TELEFONICA S A
Form 20-F
April 12, 2006

As filed with the Securities and Exchange Commission on April 12, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 20-F

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2005

Commission file number: 1-9531

TELEFÓNICA, S.A.

(Exact name of Registrant as specified in its charter)

KINGDOM OF SPAIN

(Jurisdiction of incorporation or organization)

Gran Vía, 28, 28013 Madrid, Spain

(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Ordinary Shares, nominal value €1.00 per share*	**New York Stock Exchange**
American Depositary Shares, each representing three Ordinary Shares	**New York Stock Exchange**

* Not for trading, but only in connection with the listing of American Depositary Shares, pursuant to the requirements of the New York Stock Exchange.

Securities registered or to be registered pursuant to Section 12(g) of the Act: None

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Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: None

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The number of outstanding shares of each class of capital stock of Telefónica, S.A. at December 31, 2005 was:

Ordinary Shares, nominal value €1.00 per share: 4,921,130,397

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes x **No o**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes x **No o**

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer" and "large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer x **Accelerated filer o** **Non-accelerated filer o**

Indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 o **Item 18 x**

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o **No x**

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report contains statements that constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, Section 21E of the U.S. Securities Exchange Act of 1934, as amended, and the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The forward-looking statements in this Annual Report can be identified, in some instances, by the use of words such as “expect”, “aim”, “hope”, “anticipate”, “intend”, “believe” and similar language or the negative thereof or by the forward-looking nature of discussions of strategy, plans or intentions. These statements appear in a number of places in this Annual Report including, without limitation, certain statements made in “Item 3—Key Information—Risk Factors”, “Item 4—Information on the Company” and “Item 5—Operating and Financial Review and Prospects” and include statements regarding our intent, belief or current expectations with respect to, among other things:

- the effect on our results of operations of competition in the Spanish telecommunications market and our other principal markets;
- trends affecting our financial condition or results of operations;
- acquisitions or investments which we may make in the future;
- our capital expenditures plan;
- our estimated availability of funds;
- our ability to repay debt with estimated future cash flows;
- our shareholder remuneration policies;
- supervision and regulation of the Spanish telecommunications sector and of the telecommunications sectors in other countries where we have significant operations;
- our strategic partnerships; and
- the potential for growth and competition in current and anticipated areas of our business.

Such forward-looking statements are not guarantees of future performance and involve numerous risks and uncertainties, and actual results may differ materially from those anticipated in the forward-looking statements as a result of various factors. The risks and uncertainties involved in our businesses that could affect the matters referred to in such forward-looking statements include but are not limited to:

- changes in general economic, business or political conditions in the domestic or international markets in which we operate or have material investments that may affect demand for our services;
- changes in currency exchange rates and interest rates;
- the impact of current, pending or future legislation and regulation in Spain, the European Union and other countries where we operate;
- the actions of existing and potential competitors in each of our markets;
- the outcome of pending litigation; and
- the potential effects of technological changes.

Some of these and other important factors that could cause such differences are discussed in more detail under “Item 3—Key Information—Risk Factors”, “Item 4—Information on the Company”, “Item 5—Operating and Financial Review and Prospects” and “Item 11—Quantitative and Qualitative Disclosures About Market Risk”.

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Readers are cautioned not to place undue reliance on those forward-looking statements, which speak only as of the date of this Annual Report. We undertake no obligation to release publicly the result of any revisions to these forward-looking statements which may be made to reflect events or circumstances after the date of this Annual Report including, without limitation, changes in our business or acquisition strategy or planned capital expenditures, or to reflect the occurrence of unanticipated events.

CERTAIN TERMS AND CONVENTIONS

Our ordinary shares, nominal value one euro each, are currently listed on each of the Madrid, Barcelona, Bilbao and Valencia stock exchanges under the symbol “TEF”. They are also listed on various foreign exchanges such as the London, Frankfurt, Paris, Buenos Aires and Tokyo stock exchanges and are quoted through the Automated Quotation System of the Spanish stock exchanges and through the SEAQ International System of the London Stock Exchange. American Depositary Shares (“ADSs”), each representing the right to receive three ordinary shares, are listed on the New York Stock Exchange under the symbol “TEF” and on the Lima Stock Exchange. ADSs are evidenced by American Depositary Receipts (“ADRs”) issued under a Deposit Agreement with Citibank, N.A., as Depositary. Brazilian Depositary Shares (“BDSs”), each representing the right to receive one ordinary share, are listed on the São Paulo Stock Exchange. BDSs are evidenced by Brazilian Depositary Receipts (“BDRs”) issued under a Deposit Agreement with Banco Bradesco, S.A., as Depositary.

As used herein, “Telefónica”, “Telefónica Group” and terms such as “we”, “us” and “our” mean Telefónica, S.A. and it consolidated subsidiaries unless the context otherwise requires.

Following are definitions of certain technical terms used in this Annual Report:

“Access” refers to a connection to any of the telecommunications services offered by the Telefónica Group. We present our customer base using this model because the integration of telecommunications services in bundled service packages has changed the way residential and corporate customers contract for our services. Because a single customer may contract for multiple services, we believe it is more accurate to count the number of accesses, or services a customer has contracted for, as opposed to only counting our number of customers. For example, a customer that has fixed line telephony service and broadband service represents two accesses rather than a single customer: a fixed telephony access and a broadband access. The following are the main categories of accesses:

- Fixed Telephony accesses: includes PSTN lines (public switched telephone network), ISDN lines (integrated services digital network) and circuits. For purposes of calculating our number of fixed line accesses, we multiply our lines to service as follows: PSTN (x1); basic ISDN (x1); primary ISDN (x30, 20 or 10); 2/6 digital access (x30);
- Internet and data accesses: includes broadband accesses (wholesale ADSL and retail ADSL lines), narrowband accesses (internet service through the PSTN) and other accesses (unbundled local loops, circuits and other accesses including WiFi and fiber optic cable);
- Pay TV: includes cable TV and Imagenio IP TV (Internet Protocol TV); and
- Mobile accesses: includes mobile telephony.

PRESENTATION OF CERTAIN FINANCIAL INFORMATION

In this Annual Report, references to “dollars” or “$” are to United States dollars, references to “euro” or “€” are to th single currency of the participating member states in the Third Stage of the European Economic and Monetary Union pursuant to the treaty establishing the European Community, as amended from time to time.

Since January 1, 2005, our consolidated annual and interim financial statements, including our consolidated financial statements as of and for the year ended December 31, 2005, are and will be prepared in accordance with the International Financial Reporting Standards adopted by the European Union (IFRS). IFRS, as adopted by the European Union and applied by us in our consolidated financial statements as of and for the year ended

December 31, 2005, do not differ from IFRS, as published by the International Accounting Standards Board (IASB), effective as of December 31, 2005, and therefore, comply in full with IFRS, as published by the IASB. Our consolidated financial information as of and for the year ended December 31, 2004 included in our annual consolidated financial statements was restated in accordance with IFRS. For quantitative information regarding the adjustments required to reconcile our Spanish GAAP financial information to IFRS, see note 2 to our consolidated financial statements as of and for the year ended December 31, 2005 prepared under IFRS.

IFRS differs in certain significant respects from Spanish GAAP. As a result, our financial information presented under IFRS is not directly comparable to our financial information presented under Spanish GAAP, and readers should avoid such a comparison.

PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISORS

A. DIRECTORS AND SENIOR MANAGEMENT

Not applicable.

B. ADVISORS

Not applicable.

C. AUDITORS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. SELECTED FINANCIAL DATA

The following table presents selected consolidated financial data of Telefónica, S.A. You should read this table in conjunction with Item 5Operating and Financial Review and Prospects and the Consolidated Financial Statements included elsewhere in this Annual Report. The consolidated income statement data for the years ended December 31, 2004 and 2005 and the consolidated balance sheet data as of December 31, 2004 and 2005 set forth below are derived from, and are qualified in their entirety by reference to, the Consolidated Financial Statements and notes thereto included in this Annual Report. Our Consolidated Financial Statements have been prepared in accordance with IFRS, which differ in certain respects from U.S. GAAP. Please refer to note 23 to our Consolidated Financial Statements for a discussion of these differences.

The basis of presentation and principles of consolidation are described in detail in notes 2 and 4.z, respectively, to our Consolidated Financial Statements.

	As of or for the year ended December 31,	
	2004	**2005**
	(euro in millions, except per share and ADS data)	
IFRS		
Consolidated Income Statement Data		
Net sales and rendering of services	30,280.92	37,882.16
Other income	1,133.41	1,418.26
Supplies	(7,637.33)	(10,065.05)
Personnel expenses	(5,095.17)	(5,656.34)
Other expenses	(6,459.80)	(8,302.60)

Operating income before depreciation and amortization (OIBDA)	12,222.03	15,276.43
Depreciation and amortization	(5,666.03)	(6,717.68)
Operating Income	6,556.00	8,558.75
Share of profit (loss) of associates	(50.49)	(128.21)
Net financial expenses	(1,462.06)	(1,796.37)
Net exchange differences	(177.05)	162.04
Net financial income (expense)	(1,639.11)	(1,634.33)
Profit before taxes from continuing operations	4,866.40	6,796.21
Corporate income tax	(1,512.78)	(1,969.15)

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	As of or for the year ended December 31,	
	2004	2005
	(euro in millions, except per share and ADS data)	
Profit for the year from continuing operations	3,353.62	4,827.06
Profit from discontinued operations after taxes	131.97	—
Profit for the year	3,485.59	4,827.06
Minority interests	(309.92)	(381.21)
Profit for the year attributable to equity holders of the parent	3,175.67	4,445.85
Weighted average number of shares (thousands)	4,987,751	4,870,852
Earnings per share attributable to equity holders of the parent (euros)(1)(2)	0.637	0.913
Earnings per ADS(1)(2)	1.910	2.738
Weighted average number of ADS (thousands)	1,662,584	1,623,617
Consolidated Balance Sheet Data		
Cash and cash equivalents	914.35	2,213.21
Property, plant and equipment	23,193.37	27,992.60
Total assets	60,078.86	73,173.77
Non-current liabilities	27,742.58	35,126.47
Equity (net)	12,342.47	16,158.43
Book value per ordinary share (euros)	2.475	3.317
Consolidated Cash Flow Data		
Net cash provided by operating activities	10,131.13	11,139.14
Net cash used in investing activities	(5,808.16)	(9,592.02)
Net cash used in financing activities	(3,936.61)	(434.67)
Cash dividends per ordinary share (euros)	0.400	0.500

	As of or for the year ended December 31,				
	2001	2002	2003	2004	2005
	(euro in thousands)				
U.S. GAAP(3)					
Consolidated Income Statement Data					
Total revenues	31,577.20	28,912.60	27,708.40	29,854.90	35,993.30
Income (loss) before tax	(6,693.81)	(8,669.63)	3,866.05	3,947.58	6,056.12
Corporate income tax	(481.40)	3,383.16	(1,125.73)	(1,400.81)	(1,911.92)
Net income	(7,175.21)	(5,286.47)	2,740.32	2,546.77	4,144.20
Net income per share(1)	(1.403)	(1.027)	0.531	0.511	0.851
Net income per ADS(1)(2)	(4.210)	(3.082)	1.594	1.532	2.552
Consolidated Balance Sheet Data					
Total assets	90,741.77	66,905.14	61,264.42	62,455.91	76,647.79

Long-term debt	27,771.20	21,778.00	18,310.00	14,881.90	25,167.58
Shareholders equity	31,470.47	16,667.84	16,888.02	15,872.85	19,221.96
Book value per ordinary share	6.155	3.239	3.274	3.182	3.946
Consolidated Cash Flow Data					
Net cash provided by operating activities	8,995.8	9,019.5	9,558.7	10,042.7	10,891.44
Net cash used in (provided by) investing activities	(9,528.5)	(5,585.4)	(5,462.8)	(8,543.1)	(9,290.75)
Net cash used in (received from) financing activities	(1,347.0)	(2,082.0)	(4,220.0)	(2,264.6)	(803.53)
Cash dividends per ordinary share (euros)(1)	—	—	0.450	0.400	0.500

(1) The per share and per ADS computations for all periods presented have been presented using the weighted average number of shares outstanding for each period, and have been adjusted to reflect the stock dividends which occurred during the periods presented, as if these had occurred at the beginning of the earliest period presented.

(2) Each ADS represents the right to receive three ordinary shares. Figures do not include any charges of the Depositary.

(3) U.S. GAAP data for the years ended December 31, 2001, 2002, 2003 and 2004 has been restated retroactively to eliminate the monetary adjustment for inflation in hyperinflationary economies. For additional information, please refer to note 23 to our Consolidated Financial Statements included elsewhere in this document.

Exchange Rate Information

As used in this Annual Report, the term Noon Buying Rate refers to the rate of exchange for euros, expressed in U.S. dollars per euro, in the City of New York for cable transfers payable in foreign currencies as certified by the Federal Reserve Bank of New York for customs purposes. The Noon Buying Rate certified by the New York Federal Reserve Bank for the euro on April 6, 2006 was $1.2216 = 1.00.

The following tables describe, for the periods and dates indicated, information concerning the Noon Buying Rate for the euro. Amounts are expressed in U.S. dollars per 1.00.

	Noon Buying Rate			
Year ended December 31,	**Period end**	**Average(1)**	**High**	**Low**
2001	0.8901	0.8909	0.9535	0.8370
2002	1.0485	0.9495	1.0485	0.8594
2003	1.2597	1.1411	1.2597	1.0361
2004	1.3538	1.2478	1.3625	1.1801
2005	1.1842	1.2400	1.3476	1.1667

Source: Federal Reserve Bank of New York.
(1) The average of the Noon Buying Rates for the euro on the last day of each month during the relevant period.

	Noon Buying Rate	
Month ended	**High**	**Low**
October 31, 2005	1.2133	1.1914
November 30, 2005	1.2067	1.1667
December 31, 2005	1.2041	1.1699
January 31, 2006	1.2287	1.1980
February 28, 2006	1.2100	1.1860
March 31, 2006	1.2197	1.1886
April 30, 2006 (to April 6)	1.2272	1.2124

Source: Federal Reserve Bank of New York.

Monetary policy within the member states of the euro zone is set by the European Central Bank. The European Central Bank has set itself the objective of containing inflation and will adjust interest rates in line with this policy without taking account of other economic variables such as the rate of unemployment. It has further declared that it will not set an exchange rate target for the euro.

Our ordinary shares are quoted on the Spanish stock exchanges in euro. Currency fluctuations may affect the dollar equivalent of the euro price of our shares listed on the Spanish stock exchanges and, as a result, the market price of our ADSs, which are listed on the New York Stock Exchange. Currency fluctuations may also affect the dollar amounts received by holders of ADRs on conversion by the Depositary of any cash dividends paid in euro on the underlying shares.

Our consolidated results are affected by fluctuations between the euro and the currencies in which the revenues and expenses of some of our consolidated subsidiaries are denominated (principally the Brazilian real, the Argentine peso, the Chilean peso, the Peruvian nuevo sol, the Mexican dollar, the Venezuelan bolivar, the Czech kruna (crown) and the U.S. dollar). See Item 11Quantitative and Qualitative Disclosures About Market Risk.

B. CAPITALIZATION AND INDEBTEDNESS

Not applicable.

C. REASONS FOR THE OFFER AND USE OF PROCEEDS

Not applicable.

D. RISK FACTORS

In addition to the other information contained in this Annual Report, prospective investors should carefully consider the risks described below before making any investment decisions. The risks described below are not the only ones that we face. Additional risks not currently known to us or that we currently deem immaterial may also impair our business and results of operations. Our business, financial condition and results of operations could be materially adversely affected by any of these risks, and investors could lose all or part of their investment.

Risks Related to our Business

We endeavor to implement our business plans successfully, but factors beyond our control may prevent us from doing so, which could have a material adverse effect on our business.

Our ability to increase our revenues and maintain our position as a leading European and Latin American provider of advanced telecommunications and Internet services will depend in large part on the successful, timely and cost-effective implementation of our business plans.

Factors beyond our control that could affect the implementation and completion of our business plan include:

- difficulties in developing and introducing new technologies;
- declining prices for some of our services;
- the effect of increased competition;
- the effect of adverse economic trends in our principal markets;
- the effect of foreign exchange fluctuations on our results of operations;
- difficulties in obtaining applicable government, shareholder and other approvals;
- difficulties in entering into key contracts with third parties;
- our ability to establish and maintain strategic relationships;
- difficulties in integrating our acquired businesses;
- the effect of future acquisitions on our financial condition and results of operations;
- difficulties in securing the timely performance of independent contractors hired to engineer, design and construct portions of our network;

- the potential lack of attractive investment targets;
- difficulties in attracting and retaining highly skilled and qualified personnel;

- changes in regulations or the interpretation or enforcement thereof and other possible regulatory actions; and
- the effect of unanticipated network interruptions.

A material portion of our foreign operations and investments is located in Latin America, and we are therefore exposed to risks inherent in operating and investing in Latin America.

At December 31, 2005, approximately 51.2% of our assets were located in Latin America. In addition, approximately 41.5% of our revenue from operations for 2005 was derived from our Latin American operations. Our foreign operations and investments in Latin America are subject to various risks, including risks related to the following:

- government regulations and administrative policies may change quickly;
- currencies may be devalued or may depreciate or currency restrictions and other restraints on transfer of funds may be imposed;
- The effects of inflation and currency depreciation may require certain of our subsidiaries to undertake a mandatory recapitalization or commence dissolution proceedings;
- governments may expropriate assets;
- governments may impose burdensome taxes or tariffs;
- political changes may lead to changes in the business environments in which we operate;
- our operations are dependent on concessions and other agreements with existing governments; and
- economic downturns, political instability and civil disturbances may negatively affect our operations.

In addition, revenues from operations of our Latin American subsidiaries, their market value and the dividends and management fees expected to be received from them are exposed to material country risk as a result of adverse economic conditions in the region that may adversely affect demand, consumption and exchange rates.

Our financial condition and results of operations may be adversely affected if we do not effectively manage our exposure to foreign currency exchange and interest rate risk.

We are exposed to various types of market risk in the normal course of our business, including the impact of changes in foreign currency exchange rates, as well as the impact of changes in interest rates. We employ risk management strategies to manage this exposure, in part through the use of financial derivatives such as foreign currency forwards, currency swap agreements and interest rate swap agreements. In particular, in order to limit our exposure to Latin American currency exchange rate fluctuations, we use financial derivatives and other instruments. We also use derivatives and funding in foreign currencies in order to hedge our exposure to the Czech crown and the British pound, following our acquisitions of Cesky Telecom and O2, respectively. If the financial derivatives market is not sufficiently liquid for our risk management purposes, or if we cannot enter into arrangements of the type and for the amounts necessary to limit our exposure to currency exchange rate fluctuations, such failure could adversely affect our financial condition and results of operations. Also, our other risk management strategies may not be successful, which could adversely affect our financial condition and results of operations. For a more detailed description of our financial derivatives transactions, see “Item 11—Quantitative and Qualitative Disclosures About Market Risk” and note 15 to our Consolidated Financial Statements.

We are exposed to increased liquidity and solvency risks following our acquisition of O2, thereby increasing our vulnerability to capital markets and business downturns, and reducing our strategic flexibility.

We financed our entire acquisition cost of O2 with £17.9 billion (approximately 26.4 billion calculated based on a euro-pound exchange rate of 1.47 = 1.00 on October 31, 2005) of debt incurred under a credit facility. As a result, our leverage has increased, and our credit ratings have decreased following recent downgradings by the credit rating agencies. The credit facility has two tranches: one of which has a one-year maturity, which may be extended to two years and to two and a half years (with respect to 50% of the amount of such tranche); and the other which has a three-year maturity. Accordingly, we will be obligated to repay the entire principal amount of such debt within such period, unless we are able to refinance such debt with longer term debt. Although we have refinanced a portion of our outstanding borrowings under the credit facility through the issuance in January 2006 of approximately £4 billion aggregate principal amount of long-term bonds that mature in 2011, 2016, 2018 and 2026, we continue to have substantial refinancing needs. As of April 6, 2006, £14.175 billion (approximately 20.2 billion calculated based on a euro-pound exchange rate of 0.70060 = 1.00 on April 5, 2006) was outstanding under these credit facilities.

If our business performance deteriorates significantly, we may not be able to repay the debt maturing in the next three years with generated free cash flow plus other committed credit lines, or issue long-term debt in an amount sufficient to refinance our outstanding debt as it matures. Additional credit ratings downgrades by the credit ratings agencies could limit substantially our ability to borrow long term debt in the capital markets and thus make it more difficult to refinance the outstanding amount under the facility or increase significantly our cost of funding.

Our goal to reduce our leverage over the coming years may diminish our ability to face competitive threats, take advantage of attractive acquisition opportunities or follow a strategy requiring substantial cash consumption. If our leverage reduction goal is not met, our lenders could seek to reduce their loans to us and may refrain from granting further credit.

For a more detailed description of our liquidity risk, see Item 11Quantitative and Qualitative Disclosures About Market Risk.

The development of our business could be hindered if we fail to maintain satisfactory working relationships with our partners.

Some of our operations are conducted through joint ventures in which we own a significant, but less than controlling, ownership interest. For example, Brasilcel in Brazil, which is jointly controlled by Telefónica Móviles and Portugal Telecom, is conducted through a joint venture. As a result of our less than controlling interest in these joint ventures, our company does not have absolute control over the operations of the venture.

In addition, in some cases where we own a majority of the joint venture, we may be subject to provisions in shareholders agreements restricting our ability to control the joint venture. The relevant corporate governance provisions vary from joint venture to joint venture and often depend upon the size of our investment relative to that of the other investors, our experience as a telecommunications operator in the relevant jurisdiction compared to that of the other investors and the preference or requirement of foreign governments that local owners hold an interest in licensed telecommunications operators. As a result, in these cases we must generally obtain the cooperation of our partners in order to implement and expand upon our business strategies and to finance and manage our operations.

The risk of disagreement or deadlock is inherent in jointly controlled entities, and there is the risk that decisions against our interests will be made and that we may not realize the expected benefits from our joint ventures, including economies of scale and opportunities to realize potential synergies and cost savings. In addition, our joint venture partners may choose not to continue their partnerships with us. Moreover, changes in control of our partners could affect our relationships with them and the management of the joint ventures.

The costs and difficulties of acquiring and integrating businesses could impede our future growth, adversely affect our competitiveness and adversely affect our results of operations.

We may enter into, and have recently consummated, acquisition transactions in order to, among other things, provide services in countries in which we do not currently have operations, take advantage of growth opportunities or enhance our product portfolio in a market where we currently have operations, as we have recently done. Such recent acquisitions include: Telefónica Móviles’ acquisition of BellSouth’s wireless operations in Latin America;

the acquisition by Telefónica of Cesky Telecom in the Czech Republic; and the acquisition of substantially all of the shares of O2 by Telefónica in January 2006 pursuant to a cash tender offer.

These and our future acquisitions may expose us to certain risks, including the following:

- the difficulty of assimilating the operations, information technology systems and personnel of the acquired entities;
- the difficulty of operating in new countries in Europe where we have not previously had operations and where, for example, business practices may exist that are different from those in Spain and Latin America;
- the potential disruption to our ongoing business caused by senior management□s focus on the acquisition;
- our failure to incorporate successfully licensed or acquired technology into our network and product offerings;
- our acquisition of O2 may not be integrated successfully;
- the expected cost savings and any other synergies from an acquisition may take longer to realize than expected or may not be fully realized;
- the failure to maintain uniform standards, controls, procedures and policies; and
- the impairment of relationships with employees as a result of changes in management and ownership.

We cannot assure you that we will be successful in overcoming these risks, and our failure to overcome these risks could have a negative effect on our business, financial condition and results of operations.

We may be adversely affected by unanticipated network interruptions.

Unanticipated network interruptions as a result of system failures whether accidental or otherwise, including due to network, hardware or software failures, that affect the quality of, or cause an interruption in, our service could result in customer dissatisfaction, reduced revenues and traffic, and costly repairs and could harm our reputation. Although we carry business interruption insurance, our insurance policy may not provide coverage in amounts sufficient to compensate us for any losses we incur.

Risks Relating to our Industry

We face intense competition in most of our markets, which could result in decreases in current and potential customers, revenues and profitability.

We face significant competition in all of the markets in which we operate. Thus, we are subject to the effects of actions by our competitors in the markets where we have operations. Our competitors could:

- offer lower prices, more attractive discount plans or better services and features;
- develop and deploy more rapidly new or improved technologies, services and products;
- bundle offerings of one type of service with others;
- in the case of the wireless industry, subsidize handset procurement; or
- expand and enhance more rapidly their networks.

Furthermore, some of our competitors in certain markets have, and some potential competitors may enjoy, competitive advantages, including the following:

- greater name recognition;

- greater financial, technical, marketing and other resources;
- larger customer bases; and
- well-established relationships with current and potential customers.

To compete effectively with our competitors, we will need to market successfully our services and anticipate and respond to various competitive factors affecting the relevant markets, such as the introduction of new products and services by our competitors, pricing strategies adopted by our competitors, changes in consumer preferences and general economic, political and social conditions. If we are unable to compete effectively with our competitors, it could result in price reductions, lower revenues, under-utilization of our services, reduced operating margins and loss of market share.

We operate in a highly regulated industry and could become subject to more burdensome regulation, which could adversely affect our businesses.

As a multinational telecommunications company, we are subject to different laws and regulations in each of the jurisdictions in which we provide services. Furthermore, the licensing, construction, operation and interconnection arrangements of our communications systems are regulated to varying degrees by national, state, regional, local and supranational authorities, such as the European Union. These authorities could adopt regulations or take other actions that could adversely affect us and our companies, including revocation of any of our licenses or concessions to offer services in a particular market, failure to renew a license or concession, modification of the terms of a license or concession or the granting of new licenses or concessions to competitors, changes in the regulation of international roaming prices and mobile termination rates, introduction of virtual mobile operators and regulation of mobile data services. Increased or significant changes in the regulation of the activities of our operating companies, including the regulation of rates that may be charged to customers for services, could have a material adverse effect on our business, financial condition and results of operations.

Regulatory policies applicable in many of the countries in which we operate generally favor increased competition in most of our market segments, especially in the fixed line and wireless service industries, including by granting new licenses in existing licensed territories in order to permit the entry of new competitors. These regulatory policies are likely to have the effect, over time, of reducing our market share in the relevant markets in which we operate. In addition, because we hold leading market shares in many of the countries in which we operate, we could face regulatory actions by national or, in Europe, European Union antitrust or competition authorities if it is determined that we have prevented, restricted or distorted competition. These authorities could prohibit us from making further acquisitions or continuing to engage in particular practices or impose fines or other penalties on us, which, if significant, could harm our financial performance and future growth. For a complete description of the regulatory proceedings we currently face, please see Item 8Financial InformationLegal Proceedings.

We operate under license and concession contracts.

Most of our operating companies require licenses or concessions from the governmental authorities of the countries in which they operate. These licenses and concessions specify the types of services permitted to be offered by our operating companies. The continued existence and terms of our licenses and concessions are subject to review by regulatory authorities in each country and to interpretation, modification or termination by these authorities. The terms of these licenses granted to our operating companies and conditions of the license renewal vary from country to country. Although license renewal is not usually guaranteed, most licenses do address the renewal process and terms, which we believe we will be able to satisfy. As licenses approach the end of their terms, we intend to pursue their renewal as provided by each of the license agreements.

Many of these licenses and concessions are revocable for public interest reasons. The rules of some of the regulatory authorities with jurisdiction over our operating companies require us to meet specified network build-out requirements and schedules. In particular, our existing licenses and concessions typically require that we satisfy certain obligations, including minimum specified quality, service and coverage conditions and capital investment. Failure to comply with these obligations could result in the imposition of fines or revocation or forfeiture of the

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license for the relevant area. In addition, the need to meet scheduled deadlines may require our companies to expend more resources than otherwise budgeted for a particular network build-out.

The industry in which we operate is subject to rapid technological changes, and if we are unable to adapt to such changes our ability to provide competitive services could be materially adversely affected.

The telecommunications industry is in a period of rapid technological change. Our future success depends, in part, on our ability to anticipate and adapt in a timely manner to technological changes. We expect that new products and technologies will emerge and that existing products and technologies will further develop. These new products and technologies may reduce the prices for our services or they may be superior to, and render obsolete, the products and services we offer and the technologies we use, and may consequently reduce the revenues generated by our products and services and require investment in new technology. Our most significant competitors in the future may be new entrants to our markets who are not burdened by an installed base of older equipment. In addition, we may be subject to competition in the future from other companies that are not subject to regulation as a result of the convergence of telecommunications technologies. As a result, it may be very expensive for us to upgrade our products and technology in order to continue to compete effectively with new or existing competitors. Such increased costs could adversely affect our business, financial condition and results of operations.

Our business depends on the upgrading of our existing networks.

We must continue to upgrade our existing wireless and fixed line networks in a timely and satisfactory manner in order to retain and expand our customer base in each of our markets, to enhance our financial performance and to satisfy regulatory requirements. Among other things, we could be required to:

- upgrade the functionality of our networks to permit increased customization of services;
- increase coverage in some of our markets;
- expand and maintain customer service, network management and administrative systems; and
- upgrade older systems and networks to adapt them to new technologies.

Many of these tasks are not entirely under our control and may be affected by applicable regulation. If we fail to execute them successfully, our services and products may be less attractive to new customers and we may lose existing customers to our competitors, which would adversely affect our business, financial condition and results of operations.

Our business could be adversely affected if our suppliers fail to provide necessary equipment and services on a timely basis.

We depend upon a small number of major suppliers for essential products and services, mainly network infrastructure. These suppliers may, among other things, extend delivery times, raise prices and limit supply due to their own shortages and business requirements. If these suppliers fail to deliver products and services on a timely basis, our business and results of operations could be negatively affected. Similarly, interruptions in the supply of telecommunications equipment for our networks could impede network development and expansion, which in some cases could adversely affect our ability to satisfy our license requirements.

The wireless industry may be harmed by reports suggesting that radio frequency emissions cause health problems.

Media and other reports have suggested that radio frequency emissions from wireless handsets and base stations may cause health problems. If consumers harbor health-related concerns, they may be discouraged from using wireless handsets. While we are not aware that such health risks have been substantiated, there can be no assurance that these concerns could have an adverse effect on the wireless communications industry and, possibly, expose wireless providers, including us, to litigation. Even if the authorized health institutions confirm there is no scientific evidence of adverse health effects, we cannot assure you that further medical research and studies will refute a link between the radio frequency emissions of wireless handsets and base stations and these health concerns.

Government authorities could increase regulation of wireless handsets and base stations as a result of these health concerns and wireless companies, including Telefónica Móviles and O2, could be held liable for costs or damages associated with these concerns, which could have an adverse effect on our business, financial condition and results of operations. In Spain, for example, Telefónica Móviles was required by law to test and certify the emissions of all its base stations in or close to populated areas. For the year ended December 31, 2005, such tests have again confirmed lower emission levels than those required by Royal Decree 1066/2001, which approves the regulation and which establishes the conditions for the protection of the public spectrum domain, restrictions for radio frequency emissions and measures for protection against radio frequency emissions. If in the future Telefónica Móviles fails to comply fully with these standards, it could be subject to claims or regulatory actions.

Other Risks

We face risks associated with litigation.

We are party to lawsuits and other legal proceedings in the ordinary course of our business. An adverse outcome in, or any settlement of, these or other lawsuits (including any that may be asserted in the future) could result in significant costs to us. In addition, our senior management may be required to devote substantial time to these lawsuits which they could otherwise devote to our business. For a more detailed description of current lawsuits, see “Item 8—Financial Information—Legal Proceedings”.

ITEM 4. INFORMATION ON THE COMPANY

A. HISTORY AND DEVELOPMENT OF THE COMPANY

Overview

Telefónica, S.A. is a corporation duly organized and existing under the laws of the Kingdom of Spain, incorporated on April 19, 1924. We are:

- a diversified telecommunications group which provides a comprehensive range of services, mainly in Spain and 13 countries in Latin America, through one of the world’s largest and most modern telecommunications networks;
- mainly focused on providing fixed and mobile telephony services and using broadband as a means to develop each of these businesses; and
- expanding our presence in Europe, following our acquisition of substantially all of the shares of O2 in January 2006 and our acquisition of a majority stake in Cesky Telecom in June 2005.

The following significant events occurred in 2005:

- In January 2005, Telefónica Móviles completed the acquisition of 100% of BellSouth Chile and BellSouth Argentina (Movicom).
- In June 2005, we acquired a majority stake in Cesky Telecom. We have consolidated Cesky Telecom’s results of operations in our Consolidated Financial Statements since July 2005. The acquisition of Cesky Telecom, the leading operator of fixed telephony and mobile telephony in the Czech Republic, will serve as a platform for us to further develop our business in Europe.
- In July 2005, Terra Networks was merged into Telefónica. This merger was intended to allow us to enhance our business model based on the integration of fixed line telephony and Internet services, following the market’s evolution towards broadband services.

- In November 2005, we announced our agreement to acquire O2 plc, a U.K. mobile telephony provider with operations in the United Kingdom, Germany, Ireland and The Isle of Man. See “—Recent Developments”.

Business Lines

In 2005, we reorganized the structure of our business lines to reflect the Groups new multinational scope and the integration of new businesses that we have recently acquired. The objectives of this new structure are to: (i) seek to take advantage of newly-created opportunities for synergies among our businesses; (ii) continue to transform Telefónica into a customer-service oriented company with a special focus on delivering high quality customer service and innovation; and (iii) continue developing and offering integrated telecommunications solutions to each customer segment.

