisition of spectrum recognised in the third and fourth quarters of 2011. The improvements in the quality levels and the reduction in the level of claims have resulted in higher investment efficiency, permitting a sustainable reduction in total investment volume and at the same time an increase in the resources dedicated to growth areas such as fibre (+32% year-on-year).

Finally, operating cash flow (OIBDA-CapEx), excluding the impact of restructuring provision and the acquisition of spectrum, totalled 5,139 million euros in 2012 (-8.5% year-on-year) and showed an improvement compared to the performance in 2011 (-15.9% year-on-year) and the first nine months of 2012 (-12.5% year-on-year) thanks to the growth achieved in the fourth quarter.

Telefónica UK (Year-on-year changes in local currency)

In the fourth quarter of 2012, Telefónica UK posted a further improvement in commercial traction in a highly competitive market, leading to strong performance of both contract and prepay net additions. This improvement of trading momentum was driven by the sustained success of the "On&On" smartphone tariffs as well as the prepay "Pay and Go Go Go" tariffs. The successful execution of efficiency measures also resulted in revenue, cost, OIBDA margin and operating cash flow trends all improving in the fourth quarter, leaving the company well positioned to keep improving in 2013.

Telefónica UK has been able to prepare for the commercial launch of 4G services in 2013 with the network sharing agreement with Vodafone, and after being instrumental in bringing forward the date when spectrum will be cleared for LTE use. This will also allow the company to strengthen the existing network collaboration, broadening coverage and laying the foundations for the 4G network. Telefónica UK has secured two blocks of 10 MHz in the 800 MHz spectrum band for a total investment of 550 million pounds sterling, allowing delivery of a leading nationwide 4G network in the UK.

At the end of 2012, **total access base** reached 23.8 million (+4% year-on-year), mainly driven by the higher contract mobile base.

In 2012, main **mobile operating performance** highlights are:

- The mobile customer base grew 3% year-on-year and stood at 22.9 million at the end of 2012, mainly driven by the solid growth of the mobile contract customer base (+9% year-on-year). As such, the contract mix accounted for 52% of the mobile base (+3 percentage points year-on-year).

- **Contract net additions** showed an improvement in the fourth quarter and reached 282 thousand (+61% year-on-year and +37% quarter-on-quarter) despite the absence of 4G, to total 961 thousand in 2012 (+118% year-on-year). Prepay net additions turned positive in the fourth quarter (+99 thousand vs. net loss the previous year) as the result of the success of the new "Pay and Go Go Go" tariffs, focusing on retention and data monetisation. In 2012, **total net additions** totalled 697 thousand, of which 55% (381 thousand) were in the fourth quarter, a clear contrast vs. the net disconnections posted in the same period of 2011.

- Sustained **contract churn** at low levels in 2012 at 1.0% and in the fourth quarter at 1.1% (-0.1 percentage points year-on-year in both cases) while prepay churn improved 1.6 percentage points year-on-year to 3.8% in the fourth quarter. **Total churn** improved 1.0 percentage points year-on-year in the fourth quarter to reach 2.4% and 2.7% in 2012 (-0.4 percentage points year-on-year) as the result of successful customer management with the company maintaining its Customer Satisfaction Index[2] and being the least complained about network[3] for the eight quarter in a row.

- **Smartphone penetration** reached 45% at the end of 2012 (+7 percentage points year-on-year), and smartphones accounted for over 88% of contract handset sales (shipments) in the quarter.

2. Internal survey run by a third party agency. CSI uses competitor sample to benchmark satisfaction of the key experience touch-points with our base. CSI is not for public consumption.
3. Ofcom.

- The **Tesco Mobile** joint venture (not included in the company's total customer base) maintained its good momentum, consolidating its position as the largest MVNO in the country, with 174 thousand net additions in the fourth quarter to reach 3.5 million customers at the end of the quarter (+19% year-on-year). The base growth has been predominantly in contract base which has now reached 1.2 million.

- **Voice traffic** decreased 6% year-on-year in the fourth quarter (-8% year-on-year in 2012), as a result of the continued impact of usage optimisation.

- **ARPU** declined 9.3% in 2012 (-9.9% in the fourth quarter), driven by regulatory cuts (MTRs and roaming regulation) coupled with strong competitive pressure. Excluding mobile termination rate cuts ARPU would have declined 6.0% in 2012 (-6.3% in the fourth quarter). Voice ARPU declined 18.3% year-on-year in 2012 (-20.4% in the fourth quarter) with trends remaining stable in the fourth quarter vs. the third quarter when excluding regulatory impacts. Data ARPU improved its year-on-year growth trend (+2.1% year-on-year in the fourth quarter vs +1.5% in 2012) as a result of the success of our tiered data strategy.

Revenue trend has improved quarter by quarter since the fourth quarter of 2011 from -6.8% year-on-year to -3.2% in the fourth quarter of 2012 to total 7,042 million euros in 2012 (-5.0% year-on-year), on the back of solid **mobile service revenues**, resulting in a sequential improvement ex-regulation year-on-year (+0.5% in the fourth quarter; -1.5% year-on-year in 2012).

Consistent and solid trading performance through 2012 led to a mobile service revenue sequential improvement in the year-on-year growth trends (-8.5% year-on-year in the fourth quarter; -9.6% in the third quarter) to reach 6,060 million euros in 2012 (-8.6% year-on-year). Excluding the impact of mobile termination rate cuts and new roaming regulations, mobile service revenues would have declined 4.7% in the year (-4.2% in the fourth quarter).

Non-SMS data revenue growth accelerated in the last quarter on the back of increased smartphone penetration and the successful adoption of tiered data plans (+18.4% year-on-year in 2012; +19.8% in the fourth quarter). Total **data revenues** grew 2.4% year-on-year in 2012 (+3.9% year-on-year in the fourth quarter) and its weighting on mobile service revenues increased 5 percentage points year-on-year to over 51%.

OIBDA totalled 1,601 million euros in 2012, with a sequential improvement in the fourth quarter (-8.7% year-on-year in the quarter vs. -10.2 year-on-year in the third quarter and -18.5% in the year to December 2012). OIBDA margin stood at 22.8% in the fourth quarter (22.7% in 2012), with higher commercial expenses in the first half of 2012 due to the increased trading since the third quarter of 2011.

CapEx stood at 748 million euros in the year to December 2012 (-4.5% year-on-year) as the company continued to focus on increasing its 3G coverage and capacity, resulting in O2 UK having the least complained about network.

Operating Cash Flow (OIBDA-CapEx) totalled 854 million euros in 2012.

Telefónica Germany

In the fourth quarter of the year, Telefonica Germany posted solid results, both financially and operationally, with strong commercial traction in the contract segment and successful monetisation of mobile data. The company's focus on profitable growth led to a sustained expansion of OIBDA margin while revenues continued to grow despite a new set of mobile termination rate cuts in December 2012. As a result, the company retained its third position as an integrated operator in Germany.

Additionally, the company continued the execution of focused investment in LTE mobile networks in order to cope for future growth and secured access to the most advanced VDSL platform in Germany.

At the end of 2012, **total access base** reached 25.4 million (+4% year-on-year). Main operating highlights are as follows:

- The **contract mobile customer base** showed a sustained growth of 9% year-on-year and increased its weight by 2 percentage points year-on-year over the mobile customer base to account for 52% at the end of 2012. The **total mobile customer base** reached 19.3 million accesses (+5% year-on-year).

- Contract mobile performance continued keeping momentum in a competitive market, with 219 thousand **contract net additions** in the fourth quarter of 2012 (171 thousand in the third quarter) to reach 873 thousand in 2012, highlighting strong demand for mobile integrated data tariffs in the retail mass-market segment ("O2 Blue" family). **Total net additions** remained strong throughout the year to reach 920 thousand in 2012 (186 thousand in the fourth quarter), due to the success of the differential market approach and the multi-brand portfolio.

- **Contract churn** improved significantly (-0.4 percentage points year-on-year in the fourth quarter; -0.3 percentage points year-on-year in 2012) to reach 1.5% in both the fourth quarter and in the year to December 2012 as a result of a successful customer base management and focus on service quality. **Total churn** stood at 2.2% in 2012 stable year-on-year with higher prepay churn, that is mainly due to the competitive environment.

- **Smartphone penetration** reached 26% at the end of December 2012, 6 percentage points more than a year ago, reflecting the success of "O2 My Handy" handset distribution model (more than 98% of total handset sales in the fourth quarter), with an increasing share of prepay customers using smartphones as unit costs are becoming more attractive to this segment.

- The increasing contract customer base continued to drive **voice traffic** growth in the fourth quarter (+4% in the quarter; +5% year-on-year in 2012).

- **ARPU**[4] increased 0.9% year-on-year in 2012 (+1.2% excluding mobile termination rate cuts). In the fourth quarter ARPU declined 1.3% year-on-year, but was broadly stable quarter-on-quarter and year-on-year excluding mobile termination rate cuts. This evolution was impacted by a mobile termination rate cut in December 2012 as well as the annualisation effect from early adoption of smartphones

4. Revenues from the "My Handy" model are not reported under mobile service revenues and are instead reported in hardware revenues, thus smartphone device sales are not reflected in ARPU.

in the market and the dilution effect from these same customers renewing the tariff as the contract expires.