In 2005, our principal business lines were:

- Telefónica de España: fixed line telephony in Spain;
- Telefónica Móviles: mobile telephony in Spain and Latin America;
- Telefónica Latinoamérica: fixed line telephony in Latin America;
- Cesky Group: integrated telecommunications services in the Czech Republic;
- Telefónica Contenidos: audio-visual media and content in Europe and Latin America;
- Directories Business: publication, development and sale of advertising for telephone directories in Europe and Latin America; and
- Atento: call centers in Europe, Latin America and North Africa.

In order to integrate O2 into the Telefónica Group, in 2006 we expect to add a new business line that will be principally comprised of O2 and will also include Cesky Telecom and Telefónica Deutschland. All other subsidiaries that are not part of our core business lines, including Telefónica Publicidad e Informacion, S.A., (see Recent Developments) Endemol Entertainment Holding N.V., Telefónica Contenidos, S.A. and Telefónica Servicios Audiovisuales will be managed by our Director of Affiliates.

In addition, on March 29, 2006, our Board of Directors approved a merger plan for the acquisition of Telefónica Móviles, S.A. by Telefónica, S.A. The Board of Directors of Telefónica Móviles also approved the merger plan. The merger is subject to approval by our shareholders and the shareholders of Telefónica Móviles.

The following chart shows the organizational structure of the principal subsidiaries of the Telefónica Group at December 31, 2005, including their jurisdictions of incorporation and our ownership interest.

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Telefónica, S.A., the parent company of the Telefónica Group, also operates as a holding company with the following objectives:

- coordinate the group□s activities;
- allocate resources efficiently among the group;
- provide managerial guidelines for the group;
- manage the portfolio of businesses;
- provide cohesion within the group; and
- foster synergies among the group□s subsidiaries.

Our principal executive offices are located at Gran Vía, 28, 28013 Madrid, Spain, and our telephone number is (34) 91-584-03-06.

Capital Expenditures and Divestitures

Our principal capital expenditures during the three years ended December 31, 2005 consisted of additions to property, plant and equipment and additions to intangible assets. In 2003, 2004 and 2005, □3,705.8 million, □3,768.1 million and □5,468.6 million, respectively, was invested.

Year Ended December 31, 2005

In 2005, capital expenditures increased by 45.1% from 2004, principally due to expenditures relating to growth initiatives in Spain and Latin America related to our broadband business, increases in the capacity of our mobile telephony networks, the rollout of our UMTS network in Spain, technological developments in Latin America, the investment made in Distrito C (the future Telefónica Group headquarters in Madrid) and the capital expenditures of Cesky Telecom, which we consolidate as from July 2005. Our principal capital expenditures in 2005 included investments in:

- intangible assets (□1,077.32 million)
- property, plant and equipment made by Telefónica Latinoamérica (□903.6 million)
- property, plant and equipment made by Telefónica de España (□1,141.2 million)
- property, plant and equipment made by Telefónica Móviles (□1,889.9 million)
- property, plant and equipment made by Cesky Telecom (□119.7 million)

Year Ended December 31, 2004

In 2004, capital expenditures increased by 1.7% from 2003, principally due to expenditures by Telefónica Móviles on networks and technology for our mobile businesses in Spain, Brazil, Argentina and Mexico and investments by Telefónica Latinoamérica to further develop our broadband network for our Latin America fixed line business. Our principal capital expenditures in 2004 included:

- intangible assets (□594.1 million)
- property, plant and equipment made by Telefónica Latinoamérica (□680.6 million)

- property, plant and equipment made by Telefónica de España (965.4 million)
- property, plant and equipment made by Telefónica Móviles (1,352.3 million)

Year Ended December 31, 2003

In 2003, capital expenditure decreased by 5.6% from 2002, due to a more controlled and conservative investment policy implemented in 2003. Each of our principal business lines maintained a policy of reduced capital expenditure compared to the prior year, with the exception of our worldwide mobile business as a result of the rollout of GSM networks in Mexico and Chile. Telefónica de España and Telefónica Latinoamérica have maintained their policy of focusing capital expenditures on the development of broadband technology while maintaining the necessary capital expenditures for their traditional business. Our principal capital expenditures in 2003 included:

- intangible assets (806.5 million)
- property, plant and equipment made by Telefónica Latinoamérica (504.5 million)
- property, plant and equipment made by Telefónica de España (1,804.4 million)
- property, plant and equipment made by Telefónica Móviles (996.9 million)
- property, plant and equipment made by Telefónica Empresas (100.3 million)

Financial Investments and Divestitures

Our principal financial investments in 2005 were made by Telefónica, S.A. (3,662.5 million for the acquisition of Cesky Telecom a.s. and 1,265.8 million for the acquisition of 4.97% of O2 Plc (O2) through open market purchases), and Telefónica Internacional (424.5 million for the acquisition of 5.0% of China Netcom Group Corporations outstanding shares through open market purchases). Our principal financial divestiture in 2005 was the sale of a 25% interest in Endemol Entertainment Holding, N.V.

Our principal financial investments in 2004 were made by Telefónica Móviles ($5,850 million for the acquisition of certain BellSouth companies, a portion of the acquisition price of which was paid in January 2005) and Telefónica, S.A. (530.8 million, which included 475.1 million for additional acquisitions of Portugal Telecom shares). Our principal financial divestitures in 2004 were the sale of Lycos, Inc. and Pearson Plc by Terra Networks S.A. and Telefónica Contenidos, respectively.

Our principal financial investments in 2003 were made by Telefónica, S.A. (1,528.5 million, which included 1,029.6 million from acceptances to our tender offer for Terra Networks shares), Telefónica Contenidos (708.6 million) and Telefónica Móviles (567.4 million). Our principal financial divestitures in 2003 were the overall divestiture of our interest in Antena 3 TV and the sale of our interests in Sonda, 3G Telecommunications and Inmarsat by Telefónica Internacional, Telefónica Móviles and Telefónica de España, respectively.

Public Takeover Offers

On March 29, 2006, the Boards of Directors of Telefónica, S.A. and Telefónica Móviles, S.A. approved a merger plan which provides for the merger of the two companies. The exchange ratio was set at four ordinary shares of Telefónica, S.A. for every five shares of Telefónica Móviles, S.A.

On October 31, 2005, we commenced a public tender offer for all of the outstanding shares of O2, a U.K. mobile services provider, for a total of approximately £17.9 billion (approximately 26.4 billion calculated based on a euro-pound exchange rate of 1.00 = £0.6767 on October 31, 2005). On January 10, 2006, we received clearance for our acquisition of O2 plc from the European Commission, subject to Telefónica Móviles withdrawal from the European mobile operators alliance, Freemove, and its agreement not to rejoin such alliance in the future without the European Commissions prior consent. On January 23, 2006, we made our tender offer for O2 plc unconditional in accordance with the rules of the U.K. City Code on Takeovers and Mergers. As of March 30, 2006, after the expiration of our tender offer for O2, we owned an aggregate of approximately 98.6% of O2 plcs issued share capital. We will consolidate O2 in our Consolidated Financial Statements as from January 31, 2006.

On March 29, 2005, Telefónica submitted a binding bid to purchase 51.1% of the share capital of the Czech telecommunications company, Cesky Telecom a.s., from the Czech government in an auction as part of a privatization process. The bid price submitted by Telefónica was CZK502 per share, representing a total value of 2,745.9 million for the Czech governments 51.1% of the share capital of Cesky Telecom a.s. The privatization commission formed by the Czech government for the privatization process issued a non-binding recommendation that the government of the Czech Republic accept Telefónicas bid. On April 6, 2005, the government of the Czech

Republic declared officially that Telefónicas bid was the winner of the auction through which the privatization was being conducted. On April 12, 2005, we signed an agreement with the Czech government to purchase its 51.1% stake in Cesky Telecom a.s. As a result of our acquisition of the Czech governments 51.1% stake in Cesky Telecom a.s., we were required to conduct a public tender offer for all of the remaining outstanding shares of Cesky Telecom a.s. Pursuant to the tender offer, we acquired an additional 18.3% interest in Cesky Telecom a.s. for approximately 911 million. As of December 31, 2005, we held a 69.4% interest in Cesky Telecom.

On February 23, 2005, the Boards of Directors of Telefónica and Terra Networks approved a merger plan which provides for the merger of the two companies, with the termination through dissolution without liquidation of Terra Networks and the *en bloc* transmission of all of its assets to Telefónica, which through universal succession will acquire the rights and obligations of Terra Networks. The exchange ratio was set at two ordinary shares of Telefónica for every nine ordinary Terra Networks shares. Each of Telefónicas and Terra Networks General Shareholders Meetings held on May 31, 2005 and June 1, 2005, respectively, approved the merger plan for the acquisition of Terra Networks by Telefónica, which was effected on July 16, 2005.

In August 2004, Brasilcel launched tender offers for part of the outstanding shares of Tele Sudeste Celular Participações S.A., or TSD, Tele Leste Celular Participações S.A., or TBE, Celular CRT Participações S.A., or CRT, and TCO directly and indirectly through its subsidiary TCP, which concluded in October 2004. As a result of the shares acquired in the tender offers, Brasilcels stakes in these companies share capital increased to 90.9% in TSD, 50.6% in TBE and 67.0% in CRT, and TCPs stake in TCO increased to 32.9% . The aggregate amount of consideration paid for such shares was approximately R$607 million for Brasilcel and approximately R$902 million for TCP.

On May 25, 2003, Telesp Celular Participaço s S.A., or TCP, launched a tender offer for the common shares of Centro Oeste Celular Participações S.A., or TCO, not owned by it at that date. The acceptance period finished on November 18, 2003. As a result of the shares tendered, TCP acquired 72.2% of TCOs outstanding common shares for R$16.73 per 1,000 common shares. The total purchase price for the TCO shares acquired was R$538.8 million. At December 31, 2003, TCP held 86.6% of TCOs ordinary shares, representing a 28.29% interest in TCO. TCP also announced the intention to launch an exchange offer for the remaining shares of TCO through which TCP would have become TCOs sole shareholder. This would have been followed by a merger of TCO into TCP. After the launch of the exchange offer, the *Commissão de Valores Mobiliários,* the Brazilian Securities Commission raised questions as to the exchange offers compliance with Brazilian law. Although TCP and TCO believed that the exchange offer complied with applicable law, TCP and TCO decided to terminate the exchange offer in January 2004.

On May 28, 2003, we launched a tender offer for 100% of the outstanding shares of Terra Networks that we did not own at that date. The *Comisión Nacional del Mercado de Valores*, or CNMV, approved the prospectus for the tender offer on June 19, 2003. The offer price was 5.25 per share, payable in cash. Following the tender offer, we held 71.97% of the outstanding shares of Terra Networks.

Recent Developments

The principal events that have occurred since December 31, 2005 are set forth below.

- On April 7, 2006, Telefónica announced that it has won the auction conducted by the Colombian government for a majority stake in Colombia Telecom (representing 50% plus one of the companys outstanding shares) for 853,577 million Colombian pesos (approximately $368 million). Telefónica expects the acquisition of such shares to occur on or about April 24, 2006. Colombia Telecom is a Colombian fixed line telecommunications company.

- On March 1, 2006, Cesky Group announced the approval of its board of directors intention to integrate its fixed line and mobile operations into a new, integrated telecommunications operator (Telefónica O2 Czech Republic, a.s.).

- At its meeting on March 29, 2006, the Board of Directors of Telefónica, S.A. decided to tentatively schedule the Annual General Shareholders Meeting for June 20, 2006, on first call, or on June 21, 2006, on second call. At the same meeting, the Board of Directors accepted the resignation of Mr. Miguel Horta e Costa from the Board of Directors.

- On March 29, 2006, the Board of Directors of Telefónica, S.A. and Telefónica Móviles, S.A. approved a Merger Plan for the merger of Telefónica, S.A. and Telefónica Móviles, S.A. and the *en bloc* transmission of Telefónica Móviles, S.A.s net worth to Telefónica, S.A. Telefónica, S.A. will acquire by universal succession, all rights and obligations of Telefónica Móviles, S.A. The Merger Plan is subject to the approval of the respective general shareholders meetings of Telefónica, S.A. and Telefónica Móviles, S.A.

  The exchange ratio for shares of the companies participating in the merger shall be four ordinary shares of Telefónica, S.A., nominal value 1.00 each, for every five ordinary shares of Telefónica Móviles, S.A., nominal value 0.50 each, with no supplemental cash compensation. In addition, the Merger Plan sets forth the distribution by Telefónica Móviles, S.A. of an extraordinary dividend charged against the issue premium reserve and other distributable reserves for a gross amount of 0.085 per share and an interim extraordinary dividend, charged against the results obtained from January 1, 2006 to March 28, 2006, in a gross amount of 0.35 per share.

  Telefónica, S.A. plans to increase its share capital by the exact amount needed to make the exchange for Telefónica Móviles S.A. shares in accordance with the exchange ratio established in the merger plan. The maximum amount of the capital increase to be effected by Telefónica pursuant to the established exchange ratio may be reduced through the delivery to Telefónica Móviles shareholders of shares held in Telefónicas treasury.

  In compliance with the terms of Section 226 of the Commercial Registry Regulations (*Reglamento del Registro Mercantil*), a copy of the Merger Plan was filed with the Commercial Registry of Madrid on April 3, 2006.

- On February 28, 2006, the Board of Directors of Telefónica resolved to explore strategic alternatives in relation to Telefónicas holding in the share capital of Telefónica Publicidad e Información, S.A(TPI), which operates our directories business, including a possible total or partial divestiture of its holdings in that company. Telefónica intends to explore such a sale with potential buyers.

- The Board of Directors of Telefónica, S.A. at its meeting held on February 28, 2006, approved the distribution of an interim dividend from 2005 net income of 0.25 for each outstanding share with the right to receive dividends of the Company. The payment of this dividend will be effected on May 12, 2006. It is also the Boards intention to pay a further dividend of the same amount per share in the course of 2006, in accordance with the shareholder remuneration policy approved by the Companys Board of Directors. See Cautionary Statement Requiring Forward-Looking Statements.

- On February 22, 2006, at each of the Telesp Celular Participações S.A. (TCP), Tele Centro Oeste Celular Participações S.A. (TCO), Tele Sudeste Celular Participações S.A. (TSD), Tele Leste Celular Participações S.A. (TLE) and Celular CRT Participações S.A. (CRTPart) general shareholders meetings a restructuring was approved that will be effected by (i) exchanging TCO shares for TCP shares in order for TCO to consequently become a wholly owned subsidiary of TCP and (ii) the absorption of TSD, TLE and CRTPart by TCP.

- Following the expiration of our tender offer for O2, we now own substantially all of the shares of O2. O2 is a leading provider of mobile communications services in Europe, providing services in the United Kingdom, Germany, Ireland and the Isle of Man. For information on O2s business, see —B. Business Overview—O2.

B. BUSINESS OVERVIEW

At December 31, 2005, the Telefónica Groups total accesses increased 24.3% to 153.5 million from 123.5 million as at December 31, 2004. See Certain Terms and Conventions. This increase in accesses is due in part to

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the acquisition of the former BellSouth mobile operators in Argentina and Chile (together, an aggregate of 3.8 million accesses) in January 2005 and the acquisition of Cesky Telecom (an aggregate of 8.3 million accesses) in June 2005. Total accesses includes 99.1 million mobile, 40.9 million fixed telephony accesses, 12.9 million Internet and data accesses and 0.7 million pay TV accesses.

The following table shows our total accesses as at the dates indicated.

	At December 31,		
	2004	**2005**	**% Change**
Fixed telephony accesses	37,768.5	40,859.0	8.2
Internet and Data accesses	10,872.2	12,859.9	18.3
Narrowband	5,672.5	5,166.9	(8.9)
Broadband	4,736.7	6,902.7	45.7
Other accesses (1)	463.0	790.3	70.7
Pay TV	410.7	683.2	66.3
Mobile accesses	74,441.4	99,124.0	33.2
Total Accesses	123,492.8	153,526.0	24.3

(1) Includes broadband cable accesses in El Salvador, wireless fidelity (Wi-Fi) accesses, satellite accesses in Latin America, broadband fiber optics and leased circuits.

Telefónica de España—Spanish Fixed Line Business

Our Spanish fixed line business is managed by Telefónica de España. The principal companies of the Telefónica de España group are:

- Telefónica de España, the parent company;
- Telefónica Data España;
- Telyco;
- Telefónica Telecomunicaciones Públicas;
- Terra Networks España;
- Telefónica Soluciones;
- Telefónica Soluciones Sectoriales; and
- Telefónica Cable.

The principal services offered by Telefónica de España are:

- Traditional fixed line telecommunication services, principally including PSTN (public switched telephone network) lines; ISDN (integrated services digital network) access; public telephone services; local, domestic and international long distance and fixed-to-mobile communications services; corporate communications services; supplementary value-added services (including call waiting, call forwarding, voice and text messaging, advanced voicemail services and conference-call facilities); video telephony; intelligent network services; leasing and sale of terminal equipment; and telephony information service.

- Internet and broadband multimedia services, principally including narrowband switched access to Internet; Internet service provider (ISP) service; portal and network services; retail and wholesale broadband access, through asymmetrical digital subscriber line (ADSL) and satellite technologies; residential-oriented value-added services (including instant messaging, concerts and video clips by streaming, e-learning, parental control, firewall, anti-virus and content delivery); IP TV service (Imagenio) and Voice over Internet protocol (VoIP) services.

- Data and business-solutions services, principally including leased lines; virtual private network (VPN) services; fiberoptics services; hosting and application service provider (ASP) service, including web hosting, managed hosting, content delivery and application, and security services; outsourcing and consultancy services, including network management (CGPs) and desktop services and system integration and professional services.

- Wholesale services for telecommunication operators, principally including domestic interconnection services; international wholesale services; leased lines for other operators network deployment; and local loop leasing under the unbundled local loop regulation framework.

Operations

The following table shows the development of Telefónica de Españas domestic telecommunications network and growth in usage of that network since 2003:

	As of or for the year ended December 31,		
	2003	**2004**	**2005**
Fixed telephony accesses (in thousands)	16,510.1	16,334.8	16,135.6
Pre-selected lines (in thousands)	2,279.0	2,379.5	2,284.6
Shared access local loops (in thousands)	0.004	37.7	279.0
Fully unbundled local loops (in thousands)	16.3	78.4	155.7
Narrowband accesses (in thousands)	2,722.9	2,263.5	1,614.9
Broadband connections (in thousands)	1,660.6	2,492.7	3,441.6
Retail Broadband connections (in thousands)(1)	1,070.5	1,614.5	2,719.7(1)
IPTV (Imagenio) connections (in thousands)	N/A	6.0	206.6
Average time for the provision of the PSTN service (days)	10.9	18.6	20.4
Lines in service per employee(2)	515.4	566.0	623.5
Average consumption per line (minutes/day)	21.8	19.7	17.8
Market growth of fixed line voice traffic (%)	(0.7)	(5.0)	(3.1)
Volume of fixed line voice traffic (in millions of minutes)	131,897	123,026	110,207
Volume of outgoing fixed line voice traffic (in millions of minutes)	80,822	68,787	59,418
Volume of incoming fixed line voice traffic (in millions of minutes)	51,075	54,239	50,789
Growth of outgoing fixed line voice traffic (%)	(12.6)	(14.9)	(13.6)
Growth of outgoing fixed line international traffic (%)	(1.4)	4.0	13.5
Growth of incoming fixed line international traffic (%)	3.4	3.3	3.3
Growth of fixed-to-mobile traffic (%)	2.2	(1.3)	(1.6)
Growth of outgoing internet traffic (%)	(18.9)	(22.5)	(27.8)
Growth of incoming traffic (%)	14.8	6.2	(6.4)

(1) Includes accesses of the former Terra Networks group companies in Spain.
(2) For 2004 and 2005, this line item includes employees of Telefónica de España, S.A. (the parent company of the Telefónica de España group) and Telefónica Data España. Lines include unbundled loops.

In 2005, voice and Internet traffic decreased mainly as a result of a decrease in local calls and calls for Internet access as well as decreases in incoming traffic from other operators. The number of minutes consumed in 2005 decreased by 10.4% to 110,207 million minutes in 2005 from 123,026 million minutes in 2004. The decrease in minutes consumed in 2005 was mainly due to a 9.6% decrease in minutes per line per day to 17.8 minutes in 2005 from 19.7 minutes in 2004, mainly due to a decrease in minutes per day per line of traditional and incoming traffic.

Outgoing traffic, which includes voice and Internet calls, accounted for 53.9% of Telefónica de España□s total traffic in 2005. Outgoing traffic decreased by 13.6% to 59,418 million minutes in 2005 from 68,787 million minutes in 2004. During 2005, fixed-to-mobile calls decreased 1.6% to 5,684 million minutes in 2005 from 5,777 million minutes in 2004. Calls for Internet access decreased by 27.8% to 15,486 million minutes in 2005 from 21,453 million minutes in 2004. Local calls decreased by 10.9% to 22,209 million minutes in 2005 from 24,929 million minutes in 2004. Provincial calls decreased 10.5% to 5,417 million minutes in 2005 from 6,053 million minutes in 2004. Interprovincial calls decreased 5.5% to 5,899 million minutes in 2005 from 6,242 million minutes in 2004. International outgoing calls increased 13.4% to 1,967 million minutes in 2005 from 1,734 million minutes in 2004. With respect to value added services, the number of voice mails used increased by 1.7% to 12.1 million in 2005 compared to 11.9 million in 2004. Subscribers to caller identification increased by 5.3% to 7.9 million in 2005 compared to 7.5 million in 2004. Incoming traffic, which also includes voice and Internet calls, accounted for 46.1% of Telefónica de España□s total traffic in 2005. Incoming traffic decreased by 6.4% to 50,789 million minutes in 2005 from 54,239 million minutes in 2004.

During 2005, Telefónica de España continued offering different discount plans (bundled service plans and flat rate plans) targeted to different client profiles. At December 31, 2005, the total number of subscribers for such discount plans was 4,306,984. In September 2005, Telefónica de España launched a new range of bundled service packages (□Duos□ and □Trios□ offers). More than one million of these services packages were subscribed during the last four months of 2005, and at December 31, 2005, the total number of Duos and Trios packages was 1,180,288.

During 2005, Telefónica de España continued to expand its Internet and broadband businesses. As a result of Telefónica de España□s commitment to broadband technology, at December 31, 2005 broadband customers in Spain numbered 3.4 million, representing a 36.0% increase compared to 2.5 million at December 31, 2004. Of the total number of broadband customers at December 31, 2005, 2.7 million were retail broadband clients, representing a 68.8% increase compared to 1.6 million at December 31, 2004, principally driven by the good market acceptance of the □Duos□ and □Trios□ bundled service packages included in the fourth quarter of 2005. Of this 68.5% increase, 9.8 percentage points of the increase is due to the consolidation of former Terra Networks entities.

IP TV (Imagenio) accesses increased to 206.6 thousand at December 31, 2005 compared to 6.0 thousand at December 31, 2004 due to intense commercial campaigns and the deployment of ADSL2+ technology.

Regulation

Below is a description of the current Spanish telecommunications regulatory framework. This description should be considered in light of certain developments currently underway in the regulatory and competitive environment that will have a material impact on Telefónica de España□s business and operations in future years.

Overview

Spain is a member state of the European Union. As such, it is required to enact E.U. legislation in its domestic law and to take E.U. legislation into account in applying its domestic law. E.U. legislation can take a number of forms. □Regulations□ have general application, are binding in their entirety and are directly applicable in all member states. □Directives□ are also binding, but national authorities may choose the form and method of implementation. □Recommendations□ are not binding, but Spanish courts are obligated to take them into consideration.

In order to strengthen free competition throughout its member states, the European Union approved a new regulatory framework in 2002. This framework is composed of a series of directives aimed at strengthening competition in the electronic communications industry within the European Union, establishing mandatory minimum service standards for all users (universal service) and users□ rights, improving licensing regimes and enhancing telecommunications data protection. These directives required that member states□ regulatory frameworks be modified accordingly to comply with the E.U.□s telecommunications regulatory framework within 15 months.

The General Telecommunications Law

In compliance with the obligation to enact this new E.U. legal framework, on November 23, 2003, the Spanish Parliament enacted Law 32/2003 (the General Telecommunications Law). The purpose of the General

Telecommunications Law is to advance the liberalization of the provision of telecommunications services and the installation and operation of electronic communications networks, and in this regard satisfy the principle of minimal government intervention. Accordingly, the provision of these services and the ability to operate such networks is granted as a matter of law. In this regard, the law avoids *ex ante* control by regulators as a fundamental principle, removing the current regime of authorizations and licenses and substituting them with *ex post* controls, through market analysis mechanisms necessary to determine the existence of effective competition. Furthermore, in the absence of effective competition, a series of obligations are imposed upon operators with significant market power. Within this regulatory framework, the national regulatory authority has a leading role in the implementation of the ex-post controls.

Under the General Telecommunications Law, the Spanish government issued Royal Decree 2296/2004 on December 10, 2004, containing new regulations governing the electronic communications and network access markets.

During 2005, the Spanish government approved a new regulation for the offer of electronic communication services, universal service obligations and consumer protection. This regulation, Royal Decree 424/2005, was approved on April 15, 2005. The principal aspects of the Royal Decree are as follows:

Conditions for the Offer of Electronic Communications Services:

- The prior regime requiring approval for the offer of electronic communications services has been superseded by this new regulation. Under the new regime, operators are only required to provide the Telecommunications Market Commission advance notice of their intention to offer electronic communications services or to operate networks; and
- Every three years, operators will be required to notify the Telecommunications Market Commission of their intention to continue with the offer of electronic communications services or the operation of networks.

Universal Service Obligations:

- The Telecommunications Market Commission must evaluate the net cost to operators of providing universal service. Depending on the results of such evaluations, Telefónica de España, along with other operators, may be entitled to recover certain of their respective costs incurred in providing universal service; and
- The costs of intercepting communications for law enforcement purposes (whether telephone calls, e-mail or other types of communications) must be borne by operators, except that the government will continue to be responsible for its costs in connection with its direct use of communications services (e.g., telephone calls or e-mails).

Consumer Protection:

- Operators must meet certain minimum criteria with respect to protecting the privacy of customers communications. For example, operators are not permitted to divulge any information regarding customers communications to law enforcement authorities in the absence of a judicial order; and
- Customers that receive poor quality service (e.g., temporary interruptions in service and poor connection quality) may either (i) terminate service contracts with operators or (ii) be entitled to indemnification payments.

The State Contract

Since 1991, we have provided telecommunications services through a contract signed with the Spanish government on December 26, 1991. The resolution of the Ministry Counsel that was enacted on August 1, 2003, prior to the approval of the General Telecommunications Law, approved the transformation of our contract with the Spanish government, adapting it to the current regulatory framework.

Under the new regulatory framework described above, all licenses and authorizations for the operation of telecommunications networks or for the provision of electronic communications services were void once the new General Telecommunications Law came into effect. However, in accordance with the first transitory disposition of the new General Telecommunications Law, the rights and obligations applicable to the individual licenses and general authorizations held by Telefónica de España will remain valid.

Fixed telephony

In February 2006, the Telecommunications Market Commission issued a final resolution liberalizing tariffs in connection with fixed telephony for retail markets, including individuals and companies. This resolution abolished the previous fixed telephony tariff regime in Spain known as “price caps”. Under the new regime, operators are required to inform customers in advance of the tariffs that will be charged and the conditions of service.

Under Spanish law, the Telecommunications Market Commission considers Telefónica de España a market dominant operator in the provision of fixed line telephony services and leasing of circuits. As a market dominant operator, Telefónica de España has certain obligations regarding interconnection and access to public networks and the supply of universal service, as well as other obligations to provide public telephony service.

However, in order to comply with Article 7 of the European Union’s Electronic Communications Framework Directive (2002/21/EC), the Telecommunications Market Commission conducted a study that included a public consultation period and analyzed the 18 telecommunications markets set forth in the European Commission’s Recommendation on relevant product and service markets susceptible to *ex ante* regulation. The Telecommunications Market Commission conducted this study in order to be able to identify those operators with significant market power in each market and establish regulations that such operators must comply with in each market. The Telecommunications Market Commission completed its study in early 2006. The Telecommunications Market Commission’s study and efforts to regulate in a manner that complies with the European Union’s Electronic Communications Framework Directive is expected to produce significant changes in Spanish telecommunications regulation. See “Item 3.D.—Risk Factors—Risks Relating to our Industry—We operate in a highly regulated industry and could become subject to more burdensome regulation, which could adversely affect our businesses.”

Mobile telephony

Mobile telephony regulation concentrates on the management and control of the use of the radio-electric public domain, which is used by operators through the allocation of frequencies in the radio-electric public domain.

For the provision of mobile telephony services, Telefónica Móviles España is considered a market dominant operator and is subject to the fulfillment of certain obligations in the interconnection services market.

Internet

Spanish law has attempted to remove legal uncertainties regarding the Internet as a transmission vehicle for diffusion and exchange of various types of information. Law 34/2002 established the concept of “information society services” which incorporates, among other things, the purchase of goods and services through electronic means and the supply of information through the Internet.

Service quality

The service quality parameters were first established through a ministerial order, dated October 14, 1999, and through the universal service quality ministerial order, dated December 21, 2001. This regulatory framework sets forth the quality standards for telecommunications services, including fixed telephony, mobile telephony and Internet access. An amendment to these service quality parameters is expected to be published in the Official

Registry (*Boletin Official del Estado*) in 2006. The contemplated amendments to these service quality parameters set forth more stringent requirements with respect to the level of service quality that operators must provide consumers.

Regulatory authorities

In accordance with General Telecommunications Law 32/2003, the national regulatory authorities in the telecommunications sector are:

- The Spanish Government;
- The senior and directive bodies of the Ministry of Economy on issues of price regulations (Government Deputy Commission for Financial Affairs);
- The Communications State Secretary for the Information Society, a member of the Ministry of Industry, Tourism and Trade;
- The Telecommunications Market Commission; and
- The State radio-communications agency.

Fixed telephony regulation

Licenses and Concessions

Under the new General Telecommunications Law, anyone involved in the operation of a telecommunications network or in the provision of electronic communication services should notify the Telecommunications Market Commission prior to the commencement of such activity. The Telecommunications Market Commission will register the telecommunications operator in the operator registry, so long as it complies with the General Telecommunications Law and all relevant regulations pursuant thereto.

All licenses and authorizations for the use of telecommunications networks or for the provision of electronic communications services expired after the new General Telecommunications Law came into force. Nevertheless, the right to occupy public and private property should continue according to the relevant regulation.

Interconnection

The General Telecommunications Law requires owners of public telecommunications networks, which includes Telefónica de España, to allow competitors to interconnect with their networks and services under non-discriminatory terms and conditions. The General Law on Telecommunications provides that the conditions for interconnection are to be freely agreed among the parties in compliance with certain minimum conditions established by law for interconnection agreements. Where the parties are unable to reach an agreement, the Telecommunications Market Commission may impose the obligation to interconnect upon the conditions it dictates.

Until the regulations governing the telecommunications markets in Spain under the General Telecommunications Law are fully developed and an analysis is completed by the Telecommunications Market Commission, the reference interconnection offer (RIO) applies. The RIO is an instrument created by Spanish law under which Telefónica de España sets forth the terms and the general, technical and financial conditions through which Telefónica de España interconnects with other operators. The applicable regulations state that interconnection prices charged by Telefónica de España in its RIO must be based on cost rather than profit. The RIO is updated periodically by regulations of the Telecommunications Market Commission.

Significant updates to the RIO have included:

- Telecommunications Market Commission resolution dated August 9, 2001, introducing interconnection pricing by digital capacity in addition to interconnection pricing per minute;

- Telecommunications Market Commission resolution dated March 31, 2004, introducing the charging of interconnection fees for toll-free calls from public-use terminals; and

- Telecommunications Market Commission resolution dated November 23, 2005, introducing interconnection prices. Telefónica de España has filed an administrative appeal against some of the sections of this resolution.

Network access

The General Telecommunications Law provides that the Telecommunications Market Commission can require an electronic communications public network operator to allow other operators to access its network. The Telecommunications Market Commission can establish the technical or operating requirements to ensure normal performance of such network. In the same manner as interconnection obligations, an operator may be declared to have significant market power, which imposes obligations regarding information transparency, non-discrimination, separation of accounts, access to specific network resources and price controls.

Under Royal Decree 7/2000 and Royal Decree 3456/2000, the unbundling of the local loop was established by setting forth the conditions under which the dominant operators of fixed line public networks must provide shared access to the local loop, with prices set by the Spanish government s Deputy Commission for Financial Affairs.

The Telecommunications Market Commission has amended Telefónica de España s local loop offer for 2004:

- on March 31, 2004 by lowering the monthly rental fees charged for access to the local loop;
- on July 22, 2004 by adapting the local loop offer to new ADSL velocities at the retail level; and
- on July 28, 2004 by modifying the local loop offer for massive migrations between different varieties for access to the local loop.

The Telecommunications Market Commission is expected to amend Telefónica de España s local loop offer in 2006 as a result of the development of new ADSL speeds.

Royal Decree 2296/2004 regulates matters concerning call-to-call operator selection, pre-selection of operator and safekeeping of numbers by subscribers, irrespective of the operator that provides the service.

In order to provide operators with guidance on how they can comply with their obligations pursuant to Royal Decree 2296/2004, the Telecommunications Market Commission issued Circular 1/2004. Circular 1/2004 states that operators may meet their obligations under such Royal Decree by hiring an unaffiliated third-party vendor to process customer requests regarding the selection of operators. In this manner, the third-party vendor may verify that the operator has complied with its legal obligation to allow customers to select the operator of their choice to process their telephone calls. Telefónica de España has adopted the Telecommunications Market Commission s guidance and has contracted a third-party vendor to process customer requests to use different operators to process their telephone calls.

Selection of operator

Telefónica de España, as a designated market dominant operator in the supply of connection to public telephone networks from a fixed location, must allow subscribers to place calls with any operator. Customers may pre-select any operator or choose another operator by dialing a three-digit code.

Public service obligations

Universal service. The General Telecommunications Law provides that operators shall be subject to rules of public service and other general public obligations in order to guarantee the existence and quality of electronic communications services.

Universal service is defined as a set of communication services guaranteed to all end users, irrespective of their geographic location, of a determined quality and at an affordable price. Such services must guarantee that all citizens can receive a connection to the fixed line public network and access to the fixed line telecommunications services available to the public, a free telephone directory, a sufficient number of public telephones, equal access to fixed line telephony services for disabled persons or those with special social needs and functional Internet access.

In addition, Law 34/2002, governing e-commerce and information services over the Internet, provides that all subscribers to the rural telephone cellular access system (TRAC) that requested an Internet connection prior to December 31, 2004 could progressively be provided with a connection that allows them functional connection to the Internet.

Pursuant to Royal Decree 424/2005, Telefónica de España's current obligation to provide universal service is imposed until 2007. Pursuant to the Telecommunications Market Commission's Regulation dated December 21, 2005, there will be a public comment period whereby members of the public may express views for the Telecommunications Market Commission's consideration regarding what operator should be selected to provide universal service after 2007. Telefónica de España has been the only operator in Spain to provide universal service since December 1998.

To finance the universal service, the General Telecommunications Law stipulates that the Telecommunications Market Commission must determine whether the net cost to provide universal services implies an unfair burden for the operators required to provide such service. The Telecommunications Market Commission has issued several resolutions relating to Telefónica de España's net costs for the provision of the universal service, indicating that Telefónica de España does not have a right to be compensated by other operators as there is no competitive disadvantage or unfair burden. On March 25, 2004, the Telecommunications Market Commission recognized the existence of a net cost of €110.0 million for Telefónica de España as a result of providing universal service, but provided no compensation since the amount was not considered an undue burden. However, Royal Decree 424/2005 provides for the possibility that Telefónica de España may recover certain costs incurred in providing universal service in 2006. See "—The General Telecommunications Law" above.

Competition

The following describes our current main competitors in the principal market segments in which the Telefónica de España Group operates.

Since 1997, the supply of fixed line telephone services to the public has been open to all competitors, subject to basic licensing requirements as provided for in the General Telecommunications Law, as well as the attainment of legal authorization for installment of such services.

In June 1997, Retevisión was granted a license to provide public fixed line telephone services in Spain, becoming the second operator after Telefónica de España to hold such a license. Retevisión began operations in January 1998. During 2002, as part of a reorganization process undertaken by the Auna Group, Retevisión merged with Aunacable (a cable operator belonging to the Auna Group). The new name of this fixed line telephone company is Auna Telecommunicaciones, S.A. The principal shareholders of the Auna Group are Endesa, Santander Central Hispano, Unión Fenosa and ING, together with several savings banks. In November 2005, the cable operator ONO acquired Auna Telecomunicaciones, becoming the first cable operator in Spain, named Grupo Corporativo ONO. The principal shareholders of the new group are Grupo Multitel, JP Morgan Partners, Providence Equity Partners and Thomas H. Lee Partners.

In May 1998, the Lince consortium, comprised of France Telecom and Editel, S.A. (a consortium which includes Multitel Cable, S.A. and Ferrovial Telecommunicaciones), received the third license for the provision of fixed line telephone services in Spain. Lince commenced operations in December 1998 under the trade name Uni2. In July 2001, France Telecom reached an agreement with its partners in the Lince consortium to acquire their interests in the Lince group. As a result, France Telecom now owns 100% of Uni2, which, together with Al-Pi Telecommunicaciones (a subsidiary of Uni2 that serves corporate clients and professionals in Catalonia), comprises the Uni2 group. In July 2005, France Telecom acquired 80% of Amena, the third largest Spanish mobile operator.

Jazztel plc, a company created in July 1998, received the fourth license for the provision of fixed line telephone services in Spain. Jazztel, p.l.c. is controlled by a consortium comprised of funds managed by Espírito Santo Bank, ING and Fidelity Investments.

Tariffs

On October 15, 1999, the Spanish government issued Royal Decree 16/1999 in order to address increasing inflation and promote a higher degree of competition among telecommunications operators. This decree established a price regulatory framework for fixed line telephony service and for lines to be leased by Telefónica de España based on maximum prices per year.

On December 22, 2005, the Spanish government's Deputy Commission for Financial Affairs (CDGAE) approved a new price regulatory framework for 2006. This new framework limits the CDGAE's regulatory jurisdiction in establishing price regulatory frameworks and guarantees the provision of universal service. For more information regarding the Telecommunications Market Commission's compliance with Article 7 of the European Union's Electronic Communications Framework Directive (2002/21/EC), see "Regulation—The General Telecommunications Law" above.

Once the Telecommunications Market Commission completes its analysis of the telecommunications markets in Spain and adopts regulations pursuant thereto, as required by Article 7 of the European Union's Electronic Communications Framework Directive (2002/21/EC), this regulatory framework will no longer be valid and will be replaced by the new regulations adopted by the Telecommunications Market Commission.

On February 16, 2006, the Telecommunications Market Commission completed its analysis of the local and national fixed telephony markets in Spain and adopted regulations with respect to such markets.

The most important aspects of the newly adopted regulations are the following:

- Telefónica de España may not engage in anticompetitive pricing or price discrimination among customers, offer anticompetitive bundled service packages or enter into abusive (as defined by the regulation) contractual terms with customers.
- Telefónica de España is required to meet certain disclosure requirements, including requirements to communicate terms and prices of its service offers to the Telecommunications Market Commission at least 21 days prior to their adoption (in the case of bundled service offers, these disclosures must include itemized prices with respect to each service offered), upon request, to provide to the Telecommunications Market Commission details regarding the prices applicable to entities with which Telefónica de España has service contracts (this requires Telefónica de España to maintain records of all of the customers with which it has service contracts along with copies of such contracts).

The following table sets forth the variation in price caps from the previous price regulatory framework.

Concept	Variation
Local	—
Provincial	(36.4)%
Interprovincial	(45.6)%
International	(41.2)%
Fixed-to-mobile	(32.3)%
Information service	100.7%
Monthly rental fee	44.9%
Subscription fee	(53.4)%

Tariffs for main services

The tariffs for electronic telecommunication services for the three years ended December 31, 2005 (excluding applicable taxes) are set forth below. These are the nominal tariffs set by Telefónica de España in accordance with the applicable price regulatory framework.

	Year ended December 31,		
	2003	2004	2005
	(in euro)		
Subscription fee			
Individual lines and trunk lines	59.50	59.50	59.50
Integrated Service Digital Network			
Primary access	3,606.07	3,606.07	3,606.07
Basic access	168.28	168.28	168.28
Monthly subscription fee			
Individual telephone line	12.61	13.17	13.43
Integrated Service Digital Network			
Primary access	342.58	342.58	349.43
Basic access	23.78	24.81	25.31
Digital circuit 64 kbits/s of 4 km	236.24	236.24	236.24

Comparison to other European Operators

The following table sets forth the tariffs charged by Telefónica de España at December 31, 2005 compared to other European operators. Applicable rates during normal business hours have been used.

	Telefónica de España	Deutsche Telekom	France Telecom	Telecom Italia	BT (UK)
			(in euro)		
Residential monthly rental fee	13.43	13.75	11.70	12.14	13.03
Business monthly rental fee	13.43	13.75	13.10	19.20	13.72

	During Business Hours				
	Telefónica de España	Deutsche Telekom	France Telecom	Telecom Italia	BT (UK)
			(in euro)		
3-minute calls					
Local	0.0765	0.1008	0.1354	0.1013	0.1730
Long-distance national	0.2771	0.1266	0.2834	0.3329	0.1730

Source: Eurodata, Tarifica and operators.

Customer Service

One of our main priorities is to satisfy customer needs by improving the quality of our customer service. We have continued our strategy of segmenting our customers in order to tailor our services to best meet the specific needs of each customer segment. In addition, in order to increase our ability to distribute our products and services we have signed agreements with large department stores to complement our traditional channels of distribution.

The corporate customer service model developed by Telefónica de España, which is aimed at achieving the highest degree of efficiency in customer service, features the following:

- a 24-hour personal customer service line for purchasing any type of product and service and handling customer queries;
- the Tiendas Telefónica (Telefónica stores) where customers can test and buy products marketed by Telefónica;
- Telefónicas virtual store, accessible by Internet, which offers the ability to order and purchase online the majority of services and products offered by Telefónica; and

- a sophisticated customer service system for corporate clients, ranging from a telephone help line for small and medium-sized businesses to the assignment of sales managers to address the needs of larger corporate clients.

In addition, we have continued to develop our product portfolio, especially in broadband services. For instance, customers now have the option to finance the acquisition of desktop or portable computers from us as part of our ADSL offerings. We also launched the Imagenio service in 2004. Imagenio is a leisure and communication service, including pay-TV with a broad range of content, from regular television channels to movies, documentary films and music concerts, and featuring Videoclub, an advanced video-on-demand service. Imagenio includes broadband Internet access, although there is a way for customers to access the service through a digital television connection. Services launched in 2005 include the "Duos" and "Trios" packages that offer broadband Internet access and/or IPTV plus unlimited local and national calls.

We have also continued to develop products previously introduced including our "combinados" plans that combine access and traffic, allowing each client to optimize its consumption according to calling destination and calling time profile. We have also initiated new access offers including "holiday line" and "young line" in order to better satisfy client needs. We have introduced packages for different customer segments, such as:

- "Tarifa mini": provides unlimited local and long distance calls for a fixed price per call;
- "Tarifa mini internacional": provides competitive prices for international calls to the Americas, Africa, Asia and Eastern Europe;
- "Tarifas planas": provides unlimited calls for different geographic areas; and
- "Bonos Fijo Móvil": provides competitive packages for calls from fixed to mobile telephones.

During 2005, the Telefonica de España Group launched a range of bundled service packages that combine IPTV, ADSL and voice services under the name "Trios" (a package comprising all three services) and "Duos" (a package allowing customers to choose two of the three services). This is in line with our strategy of focusing on an integrated offer of telecommunications solutions to satisfy customer needs and to reinforce their loyalty and the quality of the service.

Telefónica Móviles—Mobile Business in Spain and Latin America

We conduct our mobile business in Spain and Latin America through Telefónica Móviles, which is a leading provider of wireless communications services in Spain and Latin America in terms of managed customers. Telefónica Móviles estimates, based on annual reports and press releases made public by its competitors and information from regulatory authorities, that it is one of the four largest global providers of wireless communications services based upon total managed customers at December 31, 2005. Telefónica Móviles offers a broad range of wireless services, including voice services, enhanced calling features, international roaming and wireless internet services.

At December 31, 2005, Telefónica Móviles provided wireless services through its operating companies and joint venture to approximately 94.4 million managed customers in territories with a population of approximately 518 million. Telefónica Móviles has operations in Spain, Mexico, Peru, El Salvador, Guatemala, Venezuela, Colombia, Panama, Nicaragua, Ecuador, Uruguay, Argentina and Chile and, through its joint venture with Portugal Telecom, it also provides wireless communication services in Brazil. Telefónica Móviles also operates in Morocco where it has a 32.18% interest in Medi Telecom and currently appoints Medi Telecom's chief executive officer.

On March 29, 2006, Telefónica Móviles' Board of Directors approved our merger proposal which is now subject to approval by shareholders at the annual general shareholders' meeting of both companies. If the merger is effected, Telefónica Móviles, S.A. will be merged into Telefónica, S.A. and will cease to exist as an independent corporate entity, with Telefónica, S.A. acquiring all of the rights and obligations of Telefónica Móviles, S.A. by universal succession.

The following table provides a summary overview of Telefónica Móviles principal operating companies and those companies in which it has non-controlling minority interests.

Region	Country	Company	Population	Total customers at December 31, 2005
			(in millions)	(in millions)
Spain	Spain	Telefónica Móviles España	44.6	19.9
Brazil	Brazil	Brasilcel, N.V.(1)	136.5	29.8
Northern Region			134.7	9.2
	Mexico	Telefónica Móviles México, S.A. de C.V.	106.2	6.4
	Panama	Telefónica Móviles Panamá	3.2	0.8
	Nicaragua	Telefónica Celular de Nicaragua, S.A.	5.8	0.4
	Guatemala	Telefónica Centroamérica Guatemala, and Telefónica Móviles y Compañía, S.C.A.	12.6	1.0
	El Salvador	Telefónica Móviles El Salvador	6.9	0.5
Andean Region			113.7	17.5
	Venezuela	Telcel, S.A.	26.5	6.2
	Colombia	Telefónica Móviles Colombia, S.A.	46.0	6.0
	Peru	Telefónica Móviles Peru	28.0	3.5
	Ecuador	Otecel, S.A.	13.2	1.9
Southern Cone			57.9	14.0
	Argentina	TCP Argentina and Radiocomunicaciones Móviles S.A.	39.1	8.3
	Chile	Telefónica Móvil de Chile and Telefónica Móviles Chile	15.5	5.3
	Uruguay	Abiatar, S.A.	3.3	0.4
Morocco	Morocco	Medi Telecom (2)	31.0	4.0

(1) Jointly controlled and managed by Telefónica Móviles and Portugal Telecom. Through its 50% interest in Brasilcel, as of December 31, 2005, Telefónica Móviles indirectly holds 45.50% of Tele Sudeste (TDS), 33.5 % of Celular CRT (CRTPart), 25.33% of Tele Leste Celular (TBE), 33.04% of Telesp Celular Participações, S.A. (TCP) and 17.34% of Tele Centro Oeste Celular Participaçoes, S.A.(TCO). Brasilcel is proportionally consolidated in Telefónica Móviles financial statements. As of March 26, 2006, following TCOs merger with TCP, and TSDs, TBEs and CRTParts merger into TCP, only one company exists, which has changed its name to VIVO Participaçoes S.A.

(2) Jointly managed by Telefónica Móviles and Portugal Telecom. Each of Telefónica Móviles and Portugal Telecom has a 32.18% interest in Medi Telecom.

Services and Products

Telefónica Móviles operating companies offer a wide variety of wireless and related services and products to consumer and business customers. Although the services and products available vary from country to country, the following are Telefónica Móviles principal services and products:

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- *Wireless Voice Services*. Telefónica Móviles principal service in all of its markets is wireless voice telephony, which has gained increased usage as a result of Telefónica Móviles increased customer base and increased market penetration rates.
- *Value Added Services*. Customers in most of Telefónica Móviles markets have access to a range of enhanced calling features including voice mail, call hold, call waiting, call forwarding and three-way calling.
- *Wireless Data and Internet Services*. Current data services offered include Short Messaging Services, or SMS, and Multimedia Messaging Services, or MMS, which allow customers to send messages with images, photographs and sounds. Customers may also receive selected information, such as news, sports scores and stock quotes. Telefónica Móviles also provides wireless connectivity and internet access. Through wireless internet access, its customers are able to send and receive e-mail, browse web pages, download games, purchase goods and services in m-commerce transactions and use its other data services.
- *Corporate Services*. Telefónica Móviles provides business solutions, including wireless infrastructure in offices, private networking and portals for corporate customers that provide flexible on-line billing. Telefónica Móviles España offers corporate services through *MoviStar Corporativo*, and other advanced solutions for data, developed for specific sectors.
- *Roaming*. Telefónica Móviles has roaming agreements that allow its customers to use their handsets when they are outside of their service territories, including on an international basis.
- *Fixed Wireless*. In Argentina, Peru and Venezuela, Telefónica Móviles provides local fixed wireless service.
- *Trunking and Paging*. In Spain and Guatemala, Telefónica Móviles provides digital wireless services for closed-user groups of clients and paging services.
- *M-payment*. Through its subsidiary, Telefónica Móviles España, and together with Vodafone España, Amena and other financial institutions and processing companies, Telefónica Móviles has a 13.36% interest in Mobipay España, a company incorporated to develop micro-payments. Telefónica Móviles also has a 50% interest in Mobipay International, aimed at expediting payments through mobile phones in an international setting. Banco Bilbao Vizcaya Argentaria, S.A. is the other 50% shareholder in Mobipay International.

Telefónica Móviles Operations

Telefónica Móviles operations currently are conducted in three distinct geographic areas:

- Spain;
- Morocco; and
- Latin America.

In order to achieve critical mass of customers and to enhance efficiency, Telefónica Móviles manages its wireless assets in Latin American in four large regions:

- the Northern Region, which is managed from Mexico and includes both our Mexican subsidiary and our operations in Guatemala, El Salvador, Panama and Nicaragua;

- the Andean Region, which includes our operations in Venezuela, Columbia, Peru and Ecuador;
- Brazil; and
- the Southern Cone, which includes our operations in Argentina, Chile and Uruguay.

The following section provides a description of the markets in which Telefónica Móviles operates. Customer information on the wireless markets in which Telefónica Móviles operates, including its market share, are estimates that Telefónica Móviles has made based on annual reports and press releases made public by its competitors or information from local regulators in the respective markets.

Spain

Telefónica Móviles offers wireless services in Spain through Telefónica Móviles España, the leading wireless operator in Spain in terms of total number of customers at December 31, 2005. Telefónica Móviles España had approximately 20 million customers at December 31, 2005, representing an estimated 46% market share and 51% outgoing revenues market share.

The following table presents selected statistical data relating to the operations of Telefónica Móviles España:

	At December 31,	
	2004	**2005**
Total customers (in millions)	19.0	19.9
Pre-paid customers (in millions)	9.7	9.19
Population in service territory (in millions)	44	45

Source: Telefónica Móviles.

Telefónica Móviles España has offered wireless services in Spain since 1982 with the launch of analog wireless services under the brand MoviLine (services discontinued in 2004). Digital wireless services, using GSM 900 MHz technology, were launched in 1995 under the MoviStar brand name, which has since become one of the most widely recognized brands in Spain. In January 1999, Telefónica Móviles España launched the GSM 1800 MHz service. In March 2000, having achieved the highest rating in the award process, Telefónica Móviles España was awarded a third generation wireless, or UMTS, license covering the Spanish national territory for 131 million. In June 2005, Telefónica Móviles España was granted a 4 MHz block for the provision of GSM mobile telephony services in the 900 MHz band.

Market. With an estimated population of approximately 44 million people, Spain is the fifth largest wireless market in Western Europe with approximately 43 million wireless customers at December 31, 2005. This customer base represents a penetration rate of 98%. The penetration rate in the Spanish market grew 7.5 percentage points in 2005.

The Spanish wireless market has shown growth as a result of a decline of wireless handset prices and per minute call rates, and the introduction of pre-paid tariffs. At December 31, 2005, Telefónica Móviles España had approximately 20 million customers. The number of contract customers totaled approximately 10.7 million, representing a 15.6% increase compared to 2004.

In an increasingly competitive market, with strong competition in number portability and pressure on pricing, including termination rate reductions, along with the potential entry of new competitors, Telefónica Móviles España is focused on key initiatives to preserve its position as a leading mobile operator in the market, leading it to increase commercial efforts with measures including:

- in-depth market segmentation, with a focus on customer value;
- smart pricing to stimulate usage, launching segmented packages and innovative tariff options; and
- leveraging UMTS to develop new services, deploying the network ahead of competitors.

Network and Technology. Telefónica Móviles España's digital network in Spain is based upon the GSM/UMTS standard. The prevalence of the GSM standard, together with Telefónica Móviles España's international roaming agreements, enables its MoviStar customers to make and receive calls throughout Western Europe and in almost 200 countries worldwide. Telefónica Móviles Españas GSM/UMTS based network provides its customers with access to many of the most advanced wireless handsets and a full panoply of services and products.

In 2004 and 2005, Telefónica Móviles España invested in the aggregate approximately 1,356 million in building out and enhancing its networks in Spain and developing its technological platforms and information systems. At December 31, 2005, Telefónica Móviles Españas GSM/GPRS digital network in Spain, which consisted of 115 switching centers and approximately 18,000 base stations, provided coverage to approximately 99% of the population. At December 31, 2005, Telefónica Móviles Españas UMTS network provided coverage in areas where 70% of the Spanish population resides, with 5,000 UMTS base stations installed.

Sales and Marketing. Since Telefónica Móviles España began providing wireless services in Spain, its sales and marketing strategy has been to generate increased brand awareness, customer growth and increased revenues. Telefónica Móviles España utilizes all types of marketing channels, including television, radio, exterior signage, telemarketing, direct mail and internet advertising. Telefónica Móviles España also sponsors several cultural and sporting events in order to increase its brand recognition.

For purposes of sales and distribution, Telefónica Móviles España divides the Spanish market into the consumer market and business market. At December 31, 2005, Telefónica Móviles España had 9,362 points of sale for the consumer market, including specialized and large retailers. In addition, Telefónica Móviles España uses approximately 118 points of sale that are owned by the Telefónica Group.

In 2005, Telefónica Móviles España continued to encourage customer migration from its pre-paid plans to its contract plans, in line with the process that started in March 2002, when the contract plans of Telefónica Móviles España shifted from a monthly fee to a minimum usage commitment. In 2005, prepaid to contract migrations were over one million, contributing to an improvement in the percentage of its contract customers to its total customers by 5 percentage points as of December 31, 2005 compared to December 31, 2004.

Competition. Telefónica Móviles España currently has two competitors in the Spanish market for wireless communications service: Vodafone España, a subsidiary of Vodafone PLC, and Retevisión Móvil S.A., which operates under the trade name *Amena* and was acquired by France Telecom during the second half of 2005.

Regulation. Licenses and concessions Under the new General Telecommunications Law, anyone interested in the operation of a telecommunications network or in the provision of electronic communications services should notify the Telecommunications Market Commission prior to the commencement of the activity. The Telecommunications Market Commission will register the telecommunications operator in the Operator Registry.

Under the new regulatory framework, all licenses and authorizations for the operation of telecommunications networks or for the provision of electronic communications services were extinguished once the new General Telecommunications Law came into force. However, in accordance with the first transitory disposition of the new General Telecommunications Law, the rights and obligations applicable to the individual licenses and general authorizations held by Telefónica Móviles España will remain valid. Consequently, Telefónica Móviles España must comply with the obligations established before new General Telecommunications Law came into force.

Telefónica Móviles España holds the following concessions for the use of spectrum which terms and conditions are associated with the former licenses now extinguished:

Spectrum rights	Duration	Ending Date	Extension Period
GSM 900 (2x12)	15 years	February 3, 2010	5 years
GSM 900 (2x4)	15 years	June 6, 2020	5 years
DCS-1800 (1)	25 years	July 24, 2023	5 years
UMTS	20 years	April 18, 2020	10 years
Paging	20 years	April 24, 2020	10 years

(8) Analogic Trunking	20 years	June 2014	10 years
(4) Analogic Trunking	20 years	November 2016	10 years

(1) On November 29, 2002, the Ministry of Industries, Tourism and Commerce completed the allocation of the DCS-1800 band. We received 2 x 24.8 MHz of spectrum.

Interconnection Spanish law requires public telecommunications networks to provide interconnection to other public telecommunications networks established in Spain, the terms of which must be specified in an interconnection agreement between the parties. Because Telefónica Móviles España has been classified by the Telecommunications Market Commission as an operator with significant market power in the wireless communications and interconnection markets, it is required, among other obligations, to facilitate cost-oriented interconnection rates on a non-discriminatory and transparent basis and report to the Ministry of Economy and the Ministry of Industries, Tourism and Commerce regarding its compliance. In October 2005, the Telecommunications Market Commission established the average maximum price for Telefónica Móviles Españas interconnection termination service at approximately 0.11 per minute.

Tariffs The mobile operators that provide mobile telephone services may generally set the tariffs they charge their customers. However, the General Telecommunications Law authorizes the Governments Deputy Commission for Financial Affairs to set transitory maximum and minimum prices, as well as fixed prices. As of the date of this Annual Report, the Deputy Commission for Financial Affairs has not regulated rates of digital wireless services.

Telefónica Móviles España can freely set rates for services provided to its customers and must only communicate the rates to the regulatory authorities and to consumer and customer organizations.

Virtual mobile operators Virtual mobile operators are mobile operators that do not own a network and that may provide mobile telephony service through voluntary non-discriminatory access agreements with mobile operators that own existing networks. On February 2, 2006, the Telecommunications Market Commission issued a regulation concerning the market for access to and call origination on public mobile telecommunications networks in Spain. In connection with this regulation, the Telecommunications Market Commission found that all mobile network operators in Spain collectively hold a dominant position in the wholesale market for mobile telephony. Consequently, the Telecommunications Market Commission has imposed an obligation on mobile operators in Spain to (i) provide network access following a reasonable request by a virtual mobile operator and (ii) offer reasonable prices for access services. The Telecommunications Market Commission in the first instance will allow mobile operators with networks and virtual mobile operators to negotiate agreements that meet the requirements set forth above. However, if mobile operators with networks and virtual mobile operators are unable to negotiate such agreements independently, the Telecommunications Market Commission will set forth the terms of such agreements for the parties.

EC regulation on roaming tariffs On March 28, 2006, Commissioner Reding announced a proposal for a new regulation on international roaming tariffs. The Commissioner intends to base such regulation on Article 95 of the EC Treaty, pursuant to the approach followed in relation to the cross-border payment regulation in 2001. To assist with the preparation of this regulation, the Commission has sought public comment. The second public comment period opened on April 3, 2006 and is to end on April 28, 2006. The European Commission could adopt the proposal in June. If such regulation were to be adopted by the European Parliament and the European Council of Ministers, it would be immediately in effect in all 25 Member States without transposition into national law and could adversely affect Telefónica Móviles and its operations.

Morocco

Telefónica Móviles provides wireless services in Morocco through Medi Telecom, S.A., in which it holds a 32.18% interest and shares management responsibilities with Portugal Telecom, which also holds a 32.18% interest in Medi Telecom. Medi Telecom is also owned by local minority shareholders. Medi Telecom is one of two wireless operators in Morocco, with over 4 million customers at December 31, 2005. Medi Telecom commenced offering wireless services in Morocco in March 2000, eight months after it was awarded a GSM license covering the Moroccan national territory.

The following table presents selected statistical data relating to Telefónica Móviles investment in Medi Telecom:

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	At December 31,	
	2004	2005
Total wireless customers (in millions)	2.73	4.02
Pre-paid customers (in millions)	2.62	3.87
Population in service territory (in millions)	31	31

Source: Telefónica Móviles, except population data from Pyramid Research.

Shareholders’ Agreement. Telefónica Móviles España has entered into a shareholders’ agreement with other shareholders of Medi Telecom under which it has the right to appoint the chief executive officer of Medi Telecom. In addition, as of April 2003, the sale or transfer of shares in Medi Telecom triggers a right of first refusal to the other non-transferring shareholder in two steps: firstly to the Technical Shareholders (Telefónica Móviles España and Portugal Telecom) and secondly to the remaining shareholders. In addition, the change of control in the direct or indirect shareholders of Medi Telecom (which specifically includes the acquisitions of such interest by a competitor of Telefónica, S.A. or Portugal Telecom) would entitle the non-affected shareholder to exercise a call option over Medi Telecom’s shares owned by the party undergoing such change of control. The shareholders’ agreement also requires specified majority votes to approve most corporate actions.

Market. With a population of approximately 31 million people, Morocco had 12.3 million wireless customers at December 31, 2005, representing a penetration rate of 40%. Medi Telecom estimates that the Moroccan market grew 34% in 2005 compared to 2004.

Network and Technology. Medi Telecom’s network in Morocco is based upon the GSM standard. In 2004 and 2005, Medi Telecom invested a total of approximately €156 million in building out and enhancing its digital network in Morocco. Medi Telecom has been offering wireless internet since April 2001. In 2005, Medi Telecom has been awarded a fixed license in Morocco, and the company is rolling out a fixed network based on WiMax technology.

Sales and Marketing. Medi Telecom’s sales and marketing strategy has been to generate rapid customer growth. At December 31, 2005, approximately 96% of Medi Telecom’s customers used pre-paid plans with the remainder using contract service.

Competition. Medi Telecom competes with Maroc Telecom, the former state monopoly provider of all telecommunications services in Morocco.

Latin America—Brazil

Telefónica Móviles and Portugal Telecom are 50:50 shareholders in Brasilcel, N.V., or Brasilcel, a joint venture which combined Telefónica Móviles’ and Portugal Telecom’s wireless businesses in Brazil. This joint venture is the leading wireless operator in Brazil in terms of total number of customers at December 31, 2005. At December 31, 2005, Brasilcel had a total of 29.8 million customers, of which 5.7 million were contract customers. Brasilcel had an estimated average share in its markets of operations of approximately 44.2% at December 31, 2005. All of the operating companies participating in the joint venture have been operating under the brand name “Vivo” since April 2003. The licensed areas of Brasilcel include 19 states in Brazil and its federal capital, with a population of approximately 136.5 million, and covering 85.5% of Brazil’s gross domestic product.

On February 22, 2006, the respective shareholders’ meetings of Telesp Celular Participações S.A. (“TCP”), Tele Centro Oeste Celular Participações S.A. (“TCO”), Tele Sudeste Celular Participações S.A. (“TSD”), Tele Leste Celular Participações, S.A. (“TBE”) and Celular CRT Participações S.A. (“CRTPart”) approved (i) the merger of TCO in order to convert it into a wholly owned subsidiary of TCP and (ii) the merger of TSD, TBE and CRT Part into TCP. TCP was the sole surviving company of these mergers and subsequently changed its name to “VIVO Participaçoes S.A.”

The following table shows the different states where service is provided by Brasilcels operators in 2005:

Company	State
Telesp Celular	São Paulo (SP)
Tele Sudeste	Rio de Janeiro (RJ) and Espirito Santo (ES)
Global Telecom	Paraná (PA) and Santa Catarina (SC)
CRT Celular	Rio Grande do Sul (RS)
Tele Centro Oeste	Acre (AC), Goiás (GO), Mato Grosso (MT), Mato Grosso do Sul (MS), Rondônia (RO), Tocantins (TO), Distrito Federal (DF), Amazonas (AM), Pará (PA), Amapá (AP), Roraima (RR) and Maranhão (MA)
Tele Leste	Bahia (BA) and Sergipe (SE)

The following table presents statistical data relating to our operations in Brazil:

	At December 31,	
	2004	2005
Population in service territory (in millions)	131.5	136.5
Total customers (in millions)	26.5	29.8
Pre-paid customers (in millions)	21.4	24.1

Source: Telefónica Móviles, except population data from Pyramid Research.

Market. Brazil is one of the largest countries in the world, with a surface area of 8.5 square million kilometers and a population of approximately 185.5 million people. At December 31, 2005, with 86.2 million wireless subscribers, Brazil ranked first in Latin America in terms of number of wireless customers. At December 31, 2005, Brazil had an estimated market penetration rate of 46.5% and of 49.2% in the areas where Vivo operates.

Network and Technology. The licenses granted to the companies integrated in Brasilcel allow operations over the CDMA, CDMA 1XRTT, CDMA EVDO and TDMA systems. Vivo offers both analog and digital services in the band of 800 MHz. CDMA 1XRTT is a broadband transmission system for wireless networks allowing for speeds of up to 144 Kbits/s. In 2004, Vivo launched CDMA EVDO, a technology that increases data capabilities allowing speeds of up 2.4 Mbits/s. TDMA, or time division multiple access, is a digital mobile phone technology that allows several calls to share a single channel without interfering with one another.

Of Vivo's investment in the development of the networks of its companies in Brazil in 2004 and 2005, approximately 677 million were attributable to Telefónica Móviles as a proportion of the total investment corresponding to its interest in the Brasilcel entities.

Sales and Marketing. The consolidation of the different brands of the Brasilcel joint venture into the "Vivo" brand in 2003, enabled Vivo companies to develop and operate under a unified commercial strategy. Vivo is actively managing its distribution channels, which consisted of 8,282 points of sale at December 31, 2005. Additionally, Vivo prepaid customers were provided access to a wide range of "recharge" points. Credit recharges can also be made by electronic transfers through the commercial banking network. As of December 31, 2005, approximately 19% of Vivo's customers were contract clients and the remaining 81% were prepaid customers.

Competition. Brasilcel is the leading wireless operator in Brazil in terms of number of customers at December 31, 2005. The growth of the Brazilian market has been considerable during the past years while being accompanied by an increase in competition due to the introduction of new competitors in the regions in which Brasilcel operates. Its major competitors are subsidiaries of Telecom Italia Mobile, America Móvil, Brazil Telecom and Telemar.

Regulation. The wireless telecommunications companies that operate pursuant to licenses and concessions are subject to general obligations set forth by the National Agency for Telecommunications, or Anatel, and to obligations pursuant to each license concerning quality of services, network expansion and modernization.