- **Data ARPU** growth remained strong throughout 2012, growing 9.3% in the year (+5.6% in the fourth quarter) due to the increased penetration of mobile integrated tariffs in the base. **Voice ARPU** declined 5.0% year-on-year in 2012 and -6.4% in the fourth quarter (-4.5% in 2012 and -4.4% in the fourth quarter excluding mobile termination rate cut impacts).
- Retail **broadband fixed internet accesses** totalled 2.4 million at the end of the year (-8% year-on-year). Net disconnections in the quarter amounted to 54 thousand from 61 disconnections in the previous quarter, reflecting customer demand for higher speeds in a declining market.

Revenues grew 3.5% (+3.7% excluding mobile termination rate cuts from December) to reach 5,213 million euros in 2012 (+0.9% in the fourth quarter; +1.6% excluding mobile termination rate cuts), driven by the strong performance of mobile revenues.

Total mobile revenues reached 3,845 million euros in the year to December 2012, an increase of 6.6% year-on-year (+4.2% in the quarter).

Mobile service revenue showed a market-leading performance with a year-on-year growth of 7.0% in 2012 (+7.3% excluding the impact of mobile termination rate cuts), as a result of contract customer base expansion and the success of tiered data pricing. Mobile service revenue growth trends have been impacted by a mobile termination rate cut in December 2012, growing 3.6% in the fourth quarter year-on-year (+4.8% excluding mobile termination rate impacts). This growth slowdown in the fourth quarter is due to the adoption of integrated mobile tariffs coupled with incoming SMS revenues being impacted by lower activity within the market.

The company continued monetising the data opportunity, with non-SMS data revenues growing by 30.7% year-on-year up to December 2012 (+27.9% year-on-year in the fourth quarter). Non-SMS data revenues as a percentage of total data revenues were 57% in 2012, 6 percentage points above the same period of last year.

Mobile data revenues grew 16.1% year-on-year in 2012 (+10.9% in the fourth quarter), accounting for 44% of mobile service revenues (+3 percentage points year-on-year).

Fixed revenues declined 4.4% year-on-year in 2012 and 8.1% year-on-year in the fourth quarter. The worse quarterly trend is mainly influenced by both the continued decline in retail fixed broadband business and lower revenues in the wholesale broadband business.

OIBDA totalled 1,351 million euros in the year to December 2012, an increase of 10.8% year-on-year. The strong OIBDA performance is the result of revenue growth, specially increasing contribution from mobile data revenues, coupled with additional efficiencies in non-commercial expenses, with performance in the fourth quarter mainly reflecting revenue trends (+5.3% year-on-year in the quarter). OIBDA margin expanded by 1.1 percentage points year-on-year to reach 27.3% in the fourth quarter (25.9% for the year to December 2012; +1.7 percentage points year-on-year).

CapEx in the year 2012 amounted to 609 million euros, an increase of 9.2% year-on-year, supporting future growth with accelerated investment in the development of the LTE network and increase of capacity in the 3G network.

Operating Cash Flow (OIBDA-CapEx) increased 12.2% year-on-year to reach 743 million euros.

Telefónica Czech Republic (Year-on-year changes in constant currency)

In the fourth quarter of 2012, Telefónica Czech Republic sustained a sound commercial momentum in focused areas despite continued intense competition. The company recorded a healthy total mobile customers' growth driven by solid contract mobile net additions in the quarter, the best quarterly figure in 2012, and low churn. On the fixed business, fixed broadband and TV accesses continued to grow.

At the end of 2012, **total accesses**, including Slovakia, totalled 9.3 million (+4% year-on-year).

Mobile operating performance highlights were:

- **Total mobile customer base** grew 3% year-on-year in the Czech Republic to reach 5.1 million at the end of the year, on the back of maintained expansion of the contract segment (+5% year-on-year), which already accounts for 63% of the base (+1 percentage point year-on-year).
- **Contract net additions** accelerated in the fourth quarter to 51 thousand vs. 27 thousand in the third quarter and totalled 142 thousand in 2012 as a result of increased activity across all segments. Total net additions totalled 59 thousand in the quarter and reached 141 thousand in the year. The prepay segment recorded a positive performance in the second half of the year (+37 thousand net additions in the second half of 2012 vs. -38 thousand up to June) driven from the successful commercial propositions.
- At the end of December 2012, the **total number of customers in Slovakia** reached 1.4 million, posting 16% year-on-year growth. In the fourth quarter of 2012, net additions totalled 62 thousand, the highest in 2012. This strong performance has been driven largely by the contract base, supported by a successful promotion tariff targeting higher value customers. The number of contract customers grew by 32% year-on-year reaching 659 thousand at the end of December 2012 (+48 thousand in the quarter), while the number of prepay customers increased by 4% year-on-year ending up at 695 thousand. Consequently, the customer mix in Slovakia further improved and contract customers represented already 49% of the total customer base at the end of 2012, up by 6 percentage points year-on-year.

- **Contract churn** in the Czech business remained low at 1.0% in both 2012, and in the fourth quarter (-0.1 percentage points and stable, respectively year-on-year). **Total churn** declined 0.1 percentage points year-on-year to reach 1.8% in the year (1.9% in the fourth quarter; +0.1 percentage point year-on-year).

- **Smartphone penetration** growth accelerated, reaching 14% (+5 percentage points year-on-year) after leading smartphone sales of over 71% of total handset sales in the quarter.

- In terms of usage, total **mobile traffic** grew 7% year-on-year in 2012 after accelerating to 8% year-on-year in the fourth quarter, supported by successful propositions for both contract and prepay customers.

- **ARPU** declined 8.3% year-on-year in 2012 (-12.2% year-on-year in the fourth quarter). Additional mobile termination rate cuts from September 2012, continuous voice ARPU dilution driven by persisting competitive pressures and lower spend evolution were the key drivers for this decline. Excluding the impact of mobile termination rate cuts, ARPU would decline 6.0% year-on-year (-8.0% year-on-year in the fourth quarter). Data ARPU declined 4.8% year-on-year in the year (-7.2% year-on-year in the fourth quarter) largely due to further mobile internet and SMS/MMS bundling in monthly fees.

In 2012, main operating highlights of the **fixed business** were:

- **Fixed telephony accesses** totalled 1.5 million at the end of the year, with 19 thousand net losses in the fourth quarter totalling 82 thousand net losses in 2012 which represents a 6% reduction in line losses year-on-year (lower loss compared to the same period in 2011).

- **Retail broadband internet accesses** grew 7% year-on-year to reach 899 thousand at the end of 2012 (60 thousand net additions in the year; 8 thousand in the quarter). In respect of VDSL, 260 thousand customers have already subscribed for the upgraded service, which represents 32% of the total xDSL residential base. In the fourth quarter of 2012, the number of VDSL customers grew by 22 thousand.

- **Pay TV** customers increased 4% year-on-year and totalled 141 thousand at the end of 2012, a sustained growth throughout the year.

Revenues for the Czech Republic and Slovakia reached 2,010 million euros in 2012 (-3.7% year-on-year). In the fourth quarter, revenues declined 4.7% year-on-year largely due to lower mobile revenues impacted by additional mobile termination rate cut. Excluding the mobile termination rate cut impact the consolidated business revenues would decline 2.7% year-on-year, lower decline compared to the third quarter (-3.4% year-on-year), mainly due to better performance in fixed business. Slovakia revenues reached 192 million euros and continued to show strong growth of 22.1% in the year (+14.8% year-on-year in the quarter).

Fixed revenues totalled 851 million euros in the year, showing improving trends as a result of growing ICT revenues (-5.4% year-on-year; -3.5 % in the fourth quarter).

In 2012, **mobile revenues** reached 1,159 million euros (-2.5% year-on-year; -5.6% year-on-year in the fourth quarter). **Mobile service revenues** totalled 1,097 million euros in the year (-2.4% year-on-year; -5.2% in the fourth quarter). Excluding mobile termination rate cuts, mobile service revenues grew 1.0% in the year (+0.5% in the fourth quarter). Mobile service revenues in Slovakia posted solid growth (+19.9% year-on-year in 2012 and +12.4% in the fourth quarter).

Operating expenses reached 1,219 million euros in 2012 (-0.3% year-on-year; -2.2% in the fourth quarter), with the successful execution of the efficiency agenda and further personnel expenses savings offsetting the higher commercial activity. In both years, mostly in the first quarters, the company recorded restructuring expenses of 11 million euros (7 million euros in 2011).