Licenses and Concessions On December 4, 2002, Anatel authorized the contribution to Brasilcel of the wireless assets in Brazil of both Portugal Telecom and Telefónica Móviles and allowed the migration of Brasilcels operators to a new licensing regime, Personal Mobile Service, or the SMP regime. Accordingly, Brasilcels operators replaced all their old licenses with new SMP licenses. The old licenses were concessions granted under the Cellular Mobile Service, or the SMC regime. The new SMP licenses include the right to provide cellular services for an unlimited period of time but restrict the right to use the spectrum according to the schedules listed in the old licenses (Celular CRT until 2007; Telerj Celular until 2005; Telest Celular until 2008; Telebahia Celular and Telergipe Celular until 2008; TCP until 2008 or 2009 (for the cities of Ribeirao Preto and Guatapará); Global Telecom until 2013; TCO until 2006 (for Brazils Federal District); Teleacre Celular, Teleron Celular, Telemat Celular and Telems Celular until 2009; Telegoiás Celular until 2008; and Norte Brasil Telecom until 2013). The Telerj Celular license was renewed in 2005 for a fifteen-year period and will expire again in 2020.

The renewal of each of these licenses must be solicited 30 months before its expiration. The companies listed above with licenses expiring within 30 months have already applied for the renewal of their licenses. For the renewal of these licenses, each operator will have to make a payment for the use of the spectrum in the amount of 2% of its annual gross revenues. This payment must be made two years after obtaining the license.

Interconnection Resolution 410/2005 approved the general interconnection regulations. Interconnection is mandatory for all telecommunications operators. Conflicts arising from the negotiations between operators are resolved through arbitration by Anatel. Existing regulations state that operators that offer general public services (fixed line services, personal mobile services and specialized mobile services such as trunking and cable TV) must publish the terms and conditions for interconnection with their networks.

Rates The rates that wireless service providers may charge their customers are also regulated by the SMP regime. The SMP regime allows operators to freely negotiate their interconnection rates with other operators. If they fail to reach an agreement, each operator may call upon ANATEL to determine the terms and conditions of interconnection. In addition, under the SMP rules, the retail rates charged to customers for fixed-to-mobile calls cannot be less than the sum of the interconnection fees charged on the fixed and mobile terminations.

Recent developments in the SMP regime In 2005, Anatel published proposed regulations under the SMP regime. These proposed regulations include increasing the period of time that pre-paid cards are valid, decreasing the minimum duration of service contracts that wireless service providers may offer customers and requiring wireless service providers to have more customer service stations in cities where wireless service is provided. During the public comment period that ended in January 2006, the Brasilcel operators submitted their comments against the proposed regulations. Except for Resolution 410/2005 discussed above, Anatel has yet to enact any of its other proposed regulations. If Anatel were to enact these proposed regulations, such regulations may negatively affect Telefónica Móviles Brazilian subsidiaries business, financial condition and results of operations.

Latin AmericaNorthern Region

The Northern Region includes Telefónica Móviles operations in Mexico, El Salvador, Guatemala, Panama and Nicaragua. This region is the second largest region in Latin America with a population of approximately 135 million. This area is an emerging wireless market with approximately 56 million customers at December 31, 2005, representing a penetration rate of approximately 41%. Telefónica Móviles has an estimated market share in this area of approximately 16.2% at December 31, 2005. Its major operation in the Northern Region is Mexico, which represents 79% of the regions population and 62% of the regions revenue.

The following table presents selected statistical data related to the operations of the Northern Region.

	At December 31,	
	2004	2005
Total customers (in millions)	7.7	9.2

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	At December 31,	
	2004	**2005**
Pre-paid customers (in millions)	7.0	8.4
Fixed wireless (in millions)	0.136	0.146
Population in service territory (in millions)	132.8	134.7

Source: Telefónica Móviles, except for population data from Pyramid Research.

Network and Technology. Telefónica Móviles Mexico offers both analog and digital networks. Its digital networks are based upon the CDMA and GSM standard. The rollout of Telefónica Móviles Mexicos GSM network on a nationwide basis started in 2003 and continued during 2004 and 2005, covering approximately 50,000 villages and geographic areas representing approximately 90% of the urban population. Telefónica Móviles México has 88% of its customers in its GSM network at the end of December 2005. The rest of the operators in the region had networks based upon the CDMA or TDMA standards, and during 2004 and 2005, they have been rolling out networks based on the GSM standard. Telefónica Móviles has invested in the Northern Region a total of €737 million during 2004 and 2005, 88% of which has been invested in Mexico principally to rollout its GSM network.

Sales and Marketing. Telefónica Móviles operating companies in these countries use a broad range of marketing channels, including television, radio, billboards, telemarketing, direct mail and internet advertising to market their products. At December 31, 2005, approximately 6% of Northern Region customers were contract customers, while 94% were prepaid customers.

Competition. Telefónica Móviles is the second largest wireless operator in Mexico, El Salvador, Nicaragua and Panama in terms of total number of customers at December 31, 2005. It is the third largest operator in Guatemala in terms of total number of customers at such date. Telefónica Móviles México competes with various operators at a national level. Telefónica Móviles Mexicos principal competitor is Telcel, a subsidiary of América Móvil. Its other significant competitors are Iusacell, Unefon and Nextel.

Mexican Regulation. The provision of telecommunications services in Mexico is regulated by the Telecommunications Federal Law (LFT), enacted in 1995 (D.O.F.7/6/95), as well as specific regulations governing the different types of telecommunications services.

Licenses and concessions In Mexico, authorization to provide mobile telephony services is granted through a concession. Telefónica Móviles Mexicos wireless operating companies have been granted concessions to operate mobile telephony services on Band A in the following states: Baja California, Baja California Sur, Sinaloa, Chihuahua, Durango, Nuevo León, Tamaulipas and Coahuila, excluding certain select the municipalities.

Currently, only one Band A and one Band B service provider may provide mobile telephony services in each region. Each concession is granted for a period of 20 years, and may be renewed for additional 20-year periods, subject to the fulfillment by the operator of certain terms and conditions. These conditions are the fulfillment of existing obligations under the license, solicitation of renewal of the license before its expiration and acceptance of the new conditions that will be established by the SCT. The concessions to provide mobile telephony services awarded to Telefónica Móviles Mexicos operating companies each expire in 2010.

In 2002, Telefónica Móviles acquired 65% of Pegaso. In 1998, Pegaso was awarded licenses to provide personal communication services until 2018. This license may be extended for additional 20-year periods, subject to the fulfillment by the operator of certain terms and conditions.

Concessionaires of public telecommunications networks are subject to general obligations set forth by the SCT and COFETEL and to obligations pursuant to each concession concerning quality of service, network expansion and modernization.

On July 12, 2004, COFETEL called for an auction to grant concessions to provide fixed and mobile wireless access. The bidding process for certain wireless frequencies available in each of nine PCS regions began on January 11, 2005. Nextel, Telcel, Iusacell and Telefónica Móviles participated in the bidding process. However, the auction was halted on February 9, 2005 due to a court order mandating that COFETEL allow UNEFON to participate in the auction. The bidding process was reinitiated on April 1, 2005 and terminated on April 11, 2005. Telefónica Móviles was granted concessions in four different regions in Mexico. However, as a result of a regulation enacted by the *Comisión Federal de Competencia* (COFECO) establishing a spectrum cap of 35 MHz in PCS bands, Telefónica Móviles was not able to obtain more spectrum in Mexico City through the bidding process. Telefónica Móviles is currently challenging the legality of COFECO’s spectrum cap regulation.

Interconnection — Mexican legislation on telecommunications matters requires all network license holders to enter into interconnection agreements whenever another operator requests it. The terms of such agreements may be freely negotiated between parties on a non-discriminatory basis. In the event of any controversy, COFETEL must arbitrate between the parties. The interconnection agreements must be registered in the telecommunications register, and those that are signed with foreign networks require prior authorization from the SCT.

Under Mexican law, COFETEL can establish specific obligations for concessionaires of public telecommunications networks who hold significant market power regarding prices, quality of service and the provision of information.

Since May 1, 1999, the Calling Party Pays (CPP) system has applied exclusively to local service (services established between exchanges of the same local area) although the user has the option of maintaining the Receiving Party Pays system. COFETEL has stated that it is considering extending CPP to national long-distance calls, which would require regulatory approval by the Federal Commission for Regulatory Improvement. While the proposed regulation is in final stages and ready for the Federal Commission for Regulatory Improvement’s approval, the approval process has been delayed as a result of the complaints of several long-distance operators.

Rates — Rates charged to customers are not regulated. They are fixed by wireless operating companies and must be registered with COFETEL. Rates are not effective until confirmed by COFETEL.

Latin America—Andean Region

The Andean Region includes Telefónica Móviles’ operations in Venezuela, Colombia, Peru and Ecuador. At December 31, 2005, the wireless market in the region had approximately 46 million customers, and Telefónica Móviles had an estimated market share in this region of approximately 38.0%. Telefónica Móviles is the leading wireless operator in Venezuela and Peru in terms of total number of customers at December 31, 2005 and the second largest operator in Colombia and Ecuador.

The following table presents the selected statistical data related to the operations of the Andean Region.

	At December 31,	
	2004	**2005**
Total customers (in millions)	11.6	17.5
Pre-paid customers (in millions)	9.1	14.2
Fixed Wireless (in millions)	0.57	0.68
Population in service territory (in millions)	112	114

Source: Telefónica Móviles, except for population data from Pyramid Research.

Network and Technology. In Venezuela, Telefónica Móviles Venezuela operates both digital and analog networks. Its digital network is based on the CDMA standard and its analog network is based on N-AMPS. Close to 100% of its customers in Venzuela are based on CDMA. During 2005, the company launched a new technology, 1X EVDO CDMA, which improves and allows higher speed data transmission services and capacity.

Telefónica Móviles Colombia operates digital networks based upon the GSM (launched in July 2005), CDMA 1XRTT and TDMA standards. At December 31, 2005, GSM customers represented 27% of total customers.

Telefónica Móviles Perú operates both analog and digital networks. Its digital network is based upon the CDMA/CDMA 1XRTT standard. At the end of 2005, Telefónica Móviles Perú started rolling out its GSM network, and the GSM services were launched as of February 2006.

Telefónica Móviles Ecuador operates digital networks based upon the GSM standard (launched in September 2005) and CDMA 1XRTT. At December 31, 2005, GSM customers represented 9% of total customers.

Telefónica Móviles has invested a total of €616 million in the Andean Region during 2004 and 2005.

Sales and Marketing. Telefónica Móviles operating companies in these countries use a broad range of marketing channels, including television, radio, billboards, telemarketing, direct mail and internet advertising to market their products. At December 31, 2005, approximately 17% of the Andean Region customers were contract customers, while approximately 78% were prepaid customers. The rest of the customers were fixed-wireless customers.

Competition. The major market competitors in Venezuela are Movilnet, which is a wireless services communication provider that uses CDMA and TDMA technology, and Digitel TIM, which is a wireless communications provider that uses GSM technology.

Telefónica Móviles Colombia currently has two competitors in the Colombian market for wireless communications services: Comcel, which belongs to América Móvil; and Colombia Móvil, whose brand is Ola, which obtained a PCS license in 2003 and is a joint venture of the two largest phone companies of the main Colombian cities of Bogota and Medellin.

Telefónica Móviles Peru currently has two competitors in the Peruvian market for wireless communications services: América Móvil and Nextel Peru.

Telefónica Móviles Ecuador currently has two competitors in the Ecuadorian market for wireless communications services: America Móvil and Alegro, which is owned by fixed line operators.

Latin America Southern Cone

The Southern Region includes Telefónica Móviles operations in Chile, Argentina and Uruguay. At December 31, 2005, the wireless market in the region had approximately 34 million customers, and Telefónica Móviles had an estimated market share of approximately 41.2% in the region. The penetration rate in the region was 58.1% at December 31, 2005. Telefónica Móviles is the leading wireless operator in Argentina and Chile in terms of total number of customers at December 31, 2005 and the second largest operator in Uruguay.

The following table presents selected statistical data related to the operations of the Northern Region.

	At December 31,	
	2004	**2005**
Total customers (in millions)	6.9	14.0
Pre-paid customers (in millions)	5.1	9.8
Fixed wireless (in millions)	0	0.2
Population in service territory (in millions)	54	57.9

Source: Telefónica Móviles, except for population data from Pyramid Research.

Network and Technology. In Argentina we operate both analog and digital networks. Telefónica Móviles digital network in Argentina is based upon the TDMA standard and the GSM standard. At December 31, 2005, GSM customers represented 51% of the total customers.

Telefónica Móvil de Chile operates both TDMA and GSM networks. GSM customers represented 51% of the total customer base as of December 31, 2005.

In Uruguay Telefónica Móviles operates both analog and digital networks. Its digital network is based upon the GSM (launched in April 2005) and CDMA standards. At December 31, 2005, GSM customers represented approximately 40% of total customers.

Telefónica Móviles has invested a total of €515 million in the Southern Region during 2004 and 2005.

Sales and Marketing. Telefónica Móviles’ operating companies in these countries use a broad range of marketing channels, including television, radio, billboards, telemarketing, direct mail and internet advertising to market their products. At December 31, 2005, approximately 26% of Southern Region customers were contract customers, while approximately 74% were prepaid customers.

Competition. Telefónica Móviles’ operators in Argentina currently have three competitors in the Argentine market for wireless communications service, each of which provides services on a nationwide basis: Telecom Personal, which is controlled by Telecom Italia through Telecom Argentina; CTI Móvil (controlled by América Móvil); and Nextel, owned by NII Holdings Inc.

Telefónica Móviles’ operators in Chile currently have two competitors in the Chilean market for wireless communications service, each of which provides services on a nationwide basis: Entel and Smartcom.

Telefónica Móviles’ operators in Uruguay currently have two competitors in the Uruguay market for wireless communications service, each of which provides services on a nationwide basis: Ancel and CTI.

Wireless Internet and Data Initiatives

We believe that the convergence of data communications and voice communications represents an important opportunity to increase revenue in the mobile communications sector. An important component of our strategy is broadening uses of wireless communications, currently dominated by voice services, to include more widespread use of wireless internet and data services.

Telefónica Móviles España’s revenues from services increased to €1,030 million in 2005. This increase is primarily due to the increased use of other data services (downloads, browsing, data transmission, MMS and content SMS) in addition to traditional person-to-person SMS usage. Revenues from non-traditional person-to-person SMS increased by approximately 9 percentage points in 2005 to 38% of total data revenues.

We expect that the contribution of wireless internet and data services to our revenues will increase significantly as technology and services improve and are made more accessible and user-friendly to mass-market consumers and business customers in each market in which Telefónica Móviles operates. The availability of compatible handsets at attractive prices will be key to achieving this development.

Telefónica Móviles offers its clients a wide range of data services that it seeks to continuously improve. Current data services offered include short messaging services, or SMS and Multimedia Messaging Services, or MMS, which allows customers to send messages with images, photographs and sounds. Customers may also receive selected information, such as news, sports scores and stock quotes. Telefónica Móviles also provides wireless connectivity and internet access.

Telefónica Latinoamérica—Latin American Fixed Line Business

Our Latin American fixed line business is conducted through Telefónica Latinoamérica. Telefónica Latinoamérica is comprised of:

- our fixed line telecommunications operators: Telesp (Brazil); Telefónica de Argentina (Argentina); CTC Chile (Chile); and Telefónica del Peru (Peru);

- our data business, Telefónica Empresas America;
- our wholesale data transmission and the international services business, Telefónica International Wholesale Services (TIWS); and
- our internet business, Terra Networks Latinoamérica.

The principal services offered by Telefónica Latinoamérica are:

- Traditional fixed line telecommunication services, principally including PSTN (public switched telephone network) lines; ISDN (integrated services digital network) access; public telephone services; local, domestic and international long distance and fixed-to-mobile communications services; supplementary value-added services (including call waiting, call forwarding, voice and text messaging, advanced voicemail services, information services and conference-call facilities); video telephony; intelligent network services; and leasing and sale of terminal equipment.

- Internet and broadband multimedia services, principally including narrowband switched access to Internet; ISP service; internet portal and network services; retail and wholesale broadband access, through ADSL and satellite technologies; residential-oriented value-added services (including instant messaging, concerts and videoclips by streaming, e-learning, parental control, firewall and anti-virus); pay TV service (Cable Magico) and VOIP services.

- Data and business-solutions services, principally including leased lines; VPN services; fiberoptics services; hosting and ASP service; outsourcing and consultancy services, including network management (CGPs) and desktop services and system integration and professional services.

- Wholesale services for telecommunication operators, principally including domestic interconnection services; international wholesale services; leased lines for other operators network deployment and local loop leasing, under the unbundled local loop regulation framework.

All existing fixed telephony, data and internet services in the Latin American countries in which we operate are open to free competition, including PCS service in Peru for which new licenses are expected to be granted in 2006.

The following table sets forth ownership and management information as of December 31, 2005 regarding the principal fixed line telecommunications operators that are members of the Telefónica Latinoamérica group.

Company	Year Acquired	Population at December 31, 2005 (millions)	Interest	Management
Telecomunicações de São Paulo Telesp	1998	40.4	87.5%	Telefónica Latinoamérica manages Telesp pursuant to a management contract
Compañía de Telecomunicaciones de Chile	1990	15.5	44.9%	Telefónica Latinoamérica appoints a majority of the members of the Board of Directors
Telefónica de Argentina	1990	39.1	98.0%	Telefónica Latinoamérica controls Telefónica de Argentina through its stake in COINTEL. In addition, Telefónica Latinoamérica manages Telefónica de Argentina pursuant to a

				management contract
Telefónica del Peru	1994	28.0	97.1%	Telefónica Latinoamérica appoints a majority of the members of the Board of Directors and manages Telefónica del Peru pursuant to a management contract

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In addition, Telefónica Latinoamérica groups other members include: Telefonica Empresas, following its segregation and subsequent integration into the Telefónica Latinoamérica groups fixed line activities in Latin America during 2005; Telefónica International Wholesale Services (TIWS); and Terra Networks Latinoamérica, as a result of the merger by absorption of Terra Networks into Telefónica, S.A. in July 2005.

Brazil

Telecomunicações de São PauloTelesp

Telesp provides fixed line and other telecommunications services in the Brazilian state of São Paulo under concessions and licenses from Brazils federal government. We acquired our initial interest in Telesp in 1998 as part of a consortium that acquired a majority interest in Telesp in connection with the restructuring of Telebrás, the former Brazilian state-owned telecommunications monopoly. In mid-2000, we completed an exchange offer for the Telesp shares and ADSs held by minority investors. In July 2000, we agreed to exchange our interest in Portelcom Participações S.A., the holding company which controls Telesp Celular, for Portugal Telecoms minority interest in SP Telecomunicações S.A., the holding company through which we control Telesp and paid an aggregate of approximately U.S.$60 million to Portugal Telecom pursuant to the terms of the agreement. In December 2001, we acquired an additional 3.5% of SP Telecomunicações S.A. from Iberdrola.

Under a management contract between Telefónica Latinoamérica and Telesp, Telefónica Latinoamérica provides Telesp with management and technical support in exchange for management fees equivalent to 0.1% of Telesps revenues, as defined in the management contract. The management contract expired in December 2005 and was renegotiated and renewed.

Operations

The following table provides information with respect to Telesps fixed line telecommunications network at the dates indicated.

	At December 31,			Increase/ (Decrease)
	2003	**2004**	**2005**	**2004-2005**
Fixed telephony accesses (in thousands)	12,287.0	12,455.0	12,340.0	(0.9)%
Data and Internet accesses (in thousands)	1,368.2	2,955.5	4,261.4	44.2%(1)
Broadband accesses (in thousands)	484.4	826.4	1,690.4	104.6%(1)
Penetration rate in São Paulo	31.6%	31.7%	30.9%	(0.8) p.p.
Lines in service per employee	1,792	1,865	1,744	(6.5)%

(1) Includes the former Terra Networks group companies in Brazil at December 31, 2005.

At December 31, 2005, Telesp managed approximately 16.6 million accesses, representing an increase of 7.8% from 15.4 million accesses at December 31, 2004, due to a 104.6% increase in broadband accesses due to a 46% increase in Telesps broadband accesses as a result of its commercial efforts and the consolidation of the former Terra Networks group companies in Brazil (approximately 932 thousand accesses, of which 483.6 thousand were broadband accesses), offset in part by a 0.9% decrease in the number of fixed telephony accesses.

Telesps network is 100% digitalized. Its productivity ratio decreased to 1,744 lines in service per employee at December 31, 2005 from 1,865 lines in service per employee at December 31, 2004, principally due to a decrease in lines in service (traditional and ADSL lines) and an increase in the number of employees as at December 31, 2005 compared to December 31, 2004, mainly due to the acquisition of Atrium (an integrated telecommunications service provider to small- and medium-size enterprises) in 2005.

Fixed line voice traffic decreased 2.3% to 57,577 million minutes in 2005. This decrease was due to the increased use of mobile phones, which affected mainly long distance and public telephone traffic, to the decline in traffic in the intrastate long distance market and to the increase in pre-paid lines relative to post-paid lines, which affects fixed-to-mobile and long distance traffic because of the restrictions relating to calls made from such lines. Local fixed-to-fixed traffic increased 2.6% in 2005, while internet traffic decreased 12.3% due to the migration of customers to broadband.

Regulation. In 1997, the Telecommunications General Law was passed in Brazil (Law 9472/97) creating a National Agency for Telecommunications, or Anatel.

Concessions and Authorizations — Concessions and licenses to provide telecommunications services are granted under the public regime, while authorizations are granted under the private regime. Companies that provide services under the public regime, or public regime companies, are subject to certain obligations as to quality of service, continuity of service, universality of service, network expansion and modernization. Companies that provide services under the private regime, or private regime companies, are generally not subject to the same requirements regarding continuity or universality of service. However, they are subject to certain network expansion and quality of service obligations set forth in their authorizations. Public regime companies, including Telesp, can also offer certain telecommunications services in the private regime, including data transmission services.

Fixed-line Services (Public Regime) — Our current concession agreement was extended on December 22, 2005, for an additional period of 20 years. In accordance with the Concession Agreement before the renewal, we had notified Anatel of our intention to renew such Concession Agreement on June 30, 2003.

On December 1, 2005, we sent to Anatel the necessary evidence that we had accomplished our network expansion targets established by the Serviço Telefónica Fixo Comutado, or the STFC, for 2005. The evidence of our accomplishment was submitted by Anatel to a public hearing on December 22, 2005, which was completed on February 6, 2006. Anatel is in the process of issuing a certificate.

The renewed Concession Agreement contemplates possible changes to its terms to Anatel in 2010, 2015 and 2020. This provision permits Anatel to update the renewed Concession Agreement with respect to network expansion, modernization and quality of service targets in response to changes in technology, competition in the marketplace and domestic and international economic conditions.

Fixed-line Services (Private Regime) — The Brazilian telecommunications regulations provide for the introduction of competition in telecommunications services by requiring Anatel to authorize private regime companies to provide local and intraregional long-distance service in each of the three fixed-line regions and to provide intraregional, interregional and international long distance services throughout Brazil. Anatel has already granted authorizations to private regime operators to operate in Region III, Telesp's concession region.

Interconnection — In July 2005, Anatel published a new regulation for interconnection among providers of telecommunications services, with material changes compared to the prior regulation. Among the key changes, it became mandatory to make an interconnection public offer for all classes and types of services, requiring operators to prepare a public document setting forth all of the conditions for the establishment of interconnection. In addition to the offers that were already contained in the current model, such as the offer between STFC carriers or between STFC and SMP/SME carriers, Telesp will have to make offers to MSC authorized companies in classes III and/or IV. Moreover, those offers are required to include criteria for treating fraudulent calls. These new regulations also contemplate the reduction of the period to fulfill the new interconnection requirements.

Rates — For local network usage (TURL) and the interurban network (TU-RIU), rates are regulated by Anatel and an inflation index formula is included in the concession contract. Concession agreements also establish a price cap for annual rate adjustments, depending upon the type of service provided. Rates for international services are not required to follow the price cap.

In June 2003, Anatel prescribed new rates for Telesp's concession area. However, based on an injunction issued by a federal court, Telesp charged lower rates than those prescribed by Anatel. After the final decision regarding the legal injunction with the reincorporation of the IGP-DI as the index, the approved increases were applied in addition to the approved tariffs in June 2003. The increase was divided into two installments, the first one effective after September 1, 2004 and the second installment effective after November 1, 2004.

In June 2004, Anatel approved new rates for Telesps concession areas starting in July 2004. The approved increases were applied in addition to the tariffs determined by the legal injunction. In June 2005, new rates were approved by Anatel according to the concession agreement.

In addition, in 2006 a new index will be applicable to the adjustments of telecommunication tariffs. The current index applicable to telecommunications tariffs, Indice Geral de Preços (IGP-DI) will be replaced by the Indice Sectorial de Telecomunicações or the IST, the Telecommunications Sector Index, which was created to reflect the costs incurred by the telecommunications operators.

Competition. In addition to evolving regulatory considerations, Telesps business is affected by competition from other telecommunications providers. Telesp began to face competition in its region in July 1999 and anticipates that competition will contribute to declining prices for fixed line telecommunications services and increasing pressure on operating margins. Telesps future growth and results of operations will depend significantly on a variety of factors, including:

- Brazils economic growth and its impact on the greater demand for services;
- the costs and availability of financing; and
- the exchange rate between the *real* and other currencies.

Telesp is subject to competition for local telephone services from a mirror license holder, who was granted rights similar to those granted to Telesp as part of the privatization of Telebrás. It is subject to competition for interprovincial long distance services from a mirror license holder, Embratel and Embratels mirror license holder.

Network and Technology. In 2003, Telesp began to offer international and interregional long distance telecommunications services known as Super 15. Since 1999, Telesp has made significant investments to develop its broadband access business through ADSL technology under the brand Speedy. Telesp also offers wireless broadband connectivity to its clients through Wi-Fi.

Chile

CTC Chile

Compañía de Telecomunicaciones de Chile, or CTC Chile, a company in which we held a 44.89% stake at December 31, 2005, is the leading telecommunications operator in Chile based on number of customers, according to information provided by its competitors and regulatory authorities. As of December 31, 2005, CTC Chile owned approximately 72.5% of all telephone lines in Chile, according to its estimates.

Operations

The following table provides information with respect to CTCs fixed line telecommunications network at the dates indicated.

	At December 31,			Increase/ (Decrease)
	2003	**2004**	**2005**	**2004-2005**
Fixed telephony accesses (in thousands)	2,399.0	2,412.5	2,429.1	0.7%
Data and Internet accesses (in thousands)	487.2	473.7	483.6	2.1%

Broadband accesses (in thousands)	125.3	200.8	314.2	56.5%
Penetration rate in Chile	21.5%	22.0%	21.0%	(1.0) p.p.
Lines in service per employee	794	869	968	11.4%

CTC Chile□s accesses increased 0.9% to 2,912.7 thousand in 2005 principally due to our offering of bundled service packages and increases in broadband accesses. At December 31, 2005, the fixed telephony penetration rate

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in Chile was approximately 21%. CTC Chiles productivity ratio increased to 968 lines per employee at December 31, 2005 from 869 lines per employee at December 31, 2004, principally as a result of an increase in lines in service and workforce reductions in 2005. At December 31, 2005, CTC Chiles network was 100% digitalized, and 96.5% of its network had ADSL coverage.

Broadband accesses increased 56.5% to 314,177 thousand at December 31, 2005 from 200,794 thousand at December 31, 2004, principally due to CTC Chiles commercial efforts, including the offer of bundled service packages, undertaken during 2005.

Regulation. The regulatory framework of Chile, defined in the General Telecommunications Law (*Ley General Telecomunicaciones)*, was enacted in 1982. This law introduced competition in the telecommunications services sector in Chile (Law 18168/82 amended by Decree 1/87, Laws 19091/91 and 19302/94) and dictated provisions on licenses and permits for operating telecommunications services, rate regulation and network interconnection. Those provisions were later amended or replaced by subsequent modifications.

Regulatory authorities The following regulatory authorities exist in Chile:

- the Under-Secretary of Telecommunications (SUBTEL);
- the Ministry of Economy, Infrastructure and Reconstruction;
- the Ministry of Transport and Telecommunications; and
- the Antitrust Commission.

Licenses and Concessions Under Law No. 18,168, companies must obtain licenses in order to provide telecommunications services. Licenses granted for public and intermediate services generally have 30-year terms and may be renewed indefinitely for 30-year periods at the request of the operator (although certain licenses held by CTC Chile have longer terms).

A license may be terminated, after notice of noncompliance with the applicable technical regulations, by executive decree of the Ministry of Transport and Telecommunications, if the operator is in violation of the law or does not comply with the terms and conditions to which the license is subject. If a license is terminated, the holder is barred from applying for any license for a period of five years.

CTC Chile holds the following licenses:

- *Local Telephony Public Service.* CTC Chile holds licenses for local telephone service in all regions of Chile for a 50-year period beginning as of December 1982.
- *Multicarrier Long Distance Licenses.* CTC Chile, through Telefónica Mundo and Globus, respectively, holds 30-year licenses granted in April 1993 and licenses for an indefinite term to provide domestic and international long distance services through central switches and cable and fiber-optic networks nationwide.
- *Data Transmission.* CTC Chile, through Telefónica Empresas, holds, since March 1987, nationwide public service data transmission licenses for an indefinite term.
- *Pay TV*. In 2005, CTC Chile obtained a nationwide 10-year renewable license to provide limited satellite television service. In 2006, CTC Chile obtained a limited television service permit to provide satellite television service through CTC Chiles broadband network. The permit does not have an expiration date.

Telecommunications services in Chile are provided on a competitive basis, although access rates (for network use) must be set by the Ministry of Transport and Telecommunications and the Ministry of Economy, according to article 25 of the General Telecommunications Law.

Interconnection — Interconnection is obligatory for all license holders of public telecommunications services and intermediate services that provide long distance services. The Exempt Resolution No. 1007/95 sets the procedures and deadlines to establish and accept interconnections between networks of public telephone service and intermediate services.

Rates — Under the General Telecommunications Law, maximum tariffs for telephony services are set every five years by the Ministry of Transport and Telecommunications and the Ministry of Economy. The Antitrust Commission may subject any telephony service to price regulation, except for mobile telephone services to the public that are expressly exempted under the General Telecommunications Law.

Each maximum tariff takes into account the relevant cost components associated with providing the regulated service and is adjusted monthly in accordance with a tariff index. A distinct tariff index exists for each individual regulated service that reflects the different theoretical cost components associated with each such service.

On October 13, 2003, the Antitrust Commission issued Resolution No. 709, approving CTC Chile's request for local telephony services tariff flexibility and the ability to offer alternative plans within a framework of conditions specified by the regulator. On February 26, 2004, a framework regarding how CTC Chile may offer the above-mentioned alternative tariff plans was published. One relevant aspect is that no previous authorization is required to offer such plans. Plans are not subject to maximum levels or predetermined structures and may include joint offers with other telecommunications and non-telecommunications services.

On May 4, 2004, a new tariff decree was proposed by the Ministry of Transport and Telecommunications. CTC Chile and other operators filed appeals to the tariff decree and subsequently the Ministry resubmitted the decree to the Chilean General Controller in September 2004, and again in December 2004 with slight modifications to the document submitted in May 2004. On February 11, 2005, Tariff Decree No. 169 was published in the Official Gazette. CTC Chile has applied the new tariffs to its customers retroactively since May 6, 2004.

Argentina

Telefónica de Argentina

Telefónica de Argentina is a leading provider of fixed line public telecommunications services and basic telephone services in Argentina based on number of customers, according to information provided by its competitors and regulatory authorities. Telefónica de Argentina is licensed to provide local and domestic long distance and international services and domestic and international telex services throughout Argentina. Telefónica de Argentina's licenses do not expire but may be cancelled as a result of a failure to comply with the terms of the license. During 2000, we increased our stake in Telefónica de Argentina through a public exchange offer for Telefónica de Argentina shares and ADSs held by minority investors and our acquisition of a 50% interest in Compañía de Inversiones en Telecomunicaciones (COINTEL), which held a 52.9% stake in Telefónica de Argentina. At December 31, 2005, we held a 98.0% interest in Telefónica de Argentina.

As of December 31, 2005, approximately 57% of Telefónica de Argentina's lines in service were in the Greater Buenos Aires metropolitan area, including 20% of Telefónica de Argentina's lines in service that were located within the City of Buenos Aires. Approximately 56% of Telefónica de Argentina's lines in service as of December 31, 2005 were residential, with the remainder being professional, commercial and governmental customers.

Telefónica Latinoamérica has a management contract with Telefónica de Argentina under which it has agreed to manage Telefónica de Argentina's business and provide services and expertise regarding Telefónica de Argentina's entire range of activities in return for a percentage of Telefónica de Argentina's operating revenues equivalent to 4% of its gross revenue prior to amortization and interest expense. This contract was renegotiated during 2003 and was extended through 2008 with a five percentage point reduction of our management fee. Under the management contract, Telefónica Latinoamérica manages Telefónica de Argentina's day-to-day operations.

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Operations

The following table provides information with respect to Telefónica de Argentina's fixed line telecommunications network at the dates indicated.