As a result, **OIBDA** posted an improving year-on-year trend in the fourth quarter (-10.8% vs. -11.7% year-on-year in the third quarter) and totalled 832 million euros in 2012 (-8.7% year-on-year). In 2012, the company recorded a positive impact from the sale of non-core assets (9 million euros in the first quarter of 2012). OIBDA margin was 41.4% in the year and 42.6% in the quarter (-2.3 percentage points and -2.9 percentage points, respectively year-on-year).

CapEx reached 248 million euros in 2012 (+10.4% year-on-year). The company continued to direct investments into further capacity expansion and improvement of the quality of its mobile broadband network, in line with growing demand for mobile data services. In addition, CapEx was spent on further expansion of 3G networks coverage in the Czech Republic and Slovakia.

Operating Cash Flow (OIBDA-CapEx) totalled 584 million euros in 2012.

Telefónica Europe. Accesses

Unaudited figures (Thousands)	2011 December	2012 December	% Chg
Final Clients Accesses	99,909.7	97,498.1	(2.4)
Fixed telephony accesses [1]	16,158.5	15,849.3	(1.9)
Internet and data accesses	10,248.3	10,065.4	(1.8)
Narrowband	519.8	444.1	(14.6)
Broadband	9,680.4	9,576.2	(1.1)
Other [2]	48.2	45.1	(6.4)
Mobile accesses (3)	72,450.7	70,674.1	(2.5)
Prepay [4]	31,159.7	28,618.2	(8.2)
Contract [5]	41,291.0	42,055.8	1.9
Pay TV	1,052.2	909.3	(13.6)
Wholesale Accesses [6]	5,245.1	5,684.3	8.4
Total Accesses	**105,154.8**	**103,182.3**	**(1.9)**

Telefónica. Europe. Mobile Accesses

Unaudited figures (Thousands)	2011 December	2012 December	% Chg
Prepay percentage (%)	43.0%	40.5%	(2.5 p.p.)
Contract percentage (%)	57.0%	59.5%	2.5 p.p.
MBB accesses ('000)	21,934.8	25,499.1	16.2
MBB penetration (%)	30%	36%	5.8 p.p.
Smartphone penetration (%)	27%	35%	7.9 p.p.

Notes:

(1)PSTN (including Public Use Telephony) x1; ISDN Basic access x1; ISDN Primary access; 2/6 Access x30. Company's accesses for internal use included. Includes VoIP and Naked ADSL. Since the first quarter of 2012, fixed telephony accesses include 384 thousand VoIP customers in Germany and 65 thousand fixed lines in UK to homogenize these accesses to the criteria of Telefónica.

(2) Retail circuits other than broadband.

(3) First quarter of 2012 includes the disconnection of 2.0 million inactive accesses in Spain.

(4) First quarter of 2012 includes the disconnection of 1.2 million inactive accesses in Spain.

(5) First quarter of 2012 includes the disconnection of 800 thousand inactive accesses in Spain.

(6) Includes unbundled lines by T. Germany and T. UK. In the fourth quarter of 2011, 78 thousand inactive accesses were disconnected in Germany.

Telefónica Europe. Consolidated income statement

Unaudited figures (Euros in millions)

	January - December		
	2012	2011	% Chg
Revenues	**29,995**	**32,066**	**(6.5)**
Internal expenditure capitalized in fixed assets	478	474	0.8
Operating expenses	(19,777)	(23,411)	(15.5)
Supplies	(9,821)	(10,289)	(4.6)
Personnel expenses	(3,497)	(6,400)	(45.4)
Subcontracts	(5,844)	(6,000)	(2.6)
Bad debt provision	(250)	(305)	(18.1)
Taxes	(364)	(417)	(12.6)
Other net operating income (expense)	(61)	51	c.s.
Gain (loss) on sale of fixed assets	173	101	70.3
Impairment of goodwill and other assets	(565)	(3)	n.s.
Operating income before D&A (OIBDA)	**10,244**	**9,278**	**10.4**
OIBDA Margin	**34.2%**	**28.9%**	**5.2 p.p.**
Depreciation and amortization	(5,010)	(5,081)	(1.4)
Operating income (OI)	**5,233**	**4,197**	**24.7**

Notes:

- OIBDA and OI before management and brand fees. OIBDA and OI includes the impairment recognized by Telefónica Group on the value of Telefónica Irlanda in Q4 12 (-527 million euros).
- Personnel expenses reflect the booking during the third quarter of 2011 of the workforce provision related to the redundancy programme (2,591 million euros).
- From January 1st, 2012, and due to the implementation of the new organization announced in September 2011, companies related to the digital world and global resources that were previously included in the consolidation perimeter of T. España and T. Europe (TIWS, TNA, Jajah, Tuenti and Terra España) have been excluded from both consolidation perimeters and are included within "Other companies and eliminations". Additionally, from the beginning of the year, the perimeter of consolidation of T. Europe includes T. España. As a result, the results of T. Europe and "Other companies and eliminations" have been restated for the fiscal year 2011, to reflect the above mentioned new organization. As this is an intragroup change, Telefónica consolidated results for 2011 are not affected.

Telefónica Europe. Accesses By Country (I)

Unaudited figures (Thousands)	2011 December	2012 December	% Chg
Telefónica España			
Final Clients Accesses	43,023.8	38,744.3	(9.9)
Fixed telephony accesses (1)	12,305.4	11,723.0	(4.7)
Naked ADSL	34.4	25.0	(27.3)
Internet and data accesses	5,710.9	5,779.3	1.2
Narrowband	84.4	54.0	(36.0)
Broadband (2)	5,608.6	5,709.3	1.8
Other (3)	17.9	16.0	(10.5)
Mobile accesses (4)	24,174.3	20,531.2	(15.1)
Prepay (5)	7,359.4	5,118.3	(30.5)
Contract (6)	16,814.9	15,412.9	(8.3)
Pay TV	833.2	710.7	(14.7)
Wholesale Accesses	4,031.9	4,396.0	9.0
WLR (7)	440.6	481.2	9.2
Unbundled loops	2,881.1	3,262.0	13.2
Shared ULL	205.0	183.5	(10.5)
Full ULL (8)	2,676.1	3,078.5	15.0
Wholesale ADSL	709.6	652.3	(8.1)
Other (9)	0.6	0.5	(20.8)
Total Accesses	**47,055.7**	**43,140.3**	**(8.3)**
Telefónica UK			
Final Clients Accesses	23,003.9	23,801.7	3.5
Fixed Telephony Accesses (1)	216.1	377.4	74.6
Internet and data accesses	620.3	560.1	(9.7)
Broadband	620.3	560.1	(9.7)
Mobile accesses	22,167.5	22,864.2	3.1
Prepay	11,227.3	10,962.9	(2.4)
Contract	10,940.3	11,901.3	8.8
Wholesale Accesses (10)	26.7	40.5	51.5
Total Accesses	**23,030.7**	**23,842.2**	**3.5**
Telefónica Germany			
Final Clients Accesses	23,440.9	24,284.9	3.6
Fixed Telephony Accesses (1)	2,055.1	2,249.0	9.4
Internet and data accesses	2,922.3	2,678.9	(8.3)
Narrow band	334.6	302.6	(9.6)
Broadband	2,587.7	2,376.3	(8.2)
Mobile accesses	18,380.1	19,299.9	5.0
Prepay	9,144.5	9,191.3	0.5
Contract	9,235.7	10,108.5	9.5
Pay TV	83.3	57.2	(31.3)
Wholesale Accesses (11)	1,042.4	1,087.9	4.4
Total Accesses	**24,483.2**	**25,372.8**	**3.6**

Telefónica Europe. Accesses By Country (II)

Unaudited figures (Thousands)	2011 December	2012 December	% Chg
Telefónica Ireland			
Internet and data accesses	24.2	31.0	28.0
Broadband	24.2	31.0	28.0
Mobile accesses	1,622.9	1,541.7	(5.0)
Prepay	870.1	759.7	(12.7)
Contract	752.9	782.0	3.9
Total Accesses	**1,647.2**	**1,572.7**	**(4.5)**
Telefónica Czech Republic			
Final Clients Accesses	7,629.8	7,740.3	1.4
Fixed telephony accesses (1)	1,581.9	1,499.9	(5.2)
Naked ADSL	237.4	285.9	20.4
VoIP	52.1	76.7	47.2
Internet and data accesses	970.6	1,016.1	4.7
Narrowband	100.7	87.6	(13.1)
Broadband	839.6	899.4	7.1
Other (12)	30.3	29.1	(4.0)
Mobile accesses	4,941.7	5,082.9	2.9
Prepay	1,892.4	1,891.1	(0.1)
Contract	3,049.3	3,191.7	4.7
Pay TV	135.6	141.4	4.3
Wholesale Accesses	144.1	159.9	11.0
Total Accesses	**7,773.9**	**7,900.1**	**1.6**
Telefónica Slovakia			
Mobile accesses	1,164.1	1,354.2	16.3
Prepay	666.1	694.9	4.3
Contract	498.0	659.3	32.4
Total Accesses	**1,164.1**	**1,354.2**	**16.3**

(1) PSTN (including Public Use Telephony) x1; ISDN Basic access x1; ISDN Primary access; 2/6 Access x30. Company's accesses for internal use included. Includes VoIP and Naked ADSL. Since the first quarter of 2012, fixed telephony accesses include 384 thousand VoIP customers in Germany and 65 thousand fixed lines in UK to homogenize these accesses to the criteria of Telefónica.

(2) ADSL, satellite, optical fiber and broadband circuits.

(3) Leased lines.

(4) First quarter of 2012 includes the disconnection of 2.0 million inactive accesses.

(5) First quarter of 2012 includes the disconnection of 1.2 million inactive accesses.

(6) First quarter of 2012 includes the disconnection of 800 thousand inactive accesses.

(7) Wholesale Line Rental.

(8) Includes naked shared loops.

(9) Wholesale circuits.

(10) Includes Unbundled Lines by T. UK.

(11) Includes Unbundled Lines by T. Germany. In the fourth quarter of 2011, 78 thousand inactive accesses were disconnected in Germany.

(12) Retail circuits other than broadband.

- Accesses in UK and Ireland show a more detailed split than in previous quarters: Telefónica UK details fixed telephony and wholesale acccesses and Telefonica Ireland, Internet and data accesses, which all were previously recorded within T. Europe.

Telefónica Europe. Selected financial data by country (I)

Unaudited figures (Euros in millions)	January - December			
	2012	2011	% Chg	% Var. M. Local
Telefónica España				
Revenues	14,985	17,269	(13.2)	
Wireless Business	**6.453**	**7,739**	**(16.6)**	
Wireless service revenues	5,442	6,540	(16.8)	
Wireless data revenues	1,602	1,680	(4.6)	
Handset revenues	1,011	1,199	(15.7)	
Wireline Business	**9,541**	**10,624**	**(10.2)**	
FBB and new services (1)	4,431	4,659	(4.9)	
Voice & access revenues	4,628	5,369	(13.8)	
Others	481	596	(19.2)	
OIBDA (2)	6,830	5,095	34.0	
OIBDA margin (2)	45.6%	29.5%	16.1 p.p.	
CapEx (3)	1,692	2,912	(41.9)	
OpCF (OIBDA-CapEx) (2) (3)	5,139	2,184	135.3	
Telefónica UK				
Revenues	7,042	6,926	1.7	(5.0)
Service revenues	6,060	6,198	(2.2)	(8.6)
Data revenues	3,070	2,803	9.5	2.4
Handset revenues and other	981	728	34.8	26.0
OIBDA	1,601	1,836	(12.8)	(18.5)
OIBDA Margin	22.7%	26.5%	(3.8 p.p.)	
CapEx	748	732	2.2	(4.5)
OpCF (OIBDA-CapEx)	854	1,104	(22.7)	(27.8)
Telefónica Germany				
Revenues	5,213	5.035	3.5	
Wireless Business	**3,845**	**3,606**	**6.6**	
Wireless service revenues	3,152	2,946	7.0	
Wireless data revenues	1,391	1,197	16.1	
Handset revenues	693	659	5.1	
Wireline Business	**1,363**	**1,426**	**(4.4)**	
FBB and new services (1)	977	1,083	(9.8)	
Voice & access revenues	372	324	14.5	
Other	15	18	(16.9)	
OIBDA	1,351	1,219	10.8	
OIBDA margin	25.9%	24.2%	1.7 p.p.	
CapEx	609	558	9.2	
OpCF (OIBDA-CapEx)	743	662	12.2	

Telefónica Europe. Selected financial data by country (II)

Unaudited figures (Euros in millions)

	January - December			
	2012	2011	% Chg	% Var. M. Local
Telefónica Ireland				
Revenues	629	723	(13.1)	
Service revenues	567	677	(16.2)	
Data revenues	252	267	(5.5)	
Handset revenues and other	62	46	32.9	
OIBDA	130	206	(36.9)	
OIBDA Margin	20.7%	28.5%	(7.8 p.p.)	
CapEx (4)	192	61	n.s.	
OpCF (OIBDA-CapEx) (4)	(62)	145	c.s.	
Telefónica Czech Republic Group (5)				
Revenues	2,010	2,130	(5.7)	(3.7)
Wireless Business	**1,159**	**1,211**	**(4.3)**	**(2.5)**
Wireless service revenues	1.097	1.145	(4.2)	(2.4)
Wireless data revenues	305	308	(1.1)	0.8
Handset revenues and other	62	66	(5.9)	(4.2)
Wireline Business	**851**	**919**	**(7.4)**	**(5.4)**
FBB and new services (1)	408	430	(5.1)	(3.0)
Voice & access revenues	438	483	(9.4)	(7.4)
Other	5	6	(14.7)	(12.7)
OIBDA	832	931	(10.6)	(8.7)
OIBDA margin	41.4%	43.7%	(2.3 p.p.)	
CapEx	248	229	8.6	10.4
OpCF (OIBDA-CapEx)	584	702	(16.9)	(15.0)

Notes:

- OIBDA before management and brand fees.
- From January 1st, 2012, and due to the implementation of the new organization announced in September 2011, companies related to the digital world and global resources that were previously included in the consolidation perimeter of T. España and T. Europe (TIWS, TNA, Jajah, Tuenti and Terra España) have been excluded from both consolidation perimeters and are included within "Other companies and eliminations". Additionally, from the beginning of the year, the perimeter of consolidation of T. Europe includes T. España. As a result, the results of T. Europe and "Other companies and eliminations" have been restated for the fiscal year 2011, to reflect the above mentioned new organization. As this is an intragroup change, Telefónica consolidated results for 2011 are not affected.

(1) Includes FBB connectivity services (retail and wholesale), including value added services, TV services, ICT revenues and other services over connectivity.

(2) Includes the booking during the third quarter of 2011 of the workforce provision related to the redundancy programme (2,591 million euros).

(3) CapEx includes 842 million euros from the spectrum acquired in 2011 out of which 173 correspond to the fourth quarter of 2011.

(4) CapEx includes 127 million euros from the spectrum acquired in 2012 out of which 126 correspond to the fourth quarter of 2012.

(5) Includes Slovakia.

Addenda

Key Holdings of the Telefónica Group

Telefónica Latinoamérica

	% Stake
Telefónica Móviles Perú	100.0
Telefónica Argentina	100.0
Telefónica Móviles Argentina	100.0
Telefónica Móviles Chile	100.0
Telefónica Móviles México	100.0
Telefónica Móviles Guatemala	100.0
Telefónica Venezolana	100.0
Telefónica Ecuador	100.0
Telefónica Móviles Panamá	100.0
Telefónica Móviles Uruguay	100.0
Telefonía Celular Nicaragua	100.0
Telefónica Costa Rica	100.0
Telefónica Móviles El Salvador	99.2
Telefónica del Perú	98.5
Telefónica Chile	97.9
Telefónica Brasil (1)	73.9
Telefónica Colombia	70.0

1. Includes 100% of Vivo.

Telefónica Europe

	% Stake
Telefónica de España	100.0
Telefónica Móviles España	100.0
Telefónica Reino Unido	100.0
Telefónica Alemania	76.8
Telefónica República Checa (1) (2)	69.4
Telefónica Irlanda	100.0
Tesco Mobile	50.0
Telyco	100.0
T. Soluciones de Informática y Comunicaciones de España	100.0
Telefónica Telecomunic. Públicas	100.0
Iberbanda	100.0
Be	100.0
Acens Technologies	100.0

1. 70.3% including treasury shares.
2. It includes 100% of Telefónica Slovakia.

Other Stakes

	% Stake
Telefónica de Contenidos	100.0
T. Intern. Wholesale Serv. (TIWS)	100.0
Jajah	100.0
Tuenti	91.4
Telco SpA (1)	46.2
DTS, Distribuidora de Televisión Digital	22.0
China Unicom	5.0
Portugal Telecom	2.0
BBVA	0.8

1. Telefónica holds an indirect stake of the ordinary share capital (with voting rights) of Telecom Italia through Telco of approximately 10.46%. If we take into account the saving shares (azioni di risparmio), which do not have voting rights, the indirect stake of Telefónica over Telecom Italia would be 7.19%.

Changes to the Perimeter

The main changes in the perimeter of consolidation in the first nine months of 2012 were as follows:

- On the 29th of June 2012 the merger process between Telefónica Móviles Colombia, S.A. and Colombia Telecomunicaciones, S.A. ESP was completed, resulting in a company in which Telefónica Group holds a 70% stake. This company is still fully consolidated.

- On the 10th of June 2012, Telefónica, S.A. (through its 100% subsidiary, Telefónica Internacional, S.A.U.), and China United Network Communications Group Company Limited through a 100% owned subsidiary, signed an agreement for the acquisition by this last company of 1,073,777,121 shares of China Unicom -Hong Kong- Limited, (throughout this document referred to as China Unicom) owned by Telefónica (equivalent to 4.56% of the share capital),

  On the 30th of July, after obtaining the relevant regulatory authorizations, the transaction was completed, having received Telefónica HK: 10,748 million (€ 1,142 million).