	At December 31,			Increase/ (Decrease)
	2003	**2004**	**2005**	**2004-2005**
Fixed telephony accesses (in thousands)(1)	4,166.0	4,325.4	4,532.2	4.8%
Data and Internet accesses (in thousands)	768.0	890.1	902.1	1.4%
Broadband accesses (in thousands)	69.3	190.2	303.5	59.6%
Penetration rate in Argentina	22.1%	25.1%	26.0%	0.9 p.p.
Lines in service per employee	529.0	559.0	585.0	4.7%

Telefónica de Argentina's accesses increased 29.4% to 5,434.3 thousand at December 31, 2005 from 5,215.5 thousand in 2004. The fixed telephony penetration rate in Argentina was 26% at December 31, 2005. At December 31, 2005 Telefónica de Argentina's estimated market share for local telephony was 51.4%, its estimated market share for domestic long distance was 40.7% and its estimated market share for international long distance was 49.8% . Broadband accesses increased 177.9% to 303.5 thousand at December 31, 2005 from 190.2 thousand at December 31, 2004, principally due to Telefónica de Argentina's commercial efforts, including the expansion of broadband service in the southern part of the country.

Voice traffic per line increased 3.1% in 2005 from 2004, principally due to the 18.7% increase in total incoming traffic and the 28% increase in fixed-to-mobile traffic. Narrowband internet traffic decreased by 29.4%, mainly due to customers' migration to broadband services.

Regulation. The basic legal framework is set forth in the National Telecommunications Law (No. 19.798) from 1972 and in the specific regulations governing each service. Through Decree 264/98, the telecommunications market in Argentina was deregulated.

On September 3, 2000, the Argentine government issued Decree No. 764/00, which approved rules for licenses for telecommunications services, interconnection, universal service and for the administration, management and control of the radio electric spectrum.

In January 2002, the Public Emergency Law introduced significant changes to the agreements executed by the Argentine government, including those regarding utilities, such as Telefónica de Argentina's tariff agreements. This law mandated the conversion of prices and tariffs in such agreements into pesos at a rate of one peso per one U.S. dollar without the possibility of adjusting such conversion rate or indexation of any kind. It also authorizes the Argentine government to renegotiate the above-mentioned contracts.

On October 21, 2003, Law No. 25.790 became effective, extending the term for the renegotiation of the concession or licensing agreements with public utilities until December 31, 2004. This law also established that the decisions made by the Argentine government during the renegotiation process shall not be limited by, or subject to, the stipulations contained in the regulatory frameworks currently governing the concession or licensing agreements for the respective public utilities. Renegotiated agreements may cover some aspects of concession or licensing agreements and may contain formulas to adjust such agreements or temporarily amend them. The law includes the possibility of agreeing upon periodic reviews, as well as the establishment of conditions regarding the quality parameters applied to services. Law No. 25.972 extended the emergency renegotiation period until December 31, 2005. On January 10, 2006, Law No. 26.077 extended the emergency renegotiation period until December 31, 2006.

As an investor in Argentina through Telefónica de Argentina, we commenced arbitration proceedings against the Republic of Argentina before the CIADI (*Centro Internacional de Arreglo de Diferencias Relativas a*

Inversiones) based on the Reciprocal Protection of Investments Treaty between Spain and Argentina for damages suffered by us because of the measures adopted by the Argentine government. We have temporarily suspended our participation in these proceedings in light of an agreement we reached on February 15, 2006 with the Argentine government with respect to the renegotiation of Telefónica de Argentina's concession agreement. This agreement is currently subject to the Argentine Congress's approval. Once approved by the Congress it will have to be approved by a Presidential Decree. If our agreement with the Argentine government is approved by the Argentine Congress we plan to withdraw our claims against the Republic of Argentina.

Regulatory authorities — The provision of telecommunications services is regulated by the Secretary of Communications and supervised by the National Communications Commission, subject to the participation in certain cases of the Under Secretary of Competition, Deregulation and Consumer's Defense (*Sub Secretaría de la Competencia, la Desregulación y la Defensa del Consumidor*).

Licenses — The licenses, all granted for an unlimited period of time and held by Telefónica de Argentina S.A., and the regulations that govern them are:

- Decree 2344/90: License to provide fixed line telecommunications services.
- Decree 2346/90: License to provide international telecommunications services, including telex and data transmission.
- Decree 90/99: License to provide local, long distance, international and data transmission telecommunications services in the northern region.
- Resolution 1995/95: License to provide international telex services.
- Resolution SC 16/01: License to provide Internet access and international data transmission services.
- Resolution SC 59/01: License to provide data transmission.
- Resolution SC 225/03: License to provide transmission of television signals.

Interconnection — Decree No. 764/00 approved new rules for national interconnection and established interconnection standards and conditions with which telephone service providers must comply without affecting pre-existing agreements.

The rules for national interconnection set forth the basic principles to be taken into account regarding interconnection among operators such as who will be able to agree on tariffs and service terms and conditions on a non-discriminatory basis, provided that they comply with certain minimum obligations.

The regulations also establish the obligation for dominant and significant market operators to unbundle their local loops (physical link and its capacity between the carrier's capacity and the clients' facilities) and to allow competitors to use them on a technically reasonable basis. However, these regulations remain in the early stages of their development.

Rates — Decree No. 764/00 established that providers of telephone services may freely set rates and/or prices for their services, which shall be applied on a non-discriminatory basis. However, until the Secretary of Communications determines that there is effective competition for telecommunications services, the "dominant" providers in such areas, which include Telefónica de Argentina, must respect the maximum tariffs established in the general rate structure. Below the amounts established in such tariff structure, such providers may freely set their rates by areas, routes, long distance legs and/or customer groups.

The guidelines set forth in article 26 of Decree 1185/90 are still applicable for operators with significant market power. These established the information obligations that operators have with regard to the tariffs, both to clients as well as to the regulatory authority. This decree also establishes the powers that such authority has to revise and oppose such tariffs.

The Public Emergency Law converted these tariffs into pesos at a rate of one peso per one U.S. dollar and provided that the Argentine government would renegotiate the tariff regime.

Competition. Telecom Argentina, Compañía de Teléfonos del Interior S.A., an affiliate of Telmex, and Compañía de Teléfonos del Plata S.A., an affiliate of Bell South, were awarded licenses to provide the same basic telephone services throughout Argentina as of October 10, 1999. Since November 2000, other principal competitors, including Impsat Corp. and AT&T, have also entered the market, as well as smaller regional competitors.

Peru

Telefónica del Peru

At December 31, 2005, Telefónica del Peru was the leading fixed line telecommunications operator in Peru based on number of customers, according to information provided by its competitors and regulatory authorities. At December 31, 2005, we held a 98.2% interest in Telefónica del Peru.

Under a management contract between Telefónica Latinoamérica and Telefónica del Peru, Telefónica Latinoamérica provides Telefónica del Peru with management and technical support in exchange for management fees equivalent of 1% of Telefónica del Perus total revenues. This contract expires in 2014.

On April 15, 2003, OSIPTEL introduced the multicarrier dial-up service for the long distance market. This system allows callers to freely select the operator they want to use for each call. Each operator has a predetermined number that the caller dials as a prefix to the call. This service favored the entrance of new operators with lower long distance tariffs. In the domestic and international long distance markets, at December 31, 2005 Telefónica del Peru had 75% and 63% estimated market shares, respectively, compared with 72% and 63%, respectively, at December 31, 2004. TELMEX and Americatel are its main competitors. Telefónica del Peru is the leading provider of public telephone service, with TELMEX as its main competitor. In addition, Telefónica del Peru provides cable television in the Lima metropolitan area and seven other cities through its wholly owned subsidiary, Telefónica Multimedia S.A.C.

Operations

The following table provides information with respect to Telefonica del Perus fixed line telecommunications network at the dates indicated.

	At December 31,			**Increase/ (Decrease)**
	2003	**2004**	**2005**	**2004-2005**
Fixed telephony accesses (in thousands)	1,964.0	2,138.9	2,347.6	9.8%
Data and Internet accesses (in thousands)	234.2	298.2	403.2	35.2%
Broadband accesses (in thousands)(1)	90.7	205.4	340.4	65.7%
Pay TV accesses (in thousands)	363.1	389.2	462.2	18.8%
Penetration rate in Peru (lines over population)	7.2%	7.3%	7.9%	0.6 p.p.
Lines in service per employee	649.0	781.0	804.0	2.9%

(1) Includes ADSL and broadband cable accesses.

The number of Telefónica del Perus accesses increased 14.3% to 3,213.0 thousand at December 31, 2005 from 2,826.3 thousand at December 31, 2004 due to the 65.7% increase in broadband accesses, 18.8% increase in Pay TV accesses and 9.8% increase in fixed telephony accesses.

Total traffic decreased by 2.8% in 2005 from 2004. Voice traffic increased 2.2% in 2005 as a result of a 32.1% increase in international long distance traffic, a 14.4% increase in incoming interconnection traffic and a 1.7% increase in local fixed-to-fixed traffic, while internet traffic decreased 39.9% due to customers migration to broadband services.

At December 31, 2005, Telefónica del Perus network was 97% digitalized.

Regulation. The Telecommunications Act (*Texto Único Ordenado de la Ley de Telecomunicaciones*) approved in 1993 (DS 13-93-TCC) and the General Regulations implementing the statute approved in 1994 (DS 6-94-TCC 1994), as amended (D.S. 027-2004-MTC), make up the legal framework for the telecommunications sector in Peru.

Licenses and Concessions. Telefónica del Peru provides telecommunications services based on concessions granted by the Ministry of Transport and Telecommunications. The concession term is for 20 years, which may be renewed totally or partially at Telefónica del Peru's request. Total renewal is for a further 20-year period. Partial renewal is for periods of up to five additional years. Once a regulated operator chooses either a partial or total renewal modality, they cannot switch. Telefónica del Peru selected a partial renewal modality, which will allow Telefónica del Peru to renew its term every five years from the effective date, up to a maximum of 20 years. Under the terms of Telefónica del Peru's concession contracts, the Ministry of Transport and Telecommunications may choose not to renew or extend Telefónica del Peru's contracts if it has repeatedly not complied with the terms of its concessions contracts as determined by the Peruvian government. A partial renewal of five years was approved by Ministry Resolution No 272-92 dated June 21, 1999, extending the concession term until 2019.

In December 2003, Telefónica del Peru petitioned the government for a five-year extension of its concession contracts from 2019 to 2024. In June 2004, the Ministry of Transport and Telecommunications notified Telefónica del Peru of its recommendation not to renew the concession contracts for an additional five-year period. As of the date of this Annual Report, a final decision has not been issued. If the request for extension is denied, then Telefónica del Peru may again petition for the additional five-year extension period from 2019 to 2024 in December 2008. The maximum period of the contract is through 2034.

Rates – The tariffs for the services regulated following the period of limited concurrence must be approved by OSIPTEL in accordance with a price cap formula based on a productivity factor.

On July 19, 2004, OSIPTEL set the value of the productivity factor for the 2004 to 2007 period at an annual rate of 10.1% and 7.8% for local and long distance calls, respectively. The productivity factor set is applicable until August 31, 2007. A review process shall be put in place every three years.

Interconnection prices – Interconnection charges have exhibited a downward trend. Except for charges for call termination in the local fixed network, which are set on the basis of costs, charges were established using the international comparison method. However, OSIPTEL has initiated several administrative procedures to set new interconnection charges for several services.

Telefónica Empresas América

During 2005, we continued implementing certain measures to simplify our business lines by integrating the former Telefónica Empresas business line's operations into the Spanish and Latin American fixed line businesses. Pursuant to this reorganization, the operations of Telefónica Empresas América, or TEA, and Telefónica International Wholesale Services, or TIWS, are now conducted by Telefónica Latinoamérica.

TEA is a holding company for operations in Latin America focused on corporate communication services, including voice services, private virtual networks, Internet connectivity, International data services, hosting and other company solutions.

After the spin-off in 2001 of the data transmission operations of the integrated telecommunications operators in Brazil, Argentina and Peru into TEA and together with its other operations in Colombia, Mexico and the United States, TEA offers a unique network platform for the provision of corporate data transmission services to multinational clients in Latin America.

TEA's strategy in each country depends on the status of development of its network and its market share. In those countries in which our Group holds a leading position, TEA concentrates on offering "one-stop shopping" services and customized communications solutions to corporate customers, with particular emphasis on value added services, such as hosting, content delivery and e-solutions. We refer to these markets as TEA∏s ∏incumbent markets∏. In those countries where TEA is a new entrant, TEA offers a complete portfolio of IP services and packaged solutions to the most attractive market segments, such as small and medium-sized enterprises, Internet service providers and other Telefónica Group companies. We refer to these markets as TEAs expansion markets.

Incumbent Markets

TEAs incumbent markets include Brazil, Argentina, Chile and Peru. TEA manages operations focused on significant clients of the Telefónica Group. At December 31, 2005, TEA had 48,483 end user connections in Brazil, 9,979 in Argentina, 5,676 in Peru and 17,503 in Chile.

Expansion Markets

TEAs expansion markets include Colombia, Mexico, Puerto Rico and the United States. At December 31, 2005, TEA had an aggregate of 3,686 end user connections in these expansion markets.

Telefónica International Wholesale Services

In 2002, Telefónica Datas international network included the international data transmission services and the international services integrated in Telefónica DataCorp. During 2003, Telefónica DataCorp transferred its international network to Telefónica International Wholesale Services (TIWS), a new business line of the Telefónica Group. TIWS was created to become a global wholesale operator of data, voice and broadband capacity.

Since 2003, TIWS is the business unit responsible for other telecommunications operators and for managing the Groups international services and the network which supports these services.

Terra Networks Latinoamérica

Pursuant to its merger by absorption into Telefónica, as of July 2005, Terra Networks operations in the United States and Latin America (Terra Networks Latinoamérica) are now conducted through Telefónica Latinoamérica. Terra Networks Latinoaméricas results have been included in our Telefónica Latinoamérica business line since July 2005.

Terra Networks Latinoamérica is a leading interactive services provider in Latin America, offering Internet access and local language interactive content and services to more than 4.7 million pay customers in Brazil (including 0.48 million broadband customers in Brazil, which we have reflected under our discussion of Telesp above), Mexico, Peru, Chile, Argentina, Venezuela, Colombia, the United States and Central America at December 31, 2005.

Cesky Group

On April 12, 2005, we signed an agreement with the Czech government to purchase its 51.1% stake in Cesky Telecom a.s. As a result of our acquisition of the Czech governments 51.1% stake in Cesky Telecom a.s. for €2.7 billion, we were required to conduct a public tender offer for all of the remaining outstanding shares of Cesky Telecom a.s. Pursuant to the tender offer, we acquired an additional 18.3% interest in Cesky Telecom a.s. for approximately €911 million. As of December 31, 2005, we held a 69.4% interest in Cesky Telecom a.s.

The Cesky Group is comprised of Cesky Telecom a.s. (Cesky), Eurotel Praha, spol.s.r.o. (Eurotel) and several other companies specializing in the provision of telecommunications or related services. The Cesky Group offers a broad range of voice and data services using fixed line and mobile technologies, including access to network infrastructure for other telecommunications operators and providers of both public and private networks and services. On March 1, 2006, Cesky Group announced the approval of its board of directors intention to integrate its fixed line and mobile operations into a new integrated telecommunications operator.

Most of services of the Cesky Group are provided in the Czech Republic. The Cesky Group provides services to four main customer segments: residential, small- and medium-size enterprises, corporate clients and the government. Additionally, the Cesky Group provides wholesale services to other public telecommunications network operators and provides of public telecommunications services in the Czech Republic, Austria, Slovakia and Germany.

Cesky

The principal services offered by Cesky, our fixed line business in the Czech Republic, are:

- Traditional fixed line telecommunication services, principally including PSTN lines; ISDN access; public telephone services; local, domestic and international long distance and fixed-to-mobile communications services; supplementary value-added services (such as call waiting, call forwarding, three-party service, voice and text messaging, advanced voicemail services and conference-call facilities); intelligent network services; leasing and sale of terminal equipment; and telephony information services.

- Internet and broadband multimedia services, principally including narrowband switched access to Internet; retail and wholesale broadband access, through ADSL; and residential-oriented value-added services (such as instant messaging, concerts and videoclips by streaming, e-learning, parental control, firewall and anti-virus).

- Data and business-solutions services, principally including leased lines; VPN services; and hosting and ASP service.

- Wholesale services for telecommunication operators, principally including domestic interconnection services; international wholesale services; leased lines for other operators network deployment; and local loop leasing under the unbundled local loop regulation framework.

Operations

The following table presents, at the dates indicated, selected statistical data relating to Cesky.

	At December 31,			Increase/ (Decrease)
	2003	**2004**	**2005**	**2004-2005**
Fixed telephony accesses (in thousands)	3,585	3,368	3,126	(7.2)%
Broadband accesses (in thousands)	15	101	274	171.3%
Penetration rate in Czech Republic	36%	34%	32%	(2.0) p.p.
Lines in service per employee	329	383	415	8.4%

As at December 31, 2005, Cesky had 3,126,016 fixed telephony accesses (mainly telephone lines, including ISDN lines), of which 2,127,957 were residential lines, 972,057 were business lines and 25,486 were pay telephones. The total number of fixed telephony accesses at December 31, 2005 decreased by 242,310 from December 31, 2004. This decrease was mainly due to the rapid increase in mobile penetration in the Czech Republic, as customers have substituted their use of fixed lines for mobile phones to a greater extent than in other countries. This decrease was offset in part by the rate rebalancing of monthly access fees, which the company was able to agree with the regulator on favorable terms.

The minutes of traffic generated in 2005 decreased by 29.2% compared to 2004 as a result of both migration of Internet dial up traffic to broadband connections and the substitution effect of mobile for fixed line traffic.

Regulation

The regulatory environment for the electronic communications market in the Czech Republic experienced a number of changes in the course of 2005. The most significant development was the substitution of the Act No. 151/2000 Coll., on telecommunications, as amended (Telecommunications Act) by a new law, the Act No.

127/2005 Coll., on electronic communications, as amended (Act on Electronic Communications), effective from May 1, 2005, and the subsequent adoption of related laws (government regulations, decrees and general provisions).

The telecommunications industry in the Czech Republic is regulated by the Ministry of Informatics of the Czech Republic (MoI) and the Czech Telecommunications Office (CTO). The authority of the MoI relates mostly to policy making and international relations, whereas regulatory authority resides mainly in the CTO. Market competition is regulated by the Office for Protection of Economic Competition (OPEC).

Under the Act on Electronic Communications, Cesky provides electronic communications services on the basis of its notification to the CTO dated October 7, 2005 No.: 31618/2005-631. The telecommunications license previously granted to Cesky by CTO decision ref. no.: 38155/2001/I-603 dated March 4, 2005 ceased to be effective due to the changes in the legislation which eliminated the license regime as a result of which electronic communication services are currently provided only on the basis of notification to the CTO. Cesky Telecom has received the relevant certificates from the CTO. These certificates are not restricted for a certain period of time. In addition to these basic certificates relating to its core businesses, Cesky Telecom holds various other licenses, authorizations and permissions for specific services, some of which have expiry dates.

Universal Service

The CTO requires Cesky to provide universal service in the public interest on a public fixed telecommunications network. Cesky was determined by the CTO pursuant to the Act on Electronic Communications as a universal service provider in the following areas:

- regular publication of telephone directories in the area of the public telephone service and provision of access to users of these directories under Section 38(2c) of the Act on Electronic Communications;
- directory information service in the area of the public telephone service and provision of access to users of the information service under Section 39(2d) of the Act on Electronic Communications; and
- public telephone booth services under Section 38(2e) of the Act on Electronic Communications.

Cesky is still awaiting the decision of the CTO with respect to other services that shall form a part of the universal service, especially the service of access in the fixed point to the publicly available telephone service and connection in the fixed point to the public telephone network. The CTO was required to issue a decision regarding these services by the end of January 2006, but the decision has not yet been issued.

Pending the introduction of the other universal service elements under the Act on Electronic Communications, Cesky remains the only universal service provider under the conditions of the Regulatory Framework set forth in the Act on Electronic Communications, related laws and telecommunications licenses.

Competition

The liberalization of the Czech telecommunications market has attracted many alternative telecommunications operators. In the past, most of these alternative telecommunications operators concentrated on providing services to corporate customers. Via carrier selection and pre-selection, these alternative telecommunications providers began to focus on providing voice services to residential customers and recently on providing Internet access to the retail market. 2005 was characterized by the consolidation of several small telecommunications operators by GTS Novera and its sole shareholder, GTS Central Europe (GTS CE). GTS Novera became the largest alternative telecommunications operator in the Czech fixed line market after the merger of two biggest alternative telecommunications operators GTS CZECH and Aliatel in February 2005. On November 29, 2005, GTS CE signed a purchase agreement for 100% of the shares of Contactel. On December 6, 2005, GTS CE reached an agreement with Telenor of Norway to acquire 100% of the shares of Telenor Networks and Nextra. According to publicly available information, the market share of alternative telecommunications operators as at the end of 2005 in terms of revenues was approximately 33%.

Tariffs

Retail tariffs for Ceskys voice services are currently regulated. The main feature of the regulation of retail tariffs is the establishment of maximum prices for monthly access charges and voice services. Beginning May 1, 2006, it is expected that retail tariffs will no longer be regulated and that prices will be based on market competition.

Eurotel

Eurotel is the largest provider of wireless voice and data services in the Czech Republic in terms of customers. Customers can choose from an extensive portfolio of mobile voice and data services. Eurotel provides these services via its 450 MHz Nordic mobile telephone network (NMT) network and 900/1800 MHz GSM network. Eurotel offers voice and SMS services, as well as mobile Internet access, WAP and a wide range of multimedia services and content, including video and MMS.

On December 1, 2005, Eurotel started the commercial operation of its UMTS network. Eurotel was the first Czech mobile operator to launch UMTS services, comprising data as well as voice, video and multimedia transmission in real time. These services are available to both contract and pre-paid customers.

Eurotel also offers a wide range of value added services:

- Eurotel Asistent 1188telephone directory services;
- Voice mail, call waiting, conference calls and caller identification;
- SIM card-embedded services: two telephone numbers on one card SIM or one number on two SIM cards;
- SMS to fixed line; and
- Access to corporate mail applications, integrating corporate e-mail with an SMS gateway, for corporate customers.

Operations

The following table presents, at the dates indicated, selected statistical data relating to Eurotel.

	At December 31,		
	2003	**2004**	**2005**
	(in thousands)		
Total customers	4,215	4,394	4,676
Contract customers	885	1,058	1,546
Population in service territory	10,211	10,210	10,210

With approximately 4.7 million customers at December 31, 2005, Eurotel is the largest provider of wireless voice and data services in the Czech Republic. Eurotel is also the leading mobile Internet provider in the Czech Republic. At December 31, 2005, the wireless penetration rate in the Czech Republic was 112%.

Network and technology

Eurotel was the first operator to offer wireless services in the Czech Republic. In 1991, Eurotel obtained a license to operate a 450 MHz network and started operating in the same year. In 1996, it obtained a license to operate a 900 MHz network, and in 1999, it obtained a license to operate an 1800 MHz network, in each case using GSM technology. Each of Eurotels licenses was issued for a period of 20 years.

Eurotel uses mainly GSM technology for its voice services. In 2004, however, it began to use a 450 MHz NMT network for wireless data services, thus becoming the first European operator to use the latest CDMA2000 1xEV-DO technology for high-speed Internet access.

Eurotel uses GPRS, high-speed circuit-switched data (HSCSD), code division multiple access 1x evolution-data optimized technology (a technology that offers near-broadband packet data speeds for wireless access to the internet) (CDMA2000 1xEV-DO) and wireless fidelity (Wi-Fi) technologies to offer a broad range of Internet access services.

Currently, Eurotels 900/1800 MHz networks cover 99% of the population in the Czech Republic.

Regulation

Eurotel conducts its operations on the basis of general authorizations. Eurotel has notified its operations to the CTO and has received the relevant certificates from the CTO. These certificates are not restricted for a certain period of time. In addition to these basic certificates relating to its core businesses, Eurotel holds various other licenses, authorizations and permissions for specific services, some of which have expiry dates.

Unlike the fixed line telephone market, where the CTO regulates primarily the revenues from telecommunications services, universal service prices and interconnection prices, the main area of regulation in the mobile telephone market is the determination of the prices for interconnection to public mobile networks. In its pricing decision no. 02/PROP/2005, effective as of April 1, 2005, the CTO reduced the maximum price for interconnection to public telecommunications networks for the service of call termination in public mobile telecommunications networks by 2.5%, from CZK 3.19 per minute to CZK 3.11 per minute.

The Act on Electronic Communications requires mobile operators to provide mobile number portability. A mobile number portability solution was developed, tested and put in operation jointly by mobile operators in the Czech Republic and such service has been available since January 15, 2006.

Competition

The three principal mobile operators in the Czech Republic are Eurotel, Oskar Mobil and T-Mobile. In June 2005, the Vodafone Group acquired the newest mobile operator in the Czech Republic, Oskar Mobil. At December 31, 2005, Eurotel had an estimated 41% market share, followed by T-Mobile with an estimated 40% market share and Oskar/Vodafone with an estimated 19% market share.

Tariffs

Tariffs are freely established by telecommunications providers, subject to regulation by the CTO. Interconnection prices are set by the CTO.

Telefónica ContenidosAudio-visual Media and Content Business in Europe and Latin America

Telefónica Contenidos conducts our worldwide audio-visual content and media business. Telefónica Contenidos develops and distributes audiovisual content through traditional media and new technology platforms.

During the last three years, Telefónica Contenidos has divested its non-strategic assets, including sales of its interests in: Antena 3 and the Onda Cero radio network; Lolafilms, a Spanish motion picture production company; Rodven, a Venezuelan record company; Mediapark, a Spanish television channel production company; Radio Continental and Radio Estereo, two Argentine radio companies owned by Atlantida de Comunicaciones; and Torneos y Competencias, the company that holds the broadcasting rights for the Argentine national soccer league. In September 2004, Telefónica Contenidos sold its 5% stake in Pearson, plc for €345 million.

Endemol Entertainment

In July 2000, we acquired 99.2% of Endemol Entertainment Holding N.V., or Endemol, one of Europes leading television producers. Endemol develops and produces audiovisual programming for free-to-air television, pay television and the Internet. Endemol has produced reality television shows such as Big Brother, Fear Factor and Operación Triunfo.

In November 2005, we sold a 25% interest in Endemol N.V. through a public offering outside of the United States for an aggregate amount of approximately €281.25 million. Endemol N.V. shares are currently listed on Euronext Amsterdam.

Endemol has a very strong international network built by a combination of start-ups, acquisitions and joint ventures, with operations in 23 countries around the world.

With the further development of the Internet and increased capabilities of mobile telephony to provide new platforms suitable for delivering entertainment content that attracts younger audiences (which are more appealing to advertisers) away from traditional television production, Endemol has refined its interactive strategy by focusing on brand development, bringing content to other channels by using Endemol TV brands and developing new content for other channels and platforms.

Endemol continues to develop its strategy of geographic diversification. In 2005, Endemol started operations in Thailand and India. In 2004, Endemol started operations in Russia, Chile and Colombia.

ATCO

Telefónica Contenidos controls ATCO, a holding company that owns of Telefé, a television company in Argentina. Telefé owns a leading free-to-air television channel in Argentina in terms of audience and a broadcasting producer.

Pay Television

We hold a minority stake in Sogecable, a satellite pay TV company with operations in analog pay TV (until November 2005), thematic channels, film production and distribution. Sogecable was created in 2003 as a result of the integration of the two then existing satellite digital television platforms in Spain. The other shareholders in Sogecable are Grupo Prisa and Vivendi Universal, with whom Telefónica Contenidos signed an agreement providing for equal corporate governance rights among the three parties.

Following the integration of the two platforms in July 2003, Sogecable, launched commercial advertisements under the brand Digital+. At December 31, 2005, Sogecable had 1.96 million subscribers. In November 2005, Sogecable launched Cuatro, a new free-to-air television station, after the Spanish governments approval of the modification of the Canal+ license, removing the restrictions on the number of hours of open broadcasting. Since that time, Canal+, the premium pay-tv channel, is only available on Digital+.

In March 2006, we sold shares representing a 6.57% stake in Sogecable to Prisa in connection with their tender offer for shares of Sogecable. Following such sale and the consummation of Prisas tender offer, we held a 17.3% stake in Sogecable, while Prisa held a 44.5% stake.

In March 2006, Sogecables shareholders approved a capital increase in exchange for shares of its affiliate, Canal Satelite Digital, S.L. not owned by Sogecable. As a result of such capital increase, our stake in Sogecable was diluted to 16.84% .

Telefónica Servicios Audiovisuales and Hispasat

Through Telefónica Servicios Audiovisuales, we offer audiovisual transmission services, production services and systems integration services to the audiovisual industry. Telefónica Contenidos also holds a 13.2% interest in Hispasat, a Spanish satellite communications system.

Directories BusinessTelephone Directory Business in Europe and Latin America

Telefónica Publicidad e Información publishes, develops and sells advertising in telephone directories. In addition to printed directories, it offers directories online and in telephone-based format. Telefónica Publicidad e Información has operations in Spain, Brazil, Chile and Peru. In addition, Telinver is the Groups telephone directory subsidiary in Argentina. In 2005, we commenced offering telephone directory assistance in Italy.

At December 31, 2005, we held a 59.90% interest in TPI. On February 28, 2006, the Board of Directors of Telefónica resolved to explore strategic alternatives in relation to Telefónicas holding in the share capital of

Telefónica Publicidad e Información, S.A. (TPI), which operates our directories business, including a possible total or partial divestiture of its holdings in that company. Telefónica intends to explore such a sale with potential buyers.

AtentoCall Center Business

Atento offers integrated telephone assistance services as well as sophisticated customer relationship management services such as the development and implementation of customer loyalty programs, telemarketing services and market research. In addition, Atento rents call centers and provides staff for such centers to third parties. Atento has sought to diversify its client base and serves companies in the financial, consumer and energy sectors, as well as public institutions. At December 31, 2005, Atento operated more than 61 call centers and had 96,003 call center personnel in 12 countries on three continents, including Europe (Spain), Latin America and Northern Africa (Morocco).

O2

In order to integrate O2 into the Telefónica Group, in 2006 we expect to add a new business line that will be principally comprised of O2 and will also include Cesky Telecom and Telefónica Deutschland.

O2 is a leading provider of mobile communications services in Europe, with operations in the United Kingdom, Germany, Ireland and the Isle of Man. At December 31, 2005, O2 had approximately 27,419 thousand mobile customers, of which 39.8% were contract customers and 60.2% were prepaid customers. At that date, O2 had approximately 16,045 employees.

Operations

United Kingdom. O2 is the a leading mobile operator in the United Kingdom with approximately 15,981 thousand customers at December 31, 2005. O2 has a strong presence in business and mobile data services.

O2 provided analog mobile telephone services from January 1985 until October 2000 and has provided GSM services since July 1994. In June 2000, O2 launched GPRS services to the U.K. market. O2 was awarded one of the five UMTS licenses in the United Kingdom in April 2000 for £4.03 billion and completed the roll out of the first phase of its UMTS network in the United Kingdom in 2004. O2 commenced offering initial UMTS services to corporate customers in October 2004 and to retail customers in February 2005. In addition, following a five-year network roll-out that was also completed in 2004, O2 also provides nationwide mobile radio services designed to service the needs of police and emergency services personnel in England, Wales and Scotland.

O2 also has a 50% interest in a joint venture, Tesco Mobile, to sell exclusively Tesco branded mobile services in Tesco stores across the United Kingdom, using O2s technology and network.

The following table presents, at the dates indicated, selected statistical data relating to O2s operations in the United Kingdom.

	At December 31,	
	2004	**2005**
Total mobile customers (in thousands)	14,216	15,981
Pre-paid customers (in thousands)	9,341	10,479

Germany. O2 is a mobile operator in Germany with approximately 9,769 thousand customers at December 31, 2005.

In May 1997, O2 was awarded the fourth German GSM license and launched GSM mobile services in October 1998. In January 2001, O2 launched its GPRS service. O2 was awarded a UMTS license in Germany in August 2000 for an equivalent of £5.16 billion. O2 provides services through roaming agreements with other operators, including its agreement with T-Mobile, in the areas where it has not developed its own network. O2 is in the process of deploying its own UMTS network in Germany to offer high quality mobile services and to reduce its reliance on roaming agreements with other operators to provide its services.

The following table presents, at the dates indicated, selected statistical data relating to O2's operations in Germany.

	At December 31,	
	2004	2005
Total mobile customers (in thousands)	7,399	9,769
Pre-paid customers (in thousands)	3,254	4,799

Ireland. O2 is a mobile operator in Ireland with approximately 1,602 thousand customers at December 31, 2005.

O2 launched its commercial GSM services in Ireland in March 1997 and its GPRS service in Ireland in January 2002. In October 2002, O2 was awarded one of four UMTS licenses offered by the Irish government.

The following table presents, at the dates indicated, selected statistical data relating to O2s operations in Ireland.

	At December 31,	
	2004	2005
Total mobile customers (in thousands)	1,516	1,602
Pre-paid customers (in thousands)	1,118	1,173

Isle of Man. O2 provides mobile and fixed line and Internet services on the Isle of Man. At December 31, 2005, O2 had 67,000 customers on the Isle of Man.

O2s business in the Isle of Man, Manx Telecom, was awarded in 1987 a 20-year license to operate the Isle of Mans telecommunications network. The license originally covered fixed line telephony, but was expanded in 1994 to include GSM mobile services and in 1999 to include UMTS services. Manx Telecom launched Europes first UMTS network in December 2001. On January 1, 2004, Manx Telecom was awarded a license extension for 15 years. Manx Telecom is the only provider of mobile and fixed telephony on the Isle of Man. Furthermore, Manx Telecom has continued with its major investment program to make broadband available to as many customers on the Isle of Man as possible.