  The company, participated by Telefónica after the sale in 5.01% of its share capital, continues to be incorporated to the consolidation perimeter through the equity method.

- Through a public offering carried out in October 2012, Telefónica, S.A. sold a 23.17% interest in Telefónica Deutschland Holding, A.G., for 1,449 million euros. Following the sale, the investee continues to be fully consolidated in the Telefónica Group.

- In October 2012, the Telefónica Group sold its 50% stake in Red Universal de Marketing y Bookings Online (RUMBO), S.A., generating a gain of approximately 27 million euros. This company, which had been proportionately consolidated in the Telefónica Group, was removed from the scope of consolidation.

- In December 2012, the Group completed the sale of the Atento business to a group of companies controlled by Bain Capital. The enterprise value of the transaction amounts to €1,051 million, including a vendor loan of €110 million as well as certain deferred payments for €110 million. This operation generated a gain of approximately 61 million euros.

  The companies comprising this business, which were previously included in the Telefónica Group using the full consolidation method, were removed from the consolidation scope.

- On February 21, 2012, Telefónica de Contenidos, S.A.U., a wholly-owned company by Telefónica, S.A., had reached an agreement with Abertis Telecom, S.A. to sell its stake of Hispasat S.A.

  Following the exercise of the preferential right of acquisition by the German company Eutelsat Services & Beteiligungem, GmbH, and after obtaining the necessary authorizations by the Council of Ministers on 28 December 2012, Telefónica de Contenidos, S.A.U., as of 28th of December 2012:

  - Has transferred to Abertis Telecom, SA 23,343 shares of Hispasat, S.A. for a total price, of 68 million euros, which has been received in cash.

  - Has signed a contract with Eutelsat Services & Beteiligungem, GmbH for the sale of its remaining stake in Hispasat, SA, that is 19,359 shares of that entity, for a total price of 56 million euros, subject to approval of foreign investment.

  The capital gain resulting from the sale to Abertis Telecom, S.A., amounts to approximately 26 million euros. The joint capital gain resulting from both operations is estimated to amount to approximately 47 million euros.

Disclaimer

Risk management policy_

The Telefónica Group is exposed to different risks of the financial market as a consequence of (i) its ordinary business, (ii) the debt assumed to finance its businesses, (iii) other financial instruments related to the preceding points.

The main market risks that affect the Group companies are:

Exchange rate risk
Exchange rate risk arises mainly due to: (i) the international presence of Telefónica, with investments and businesses in countries with currencies other than the euro (fundamentally in Latin America, but also in the United Kingdom and in the Czech Republic), and (ii) due to debt in currencies other than those of the countries where the businesses are carried out or where the companies that have taken the debt are located.

Interest rate risk
The interest rate risk mainly arises due to the variations in the rates or interest that affect: (i) the financial costs of the debt at variable rate (or with short term maturity and foreseeable renewal), and as a consequence of the interest rate fluctuation, and (ii) the value of the long-term liabilities with fixed interest rates.

Share price risk
The share price risk is fundamentally due to the variation in the value of the shareholding stocks (which may be the subject of purchase or sale or that are in some way subject to some type of transaction), in exchange for the derived products associated with those investments, to changes in the value of own shares in portfolio and those deriving on shares.

Other risks
In addition, the Telefónica Group is facing the liquidity risk that arises due to the possibility of an imbalance between the needs for funds (due to operating and financial costs, investments, debt maturities and committed dividends) and the sources of the same (income, disinvestments, financing commitments by financial institutions and operations in capital markets). The cost of obtaining funds can likewise be affected by variations in the credit margins (on the rates of reference) required by the lenders.

Finally, the Telefónica Group is exposed to the “country risk” (related to market and liquidity risks). This consists of the possibility of a loss of value of the assets or a reduction in the flows generated or sent to the parent company, as a consequence of political, social and economic instability in the countries where the Telefónica Group operates, especially in Latin America.

Risk management

The Telefónica Group actively manages the aforementioned risks by means of the use of derived financial instruments (in particular, on exchange rates, interest rates and shares) and incurring debt in local currencies, when this is convenient, with the aim of reducing the cash flows of the P&L account and, to a lesser extent, partially, of the investments. In this way, the aim is to protect the solvency of the Telefónica Group and facilitate the financial planning and the leverage of investment opportunities.

The Telefónica Group manages the exchange rate risk and the interest rate risk in terms of net debt, based upon its calculations. The Telefónica Group considers that these parameters are more appropriate for understanding the debt position. The net debt and the net financial debt take into account the net financial debt and cash equivalents, including the positions in derived financial instruments with a positive value related to the assets. Neither the net debt nor the net financial debt calculated by the Telefónica Group should be considered as an alternative to the gross financial debt (sum of the short and long term financial debt) as a liquidity measure.

For greater details about the reconciliation between the net debt and the net financial debt with the gross debt, see Note 2 of the Financial Report.

Exchange rate change

The fundamental objective of the exchange rate risk management policy is that, in the case of depreciation in the currencies as compared to the euro, any potential loss in the value of the cash flows generated by the businesses in these currencies (caused by depreciation in the exchange rate as compared to the euro) are offset (at least partially) with the savings due to a lower value in euros of the debt in currencies. The degree of coverage is variable for each investment classification.

At December 31, 2012, the net debt in Latin American currencies was equivalent to approximately 4,988 million euros. Nonetheless, the composition of this net debt in the different Latin American currencies is not proportional to the flows generated in each currency. The future effectiveness of the stated strategy in dealing with protection against exchange rate risks will depend on where the possible depreciation takes place

The aim of Telefónica is to protect itself against losses in the value of the Latin American assets due to the effect of depreciation in Latin American currencies in relation to the euro. This is why the debt recurs in dollars on occasions, both in Spain (associated with the investment while it is considered that the coverage is effective) and in the particular countries with financial markets or of coverage in local currency that is inadequate or non-existent. At 31 December 2012, the net debt in dollars of Telefónica amounted to the equivalent of 1,279 million euros.

At December 31, 2012, the debt in pounds was about 1.8 times the 2012 Operational Income Before Depreciation and Amortization (hereinafter, OIBDA) for the "Telefónica Europe" business unit in the United Kingdom. The purpose of Telefónica is to maintain a similar proportion in the ratio of net debt in pounds to OIBDA as the ratio of the net OIBDA debt for Telefónica, to reduce its sensitivity to variations in the quoted rate of the pound as compared to the euro. The debt denominated in pounds at December 31, 2012 amounts to 2,629 million equivalent euros, less than the 3,540 million euros at December 31, 2011.

The management objective for the protection of the investment in the Czech Republic is similar to that described for the investment in the United Kingdom, where the amount of the debt denominated in Czech crowns is proportional to the OIBDA of the "Telefónica Europe" business unit in the Czech Republic. Thus, at December 31, 2012, the Company holds debtor net positions denominated in Czech crowns for a sum such that the net debt in Czech crowns as compared to the OIBDA in Czech crowns is at 2.1 (1.7 times in 2011) in consolidated terms and 2.97 (2.55 times in 2011) in proportional terms.

Likewise, Telefónica manages its exchange rate risk seeking to minimize the negative impacts on any exposure to the exchange rate risk in the results account, regardless of open positions being maintained. These positions arise for three types of reasons: (i) due to the tightness of some of the derivatives markets or due to the difficulty in obtaining financing in local currency, which does not allow for low cost coverage (as happens in Argentina and Venezuela); (ii) due to financing by means of intra-Group loans, with accounts treatment of the currency risk that is different from the financing through capital contributions; (iii) due to own decisions, so as to avoid high costs in coverage that are not justified due to expectations or high depreciation risks.

In 2012 negative results were obtained from exchange rate management to the tune of 534 million euros (without considering the monetary correction effect), mainly due to the effect of the Group's estimations as a consequence of the 32% fall in value of the VEB against the USD in 2013, compared to 176 million euros in negative results recorded in 2011.

The sensitivity of losses and gains on results and equity due to variations in the exchange rate can be seen in the following table, where: a) for the calculation of the impact on the results, the position of the currency is considered constant during 2013 with an impact on the results at 2012 year end; b) for the calculation of the impact on equity, only monetary items have been considered, i.e. debt and derivatives such as net investment hedges and loans to subsidiaries associated with investment, whose composition is considered constant in 2013 and equal to that existing at 2012 year-end. In both cases, the Latin American currencies are taken to depreciate against the dollar and the rest of the currencies against the euro by 10%.

Millions of euros Currency	Variation	Impact on consolidated results	Impact on consolidated equity
All the currencies vs EUR	**10%**	**112**	**(271)**
USD	10%	10	73
European currencies vs EUR	10%	-	(498)
Latin American currencies vs USD	10%	102	154
All the currencies vs EUR	**(10)%**	**(112)**	**271**
USD	(10)%	(10)	(73)
European currencies vs EUR	(10)%	-	498
Latin American currencies vs USD	(10)%	(102)	(154)

Following the decision adopted by the Government of Venezuela on February 8, 2013 in relation to the devaluation of the bolivar of 4.3 strong bolivars per dollar to 6.3 strong bolivars per dollar, in accordance with the INFI, the Group considers this valuation is a fact subsequent to the close of the financial year 2012 that does not require the altering of the exchange rate used for the conversion of the financial information of the Venezuelan companies of 4.3 strong bolivars per dollar.