The following table presents, at the dates indicated, selected statistical data relating to O2s operations on the Isle of Man.

	At December 31,	
	2004	2005
Total customers (in thousands)	63.0	67.0
Pre-paid customers (in thousands)	41.0	45.0

Selected Financial Information

The following table presents selected consolidated financial data of O2. The consolidated income statement data for the fiscal year ended March 31, 2005 and the consolidated balance sheet data as of March 31, 2005 set forth below are derived from O2s consolidated financial statements. O2s consolidated financial statements as of and for the fiscal year ended March 31, 2005 are not included in this Annual Report. O2s consolidated financial statements as of and for the fiscal year ended March 31, 2005 have been prepared in accordance with accounting principles generally accepted in the United Kingdom (UK GAAP). IFRS differs in certain significant respects from

UK GAAP.

	As of or for the year ended March 31, 2005
	(£ in millions)
UK GAAP	
Consolidated Income Statement Data	
Group turnover	6,890
Net operating expenses (including exceptional items)	(6,342)
Group operating profit	341

	As of or for the year ended March 31, 2005
	(£ in millions)
Profit on ordinary activities before taxation	309
Profit for the financial year	301
Consolidated Balance Sheet Data	
Fixed assets	11,496
Net current assets	442
Net assets	10,281
Shareholders funds	10,281

Regulation of O2

O2 is subject to national regulation in each of the countries in which it operates, as well as EU-wide regulation.

Regulation in the European Union. Regulation in the European Union is governed by the EU regulatory framework for the electronic communications sector (the EU Framework). The EU Framework comprises four principal Directives. Among other things, the Directives set out policy objectives and regulatory principles that National Regulatory Authorities (NRAs) must follow. The Directives provide for a new authorization system for companies which provide electronic communications networks and services, contain measures to ensure the universal provision of basic services to consumers and set out the terms on which providers may access each others networks and services. Importantly, the EU Framework also harmonizes the rules for deciding when regulation may be imposed on electronic communications providers. In particular, it provides that electronic communications providers can usually only be subject to specific regulation in markets in which they have SMP (equivalent to market dominance).

Currently, the European Commission is in its second and final phase of consultations on a proposed EU regulation with respect to international roaming charges. See Telefónica MóvilesMobile Business in Spain and Latin AmericaSpainRegulation. If such regulation were to be adopted, it could adversely affect O2 and its operations.

Regulation in the United Kingdom.

Implementation of the New EU Regulatory Framework The EU Framework was implemented in the United Kingdom by the Communications Act 2003 (the Communications Act) on July 25, 2003. Under the Communications Act, responsibility for the regulation of electronic communications networks and services rests with the Office of Communications (Ofcom).

Market reviews In June 2004, Ofcom completed its review of voice call termination on individual mobile networks. As a result of that review, Ofcom concluded that the charges O2 made to other operators for terminating calls on the O2 network had to be cut. From September 1, 2004, Ofcom required O2 to lower its call termination charges from an average of 8.03 pence per minute to an average of 5.63 pence per minute.

National roaming O2 in the UK and Vodafone are subject to an obligation to negotiate a national roaming agreement with the new entrant mobile network operator, 3 (the National Roaming Condition). In accordance with this obligation, O2 entered into an agreement with 3 to permit it to use O2s second generation network to originate and terminate calls to and from its subscribers while it builds its own UMTS network. On December 22, 2004, 3 invited mobile operators to tender for the supply of second generation roaming services to 3 when the exclusivity period in their agreement with O2 expires. Although Ofcom proposed discontinuing the National Roaming Condition in July 2004, its decision on this issue has been postponed pending the outcome of 3s tendering exercise.

Future Mobile Spectrum In January 2005, Ofcom began consultations on the release of future mobile spectrum over the next five years. Of particular importance will be the UMTS expansion band (2500MHz-2690MHz).

Regulation in Germany. The EU Framework was implemented in Germany at the end of June 2004 by the Telecommunication Act. Responsibility for regulation of electronic communications networks and services rests with the telecommunications regulator, RegTP.

Regulation in Ireland. The EU Framework was implemented into Irish law on 25 July 2003. Responsibility for regulation of the communications industry in Ireland lies with a three-person regulatory body, known as the Commission for Communications Regulation (ComReg).

Regulation in the Isle of Man. The Isle of Man is a self-governing Crown Dependency with its own parliament and is not part of the United Kingdom or the EU. Accordingly, Manx legislation and regulations predominantly govern operations in the Isle of Man.

International Strategic Partnerships

China Netcom

In June 2005, Telefónica Internacional acquired through open market purchases 2.99% of the outstanding shares of China Netcom Group Corporation (Hong Kong) Limited, a Chinese telecommunications company, for an equivalent of approximately €240 million. In September 2005, Telefónica Internacional increased its stake in China Netcom Group Corporation (Hong Kong) Limited to 5.0% of its outstanding shares through open market purchases for an equivalent of approximately €427.9 million. As a result of our shareholdings in China Netcom Group Corporation (Hong Kong) Limited, we have the right to appoint one of the company's directors. On September 12, 2005, José María Alvárez-Pallete López was appointed as a member of China Netcom Group Corporation (Hong Kong) Limited's Board of Directors and is also a member of China Netcom Group Corporation (Hong Kong) Limited's Strategic Planning Committee.

Portugal Telecom

At December 31, 2005, we held a 9.84% effective interest in Portugal Telecom, our joint venture partner in Brazil. See —Telefónica Móviles—Mobile Business in Spain and Latin America.

Mobipay

Telefónica Móviles is jointly developing with other telecommunications companies a new, simple, fast, low cost and secure mobile payment system, under the Mobipay brand, to process automated transactions including vending machines, personal money transfers, micropayments and electronic invoicing. For a description of Mobipay and other m-pay initiatives see —Telefónica Móviles—Mobile Business in Spain and Latin America—Services and Products.

Our Strategic Alliance with Banco Bilbao Vizcaya Argentaria

Uno-e Bank

In February 2000, we and Banco Bilbao Vizcaya Argentaria, S.A. entered into a strategic alliance agreement, which provided that the online bank, Uno-e, would be 49%-owned by Terra Lycos and 51%-owned by Banco Bilbao Vizcaya Argentaria, S.A. On May 15, 2002, Terra Networks, S.A. and Banco Bilbao Vizcaya Argentaria, S.A. agreed to merge Uno-e Bank, S.A. with Finanzia Banco de Crédito, S.A., a wholly owned subsidiary of Banco Bilbao Vizcaya Argentaria, S.A. On January 10, 2003, Terra Networks, S.A. signed a liquidity contract that replaced a previous agreement. The liquidity contract grants Terra Networks a put option to sell its interest in the merged entity to Banco Bilbao Vizcaya Argentaria, S.A. between April 1, 2005 and September 30, 2007. The sale price will be the greater of (i) the value determined by an investment bank or (ii) the value calculated by multiplying Uno-e□s earnings for the most recent fiscal year by BBVA□s price-to-earnings ratio. Additionally, the contract provides that if Uno-e does not obtain certain ordinary revenue and earnings before taxes, the aggregate market value of the shares

Terra Networks, S.A. owns cannot be valued at less than €148.5 million. In June 2003, Finanzia Banco de Crédito, S.A. contributed its consumer finance business to Uno-e Bank in exchange for ordinary shares of Uno-e Bank S.A. At December 31, 2005, Terra Networks, S.A. (now Telefónica, S.A.) and the BBVA Group held a 33% and 67% stake in Uno-e Bank, S.A., respectively.

Seasonality

Our main business is not significantly affected by seasonal trends.

Patents

Our business is not materially dependent upon the ownership of patents, commercial or financial contracts or new manufacturing processes.

C. ORGANIZATIONAL STRUCTURE

Please see "—History and Development of the Company—Overview".

D. PROPERTY, PLANT AND EQUIPMENT

Spain

Fixed lines

In order to provide residential and other telecommunications services in Spain, we operate a full telecommunications services network. We benefit from an intensive capital investment plan carried out over the last decade, which focused on network expansion as well as network upgrading. As a result, we now have:

- A network consisting of fiber optical cable to the curb in every Spanish city with a population of more than 50,000 inhabitants;
- Switching including synchronous digital hierarchy;
- An asynchronous transfer mode rollout (ATM); and
- System 7 signaling throughout (used for commutation circuits networks).

Our infrastructure development objective is to achieve a fully digital system which allows simultaneous voice, data, text, and image transmission, and which permits cost-efficient network management and maintenance. Consistent with this aim, we are moving towards a simplified two-level hierarchical network through the use of remote units, and we are presently increasing operational efficiencies through centralization of our network supervision and management functions. The local digitalization rate in our network has increased from 56.7% in 1995 to 95.62% as of December 31, 2005, and our long distance lines are now 100% digitalized.

In carrying out our infrastructure development program, we have increased the use of fiber optical cable in our network.

The following table shows the total length of the four basic types of cable used in our network:

	At December 31,				
	2001	2002	2003	2004	2005

Coaxial cable (Km.)	4,756	2,468	2,457	2,444	2,441
Optical fiber cable (Km.)	58,156	60,932	64,934	75,888	80,093
Copper cable in interurban links (Km. aerial cable)	57,095	56,753	56,492	59,324	59,326

The deployment of broadband infrastructure at December 31, 2005 is as follows:

	At December 31, 2005
ADSL connections (in thousands)	3,533
ADSL lines over Basic Telephony Network (BTN)	3,409
ADSL lines over ISDN	144
Switchboards with ADSL over BTN	4,659
Switchboards with ADSL over ISDN	1,235
Degree of DSLAM equipment occupation (%)	92.3%
Average time of retail ADSL service provision in PSTN and ISDN (in days)	12.48
ADSL lines subscribed per 100 inhabitants	10.5

Our number of ADSL lines subscribed per 100 BTN and/or ISDN access lines at December 31, 2005 were as follows:

	Lines	ADSL	Coverage
BTN (in thousands)	148.38	236.01	15.9%
ISDN	931.90	129.94	13.9%
Total	157.70	249.01	15.8%

The Spanish demography and topography presents significant challenges regarding the provision of basic telephony services throughout the country, especially to rural areas. Our continuous plan of rural expansion has been partly fostered by the Spanish local authorities. We are capable of using alternative technologies in order to extend the provision of services to remote and underpopulated areas according to our universal service obligations. Wireless access services have been established in areas in which wireless service could be provided at a lower cost per customer than fixed line telephony services.

Wireless Networks

Telefónica Móviles España's digital network in Spain is based on the GSM standard, which has been adopted by more than 130 countries worldwide, including all member countries of the European Union. The wide acceptance of the GSM standard, together with its international roaming agreements, enables Telefónica Móviles España's customers to make and receive calls throughout Western Europe and in more than 200 countries worldwide. Telefónica Móviles España's GSM-based network provides its customers with access to many of the most advanced wireless services and a full portfolio of services and products. In addition, in 2001 Telefónica Móviles España launched a general packet radio service, or GPRS, which permits faster-based technology for the transmission of data and improved networks utilization.

To continue increasing the GSM network's capacity and in order to improve network coverage quality in highly populated areas and to allow for a more intensive use of its network inside offices in urban areas, Telefónica Móviles España has continued rolling out its UMTS network in compliance with its obligations under its UMTS license. In June 2002, we fulfilled the Spanish government's requirements regarding the initial roll-out for our UTMS network. In October 2003, Telefónica Móviles was the first mobile operator in Spain to launch a pre-commercial service based on UMTS technology and in 2004, Telefónica Móviles launched its commercial UMTS service in Spain.

Argentina

Telefónica de Argentina’s properties consist of transmission plants and exchange equipment. Most of Telefónica de Argentina’s properties are located in and around the Buenos Aires region.

As of December 31, 2005, the telephony service has approximately 4.4 million lines in service with approximately 26 lines in service per each 100 inhabitants in the southern region.

Telefónica de Argentina’s long distance service is provided mainly through a microwave network using analog lines and switchboards. As of December 2005, Telefónica de Argentina had built approximately 19,000 kilometers of optical fiber network, of which 5,300 kilometers were located in the northern region and are dedicated to the provision of national long-distance services between Argentina's main cities.

Brazil

Network and Facilities

Telesp's network includes installed lines and switches, an access lines network connecting customers to switches and trunk lines connecting switches and long-distance transmission equipment. As of December 31, 2005, our regional telephone network in Brazil included approximately 14.3 million installed access lines, including public telephone lines, of which 12.3 million access lines were in service. At that time, of the access lines in service, approximately 74.7% were residential, 19.9% were commercial, 2.7% were public telephone lines and 2.7% were for our own use and for testing. Intraregional long-distance transmission is provided by a microwave network and by fiber optic cable. Telesp's network strategy is to develop a broadband integrated network that is compatible with several types of telecommunications services and multimedia applications.

The following table sets forth selected information about our network in Brazil at the dates indicated.

	At December 31,				
	2001	**2002**	**2003**	**2004**	**2005**
Installed access lines (in millions)	14.3	14.4	14.2	14.2	14.3
Access lines in service (in millions)(1)	12.6	12.5	12.3	12.5	12.3
Average access lines in service (in millions)	11.9	12.6	12.4	12.3	12.4
Access lines in service per 100 inhabitants	33.8	32.9	31.6	31.7	30.9
Percentage of installed access lines connected to digital switches	95.7	96.1	96.9	98.7	100.0
Number of public telephones (in thousands)	342.8	330.9	331.1	331.2	331.5

(1) Data includes public telephone lines.

Technology

We are currently implementing the necessary infrastructure for the offering of "Wi-Fi", which is a wireless Internet access connection that offers mobility to our Internet clients.

As of December 31, 2005, Telesp's network was 100% digital.

Peru

In order to provide telecommunications services in Peru, Telefónica del Peru operates a telecommunications multiservice network. Over the last decade, a number of significant capital investments were made in order to enlarge the telecommunications infrastructure and to provide the telecommunications network with the latest generation technologies. As a result, we currently have:

- a solid optical fiber and coaxial cable network;
- a communications network interconnected through signaling protocol number 7;

- an ATM network; and
- a transmission network including synchronous digital hierarchy (SDH) technology.

The objective while developing Telefónica del Perus infrastructure is to achieve a completely digital system that allows for simultaneous voice, video, data and text transmission, and therefore achieves network management and maintenance efficiencies. Accordingly, our network is simplified to a two-level hierarchy network through the use of remote units. We are also increasing our operating efficiencies through effective management of network centralization.

The following table sets forth selected information about our network in Peru at the date and for the period indicated.

	At or for the year ended December 31, 2005
Digitalization (%)(1)	96.81%
Number of fixed lines in service (in thousands)(2)	2,352,555
Number of fixed lines installed	2,509,789

(1) Local switching equipment only.

(2) Includes fixed line public telephones. Does not include cellular public telephones.

Telefónica del Peru has increased the number of ISDN lines. As of December 31, 2005, Telefónica del Peru had approximately 39,370 ISDN lines.

Telefónica del Peru's infrastructure development plan has increased the use of optical fiber into its network.

	At December 31,				
Description	**2001**	**2002**	**2003**	**2004**	**2005**
Coaxial cable (Km.)	5,697	5,738	5,797	5,870	7,959
Optical fiber cable (Km.)	6,728	6,761	6,993	7,090	7,563
Subscriber network (thousand Km.-pair)	5,270	5,316	5,517	5,757	6,237

Chile

The principal plant and equipment of CTC Chile consists of outside plant and switching equipment and operating units that are located throughout the country. The company's land and buildings principally consist of its telephone exchanges and other technical, administrative and commercial properties. As of December 31, 2005, the company's telephone network in Chile included approximately 3 million of lines installed, of which 2.4 million lines were in service. Additionally, CTC Chile's long distance subsidiary currently operates the most extensive fiber optic network in the country, including connections to Peru and Argentina. It also operates digital satellite and microwave links in areas not covered by the fiber optic network and participates actively in the development and use of submarine fiber optic networks.

The following table sets forth selected information about CTC Chile's fixed telephony network at the indicated dates.

	At December 31,				
	2001	**2002**	**2003**	**2004**	**2005**
Lines installed	3,019,416	3,023,541	3,037,267	3,043,379	3,007,432
Fixed lines in service	2,723,310	2,686,695	2,416,779	2,427,364	2,440,827
Average fixed lines in service	2,736,633	2,732,208	2,558,291	2,406,266	2,451,536
Lines per 100 inhabitants (1)	17.6	17.4	16.1	15.0	15.1

Number of new lines connected	330,619	340,419	308,266	343,318	358,088
Number of public telephones (in thousands)	12,880	11,834	11,060	10,288	10,272
ADSL connections in service	14,808	54,163	125,262	200,794	314,177

(1) Based on CTC Chiles average fixed lines in service per 100 inhabitants and 2002 Census.

Technology

Since 1993, CTC Chiles nationwide local telephony network is fully digitalized.

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Wireless Networks

Telefónica Móviles Chile owns, or controls through long-term leases or licenses, property consisting of plant and equipment used to provide wireless communication services.

Plant and equipment used to provide wireless communication consist of:

- switching, transmission and receiving equipment;
- connecting line (cables, wires, poles and other support structures, conduits and similar items);
- land and buildings;
- easements; and
- other miscellaneous properties (work equipment, furniture and plants under construction).

Satellite Communications

As at December 31, 2005, we had an interest in one international satellite communications organization or company: a 13.2% interest in Hispasat, the communications satellite company which carries the Digital+ direct-to-home (DTH) satellite television service and operates a new satellite system in Brazil and Latin America (Amazonas).

In March 2005, we sold our 0.7% interest in Intelsat, the international satellite company to a consortium of private equity funds for approximately $23 million.

In January 2005, we sold our 0.7% interest in New Skies Satellites, the communications satellite company that was formerly part of Intelsat, in January 2005 to Zeus Holdings Limited for approximately $8 million.

We have implemented a satellite IP-access platform, which has been in operation since February 2003. We currently provide broadband Internet and Intranet access with similar speed and performance as with the ADSL technology. This satellite platform also provides VoIP services, which have been in operation since the second half of 2004.

Submarine Cable

We are also one of the world's largest submarine cable operators. We currently participate in 44 international underwater cable systems (13 of which are moored in Spain) and own 11 domestic fiber optic cables.

ITEM 4A. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

A. OPERATING RESULTS

Overview

The Telefónica Group has structured its management according to its different business lines which are separately managed and organized by reference to the products and services provided. The Telefónica Group's principal lines of business in 2005 were:

- Telefónica de España: fixed line telephony in Spain;
- Telefónica Móviles: mobile telephony in Spain and Latin America;
- Telefónica Latinoamérica: fixed line telephony in Latin America;

- Cesky Group: integrated telecommunications services in the Czech Republic;
- Telefónica Contenidos: audio-visual media and content in Europe and Latin America;
- Directories Business: publication, development and sale of advertising for telephone directories in Europe and Latin America; and
- Atento: call centers in Europe, Latin America and North Africa.

Presentation of Financial Information

The information in this section should be read in conjunction with our Consolidated Financial Statements, and the notes thereto, included elsewhere in this Annual Report. Our Consolidated Financial Statements have been prepared in accordance with IFRS, which differ in certain respects from U.S. GAAP. Please refer to note 23 to our Consolidated Financial Statements for a discussion of these differences.

Non-GAAP Financial Information

Operating Income Before Depreciation and Amortization

Operating income before depreciation and amortization is calculated by excluding depreciation and amortization expenses from our operating income in order to eliminate the impact of generally long-term capital investments that cannot be significantly influenced by our management in the short-term. Our management believes that operating income before depreciation and amortization is meaningful for investors because it provides an analysis of our operating results and our segment profitability using the same measure used by our management. Operating income before depreciation and amortization also allows us to compare our results with those of other companies in the telecommunications sector without considering their asset structure. We use operating income before depreciation and amortization to track our business evolution and establish operational and strategic targets. Operating income before depreciation and amortization is also a measure commonly reported and widely used by analysts, investors and other interested parties in the telecommunications industry. Operating income before depreciation and amortization is not an explicit measure of financial performance under IFRS or U.S. GAAP and may not be comparable to other similarly titled measures for other companies. Operating income before depreciation and amortization should not be considered an alternative to operating income as an indicator of our operating performance, or an alternative to cash flows from operating activities as a measure of our liquidity.

The following table provides a reconciliation of operating income before depreciation and amortization to operating income for the Telefónica Group for the periods indicated.

	Year ended December 31,	
	2004	**2005**
Operating income before depreciation and amortization	12,222.03	15,276.43
Depreciation and amortization expense	(5,666.03)	(6,717.68)
Operating income	6,556.00	8,558.75

The following tables provide a reconciliation of operating income before depreciation and amortization to operating income for the Telefónica Group and each of our business lines for the periods indicated.

Year ended December 31, 2005

	Telefónica de España	Telefónica Móviles	Telefónica Latinoamérica	Cesky Group	Telefónica Contenidos	Directories Business	Atento	Others and Eliminations	Total
Operating income before depreciation and amortization	4,766.79	5,817.01	3,758.32	456.68	269.20	219.28	116.36	(127.21)	15,276.4
Depreciation and amortization expense	(2,139.15)	(2,374.01)	(1,792.47)	(291.85)	(28.88)	(23.58)	(27.87)	(39.47)	(6,717.6
Consolidated Operating income	2,627.66	3,443.00	1,965.85	164.83	240.32	195.70	88.49	(167.08)	8,558.7

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	Year ended December 31, 2004								
	Telefónica de España	Telefónica Móviles	Telefónica Latinoamérica	Cesky Group	Telefónica Contenidos	Directories Business	Atento	Others and Eliminations	Total
Operating income before depreciation and amortization	4,560.03	4,637.60	3,294.84	0.00	185.01	204.84	85.10	(745.39)	12,222.03
Depreciation and amortization expense	(2,367.66)	(1,580.14)	(1,578.73)	0.00	(28.86)	(23.80)	(33.69)	(53.15)	(5,666.03)
Operating income	2,192.37	3,057.46	1,716.11	0.00	156.15	181.04	51.41	(798.54)	6,556.00

Net Financial Debt

Net financial debt is calculated by deducting the positive mark-to-market value of derivatives with a maturity beyond one year from the relevant balance sheet date and other interest-bearing assets (each of which are components of non-current financial assets in our consolidated balance sheet), current financial assets and cash and cash equivalents from the sum of (i) current and non-current interest-bearing debt (which we refer to collectively as our gross financial debt) and (ii) other payables (a component of non-current trade and other payables in our consolidated balance sheet). Our management believes that net financial debt is meaningful for investors because it provides an analysis of our solvency using the same measure used by our management. We use net financial debt to calculate internally certain solvency and leverage ratios used by management. Net financial debt is not an explicit measure of indebtedness under IFRS or U.S. GAAP and may not be comparable to other similarly titled measures for other companies. Net debt should not be considered an alternative to gross financial debt (the sum of current and non-current interest-bearing liabilities) as a measure of our liquidity.

The following table provides a reconciliation of net financial debt to gross financial debt for the Telefónica Group as at the dates indicated.

	As of December 31,	
	2004	2005
	(euro in millions)	
Non-current interest-bearing debt	17,492.2	25,167.6
Current interest-bearing debt	10,210.4	9,235.9
Gross financial debt	27,702.6	34,403.5
Other payables	533.6	438.2
Non-current financial assets(1)	(1,070.9)	(1,043.7)
Current financial assets	(2,556.6)	(1,517.8)
Cash and cash equivalents	(914.4)	(2,213.2)
Net financial debt	23,694.4	30,067.0

(1) Positive mark-to-market value of derivatives with a maturity beyond one year from the relevant balance sheet date and other interest-bearing assets.

First-time adoption of International Financial Reporting Standards

The transition of the Telefónica Group's consolidated financial statements to IFRS has been carried out by applying IFRS 1: First-Time Adoption of International Financial Reporting Standards, being January 1, 2004 the beginning of the earliest period presented for comparative purposes under the new accounting standards. This date is considered as the date of transition to IFRS.

As a general rule, the IFRS in force at December 31, 2005 must be applied retrospectively to prepare an opening balance sheet at the date of transition and all following periods. IFRS 1 provides for certain exemptions from full retrospective application of IFRS in the opening balance sheet. The main exemptions are as follows:

- IFRS 3 Business Combinations: The Telefónica Group has elected to apply IFRS 3 Business Combinations prospectively from the date of transition; therefore it has not restated any business combination that took place before January 1, 2004.
- IAS 16 Fair value or revaluation as deemed cost: The Telefónica Group has chosen to continue to carry its property, plant and equipment and intangible assets at their respective carrying amounts under former Spanish GAAP, without remeasuring any of these items at their fair value at January 1, 2004.
- IAS 19 Employee Benefits: The Telefónica Group has elected to recognize all cumulative actuarial gains and losses at January 1, 2004.
- IAS 21 Accumulated translation differences: The Telefónica Group has elected to reset the accumulated translation adjustments up to the date of transition to zero.
- IAS 32 and IAS 39 Financial instruments: The Telefónica Group has chosen not to apply the exception allowing the application of IAS 39 Financial Instruments: Recognition and Measurement and IAS 32 Financial Instruments: Presentation and Disclosure from January 1, 2005, applying these standards as from the date of transition to IFRS, i.e., January 1, 2004.
- IFRS 2 Share-based Payment: The Telefónica Group has elected not to apply IFRS 2 Share-based Payments to account for share-based payment transactions granted prior to November 7, 2002.

The main differences and their impact on shareholders' equity at January 1 and December 31, 2004 and net income in 2004 are described in the notes to the Consolidated Financial Statements included elsewhere herein.

Significant Transactions Affecting the Comparability of our Results of Operations in the Periods Under Review

During 2005, various changes occurred in the composition of the Telefónica Group that affect the comparability of our operating results for the year ended December 31, 2005 to our operating results for the year ended December 31, 2004. Please see note 2 to our Consolidated Financial Statements for a detailed description of the principal changes in the composition of the group affecting our financial statements during the periods under review covered by the Consolidated Financial Statements. The most significant changes are summarized below.

Acquisition of BellSouth’s Mobile Operations in Latin America

In March 2004, Telefónica Móviles reached an agreement to acquire BellSouth’s interests in mobile operators in Argentina, Chile, Peru, Venezuela, Colombia, Ecuador, Uruguay, Guatemala, Nicaragua and Panama. BellSouth’s interests in the mobile operators in Peru, Venezuela, Colombia, Ecuador, Uruguay, Guatemala, Nicaragua and Panama were transferred in October 2004. BellSouth’s interests in the operators in Argentina and Chile were transferred in January 2005. We consolidate each of these operators in our Consolidated Financial Statements as from their respective dates of acquisition.

Acquisition of a Majority Stake in Cesky Telecom

In June 2005, we acquired a 51.1% stake in Cesky Telecom a.s. from the Czech government, and in September 2005, we acquired an additional 18.3% interest in Cesky Telecom a.s. pursuant to a mandatory public tender offer. As a result, we consolidate Cesky Telecom in our Consolidated Financial Statements as from July 1, 2005. For the year ended December 31, 2005, the Cesky Group is presented as a separate business line in our discussion of our results of operations by business line below. See “Group Results of Operations—Cesky Telecom”.

Significant Transactions Affecting the Comparability of our Results of Operations in the Periods Under Review with Future Periods

Acquisition of O2 plc

In October 2005, we commenced a public tender offer for all of the outstanding shares of O2 plc, a U.K. mobile services provider, for a total of approximately £17.9 billion (approximately €26.4 billion, calculated based on a euro-pound exchange rate of €1.00=£0.6767 on October 31, 2005). On January 23, 2006, we made our tender offer for O2 plc unconditional in accordance with the rules of the U.K. City Code on Takeovers and Mergers. As of that date, we and certain of our wholly-owned subsidiaries owned, or had received valid tenders in respect of an aggregate of approximately 96.9% of O2 plc’s issued share capital. We consolidate O2 plc in our Consolidated Financial Statements as from January 31, 2006. For additional information on this acquisition see “Item 4.—Public Takeover Offers”.

Factors Affecting the Comparability of our Result of Operations by Business Segment

In July 2005, we merged Terra Networks, S.A. into Telefónica, S.A., with effect for accounting purposes as from January 1, 2005. Following the merger, we include as from July 1, 2005, the results of operations of certain Terra Networks group companies in Spain (Terra Networks España, S.A., Azeler Automoción, S.A. and Maptel Networks, S.A.U.) under our fixed line telephony business in Spain (Telefónica de España), and we include the results of operations of the former Terra Networks group companies in Latin America under our fixed line telephony business in Latin America (Telefónica Latinoamérica). For the year ended December 31, 2004 and the six months ended June 30, 2005, the results of operations of the former Terra Networks group (which was consolidated in our Consolidated Financial Statements in each of 2004 and 2005) are not included in the results of operations of any of our principal business lines. See note 17 to our Consolidated Financial Statements.

Significant Changes in Accounting Policies

In 2004 and 2005, there were no changes in the accounting policies used in the preparation of our Consolidated Financial Statements under IFRS. For a discussion of changes in accounting principles under U.S. GAAP, see note 23 to our Consolidated Financial Statements.

Critical Accounting Policies

The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the amounts reflected in the consolidated financial statements and accompanying notes. We base our estimates on historical experience, where applicable, and other assumptions that we believe are reasonable under the circumstances. Actual results may differ from those estimates under different assumptions or conditions.

We consider an accounting estimate to be critical if:

- it requires us to make assumptions because information was not available at the time or it included matters that were highly uncertain at the time we were making our estimate; and
- changes in the estimate or different estimates that we could have selected may have had a material impact on our financial condition or results of operations.

The various policies that are important to the portrayal of our financial condition and results of operations include:

- accounting for long-lived assets, including goodwill;
- deferred taxes; and
- provisions.

Accounting for Long-lived Assets, including Goodwill

Property, plant and equipment and intangible assets, other than goodwill, are recorded at acquisition cost. If such assets are acquired in a business combination, the acquisition cost is the estimated fair value of the acquired property, plant and equipment or intangible assets. Property, plant and equipment and intangible assets with definite useful lives are depreciated or amortized on a straight-line basis over their estimated useful lives.

Intangible assets with indefinite useful lives are not amortized, but are, instead, subject to an impairment test on a yearly basis and whenever there is an indication that such assets may be impaired.

Accounting for long-lived assets and intangible assets involves the use of estimates for determining: (a) the fair value at the acquisition date in the case of such assets acquired in a business combination; and (b) the useful lives of the assets over which they are to be depreciated or amortized. We believe that the estimates we make to determine an asset's useful life are "critical accounting estimates" because they require our management to make estimates about technological evolution and competitive uses of assets.

When an impairment in the carrying amount of an asset occurs, nonscheduled write-downs are made. We perform impairment tests of identifiable intangible and long-lived assets whenever there is reason to believe that the carrying value may exceed the recoverable amount, which is the higher of the asset's fair value less costs to sell and its value in use. Furthermore, previously recognized impairment losses may be reversed when changes in the estimates used to determine the asset's recoverable amount indicate that an impairment loss recognized in prior periods no longer exists or may have decreased.

The determination of whether the impairment of long-lived and intangible assets is necessary involves the use of significant estimates and judgment that includes, but is not limited to, the analysis of the cause of potential impairment in value, the timing of such potential impairment and an estimate of the amount of the impairment, which requires the estimation of the future expected cash flows, discount rates and the fair value of the assets.

Specifically, management has to make certain assumptions in respect of uncertain matters, such as growth in revenues, changes in market prices, operating margins, and technology developments and obsolescence, discontinuance of services and other changes in circumstances that indicate the need to perform an impairment test. Management's estimates about technology and its future development require significant judgment because the timing and nature of technological advances are difficult to predict.

Goodwill arises when the cost of a business combination exceeds the acquirer's interest in the net fair value of the identifiable assets acquired and liabilities and contingent liabilities assumed. Goodwill is not amortized, but is, instead, subject to an impairment test on a yearly basis and whenever there is an indication that the goodwill may be impaired.

Nonscheduled write-downs of goodwill are made when an impairment in the carrying amount of goodwill occurs. We review, on a regular basis, the performance of our cash-generating units. We compare the carrying amount of the cash-generating unit to which the goodwill has been allocated with its recoverable amount. The determination of the recoverable amount of the cash-generating unit involves extensive use of estimates and significant management judgment is involved. Methods commonly used by us for valuations include discounted cash flow methods.

A significant change in the facts and circumstances that we relied upon in making our estimates may have a material impact on our operating results and financial condition.

Deferred Taxes

Management assesses the recoverability of deferred tax assets on the basis of estimates of our future taxable profit. The recoverability of deferred tax assets ultimately depends on our ability to generate sufficient taxable profit during the periods in which the deferred tax assets are utilized. In making this assessment, our management considers the scheduled reversal of deferred tax liabilities, projected taxable profit and tax planning strategies.

This assessment is carried out on the basis of internal projections which are updated to reflect our most recent operating trends. In accordance with applicable accounting standards, a deferred tax asset must be recognized for all deductible temporary differences and for the carry-forward of unused tax credits and unused tax losses to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilized. Our current and deferred income taxes are impacted by events and transactions arising in the normal course of business as well as in connection with special and non-recurring items. Assessment of the appropriate amount and classification of income taxes is dependent on several factors, including estimates of the timing and realization of deferred tax assets and the timing of income tax payments. Actual collections and payments may materially differ from these estimates as a result of changes in tax laws as well as unanticipated future transactions impacting our income tax balances.