The new exchange rate of 6.3 strong bolivars for each United States dollar will be utilized after 2013 in the conversion of the financial information of the Venezuela affiliates The main aspects to be considered in the financial year 2013 are detailed in Note 24 of the Financial Report.

The exchange rate situation of the strong Venezuelan bolivar affects the estimates made by the Group on the settlement value of the net position in foreign currency related to the investments in Venezuela, whose negative impact in the financial results of the financial year 2012 amounted to 438 million euros.

The Group's monetary position in Venezuela at December 31, 2012 is a net debtor position for the sum of 2,794 million strong bolivars (equivalent to 524 million euros, approximately). The mean exposure during 2012 was a debtor one. This represents a greater financial cost for a sum of 64 million euros due to the effect of inflation.

Interest rate risk

The financial costs of Telefónica are exposed to oscillations in interest rates. In 2012, the short-term rates with a higher debt volume of Telefónica exposed to these were fundamentally the Euribor, the Pribor of the Czech crown, the Brazilian SELIC rate, the dollar Libor and the Colombian UVR. In nominal terms, at December 31, 2012, 74% of the net debt of Telefónica (or 73% of the net long-term debt) had the rate fixed for a period of longer than one year, compared to 66% of the net debt (70% of the long-term net debt) that there had been in 2011. Of the other 26% (net floating or fixed rate debt with maturity of less than one year), 10 percentage points had the interest rate set for a period of longer than one year (or 3% of the net long-term debt), while at December 31, 2011 it was set at 15 percentage points of the net floating or fixed rate debt with maturity of less than 1 year (5% of the net long-term debt). This reduction in 2012, as compared to 2011, is a consequence of the decision to keep a sum cancelled or not renewed that is equivalent to 1,428 million euros of structures of caps and floors in euros, dollars and pounds sterling, with the policy initiated in 2009, anticipating a fall in the interest rates.

In addition, the financial updating of the liabilities for early retirement during the year were discounted at the current value, being based upon the curve for very high-quality credit instruments. The fall in interest rate meant an increase in the value of said liabilities. However this increase has been offset, almost in its entirety, by an increase in the value of the hedging derivatives associated with these positions.

The net financial costs in the whole of 2012 totaled 3,658 million euros, 24.4% more than in 2011 (2,941 million euros). This increase is explained by two effects with a similar impact. On the one hand there is an increase in the interest rate owed costs, mainly at the higher mean debt (+3.3%) up to a total of 58,187 million euros, the increase in credit differentials and the need to increase liquidity (with a low level of remuneration as compared to the cost of the debt) as a consequence of the crisis in the markets and on the other hand the effect on the estimates as a consequence of the 32% devaluation of the Venezuelan bolivar explained above. In spite of the increase in the credit costs, we have managed to keep the average weighted cost of the gross debt (excluding cash) of the Group constant at 4.7%. Excluding the exchange rate differences, these costs represent an effective cost of the debt of 5.37% in the last 12 months.

In order to give an idea of the sensitivity of the financial costs to the variation in short-term interest rates, this has meant, on the one hand, an increase of 100 basic points in the interest rates in all of the currencies where Telefónica holds a financial position at December 31, 2012 and a decrease of 100 points in all of the currencies except in those currencies (Euros, pounds and US dollars, etc.) with low rates with a view to avoiding negative rates and on the other hand a constant position equivalent to the position at the close of the year.

In order to calculate the sensitivity in equity for variation in the interest rates, this has meant on the one hand an increase of 100 basic points in the interest rates in all of the currencies and in all of the periods of the curve, where Telefónica holds a financial position at December 31, 2012, and a decrease of 100 points in all currencies and all of the periods (apart from those with rates lower than 1% with a view to avoiding negative rates) and on the other hand consideration has only been given to the positions with cash flow coverage. This is because these are fundamentally the only positions whose variation in market value due to interest rate movement is recorded in the equity.

Million euros Variation in basis points (bp)	Impact on consolidated results	Impact on consolidated equity
+100pb	(96)	747
- 100pb	36	(685)

Share price risk

The Telefónica Group is exposed to the variation in the value of the shareholding stocks that may be the subject of transactions, of the products derived from the same, of the own shares in portfolio and of those derived on shares.

According to what is stated in the Telefónica, S.A. – Performance Share Plan (PSP) and in the Performance & Investment Plan (PIP) (see Note 20 of the Financial Report), the source of the shares to be delivered to the employees may be shares in Telefónica, S.A. in own portfolio, which have been acquired o they are acquired both by Telefónica, S.A. itself and any companies of its Group or newly-issued shares. The possibility of delivering shares to the beneficiaries of the plan in the future, based upon the relative benefit or remuneration received by the shareholder implies a risk given that there may be an obligation to deliver the maximum number of shares at the end of each cycle. The acquisition of these (in the case of purchase on the market) in the future could mean a cash outlay greater than that which would be required at the date of the start of each cycle if the price of the share is above the price corresponding to the date of the start of the cycle. In the case of the issue of new shares to be issued to the beneficiaries of the plan, a diluting effect would take place for the ordinary shareholder of Telefónica as there is a greater number of shares in circulation.

With the aim of reducing the risk associated with the variations in the price of shares under this plan, Telefónica has acquired instruments that reproduce the risk profile of these plans, which are described in Note 20 of the Financial Report.

During 2012 the second general share incentive purchase plan was set underway, as approved at the Shareholders' Ordinary General Meeting of 2011 (see further details of the plan in Note 20 of the Financial Report).

Similarly, part of the shares of Telefónica, S.A. in portfolio at the close of the financial year could be used for the coverage of the PSP, of the PIP, of the general share incentive purchase plan. The settlement value of shares in own portfolio could be modified upwards or downwards depending on the price variations in the Telefónica shares.

Liquidity risk

The Telefónica Group has the intention that the profile of maturities of its debt is to be adjusted to its capacity to generate cash flows so as to pay it, maintaining a certain degree of comfort. In practice, this has translated into these two criteria being followed:

1. The average maturity of the net financial debt of the Telefónica Group should be longer than 6 years, or that is to say this threshold is to be recovered in a reasonable time period if this eventually falls below that limit. This criteria is considered to be a guideline in debt management and in access to the capital markets, but this is not a strict requirement. For the purposes of the calculation of the average value of the net financial debt, the part of the credit facilities available can be considered to compensate for the short term debt maturities and the options of extending the maturity in some financing operations may be considered to be undertaken.

2. The Telefónica Group has to be able to pay all of its commitments in the next 12 months, with no need to apply for new credits or to the capital markets (even though there are binding commitments made with financial institutions) in the case of budgetary compliance. During the course of 2012, given the crisis situation of the financial markets, it was decided to apply a policy of coverage of commitments that is substantially greater.

At December 31, 2012, the average maturity of the net financial debt (51,259 million euros) was 6.4 years.

At December 31, 2012, the gross net maturity levels expected for 2013 amount to approximately 10,074 million euros (including the net position of derived financial instruments and certain entries for short-term creditors) or 9,754 million euros if Telefónica decides not to exercise early cancellation options, which are lower than the availability of funds measured as the sum of: a) the short-term financial investments and cash and equivalents at December 31, 2012 (11,404 million euros, excluding the derived financial instruments); b) the annual cash generation expected for 2013; c) the credit facilities committed to with bank institutions, not utilized and with initial maturity of longer than one year (for a sum greater than 9,470 million euros at December 31 , 2012). This gives the Telefónica Group flexibility when it comes to accessing the capital or credit markets in the next 12 months. For the description of other financing operations framed within these measures carried out in 2013, see Note 13.2 "Financial Liabilities" and in Appendix III of the Financial Report.

Country risk

To manage or mitigate the country risk, the Telefónica Group has been acting in two large lines (apart from the ordinary management of its business), to:

1. Partially offset the assets with liabilities, not guaranteed by the parent company, in the Latin American companies of the Telefónica Group., in such a way that a possible loss of assets is accompanied by a reduction in the liabilities, and
2. Repatriate those funds generated in Latin America that are not necessary for undertaking new opportunities for the profitable development of the business in the region.

In reference to the first point, at December 31, 2012, the Latin American companies of the Telefónica Group had a volume of net finance debt not guaranteed by the parent company, which amounts to 4,169.5 million, 0.2% of the net consolidated financial debt.

As regards the repatriation of funds to Spain, 1,817 million euros was received from Latin America in 2012 (1,314 million euros as dividends, 34 million euros as intra-Group loans (repayment of principal and payment of interest), 247 million euros for capital reductions and 221 million euros for other concepts).

In this respect it can be highlighted that since February 2003, an exchange rate control system is in effect in Venezuela, managed - as has been stated - by the Exchange Rate Administration Committee (CADIVI). This body has issued diverse rules ("decisions") that regulate the modalities of the sale of currencies in Venezuela at the official exchange rate. The foreign companies are duly recorded as foreign investors and they are entitled to request approval to acquire currencies at the official exchange rate from CADIVI in accordance with the decision Number 029, Section 2, sub-section c) "Remission of profits, utilities, rents, interest and dividends from international investment". Telefónica Venezolana, C.A. (formerly known as Telcel, C.A.), affiliate of the Telefónica Group in Venezuela, in 2006 obtained approval for 295 million bolivars for this concept; in 2007 for 473 million bolivars and in 2008 for 785 million bolivars. At December 31, 2012, it is awaiting approval by the CADIVI for two dividends agreed by the Company for the total sum of 5,882 million bolivars.

Credit risk

The Telefónica Group operates in derivatives in matching entries of high-quality credit. Thus Telefónica, S.A., generally operates with lending institutions whose applicable rating for its "Senior Debts" is at least at Rank A. In Spain, where the largest portfolio of derivatives of the Group lies, there are netting agreements with the financing entities, in such a way that they can compensate for debtor and creditor positions in the case of bankruptcy, with the risk only being for the net position. In addition, following the Lehman bankruptcy, the credit rating of the rating agencies has been seen to be less effective as a credit risk management tool. This is why said minimum rating has been complemented with the five-year CDS (Credit Default Swap) of the lending institutions. Thus, monitoring of the CDS is done at all times, in the universe of matching entries in which Telefónica, S.A. operates, with a view to evaluating the maximum CDS admissible at said time, generally only operating with those whose CDS does not exceed that threshold.

For other affiliates, in particular for the Latin American affiliates, given that the sovereign rating sets a ceiling and this is lower than A, it operates with local financial entities whose rating for the local standards is considered to be of a very high credit quality.

Similarly, as regards the credit risk of the entries of cash and cash equivalents, the Telefónica Group places its surpluses in Treasury in high-quality monetary market assets with maximum liquidity. These placements are regulated by a General Framework that is reviewed yearly. The matching entries are selected based upon the criteria of liquidity, solvency and diversification, on the basis of the market conditions and the countries in which the Group operates. The following are set out in said General Framework: (i) the maximum amounts to be invested per matching entry depending on the rating (long-term credit rating) of the same, (ii) the maximum period for realizing the investments set at 180 days and (iii) the instruments in which it is authorized to place surpluses (money market instruments).

The management of the commercial credit risk in the Telefónica Group is configured as one of the essential elements to contribute towards the sustainable growth objectives of the business and of the client base, in a manner consistent with the Corporate Risks Management Model.

This management is based upon an ongoing assessment of the risk assumed and of the necessary resources, in such a way that the risk profitability relationship in its operations is optimized. In particular, all of those clients and/or products are evaluated that have a financial component that may generate a material impact on the Group's financial statements. As regards this, depending on the segment and the type of relationship, diverse management measures are established to mitigate the credit exposure.

Policies, circuits of authorization and homogeneous management practices are established in all of the Group companies, taking account of the particular features of each market and the practical international improvements, and incorporating this commercial credit risk management model into the Group's decision making processes at both the strategic level and, especially, in the day-to-day operations where the risk assessment orientates the commercial offer available for the different credit profiles.

The maximum exposure to the credit risk held with the Telefónica Group is mainly represented by the book value of the assets (see Notes, 10, 11 and 13), as well as the guarantees provided by the Telefónica Group.

Diverse companies of the Telefónica Group issue operating sureties granted for external matching entries that fall within the development of its ordinary commercial activity, in processes of awarding licences, authorizations and concessions or of spectrum acquisition. At December 31, 2012, these sureties amounted to approximately 3,312 million euros (see Note 21-e of the Financial Report).

Capital management

The Telefónica financial management, responsible for the management of the capital of Telefónica, considers various arguments for the determination of the structure of the capital of the Company, with the objective of guaranteeing the sustainability of the business and maximizing the value to the shareholders.

The first one, the consideration of the cost of the capital at any time, which means that it comes close to a combination that optimizes it. To do this, the monitoring of the financial markets and the updating of the standard methodology in the industry for its calculation (WACC "weighted average cost of capital") are the parameters that are taken into consideration for determining this. The second, a lower net financial debt level, OIBDA-Operating Income Before Repayments (excluding factors that could be of a non-recurrent nature or exceptional ones), making it possible to obtain and maintain the desired credit rating in the medium term and with which the Telefónica Group can make the cash generation potential compatible with the alternative uses that may be present at any time.

These general arguments commented on above are completed with other considerations and specifications that are taken into account when it comes to determining the financial structure of the Telefónica Group, such as the country risk in its broad acceptance, or the volatility in cash generation.

Derivatives policy

At December 31, 2012, the nominal amount of active derivatives contracted with external matching entries amounted to the equivalent of 147,724 million euros, 17% lower than the figures submitted in 2011 (178,641 equivalent euros). This volume is so high because derivatives can be applied several times on the same underlying for a sum equal to the nominal amount. For example, a debt in a currency can go from euros at variable rate and then the setting of rates can be carried out on each one of the interest rate periods, by means of an FRA (Forward Rate Agreement). Although said position will be adjusted downwards, it is necessary to stress prudence in the use of derivatives so as to avoid problems due to errors or a lack of knowledge of the actual position and of its risks.

The policy followed by Telefónica in the utilization of derivatives has placed emphasis on the following points:

1) Clearly identified underlying inventories, on which the derivative is applied

These acceptable underlyings include the assets and liabilities, results, income and cash flows, in both functional currencies of the Company and other currencies. These flows may be contractual (debt and interest payment, payments on account payable in foreign currency, etc.) reasonable secure or foreseeable (program of purchases of fixed assets, future debt issues, trade paper programs, etc.). The consideration as underlying of the cases mentioned above will not depend on whether or not they are adapted to the criteria laid down by the accounts rules for the treatment of the underlyings as covered entries, as happens, for example, with some intra-Group transactions. In addition, in the case of the parent company, an investment in affiliates with a functional currency other than the euro is also considered to be a possible underlying.

The coverage with economic sense, that is to say, that they have an assigned underlying ad that, in certain circumstances, may compensate for the variations in the value of the underlying, do not always comply with the requirements and effectiveness tests laid down by the accounts rules for being treated as such forms of coverage. The decision to maintain these once the effectiveness test has not been completed or if certain requirements have not been met, will depend on the marginal variability in the results account that may take place, and hence the difficulty that may be entailed by following the principle of stabilizing the results account. In any event, the variations are recorded in the results account.

2) Adjustment between underlying and one of the sides of the derivative

This adjustment is especially pursued for debts in a foreign currency and those derived from the coverage of the payments in a foreign currency in the affiliates of Telefónica, as a way of annulling the risk of oscillations in the interest rate in foreign currency. Nonetheless, even while seeking full coverage of the flows, the scarce depth of certain markets, in particular those associated with Latin American currencies, has meant that historically there are imbalances between the characteristics of the forms of coverage and the debts covered. The intention of Telefónica is to reduce said imbalances, as long as this does not entail disproportionate transaction costs. In this respect, if the adjustment is not possible for the reasons mentioned, it will try to modify the financial duration of the underlying in a foreign currency in such a way that the interest rate risk in foreign currency is as small as possible.

On certain occasions, the definition of the underlying to which the derivative is assigned does not coincide with the full time period of a contractual underlying.

3) Coincidence between the company that contracts the derivative and the company that holds the underlying

In general, what is sought is that the coverage derivative and the underlying one or the risk that covers are in the same company. However, other times, the coverage has been done in holding firms of the companies where the underlying is recorded (Telefónica, S.A. and Telefónica Internacional, S.A.). The main reasons for the separation mentioned between the coverage and the underlying have been the possibility of differences in the legal differences of the local coverage as compared to the international ones (as a consequence of unforeseen legal changes) and the different credit qualities of the matching entries (both of the Telefónica companies involved and those of the banking institutions).

4) Capacity of evaluation of the derivative at fair value, by means of the systems for calculating the value available at Telefónica

Telefónica uses various tools for the assessment and management of risks of the derivatives and of the debt. Amongst these we highlight the Kondor+ system, licenced by Reuters, used extensively between diverse financing institutions, as well as specialists in MRBM financial calculations.

5) Sale of options only when there is an underlying exposure

Telefónica considers the sale of options when: i) there is an underlying exposure (recorded in the statement of the consolidated financial situation or associated with a highly likely external flow) that counteracts the potential loss from the financial year for the exercising of the option by the other party, or ii) this option forms part of a structure where there is another derivative that could offset this loss. Equally, it is permitted to sell options included in structures of options where at the time of the contracting the net premium is greater than or equal to.