Provisions

Provisions are recorded when, at the end of the period, the Group has a present obligation as a result of past events, whose settlement requires an outflow of resources that is considered probable and can be measured reliably. This obligation may be legal or constructive, arising from, but not limited to, regulation, contracts, common practice or public commitments, which have created a valid expectation for third parties that the Group will assume certain responsibilities. The amount recorded is the best estimation performed by the management in respect of the expenditure that will be required to settle the obligations, considering all the information available at the closing date, including the opinion of external experts, such as legal advisors or consultants.

If we are unable to reliably measure the obligation, no provision is recorded and information is then presented in the notes to the Consolidated Financial Statements.

Because of the inherent uncertainties in this estimation, actual expenditures may be different from the originally estimated amount recognized.

Operating Environment

Our results of operations are dependent, to a large extent, on the level of demand for our services in the countries in which we operate. Demand for services in those countries is related to the performance of their respective economies, including GDP, inflation, account-deficit and unemployment rates. Following our acquisition of O2, our results of operations will also depend on the economic performance of the countries in which it operates, particularly the United Kingdom and Germany.

Operating Environment by Country

Spain

Our results of operations are dependent to a large extent on the level of demand for our services in Spain. For the year ended December 31, 2005, net sales and rendering of services of our operations in Spain represented 51.9% of our consolidated net sales and rendering of services for such year. Demand for our services in Spain is related to the performance of the Spanish economy. Spain's real gross domestic product (GDP) expanded by approximately 3.4% in 2005, the highest rate in the last five years, reflecting relatively stronger domestic demand. Inflation was 3.8% in 2005. The current account deficit was estimated at 7.4% of GDP in 2005. The unemployment rate was 8.7% at December 31, 2005, the lowest rate in decades.

Brazil

Brazil's estimated GDP growth was 2.3% in 2005 compared to 4.9% in 2004 and 0.5% in 2003. Inflation has been gradually declining, with consumer prices increasing by 5.7% in 2005 compared to 7.6% in 2004 and 9.3% in 2003. In order to curb the inflationary trend and achieve the official government target rate of inflation, the Central Bank of Brazil raised the basic interest rate (Selic) from 16.00% in August 2004 to 19.75% in June 2005. After inflation was reduced to the target rate of inflation (5.1% in 2005), the Central Bank of Brazil began to gradually reduce the Selic rate to 19.50% in September 2005. At March 22, 2006, the Selic rate was 16.5% . Brazil ended 2005 with a record trade balance surplus of US$44.7 billion, compared to U.S.$33.7 billion in 2004. In 2005, exports increased by 23% to US$118.3 billion, while imports increased by 17% to US$73.5 billion.

Argentina

Argentina's estimated GDP growth for 2005 was approximately 9.1%, which matched the average growth rate for 2003 and 2004 and represented the third consecutive year of growth after four years of recession from 1999 to 2002. The peso depreciated by 1.7% closing at 3.03 peso/U.S.$1.00. The consumer inflation rate increased by 12.3%, above the original target range of 5% to 8% established by Argentina's central bank, while wholesale prices rose by 10.6% in 2005. The external surplus, following a 2004 surplus equivalent to 2.2% of GDP, was 2.5% of GDP in September of 2005. The unemployment rate decreased to 10.1% in December 2005 from 12.1% in December 2004 due to continued economic growth and the implementation of a wide range of social assistance programs. The accumulation of international reserves in the last two years has allowed Argentina to repay $9.5 billion of its debt to the International Monetary Fund ("IMF").

Chile

Chile's GDP grew approximately 6.3% in 2005 compared to 6.1% in 2004. Inflation increased from 1.1% in 2004 to 3.1% in 2005. The Chilean peso appreciated approximately 8.9% in nominal terms (8.0% in real terms) against the U.S. dollar in 2005. Chile's unemployment rate decreased to 6.9% at December 31, 2005 compared to 7.8% at December 31, 2004. In 2005, Chile had its largest budget surplus in eight years, reaching 4.8% of GDP in 2005, more than doubling the previous year's 2.2% of GDP due to strong growth in domestic demand and increasing copper prices.

Peru

During 2005, Peru saw a significant improvement in its main macroeconomic indicators. GDP grew 6.7% in 2005 (the highest rate in eight years) and by December 2005 the Peruvian economy had experienced a record of 54 consecutive months of growth. Annual inflation was 1.5% in 2005. The balance of payment current account showed a surplus of 1.3% of GDP (the highest level in 26 years) in 2005, and the fiscal deficit decreased to 0.4% of GDP (the lowest level since 1997). The government pre-paid foreign debt in an aggregate principal amount of US$2.3 billion in 2005. Moreover, during 2005, Standard & Poors and Fitch Ratings improved the Peruvian governments credit rating outlook to positive from stable.

Mexico

Mexicos GDP growth in 2005 was 3.0% compared to 4.4% in 2004. Inflation was 3.3%, the lowest rate in the last 37 years. The Mexican pesos strength against other foreign currencies improved during much of 2005 due to Mexicos liquidity, foreign demand for Mexican financial assets and the improvement in foreign accounts, supported by immigrant repatriation flows, high crude oil prices and foreign direct investment inflows. Mexicos accumulation of international reserves allowed Mexico to prepay $6.8 billion of foreign debt.

Czech Republic

The Czech Republics GDP growth in 2005 registered its highest rate in the last ten years, growing almost 5%. This was mainly due to the performance of net exports, as a result of foreign direct investment inflows, potential entry into the EU and the general recovery of European economies in 2005. Inflation was approximately 2% in 2005, below the Central banks annual objective of 3%. The Czech koruna (crown) appreciated an average of 6.0% during 2005 relative to the currencies of the Czech Republics trading partners. The Czech Republics membership in the EU is not currently expected earlier than 2009, in line with the official expectations regarding when the Czech Republic will be able to meet the Maastricht criteria in respect of public finances, foreign exchange stability, inflation and long-term interest rates.

Exchange Rate Fluctuations

We publish our Consolidated Financial Statements in euro. Because a substantial portion of our assets, liabilities, net sales and rendering of services and profit are denominated in currencies other than the euro, we are exposed to fluctuations in the values of these currencies against the euro. These currency fluctuations have had and may continue to have a material impact on our financial condition and results of operations.

In 2005, variations in currencies increased our consolidated cash flows by approximately €166 million and increased our consolidated revenues from operations by approximately 4.7% . Currency fluctuations can also have a significant impact on our balance sheet, particularly equity attributable to equity holders of the parent, when translating the financial statements of subsidiaries located outside the euro zone into euro. For example, in 2005 equity attributable to equity holders of the parent was increased by €2,135 million due to the translation of the financial statements of our foreign subsidiaries, principally due to the appreciation of the Brazilian real relative to the euro.

The table below sets forth the average exchange rates against the euro of the U.S. dollar and the key Latin American currencies that impacted our consolidated results of operations for the periods indicated.

	2004(1)	**2005(1)**	**% change**
	Average	**Average**	**Average**
U.S. Dollar	1.24	1.24	
Argentine Peso	3.65	3.63	(0.5)%
Brazilian Real	3.63	3.00	(17.4)%
Chilean Peso	756.65	694.44	(8.2)%
Mexican Peso	14.02	13.52	(3.6)%
Peruvian Nuevos Soles	4.24	4.10	(3.3)%

Source: central treasury bank of the respective countries.

(1) These exchange rates are used to convert the income statements of our Latin American subsidiaries from local currency to euro.

In the comparison below of our results of operations for the year ended December 31, 2005 compared to the year ended December 31, 2004, we have provided certain comparisons at constant exchange rates in order to present an analysis of the development of our results of operations from year-to-year without the effects of currency fluctuation. To make such comparisons, we have converted certain financial items using the prior year's exchange rate.

We describe certain risks relating to exchange rate fluctuations in "Item 3—Key Information—Risk Factors", and we describe our policy with respect to limiting our exposure to short-term fluctuations in exchange rates under "Item 11—Quantitative and Qualitative Disclosures about Market Risk".

Regulation

We are subject to regulation in the different markets where we operate, which has a significant effect on our profitability. In Spain, we are regulated by the Telecommunications Market Commission. Although in the past the fees that we could charge customers for interconnection and subscription were regulated according to "price caps", such fees are no longer regulated in Spain. For more information regarding the abolition of "price caps" in Spain, see "Item 4—Business Overview—Telefónica de España—Spanish Fixed Line Business—Regulation".

In addition, as a market dominant operator, Telefónica de España is required to grant other operators access to its network. Interconnection prices must remain within the Interconnection Offer Framework as determined by the Telecommunications Market Commission.

Telefónica Móviles is also regulated in Spain by the Telecommunications Market Commission, which has declared Telefónica Móviles to be an operator with "significant market power". Telefónica Móviles is required to allow other mobile operators to access its network, and the Telecommunications Market Commission sets the rates that Telefónica Móviles can charge other mobile operators for such access. Telefónica Móviles must pay a yearly fee to reserve the public domain radioelectric spectrum in respect of its allocated frequencies.

We are also subject to regulation in the Latin American markets where we have operations. These regulations include the application of, among other things, "price caps", governmental regulation of rates and fees and the obligation to allow other operators to access our networks at competitive or regulated rates.

For a more detailed description of how regulation affects us, please see "Item 4—Information on the Company—Business Overview".

Group Results of Operations

A summary of our results of operations for 2004 and 2005 are shown below.

	Year ended December 31,	
	2004	**2005**
	(in millions of euro, except share and per share data)	
Net sales and rendering of services	30,280.92	37,882.16
Operating income before depreciation and amortization (OIBDA)(1)	12,222.03	15,276.43
Operating income	6,556.00	8,558.75
Profit before taxes from continuing operations	4,866.40	6,796.21
Profit for the year attributable to equity holders of the parent company	3,175.67	4,445.85
Profit per share(2)	0.637	0.913

Weighted average number of shares (millions)	4,987.75	4,870.85

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(1) For a reconciliation of OIBDA to operating income, see Presentation of Financial Information Non-GAAP Financial Information Operating Income Before Depreciation and Amortization.

(2) The per share computations have been adjusted to reflect the stock dividends which were effected during the periods presented, as if these had occurred at the beginning of the earliest period presented.

The table below sets forth certain consolidated revenue and expense items as a percentage of net sales and rendering of services for the periods indicated.

	Year ended December 31,	
	2004	**2005**
Net sales and rendering of services	100.0%	100.0%
Other income	3.7%	3.7%
Supplies	(25.2)%	(26.6)%
Personnel expenses	(16.8)%	(14.9)%
Other expenses	(21.3)%	(21.9)%
Operating income before depreciation and amortization(1)	40.4%	40.3%
Depreciation and amortization	(18.7)%	(17.7)%
Operating income	21.7%	22.6%
Share of profit (loss) of associates	(0.2)%	(0.3)%
Net financial expense	(5.4)%	(4.3)%
Corporate income tax	(5.0)%	(5.2)%
Profit for the year from continuing operations	11.1%	12.7%
Profit from continuing operations after taxes	(0.4)%	—
Minority interests	(1.0)%	(1.0)%
Profit for the year attributable to equity holders of the parent company	10.5%	11.7%

(1) For a reconciliation of OIBDA to operating income, see Presentation of Financial InformationNon-GAAP Financial InformationOperating Income Before Depreciation and Amortization.

The table below sets forth the percentage of our consolidated net sales and rendering of services by geographic region for the periods indicated.

	Year ended December 31,	
	2004	**2005**
Spain	61.4%	51.9%
Latin America	34.1%	41.5%
Rest of Europe	3.6%	5.5%
Rest of World	0.9%	1.1%
Total	100.0%	100.0%

The table above reflects the impact on our consolidated financial statements in 2005 of the incorporation of the former BellSouth mobile operations and Cesky Telecom.

Year Ended December 31, 2005 Compared to Year Ended December 31, 2004

Net Sales and Rendering of Services

Our net sales and rendering of services increased 25.2% to €37,882.1 million in 2005 from €30,280.9 million in 2004, principally due to an increase in net sales and rendering of services of Telefónica Móviles, Telefónica

Latinoamérica and Cesky Telecom (which we consolidated as from July 2005). Variations in exchange rates had a positive impact on our net sales and rendering of services in 2005, contributing 4.7 percentage points to the increase in 2005.

Total Expenses

Total expenses include supplies, personnel expenses and other expenses (mainly external services and taxes). Total expenses increased 25.2% to €24,024.0 million in 2005 from €19,192.3 million in 2004, primarily due to an increase in supplies and other expenses, principally as a result of an increase in commissions to distributors of our services, advertising and marketing expenses and customer service-related expenses in connection with our intense commercial and marketing efforts to add new customers and maintain existing customers under competitive market conditions.

Supplies. Supplies increased 31.8% to €10,065.1 million in 2005 from €7,637.3 million in 2004, principally due to the consolidation of the BellSouth mobile operators acquired by Telefónica Móviles in late 2004 and early 2005, an increase in interconnection costs of our mobile telephony business, purchases of equipment for ADSL and IPTV (Imagenio) services in Spain and expenses to implement the unbundling of the local loop in Spain.

Personnel Expenses. Personnel expenses increased 11.0% to €5,656.3 million in 2005 from €5,095.2 million in 2004, due to increases in wages, salaries and other personnel expenses as a result of an increase in the average number of employees of the Telefónica Group to an average of 195,086 thousand in 2005 from 156,819 in 2004. The increase in the average number of employees of the Telefónica Group in 2005 was mainly due to increases in the average number of employees in our call center business, Cesky Telecom (which we consolidated as from July 2005) and our mobile telephony business (mainly due to the consolidation of the BellSouth mobile operators acquired by Telefónica Móviles in late 2004 and early 2005).

Other Expenses. Other expenses are mainly comprised of external services, which consist of commercial expenses related to our business (such as commissions to distributors of services, marketing and advertising expenses and customer service related expenses), network maintenance expenses, general administrative expenses and subcontracted services expenses, as well as taxes. Other expenses also include other operating expenses, changes in operating allowances, impairment of goodwill and loss on disposal of assets. Other expenses increased 28.5% to €8,302.6 million in 2005 from €6,459.8 million in 2004, principally due to a 32.4% increase in external services to €6,715.3 million in 2005 from €5,072.0 million in 2004. The increase in external services was mainly due to significant commercial and marketing efforts in each of our lines of business, as well as to the consolidation of Cesky Telecom and the BellSouth mobile operators acquired by Telefónica Móviles in late 2004 and early 2005.

Operating Income Before Depreciation and Amortization (OIBDA)

Operating income before depreciation and amortization (OIBDA) increased 25.0% to €15,276.4 million in 2005 from €12,222.0 million in 2004.

Depreciation and Amortization

Depreciation and amortization increased 18.6% to €6,717.7 million in 2005 from €5,666.0 million in 2004, principally due to an increase in depreciation and amortization expense of our mobile telephony business (mainly due to the consolidation of the BellSouth mobile operators acquired by Telefónica Móviles in late 2004 and early 2005), as well as depreciation and amortization expense of Cesky Telecom (which we consolidate as from July 2005).

Operating Income

Operating income increased 30.5% to €8,558.8 million in 2005 from €6,556.0 million in 2004. The increase was the result of the 25.0% increase in operating income before depreciation and amortization exceeding the rate of increase (18.6%) in depreciation at amortization.

Share of Profit (Loss) of Associates

Share of loss of associates increased 153.9% to €128.2 million in 2005 from €50.5 million in 2004, principally due to the writedown of the remaining value of the IPSE 2000s UMTS license, offset by a decrease in our share of the losses of Sogecable and Lycos Europe and our share of the profit of Medi Telecom in 2005, which had losses in 2004.

Net Financial Expense

Net financial expenses were €1,769.4 million in 2005 compared to €1,462.1 million in 2004, mainly due to an increase in average net debt outstanding, offset by a decrease in average interest rates on our debt in 2005 compared to 2004.

Positive exchange rate differences were €162.0 million in 2005 compared to negative exchange rate differences of €177.1 million in 2004, reflecting the impact of the appreciation of the U.S. dollar against the euro at December 31, 2005 compared to December 31, 2004.

As a result, net financial expense was €1,634.3 million in 2005 compared to €1,639.1 million in 2004.

Corporate Income Tax

Corporate income tax increased 30.2% to €1,969.2 million in 2005 from €1,512.8 million in 2004. This increase was principally due to the increase in profit before taxes from continuing operations of Telefónica de España and the consolidation of the BellSouth mobile operators acquired by Telefónica Móviles in late 2004 and early 2005. Our effective corporate income tax rate (corporate income tax as a percentage of profit before taxes from continuing operations) was 29.0% in 2005 compared to 31.1% in 2004.

Minority Interests

Profit attributable to minority interests increased 23.0% to €381.2 million in 2005 from €309.9 million in 2004, mainly due to the minority shareholders share of the profit of Cesky Telecom (which we consolidate as from July 2005) and the increased profit of Telesp in 2005 compared to 2004, as well as the decrease in minority investors share of the losses of Telefónica Móviles Mexico, which had lower losses in 2005 compared to 2004.

Profit for the Year Attributable to Equity Holders of the Parent Company

As a result of the above, profit for the year attributable to equity holders of the parent company increased 40.0% in 2005 to €4,445.9 million from €3,175.7 million in 2004.

Results of Operations by Business Line

The table below sets forth the contribution to our results of operations by each of our principal business lines for 2004 and 2005. Net sales and rendering of services is presented for each of the business lines after elimination of sales to other members of the Telefónica Group. See note 17 to our Consolidated Financial Statements.

	Year ended December 31,	
	2004	2005
	(in millions of euro)	
Net sales and rendering of services	**30,280.9**	**37,882.2**
Telefónica de España	10,566.9	11,019.5
Telefónica Móviles (1)	10,492.0	15,068.4
Telefónica Latinoamérica	6,420.0	7,902.0
Cesky Group (2)		1,035.2
Telefónica Contenidos	1,200.2	1,251.2
Directories Business	535.6	559.6
Atento	267.6	383.9
Other companies & eliminations (3)	798.6	662.4
Expenses (4)	**19,192.3**	**24,024.0**
Telefónica de España	6,985.7	7,324.1
Telefónica Móviles	7,523.6	10,966.3

Telefónica Latinoamérica Group	4,043.4	4,776.6
Cesky Group (2)		599.9
Telefónica Contenidos	1,059.6	1,073.9
Directories Business	414.6	434.9
Atento	526.0	742.4
Other companies & eliminations (3)	(1,360.2)	(1,894.1)
Depreciation and amortization	**5,666.0**	**6,717.7**

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	Year ended December 31,	
	2004	2005
	(in millions of euro)	
Telefónica de España	2,367.7	2,139.1
Telefónica Móviles	1,580.1	2,374.0
Telefónica Latinoamérica	1,578.7	1,792.5
Cesky Group (2)		291.9
Telefónica Contenidos	28.9	28.9
Directories Business	23.8	23.5
Atento	33.7	27.9
Other companies & eliminations (3)	53.1	39.9
Operating income	**6,556.0**	**8,558.7**
Telefónica de España	2,192.4	2,627.6
Telefónica Móviles	3,057.5	3,443.0
Telefónica Latinoamérica	1,716.1	1,965.8
Cesky Group (2)		164.8
Telefónica Contenidos	156.2	240.3
Directories Business	181.0	195.7
Atento	51.4	88.5
Other companies & eliminations (3)	(798.6)	(167.1)
Profit (loss) for the year	**3,175.6**	**4,445.8**
Telefónica de España	1,113.2	1,494.3
Telefónica Móviles	1,682.7	1,918.9
Telefónica Latinoamérica	754.3	1,106.7
Cesky Group (2)		118.0
Telefónica Contenidos	(40.6)	78.8
Directories Business	113.8	125.3
Atento	32.3	48.2
Other companies & eliminations (3)	(480.1)	(444.4)

(1) The results of operations shown for Telefónica Móviles, S.A. may differ from those reported by Telefónica Móviles, S.A. which is a reporting company in the United States, primarily because it is not a wholly owned subsidiary and because certain transactions it enters into with other members of the Telefónica Group are eliminated in consolidation.

(2) Consolidated as from July 2005.

(3) As from July 1, 2005, the results of operations of the former Terra Networks group companies in Spain are included under Telefónica de España, and the results of operations of the former Terra Networks group companies in Latin America are included under Telefónica Latinoamérica. For the year ended December 31, 2004 and the six months ended June 30, 2005, the results of operations of the former Terra Networks group are included under other companies and eliminations. See note 17 to our Consolidated Financial Statements.

(4) Expenses as used in this table and in the below discussion include supplies expenses, personnel expenses and other expenses. It does not include depreciation and amortization expense.

Telefónica de España

Net sales and Rendering of Services

Telefónica de España□s net sales and rendering of services increased 4.4% to €11,019.5 million in 2005 from €10,566.9 million in 2004, principally due to increases in net sales and rendering of services from broadband services and operator services, offset in part by decreases in net sales and rendering of services from outgoing traffic, commercialization of handsets and data services.

- Revenues from access fees include all revenues from our customers for rental of and connection to the public switched telephone network (PSTN) lines (for basic telephony service), ISDN lines (for integration of voice, data and video services), corporate services and public use telephony and additional charges and advertising in telephone booths. Revenues from access fees remained flat at 2,885.9 million in 2005 compared to 2,885.0 million in 2004, mainly due to the increase in monthly access fees, offset by the decrease in connection fees as a result of free connection promotions.

- Revenues from leased circuits include revenues received from leasing our circuits, both domestic and international, to customers and other telecommunication operators. Revenue from leased circuits decreased slightly to 184.2 million in 2005 from 184.8 million in 2004. In 2004, there were no significant changes in the number of leased circuits or the carrier capacity of wholesalers.

- Revenues from the commercialization of handsets include revenues from the sale, leasing, maintenance and installation of handsets. Revenues from the commercialization of handsets decreased 5.6% to 553.4 million in 2005 from 584.6 million in 2004, mainly due to a decrease in the sale and rental of handsets and to higher discounts and bonuses offered to certain client segments.

- Revenues from broadband services which mainly include revenues generated by Telefónica de España IP network, increased 44.0% to 1,540.9 million in 2005 from 1,070.0 million in 2004. This increase was principally due to a 68.5% increase in the total number of retail broadband connections in 2005. Retail broadband connections increased to 2,719.7 million at December 31, 2005 compared to 1,614.5 million at December 31, 2004. The increase in the number of retail broadband connections reflected our marketing efforts, including our sale of bundled service packages (including broadband and fixed line packages and broadband, fixed line and IP TV packages).

- Revenues from operator services include revenues from both national and international operator services. International operator services include automatic access, transit, leasing capacity and manual international access. National operator services include national interconnection, rented subscriber loop and commercial wholesale services (access, traffic and support). Revenues from operator services increased 19.2% to 1,005.2 million in 2005 from 843.1 million in 2004, due to an increase in the use by our competitors of our rented subscriber loop as they expand their business and commercial wholesale services.

- Revenues from outgoing traffic, which include revenues from net effective consumption and other consumption (including phone cards, messages, manual traffic and VPN, decreased 3.5% to 3,462.0 million in 2005 from 3,582.9 million in 2004. This decrease was due to a shrinking in the size of the overall market and increased competition, which led to a loss of market share, and a 1% reduction in tariffs in 2005 as a result of a price cap on tariffs imposed by the Spanish telecommunications market regulator. See Item 4Information on the CompanyBusiness OverviewFixed-Line Telecommunications Services in SpainTelefónica de EspañaSpainRegulation.

- Revenues from data services, which include revenues from retail access, the installation and operation of virtual private networks and business solutions, decreased 1.1% to 739.6 million in 2005 from 747.7 in 2004.

Expenses

Telefónica de Españas expenses increased 4.8% to 7,324.1 million in 2005 from 6,985.7 million in 2004, principally due to an increase in supplies and other expenses.

- Supplies expenses increased 8.7% to €3,032.0 million in 2005 from €2,789.9 million in 2004, mainly due to purchases of equipment for Imagenio, our IPTV service, expenses relating to new broadband connections and to the implementation of the unbundling of the local loop.
- Personnel expenses decreased 0.8% to €2,695.8 million in 2005 from €2,717.0 in 2004, principally due to the decrease in the average number of employees of Telefónica de España to 35,855 in 2005 from 37,281 in 2004 as a result of voluntary early retirement programs.

- Other expenses increased 8.0% to 1,596.3 million in 2005 from 1,478.7 million in 2004, principally due to an 8.7% increase in external expenses to 1,282.9 million in 2005 from 1,179.9 million in 2004. This increase in external expenses is due to intense commercial and marketing efforts under competitive market conditions, including publicity expenses, promotional expenses, public relations expenses, customer service expenses (both pre- and post-sale) and market research expenses.

Operating Income Before Depreciation and Amortization

Telefónica de Españas operating income before depreciation and amortization increased 4.5% to 4,766.8 million in 2005 from 4,560.0 million in 2004.

Telefónica de Españas operating income before depreciation and amortization, as a percentage of Telefónica de Españas net sales and rendering of services, was 39.4% in 2005 compared to 40.3% in 2004.

Depreciation and Amortization

Telefónica de Españas depreciation and amortization decreased 9.7% to 2,139.2 million in 2005 from 2,367.7 million in 2004, principally due to our conservative investment policy, which seeks to control capital expenditure.

Operating Income

Telefónica de Españas operating income increased 19.9% to 2,627.6 million in 2005 from 2,192.4 million in 2004.

Telefónica Móviles

Net Sales and Rendering of Services

Telefónica Móviles net sales and rendering of services increased 43.6% in 2005 to 15,068.4 million from 10,492.1 million in 2004. Excluding the impact of variations in exchange rates, Telefónica Móviles net sales and rendering of services would have increased 40.6% in 2005 from 2004.

Net sales and rendering of services of Telefónica Móviles Spanish operations increased 10.1% to 7,857.0 million in 2005 from 7,138.2 million in 2004, principally due to increases in voice and data traffic, offset in part by decreases in service prices and lower interconnection tariffs.

Net sales and rendering of services of Telefónica Móviles Latin American operations increased 134.3% to 7,704.5 million in 2005 from 3,552.4 million in 2004, principally due to the consolidation of the BellSouth mobile operators acquired in October 2004 and January 2005 and the organic growth of our customer base in Colombia, Argentina and Venezuela. Excluding the impact of variations in exchange rates, Telefónica Móviles Latin American operations net sales and rendering of services would have increased 43.8% in 2005 from 2004.

Expenses

Telefónica Móviles expenses increased 45.8% to 10,966.3 million in 2005 from 7,523.6 million in 2004, principally due to an increase in supplies expenses, personnel expenses and other expenses.

- Supplies expenses increased 45.5% to 5,365.5 million in 2005 from 3,687.9 million in 2004, mainly due to the consolidation of the BellSouth mobile operators acquired by Telefónica Móviles in late 2004 and early 2005, the increase in commercial activity in Spain and Latin America and the increase in interconnection expenses in Spain mainly as a result of the growth in outgoing traffic.

- Personnel expenses increased 44.0% to €799.7 million in 2005 from €555.5 million in 2004, principally due to the consolidation of the BellSouth mobile operators acquired by Telefónica Móviles in late 2004 and early 2005 and the increase in the average workforce and salaries in Spain.

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- Other expenses increased 46.4% to €4,801.1 million in 2005 from €3,280.2 million in 2004, principally due to a 41.6% increase in external expenses to €4,135.6 million in 2005 from €2,921.2 million in 2004 as a result of the consolidation of the BellSouth mobile operators acquired by Telefónica Móviles in late 2004 and early 2005 and the commercial efforts in Spain and Latin America including increases in commissions to distributors, costs related to the acquisition and retention of customers and advertising expenses.

Operating Income Before Depreciation and Amortization

Telefónica Móviles’ operating income before depreciation and amortization increased 25.4% to €5,817.0 million from €4,637.6 million in 2004.

Telefónica Móviles’ operating income before depreciation and amortization, as a percentage of Telefónica Móviles’ net sales and rendering of services, was 38.6% in 2005 compared to 44.2% in 2004.

Depreciation and Amortization

Telefónica Móviles’ depreciation and amortization increased 50.2% to €2,374.0 million in 2005 from €1,580.1 million in 2004, principally due to the consolidation of the BellSouth mobile operators acquired by Telefónica Móviles in late 2004 and early 2005.

Operating Income

Telefónica Móviles’ operating income increased 12.6% to €3,443.0 million in 2005 from €3,057.5 million in 2004.

Telefónica Latinoamérica

Net Sales and Rendering of Services

Net sales and rendering of services increased 23.1% to €7,902.0 million in 2005 from €6,420.1 million in 2004. Variations in exchange rates had a positive impact on Telefónica Latinoamérica’s net sales and rendering of services in 2005, contributing 15.3 percentage points to the increase in 2005 from 2004. Excluding the impact of variations in exchange rates, Telefónica Latinoamérica’s net sales and rendering of services would have increased 7.8% in 2005 from 2004, principally due to an increase in net sales and rendering of services, in local currency terms, of Telesp, Telefónica de Argentina, Telefónica Empresas América, Telefónica del Peru, Telefónica International Wholesale Services (TIWS), offset in part by a decrease in net sales and rendering of services of CTC Chile. The increase is also attributable in part to the inclusion of the results of operations of the former Terra Networks group companies in Latin America, which are included under Telefónica Latinoamérica as from July 1, 2005. Excluding the impact of the results of the former Terra Networks group companies in Latin America, Telefónica Latinoamérica’s net sales and rendering of services would have increased 21.1% in 2005 from 2004, while excluding the impact of variations in exchange rates and the results of the former Terra Networks group companies in Latin America, Telefónica Latinoamérica’s net sales and rendering of services would have increased 6.0% in 2005 from 2004.

- Net sales and rendering of services of Telesp increased 30.6% to €4,715.3 million in 2005 from €3,611.7 million in 2004. Excluding the impact of variations in exchange rates, Telesp’s net sales and rendering of services would have increased 7.9% in 2005 from 2004, principally due to an increase in revenues from its broadband business and public telephony service and, to a lesser extent, the increase in revenues from value-added services, such as automatic redial, call waiting and call forwarding.

- Net sales and rendering of services of Telefónica del Peru increased 6.9% to €972.6 million in 2005 from €910.0 million in 2004. Excluding the impact of variations in exchange rates, Telefónica del Peru’s net sales and rendering of services would have increased 3.3% in 2005 from 2004, principally due to the rapid growth of its broadband business, offset in part by a decrease in local and long distance traffic as a result of the tariff reduction implemented by the Peruvian government.

- Net sales and rendering of services of CTC Chile increased 3.8% to €810.2 million in 2005 from €780.8 million in 2004. Excluding the impact of variations in exchange rates, CTC Chile's net sales and rendering of services would have decreased 4.9% in 2005 from 2004, principally due to the decrease in local and long-distance traffic as a result of customers continuing to substitute the use of mobile telephones for fixed line telephones, offset in part by an increase in revenues from Internet services, including narrowband and broadband access.

- Net sales and rendering of services of Telefónica de Argentina increased 5.6% to €783.1 million in 2005 from €741.6 million in 2004. Excluding the impact of variations in exchange rates, Telefónica de Argentina's net sales and rendering of services would have increased 5.0% in 2005 from 2004, principally due to the increase in fixed lines in service and an increase in wholesale services to other operators, as well as an increase in revenues from its broadband business.

- Net sales and rendering of services of Telefónica Empresas América increased 32.2% to €452.2 million in 2005 from €342.2 million in 2004. Excluding the impact of variations in exchange rates, Telefónica Empresas América's net sales and rendering of services would have increased 9.7% in 2005 from 2004, principally due to the performance of its data services business in Brazil.

Expenses

Telefónica Latinoamérica's expenses increased 18.1% to €4,776.6 million from €4,043.4 million in 2004, principally due to an increase in expenses of Telesp, Telefónica de Argentina and Telefónica Empresas América, offset in part by a decrease in expenses of CTC Chile, Telefónica del Peru and Telefónica International Wholesale Services (TIWS). The increase is also attributable in part to the inclusion of the results of operations of the former Terra Networks group companies in Latin America, which are included under Telefónica Latinoamérica as from July 1, 2005.

- Telesp's expenses increased 28.0% to €2,730.4 million in 2005 from €2,133.4 million in 2004, principally due to an increase in external services as a result of Telesp's increased commercial activity, including network maintenance expenses.

- Telefónica del Peru's expenses decreased 9.4% to €624.1 million in 2005 from €689.1 million in 2004, principally due to a decrease in personnel expenses, and interconnection expenses and a reduction in management fees under the new management contract with the Telefónica Group. These management fees are eliminated in consolidation in connection with the preparation of our consolidated financial statements.

- CTC Chile's expenses increased 5.9% to €535.1 million in 2005 from €505.3 million in 2004, principally due to an increase in interconnection expenses and external services (mainly advertising and customer service related expenses).

- Telefónica de Argentina's expenses increased 13.3% to €427.6 million in 2005 from €377.5 million in 2004, principally due to an increase in external services as a result of an increase in network maintenance expenses.

- Telefónica Empresas América's expenses increased 57.6% to €536.1 million in 2005 from €340.1 million in 2004, principally due to an increase in interconnection expenses and external services.

Operating Income Before Depreciation and Amortization

Telefónica Latinoamérica's operating income before depreciation and amortization increased 14.1% to €3,758.3 million in 2005 from €3,294.8 million in 2004.

Excluding the impact of variations in exchange rates, Telefónica Latinoamérica's operating income before depreciation and amortization would have increased 14.1% in 2005 from 2004. Excluding the impact of variations in exchange rates and the results of the former Terra Networks group companies in Latin America, Telefónica Latinoamérica's operating income before depreciation and amortization would have increased 0.4% in 2005 from 2004.