As an example, it is considered feasible to sell short-term options on interest rate swaps that give the other party the right to receive a particular fixed rate, lower than the level in effect at the time of selling the option. In this way, if the rates go down, part of the debt would go from a variable to a fixed rate, at lower levels than the official ones, having charged a premium.

6) Accounting of coverage

The risks whose coverage can be accounted as such are mainly:

- The variation in the market interest rates (either of the monetary rate or credit differential, or both) that influences the evaluation of the underlying, or in the determining of the flows.
- The variation in the exchange rate that modifies the valuation of the underlying on terms of the functional currency of the Company and that influences the determination of the flow with respect to the functional currency.
- The variation in the volatility associated with any financial variable, financial asset or liability, which modifies either the valuation or the determination of the flows in debts or investments with implied options, whether these are separable or not.

In relation to the underlying,

- The coverage can be for the full amount or for a part of the same.
- The risk to be covered may be for the whole period of the operation, or a time fraction of the same.
- The underlying, may be a highly likely future transaction, or a contractual underlying (a loan, a payment in foreign currency, an investment, a financial asset, etc.) or a combination of both situations that make up a definition of a more extensive underlying in terms of the period of the same.

  Thus, cases may arise in which the hedging instruments contracted have longer periods than the contractual underlyings that they are associated with. This happens when Telefónica enters into long term swaps, caps or collars, so as to protect against rises in interest rates that may raise the financial costs generated by promissory notes, trade paper and certain loans at variable rates with maturities of less than those for coverage. The probability of renewing these financing operations at a floating rate is very high and in this respect Telefónica makes the commitment to define the underlying in a more general way, such as a program of financing at floating rates whose maturity coincides with the maturity of the coverage.

The classification of the coverages may be: +Fair value coverages.

- Effective flow coverages. Such coverages may be established for any value of the risk to be covered (interest rates, exchange rates, etc.) or at a particular range of the same (interest rates between 2% and 4%, interest rate above 4%, etc). In this latter case, the options will be utilized as coverage instruments, and only the intrinsic value of the option will be recognized as an effective value, recording the variations in the temporal value of the option in results.
- Net investment coverages associated with foreign affiliates. In general, these are carried out by Telefónica S.A., and the other holding companies of Telefónica. Whenever possible, real debt in a foreign currency is used for said coverages. However, on many occasions, this will not be possible for many Latin American currencies, because the non-resident companies cannot issue debt in those currencies as it is not convertible. It may come about that the depth of the debt market in said foreign currency is not sufficient in relation to the coverage objective (for example, the Czech corona and the pound sterling) or that for an acquisition accumulated cash is used and it is not necessary to make use of the financial market. In these cases, derived instruments will be used, both forward and cross-currency swaps, to do the net investment coverages.

The coverage may comprise a set of different derivatives.

The management of the accounts coverages is not static, and the coverage relationship may change before the expiry of the coverage. The coverage relations may be altered so as to be able to carry out proper management following the principles announced of stablilizing the cash flows, the financial results and protecting the value of the own resources. Thus, the designation of the coverages may be revoked as such, before it expires, either due to a change in the underlying or due to a change in the perception of the risk in the underlying or due to a change in the vision of the markets. The derivative included in these coverages may be re-assigned to other possible new coverages that must meet the effectiveness test and be well documented. In order to measure the efficacy of the operations defined as accounts coverages, the Group carries out an analysis about to what extent the changes in the fair value or in the cash flows of the coverage element would compensate for the changes in the fair value or cash flows of the covered elements that can be attributed to the risk that it is intended to cover, utilizing the lineal regression method for this analysis for both prospective and retrospective analyses.

The guidelines of the risk management are issued by the Telefónica financial management, and implemented by the financial managers of the companies (ensuring concordance between the individual interests of the companies and those of Telefónica). The financial management can authorize deviations from this policy for justified reasons, usually due to the tightness of the markets as compared to the volume of the transactions or on risks that are clearly limited and reduced. Likewise, the entry of companies in Telefónica, as a consequence of acquisitions or mergers, requires a time for adaptation.

The breakdown of the financial results recorded in the financial years 2012, 2011 and 2010 is the following:

Millions of euros	2012	2011	2010
Income from interest	557	586	454
Dividends received	28	42	40
Other financial income	276	181	266
Costs for interest	(3,094)	(2,671)	(2,514)
Ineffectiveness of cash flow coverages	1	1	(16)
Financial updating of provisions and other liabilities	(469)	(106)	(145)
Variations in fair value of financial assets at reasonable value with changes in results	648	573	25
Variations in fair value of financial liabilities at fair value with changes in results	(550)	(808)	(39)
Transfer from equity of results for cash flow coverages	(173)	(210)	(73)
Transfers from equity of results for assets available for sale and others	(50)	(3)	(202)
Profit/(loss) for hedging derivatives of fair value	198	908	168
(Loss)/profit for the adjustment to the elements covered in fair value coverages	(145)	(747)	(211)
Other costs	(289)	(528)	(290)
Net financial result excluding differences in exchange rates and monetary correction	**(3,062)**	**(2,782)**	**(2,537)**

The breakdown of the Group derivatives at December 31, 2012, as well as their fair value at said date and the scheduled timetable of maturities is the following:

Financial Year 2012

Millions of euros	Fair value (**)	Notional value (*) Maturities				
Derivatives		2013	2014	2015	Subsequent	Total
Interest rate coverage	**367**	**(1,241)**	**(844)**	**2,552**	**3,306**	**3,773**
Cash flow coverage	1,405	(1,048)	(353)	2,547	8,222	9,368
Fair value coverage	(1,038)	(193)	(491)	5	(4,916)	(5,595)
Exchange rate coverage	**(443)**	**792**	**158**	**1,558**	**6,344**	**8,536**
Cash flow coverage	(441)	1,057	158	1,558	6.344	8,801
Fair value coverage	(2)	(265)				(265)
Interest rate and exchange rate coverage	**(389)**	**(8)**	**38**	**27**	**2,468**	**2,525**
Cash flow coverage	(248)	(53)	89	90	2,478	2,604
Fair value coverage	(141)	45	(51)	(63)	(10)	(79)
Investment coverage	**(140)**	**(1,330)**	**(280)**	**(162)**	**(1,211)**	**(2,983)**
Undesignated hedging derivatives	**(534)**	**11,366**	**(13)**	**(467)**	**(1,406)**	**9,480**
Of interest rate	(384)	8,796	(13)	(545)	(2,133)	6,105
Of exchange rate	(150)	2,570		78	727	3,375
Of interest rate and exchange rate						-

(*) For interest rate coverage, the amount of the positive sign is on fixed payment terms. For exchange rate coverage, a positive amount means payment in a functional currency as compared to foreign currency.

(**) The amount of the positive sign means payment on account.

The breakdown of the derivatives of the Group at December 31, 2011, as well as their fair value at said date and the scheduled timetable of maturities is the following:

Financial year 2011

Millions of euros	Fair value (**)	Notional value (*) Maturities				
Derivatives		**2013**	**2014**	**2015**	**Subsequent**	**Total**
Interest rate coverage	**(80)**	**(1,785)**	**668**	**825**	**8,217**	**6,275**
Cash flow coverage	867	(1,118)	1,086	(350)	11,380	10,998
Fair value coverage	(947)	(667)	(418)	(475)	(3,163)	(4,723)
Exchange rate coverage	**(962)**	**328**	**339**	**77**	**6,702**	**7,446**
Cash flow coverage	(932)	340	230	1	6,519	7,090
Fair value coverage	(30)	(12)	109	76	183	356
Interest rate and exchange rate coverage	**(613)**	**76**	**1,110**	**(45)**	**2,547**	**3,536**
Cash flow coverage	(592)	(31)	1,158	66	2,098	3,291
Fair value coverage	(21)	(45)	(48)	(111)	449	245
Investment coverage	**(81)**	**(1,427)**	**(160)**	**(280)**	**(1,313)**	**3.180**
Undesignated hedging derivatives	**(493)**	**9,375**	**(480)**	**(144)**	**(1,516)**	**7,235**
Of interest rate	(235)	8,038	(579)	(144)	(2,404)	4,911
Of exchange rate	(255)	1,338	99	-	888	2,325
Of interest rate and exchange rate	(3)	(1)	-	-	-	(1)

(*) For interest rate coverage, the amount of the positive sign is on fixed payment terms.
For exchange rate coverage, a positive amount means payment in a functional currency as compared to foreign currency.

(**) The amount of the positive sign means payment of account.

Appendix III of the Financial Report details the derived products contracted at December 31, 2012 and 2011.

Telefónica, S.A.
2012 Annual Report

This report is available on the Telefónica website at:
http://annualreport2012.telefonica.com

Shareholders may also request copies of this report from the Shareholders' Office by using the free phone number 900 111 004 (in Spain) or by sending an e-mail to: accion.telefonica@telefonica.es

Since June 2012, this report is also multi-platform/cross-platform available

Likewise, the mandatory information that must be provided under prevailing legislation is also available to shareholders and the general public.

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Telefónica

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