Telefónica Latinoamérica's operating income before depreciation and amortization, as a percentage of Telefónica Latinoamérica's net sales and services rendered, was 44.0% in 2005 compared to 44.9% in 2004, reflecting the increase in lower margin businesses such as fixed-to-mobile traffic, as well as expenses relating to the rapid expansion of our broadband business.

Operating Income

Telefónica Latinoamérica's operating income increased 14.6% to 1,965.8 million in 2005 from 1,716.1 million in 2004.

Cesky Group

We present the Cesky Group, in which we acquired a majority stake in 2005 and which we consolidated as from July 2005, as a separate business line in 2005 in this discussion of our results of operations by business line. We did not consolidate the Cesky Group in our Consolidated Financial Statements in 2004 and therefore do not present comparative information for the year ended December 31, 2004 in the discussion below.

Net Sales and Rendering of Services

Cesky Telekom net sales and rendering of services in 2005 were 1,035.2 million, of which 533.3 million was attributable to Cesky Telecom's fixed line telephony business and 518.3 million was attributable to Cesky Telecom's mobile telephony business. Net sales and rendering of services of Cesky Telecom's fixed line telephony business in 2005 reflected the continuing trend of increasing contributions from broadband, data and other value added services, relative to traditional voice services. Net sales and rendering of services of Cesky Telecom's mobile telephony business in 2005 reflected continued growth of its customer base, offset by decreases in revenue from traffic as a result of an increase in the number of customers purchasing service packages based on minutes.

Expenses

Cesky Telecom's expenses were 599.9 million in 2005, including 285.7 million in supplies, 137.4 million in personnel expenses and 176.8 million in other expenses. Expenses relating to Cesky Telecom's fixed line business did not increase significantly in 2005, while expenses relating to Cesky Telecom's mobile telephony business increased during 2005 due to an increase in other expenses, particularly external services and personnel expenses, as well as supplies.

Operating Income Before Depreciation and Amortization

Cesky Group's operating income before depreciation and amortization was 456.7 million.

Cesky Group's operating income before depreciation and amortization, as a percentage of Cesky Group's net sales and rendering of services, was 44.1% in 2005.

Operating Income

Cesky Group's operating income was 164.8 million in 2005.

Telefónica Contenidos

Net Sales and Rendering of Services

Telefónica Contenidos net sales and rendering of services increased 4.3% to 1,251.2 million in 2005 from 1,200.2 million in 2004, principally due to an increase in net sales and rendering of services of Endemol and the ATCO group (Argentina), offset in part by a decrease in net sales and rendering of services due to the sale of Lola Films, a Spanish motion picture production company in 2004.

Expenses

Telefónica Contenidos expenses increased 1.3% to 1,073.9 million in 2005 from 1,059.7 million in 2004, principally due to an increase in supplies, offset in part by slight decreases in personnel expenses and other expenses.

Operating Income Before Depreciation and Amortization

Telefónica Contenidos operating income before depreciation and amortization increased 45.5% to 269.2 million in 2005 from 185.0 million in 2004, principally due to increases in operating income before depreciation and amortization of Endemol, Telefónica Audiovisuales and Telefónica Servicios de Música.

Telefónica Contenidos operating income before depreciation and amortization, as a percentage of Telefónica Contenidos total net sales and rendering services, was 21.2% in 2005 compared to 15.2% in 2004.

Operating Income

Telefónica Contenidos operating income increased 53.8% to 240.3 million in 2005 from 156.2 million in 2004.

Directories Business

Net Sales and Rendering of Services

The directories business net sales and rendering of services increased 4.5% to 559.6 million in 2005 from 535.6 million in 2004, due to an increase in advertising revenues, an increase in operator-assisted directories traffic, particularly in Spain, and net sales and rendering of services of our Italian operator-assisted directories business, which commenced operations in October 2005. Excluding the impact of variations in exchange rates, the directories business net sales and rendering of services would have increased 4.4% in 2005 from 2004.

Expenses

The directories business expenses increased 4.9% to 434.9 million in 2005 from 414.6 million in 2004, principally due to increases in supplies, personnel expenses and other expenses due in part to the commencement of operations of our Italian operator-assisted directories business in October 2005. In 2005, expenses of our directories business in Brazil decreased as a result of cost savings in general, and provisions in particular.

Operating Income Before Depreciation and Amortization

The directories business operating income before depreciation and amortization increased 7.1% to 219.3 million from 204.8 million in 2004.

The directories business operating income before depreciation and amortization, as a percentage of the directories businesss net sales and rendering of services, was 33.5% in 2005 compared to 33.1% in 2004.

Operating Income

The directories business operating income increased 8.1% to 195.7 million in 2005 from 181.0 million in 2004.

Atento

Net Sales and Rendering of Services

Atento’s net sales and rendering of services increased 43.5% to €383.9 million in 2005 from €267.6 million in 2004, principally due to increases in net sales and rendering of services of our operations in each of the countries in which we operate, especially in Brazil, Spain, Mexico and Chile. Excluding the impact of variations in exchange rates, Atento’s net sales and rendering of services would have increased 48% in 2005 from 2004.

Expenses

Atento's expenses increased 41.1% to 742.4 million in 2005 from 526.0 million in 2004, principally due to a 44.0% increase in personnel expenses to 579.8 million in 2005 from 402.6 million in 2004. The increase in personnel expenses was mainly due to an increase in the average number of employees in 2005 compared to 2004.

Operating Income Before Depreciation and Amortization

Atento's operating income before depreciation and amortization increased 36.7% to 116.4 million in 2005 from 85.1 million in 2004. Pricing pressure in 2005 in the customer relationship management business through call centers resulted in decreased margins in such market, which Atento has sought to address through its efforts to optimize costs and improve its operating efficiency. In 2005, operating income before depreciation and amortization of our Brazilian operations represented 42.1% of our total operating income before depreciation and amortization, while operating income before depreciation and amortization of our Spanish, Mexican and Chilean operations represented 11.9%, 10.8% and 10.2%, respectively, of our total operating income before depreciation and amortization.

Atento's operating income before depreciation and amortization, as a percentage of Atento's net sales and rendering of services, was 13.6% in 2005 compared to 13.9% in 2004.

Operating Income

Atento's operating income increased 72.2% to 88.5 million in 2005 from 51.4 million in 2004.

Material Differences between U.S. GAAP and IFRS

As of January 1, 2004, our Consolidated Financial Statements have been prepared in accordance with IFRS, which differ in certain respects from U.S. GAAP. The tables included in note 23 to our Consolidated Financial Statements give the effect that application of U.S. GAAP would have on profit for the year and shareholders' equity as reported under IFRS. Pursuant to current European Union law, we have applied the IFRS endorsed by the EU in preparing our Consolidated Financial Statements. Our consolidated financial statements as of and for the year ended December 31, 2005 would not present any difference had the standards issued by the IASB been applied instead of those endorsed by the EU.

IFRS 1 provides first-time adopters of IFRS with a number of exemptions and exceptions from full retrospective application, some of which are applicable to us (see "First-time Adoption of International Financial Reporting Standards"). Had IFRS been applied fully retrospectively, profit for the year and shareholders' equity under IFRS shown in the table included in note 23 to our Consolidated Financial Statements would have been different and the reconciling items to U.S. GAAP shown would also have been different.

Reconciliation to U.S. GAAP

Shareholders' equity would have been €19,221.96 million at December 31, 2005 under U.S. GAAP compared to €16,158.43 million at December 31, 2005 under IFRS, while shareholders' equity would have been €15,872.86 million at December 31, 2004 under U.S. GAAP compared to €12,342.47 million at December 31, 2004 under IFRS. The increase in shareholders' equity under U.S. GAAP at December 31, 2005 and 2004 as compared with shareholders' equity under IFRS at each of those dates is principally related to additions to shareholders' equity related to business combinations, goodwill and intangible assets and U.S. GAAP equity investees, which were offset in part principally by deductions related to the effect of presentation of minority interests (within equity under IFRS). See notes 23.7, 23.8 and 23.1, respectively, to our Consolidated Financial Statements.

Net income would have been €4,144.20 million in 2005 under U.S. GAAP compared to profit for the year of €4,827.06 million in 2005 under IFRS, while net income would have been €2,546.77 million in 2004 under U.S. GAAP compared to profit for the year of €3,485.59 million in 2004 under IFRS. The decrease in net income in 2005 under U.S. GAAP as compared with profit for the year in 2005 under IFRS is principally related to pension plan and post retirement benefits, derivatives and to the effect of presentation of minority interests within the profit for the year under IFRS. See notes 23.11, 23.10 and 23.1, respectively. The decrease in net income in 2004 under U.S. GAAP as compared with profit for the year in 2004 under IFRS is principally related to the effects of business combinations, goodwill and other intangible assets. See note 23.7 to our Consolidated Financial Statements.

See note 23 to our Consolidated Financial Statements for a description of the principal differences between IFRS and U.S. GAAP as they relate to us and for a quantitative reconciliation of profit for the year and shareholders’ equity from IFRS to U.S. GAAP.

Recent U.S. Accounting Pronouncements

Statements of Financial Accounting Standards No. 154: Accounting Changes and Error Corrections—A Replacement of APB Opinion No. 20 and FASB Statement No. 3

In May 2005, the FASB issued SFAS No. 154, “Accounting Changes and Error Corrections—A Replacement of APB Opinion No. 20 and FASB Statement No. 3”. This Statement changes the accounting for and reporting of a change in accounting policy by requiring retrospective application of changes in accounting policies to prior periods’ financial statements unless impracticable. SFAS No. 154 will be applicable to accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company does not anticipate that the adoption of SFAS No. 154 will have a material impact on its financial position, cash flows or results of operations.

SAB No. 107: Shared Based Payment

On March 29, 2005, the SEC released a Staff Accounting Bulletin (SAB) relating to the FASB accounting standard for stock options and other share-based payments. The interpretations in SAB No. 107, “Share-Based

Payment, (SAB 107) express views of the SEC Staff regarding the application of SFAS No. 123 (revised 2004), Share-Based Payment (Statement 123R). Among other things, SAB 107 provides interpretive guidance related to the interaction between Statement 123R and certain SEC rules and regulations, and provides the Staffs views regarding the valuation of share-based payment arrangements for public companies. The Company does not anticipate that adoption of SAB 107 will have any effect on its financial position, results of operations or cash flows.

Statements of Financial Accounting Standards No. 123 (Revised 2004): Share-Based Payment

In December 2004, the FASB issued SFAS No. 123 (revised 2004), Shared Based Payments (SFAS 123R). This statement eliminates the option to apply the intrinsic value measurement provisions of Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees to stock compensation awards issued to employees. Rather, SFAS 123R requires companies to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. That cost will be recognized over the period during which an employee is required to provide services in exchange for the awardthe requisite service period (usually the vesting period). SFAS 123R applies to all awards granted after the required effective date, December 15, 2005, and to awards modified, repurchased, or cancelled after that date. SFAS 123R will be effective for our fiscal year ending December 31, 2006. The Company does not anticipate that adoption of this Standard will have a material effect on its financial position, results of operations or cash flows.

Statements of Financial Accounting Standards No. 151: Inventory CostsAn Amendment of ARB No. 43, Chapter 4

On November 24, 2004, the FASB issued SFAS No. 151, Inventory Cost, a revision of ARB No. 43, Chapter 4. The amendments to SFAS No. 151 aim to improve financial information, stating that the expenses of inactive facilities, transportation costs, manipulation costs and scrap material costs should be recorded in the statement of operation as expenses of the period. The application of fixed cost to inventories should be based on the normal capacity of the production facilities.

SFAS No. 151 will be applicable to valuation of Inventories by the end of the first reporting period ending after June 15, 2005. The Company does not anticipate that the adoption of SFAS No. 151 will have a material impact on its financial position, results of operations or cash flows.

Statements of Financial Accounting Standards No. 153: Exchanges of Non-monetary AssetsAn Amendment of APB Opinion No. 29

On December 16, 2004, the FASB issued SFAS N0.153, Exchanges of Non-monetary AssetsAn amendment of APB Opinion No. 29, which amends Accounting Principles Board Opinion No. 29 Accounting for Nonmonetary Transactions. This amendment is based on the idea that exchange transactions should be valued in accordance with the value of the exchanged assets. The exception made for similar non-monetary productive assets is eliminated and substituted by a more extensive exception related to non-monetary assets with a non-commercial consideration. APB No. 29 stated that the exchange transaction of a productive asset for a similar one should be recorded at the book value of the exchanged asset.

SAS No. 153 will be applicable for non-monetary asset exchange transactions occurring in fiscal periods beginning after June 15, 2005. The Company does not anticipate that the adoption of SFAS No. 153 will have a material impact on its financial position, results of operations or cash flows.

Statement of Financial Accounting Standards No. 155 Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements Nos. 133 and 140

On February 2006 the FASB issued this Statement that amends FASB Statements No. 133, Accounting for Derivative Instruments and Hedging Activities, and No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. This Statement resolves issues addressed in Statement 133 Implementation Issue No. D1, Application of Statement 133 to Beneficial Interests in Securitized Financial Assets.

This Statement permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, clarifies which interest-only strips and principal-only strips are not subject to the requirements of Statement 133, establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives and amends Statement 140 to eliminate the prohibition on a qualifying special purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. This Statement is effective for all financial instruments acquired or issued after the beginning of an entitys first fiscal year that begins after September 15, 2006. Earlier adoption is permitted as of the beginning of an entitys fiscal year, provided the entity has not yet issued financial statements, including financial statements for any interim period for the fiscal year. The Company does not anticipate that the adoption of this new Statement at the required effective date will have a significant effect in its results of operations, financial position or cash flows.

Statement of Financial Accounting Standards No. 156 Accounting for Servicing of Financial Assets an amendment of FASB Statement No. 140

In March 2006, the FASB issued this Statement that amends FASB Statements No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, with respect to the accounting for separately recognized servicing assets and servicing liabilities. The new Statement should be adopted as of the beginning of the first fiscal year that begins after September 15, 2006. The Company does not anticipate that the adoption of this new statement at the required effective date will have a significant effect in its results of operations, financial position or cash flows.

New IFRS Pronouncements

At the date of preparation of our Consolidated Financial Statements, several new Standards ,Amendments and IFRIC Interpretations were issued but not yet effective. The following are the most relevant to our Consolidated Financial Statements:

Amendment to IAS 19Employee Benefits

This Amendment to IAS 19—Employee Benefits provides a third optional treatment to account for actuarial gains and losses related to defined benefit plans. Under the currently effective text of IAS 19, an entity can elect to recognize actuarial gains and losses either in the income statement or in shareholders equity, considering the percentages defined under the corridor approach. According to this Amendment, an entity may also choose to recognize all actuarial gains and losses directly against shareholders equity.

An entity shall apply this Amendment for annual periods beginning on or after January 1, 2006. The Group does not anticipate that the adoption of this Amendment at the required effective date will have a significant effect on its results of operations, financial position or cash flows.

Amendment to IAS 21The Effects of Changes in Foreign Exchange Rates Net Investment in a Foreign Operation

According to this Amendment to IAS 21—The Effects of Changes in Foreign Exchange Rates exchange differences arising from intragroup monetary items, which in substance, form part of the net investment in a foreign operation, are classified as equity until the disposal of the foreign operation, irrespective of which is the currency in which the monetary item is denominated.

An entity shall apply this Amendment for annual periods beginning on or after January 1, 2006. The Group does not anticipate that the adoption of this Amendment at the required effective date will have a significant effect on its results of operations, financial position or cash flows.

Amendment to IAS 39Financial Instruments: Recognition and Measurement Fair Value Option

This Amendment to IAS 39—Financial Instruments: Recognition and Measurement revises the IAS 39 fair value option for financial assets and liabilities and limits it use to those financial instruments that meet certain criteria. Thus, an entity can use the fair value option when doing so eliminates or significantly reduces measurement or recognition inconsistencies that would otherwise arise from measuring assets or liabilities, or recognizing the gains and losses on them, on different bases. An entity may also use this designation when doing so results in more relevant information because a group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy. The fair value option also applies to embedded derivatives that meet certain characteristics.

Following the recommendation of early application and transitional provisions, the Group has adopted this Amendment to IAS 39 Financial Instruments: Recognition and Measurement Fair Value Option before the effective date, which is January 1, 2006.

Amendment to IAS 39Financial Instruments: Recognition and Measurement - Cash Flow Hedges of Forecast Intragroup Transactions

This Amendment to IAS 39—Financial Instruments: Recognition and Measurement affects forecast intragroup transactions in a currency other than the functional currency of the reporting entity, when such transactions are highly probable and are subject to foreign exchange rate risk, which is likely to impact on the consolidated income statement. This Amendment allows transactions of the described nature to be designated as hedged items under a cash flow hedge for the purposes of the consolidated financial statements.

An entity shall apply this Amendment for annual periods beginning on or after January 1, 2006, although earlier application is encouraged. The Group does not anticipate that the adoption of this Amendment at the required effective date will have a significant effect on its results of operations, financial position or cash flows.

Amendment to IAS 39Financial Instruments: Recognition and Measurement Financial Guarantee Contracts

This Amendment to IAS 39—Financial Instruments: Recognition and Measurement is effective for annual periods beginning on or after January 1, 2006. Under the provisions of this Amendment, financial guarantee contracts issued and commitments to provide a loan at a below-market interest rate are included within the scope of IAS 39. Therefore, such instruments shall be measured at fair value upon initial recognition and remeasured subsequently at the higher of:

i) the amount determined in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets; and

ii) the amount initially recognized less, when appropriate, cumulative amortization recognized in accordance with IAS 18 Revenues.

The Group does not anticipate that the adoption of this Amendment at the required effective date will have a significant effect on its results of operations, financial position or cash flows.

IFRIC 4Determining Whether an Arrangement Contains a Lease (January 1, 2006)

The issues addressed in this Interpretation are: (a) how to determine whether an arrangement is, or contains, a lease as defined in IAS 17 Leases; (b) when the assessment or a reassessment of whether an arrangement is, or contains, a lease should be made; and (c) if an arrangement is, or contains, a lease, how the payments for the lease should be separated from payments for any other elements in the arrangement. According to this Interpretation, determining whether an arrangement is, or contains, a lease shall be based on the substance of the arrangement and requires an assessment of whether fulfillment of the arrangement is dependent on the use of a specific asset or assets (the asset), and whether the arrangement conveys a right to use the asset.

An entity shall apply this Interpretation for annual periods beginning on or after 1 January 2006, although earlier application is encouraged. The Group does not anticipate that the adoption of this new Interpretation at the required effective date will have a significant effect in its results of operations, financial position or cash flows.

Other IFRS Pronouncements

Other Standards, Amendments and IFRIC Interpretations that have been issued but are not yet effective at the date of preparation of our Consolidated Financial Statements are as follows:

Standards and amendments to standards		**Effective date**
IFRS 6	*Exploration for and Evaluation of Mineral Assets*	January 1, 2006
IFRS 7	*Financial Instruments: Disclosures*	January 1, 2007
Amendment to IAS 1	*Presentation of Financial Statements Capital Disclosures*	January 1, 2007

Interpretations		**Effective date**
IFRIC 5	*Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*	January 1, 2006
IFRIC 6	*Liabilities Arising from Participating in a Specific Market - Waste Electrical and Electronic Equipment*	Years beginning after December 1, 2005
IFRIC 7	*Applying the Restatement Approach under IAS 29 Financial Information in Hyperinflationary Economies*	March 1, 2006
IFRIC 8	*Scope of IFRS 2 Share-based Payment*	May 1, 2006

The Group does not anticipate that the first-time adoption of the aforementioned Standards, Amendments and Interpretations will have a significant impact on its Consolidated Financial Statements.

B. LIQUIDITY AND CAPITAL RESOURCES

Cash Flow Analysis

The table below sets forth consolidated cash flow information for the periods indicated. Positive figures refer to cash inflows and negative figures or those in parentheses refer to cash outflows.

	Year ended December 31,	
	2004	**2005**
	(in millions of euro)	
Net cash provided by operating activities	10,131.13	11,139.14
Net cash used in investing activities	(5,808.16)	(9,592.02)
Net cash used in financing activities	(3,936.61)	(434.67)

Net Cash Provided by Operating Activities

Net cash provided by operating activities increased 9.9% to €11,139.1 million in 2005 from €10,131.1 million in 2004. This growth in 2005 was mainly due to an increase in cash receipts from customers, offset in part by an increase in cash paid to suppliers and employees and taxes paid.

Cash receipts from customers increased 22.0% to €44,353.1 million in 2005 from €36,367.1 in 2004. This increase was mainly due to the consolidation of Cesky Telecom and the Argentine and Chilean mobile operators acquired from BellSouth in January 2005.

Cash paid to suppliers and employees increased 23.7% to €30,531.5 million in 2005 from €24,674.1 in 2004. These higher outflows were mainly due to the increase in advertising expenses and handset purchases for the promotional efforts made by the Telefónica Group and the consolidation of Cesky Telecom and the Argentine and Chilean mobile operators acquired from BellSouth in January 2005. Payments to employees increased as a result of the increase in the Group's average number of employees.

Taxes paid increased significantly to €1,233.0 million in 2005 from €326.0 million in 2004. This variation was mainly due to an increase in taxes paid in Brazil as a result of the expiration of certain tax credits.

As a result, cash inflow from operating activities (which is subtotal of cash receipts from customers minus cash paid to suppliers and employees and minus income taxes paid) increased 10.7% to €12,588.6 million in 2005 from €11,367.0 million in 2004.

Net interest and other financial expenses paid increased 16.3% to €1,520.0 million in 2005 from €1,307.1 million in 2004, principally due to an increase in the Group's average net financial debt in 2005 compared to 2004.

Net Cash Used in Investing Activities

Net cash used in investing activities increased to €9,592.0 million in 2005 from €5,808.2 million in 2004, mainly due to an increase in payments on investments in companies, net of cash and cash equivalents acquired and payments on investments in property, plant and equipment and intangible assets and a decrease in interest received on excess cash not included under cash and cash equivalents.

Payments on investments in companies, net of cash and cash equivalents acquired increased 56.4% to €6,571.4 million in 2005 from €4,201.6 million in 2004. Our main investments in companies in 2005 were €912.7 million for the acquisition of the mobile operators in Chile and Argentina from BellSouth for €3,662.5 million for the acquisition of Cesky Telecom, €1,265.8 million for the acquisition of 4.97% of the shares of O2 and €424.5 million for the acquisition of a minority stake in China Netcom. Our main investments in companies in 2004 were €208.7 million related to tender offers to increase our interests in the Brasilcel subsidiaries, €3,179.4 million for the acquisition of the BellSouth's operators in Latin America (other than in Chile and Argentina, which we acquired in 2005) and €483.7 million for the acquisition of additional Portugal Telecom shares.

Payments on investments in property, plant and equipment and intangible assets increased 26.8% to €4,423.2 million in 2005 from €3,488.2 million in 2004, principally due to an increase at Telefónica de España as a result of the expansion of its broadband business, Telefónica Latinoamérica as a result of the expansion of its broadband and fixed line telephony business, Telefónica Móviles as a result of network upgrades and the roll-out of its GSM network the investment made in Distrito C (the future Telefónica Group headquarters in Madrid).

Interest received on excess cash not included under cash and cash equivalents decreased 45.1% to €625.2 million in 2005 from €1,139.5 million in 2004, principally due to lower levels of excess cash in 2005 as a result of our increased investing activity in 2005.

Net Cash Used in Financing Activities

Net cash used in financing activities decreased to €434.7 million in 2005 from €3,936.6 million in 2004. This decrease was due principally to the increase in proceeds, net of repayments, from loans, credits and promissory notes, to €7,209.4 million in 2005 from €2,085.3 in 2004 offset in part by the increase in cancellation of debentures and bonds redeemed, net of proceeds, to €2,821.4 million in 2005 from €1,217.6 in 2004.

Anticipated Uses of Funds

Our principal liquidity and capital resource requirements consist of the following:

- debt service requirements relating to our existing and future debt;
- capital expenditures for existing and new operations;
- acquisitions of new licenses or other operators or companies engaged in complementary or related businesses;
- costs and expenses relating to the operation of our business; and
- dividend, other shareholder remuneration, and early retirement payments.

Our principal liquidity requirements relate to our debt service requirements. At December 31, 2005, we had gross financial debt of €34,403.4 million and net financial debt of €30,067 million. For a reconciliation of net financial debt to gross financial debt (the sum of current and non-current interest-bearing liabilities), see "Presentation of Financial Information—Non-GAAP Financial Information—Net Financial Debt." We incurred a further approximately £16,600 million in debt after such date to fund our acquisition of O2**.**

We expect to spend approximately 35% of our capital expenditures budget for 2006 on our fixed line telephony business (Telefónica de España and Telefónica Latinoamérica) mainly to improve broadband services and 60% on our mobile businesses (Telefónica Móviles and O2) in order to increase the capacity of our mobile telephony networks, roll-out the UMTS network in Europe and to make technological upgrades in Latin America. Our principal capital expenditures are described in "Item 4—Information on the Company". Our anticipated amounts of capital expenditures and investments in affiliates and the underlying assumptions are subject to risks and uncertainties, and actual capital expenditures and investments in affiliates may be less than or exceed these amounts. See "Cautionary Statement Regarding Forward-Looking Statements".

Anticipated Sources of Liquidity

Cash flows from operations are our primary source of cash funding for existing operations, capital expenditures, interest obligations and principal payments. We also rely on external borrowings, including a variety of short- and medium-term financial instruments, principally bonds and debentures, and borrowings from financial institutions. Cash and equivalents are mainly held in euro and euro-denominated instruments. We believe that, in addition to internal generation of funds, our medium-term note program, our euro commercial paper program, our corporate domestic promissory note program and available lines of credit will provide us with substantial flexibility for our future capital requirements as existing debt is retired. As of the date of this Annual Report, our management believes that our working capital is sufficient to meet our present requirements.

The following table describes our consolidated gross financial debt, as stated in euro using the noon buying rate for euro at December 31, 2005. We may have exchange rate financial derivatives instruments assigned to the underlying debt instruments. In 2005, the average interest rate on our consolidated gross financial debt was 6.4% . The debt profile below shows the notional amount at the date at which we entered into the related derivatives.

Amortization schedule(1)

	Year ended December 31,					
	2006	**2007**	**2008**	**2009**	**2010**	**S**

(in millions of euro)

Non-convertible euro and foreign currency debentures and bonds	1,948.27	1,427.32	751.80	874.04	2,747.46
Promissory notes and commercial paper	2,497.95	—	—	—	—
Other marketable debt securities	—	—	—	—	—
Loans and other payables (principal and interest)	4,789.66	1,300.14	1,256.64	3,266.24	1,048.96
TOTAL	**9,235.88**	**2,727.46**	**2,008.44**	**4,140.28**	**3,796.42**

(1) This table includes the fair value of those derivatives classified as financial liabilities (negative mark to market) under IFRS. It does not include the fair value of derivatives classified as financial assets (positive mark to market) under IFRS. See “Item 11—Quantitative and Qualitative Disclosures About Market Risk”.

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At December 31, 2005, we had unused committed credit lines in an amount of €4,728 million, all of which bear interest at a floating rate based on market indices, principally the Euro Interbank Offered Rate (EURIBOR) and the London Interbank Offered Rate (LIBOR). At the same date, we also had €223 million available under our €3 billion syndicated revolving credit facility, which we entered into on July 6, 2004. Also, on October 31, 2005, in connection with our acquisition of O2 plc, we entered into a syndicated loan with a credit line of up to £18,500 million. As at December 31, 2005, we had not drawn down any amounts under such syndicated loan. At April 12, 2006, this syndicated loan has been completely drawn down. As of that date, the total amount outstanding under this loan was approximately £14,200 million, after two partial cancellations in 2006. See “Item 7—Major Shareholders and Related Party Transactions—Related Party Transactions”.

Our borrowing requirements are not significantly affected by seasonal trends.

The table below sets forth the ratings of our short- and long-term debt as of the date of this Annual Report. A credit rating is not a recommendation to buy, sell or hold securities, may be subject to revision at any time and should be evaluated independently of any other rating.

Rating Agency	**Issuer**	**Long-Term Debt**	**Short-Term Debt**	**Outlook**	**Last Update**
Standard & Poor’s	Telefónica, S.A	BBB+	A-2	Stable	January 11, 2006
Moody’s	Telefónica, S.A.	Baa1	P-2	Stable	December 22, 2005
Fitch	Telefónica, S.A.	BBB+	F-2	Stable	April 11, 2006

On March 31, 2005 and April 1, 2005, Standard and Poor’s and Fitch placed our corporate credit ratings on “CreditWatch” and “Rating Watch”, respectively, with negative implications following the announcement by the Czech Republic’s privatization commission that our €2.7 billion bid to acquire a 51.1% state in Cesky Telecom a.s. was the preferred bid in the auction process. Subsequently, on April 21 and April 27, 2005, Fitch and Standard & Poor’s, respectively, confirmed the Company’s ratings, suppressing their ratings watch.

On October 31, 2005, Moody’s and Fitch Ratings put our credit ratings on watch, with a negative outlook following the Company’s announcement of a tender offer for 100% of O2’s share capital. On the same day, Standard & Poor’s decreased the Company’s long-term credit rating to A- and also put the Company on a ratings watch, with a negative outlook. Each of Moody’s and Fitch Ratings stated that they would not take a ratings action until the completion of the O2 acquisition, limiting the downgrade, in both cases, to one grade, Baa1 and A-, respectively, while Standard & Poor’s stated that if any further downgrades took place they would be limited to BBB+.

On December 22, 2005, Moody’s downgraded the Company’s long-term credit rating to Baa1, with a stable outlook and confirmed the Company’s short-term credit rating (P-2). On January 11, 2006, Fitch Ratings downgraded the Company’s long-term credit rating to A- with a stable outlook and the Company’s short-term credit rating to F-2. On the same day, Standard & Poor’s downgraded the Company’s long-term credit rating to BBB+, with a stable outlook, while confirming the Company’s short-term credit rating (A-2).On April 11, 2006, Fitch Ratings downgraded the Company’s long-term credit rating to BBB+ with a stable outlook following the announcement of the acquisition of a majority stake in Colombia Telecom.

Our ability to use external sources of financing will depend in large part on our credit ratings. We believe that we are well-positioned to raise capital in the public debt markets. However, a downgrade of any of the ratings of our debt by any of Moody’s, Standard & Poor’s and/or Fitch may increase the cost of our future borrowing or may make it more difficult to access the public debt markets. In connection with the credit rating agencies’ review of our debt

ratings, the rating agencies may give considerable weight to the general macroeconomic and political conditions in Latin America given our high degree of exposure in such region, the performance of our businesses in the Spanish market, our financial and shareholder remuneration policy, our acquisition policy, our ability to integrate recent acquisitions and our ability to refinance debt incurred in connection with recent acquisitions.

Intragroup Loans

We lend funds to our operating subsidiaries, directly or through holding companies that head our different lines of business. These funds are derived from retained cash flows, loans, bonds and other sources (such as asset disposals). Some of the subsidiaries receiving funds are located in Latin American countries.

C. RESEARCH AND DEVELOPMENT

We continue to be firmly committed to technological innovation as a key tool to achieving sustainable competitive advantage, preempting market trends and differentiating our products. Through the introduction of new technologies and the development of new products and business processes we seek to become a more effective, efficient and customer-oriented Group.

In 2005, Telefónica further developed the model in technological innovation management it established in 2004, to align, even more, our technological innovation with the strategy of the Telefónica Group. This model encourages collaboration with other agents, who will become “technological partners”, including clients, public administrations, suppliers, content providers and other enterprises. Our “technological partners” include Microsoft, Ericsson, Google and Huawei.

Telefónica believes that differentiating its products with respect to its competitors and improving its market positions cannot be based solely on acquired technology. Telefónica believes it is important to foster research and development activities in an effort to achieve this differentiation and to advance other innovation activities. Our research and development (R&D) policy is aimed at:

- developing new products and services in order to gain market share;
- fostering customer loyalty;
- increasing revenues;
- improving management;
- improving business practices; and
- increasing the quality of our infrastructure and services to improve customer service and reducing costs.

In 2005, the Telefónica Group undertook technological innovation projects focusing on profitable innovation, process efficiency, the creation of new sources of revenues, customer satisfaction, the consolidation of new markets and technological leadership. Our technological innovation activities have been especially integrated in Telefónica’s strategy to create value through broadband and IP network communications and services.

In addition, projects to promote the information society were undertaken, new services that will use 3G mobile technologies capacities and new wireless handsets were prepared and work was undertaken with a view to identifying as soon as possible the emerging technologies that might have a relevant impact on our businesses, testing them with trials relating to new services, applications and platform prototypes.

In 2005, new business and operational support systems were developed and existing systems were improved.

Most of the Groups R&D activities are undertaken by Telefónica Investigación y Desarrollo S.A.U. (Telefónica I&D), a wholly owned subsidiary of Telefónica, which works principally for the Groups lines of business. In performing its functions, Telefónica I&D receives assistance from other companies and universities. Telefónica I&Ds mission focuses on improving the Telefónica Groups competitiveness through technological innovation and product development. Telefónica I&D conducts experimental and applied research and product development to increase the range of our services and reduce operating costs. It also provides technical assistance to our Latin American operations. Telefónica I&Ds activities include the following:

- the development of new products and fixed telephone services, particularly the development of such value added services as broadband, wireless communications and Internet services for the public, corporate, wireless and multimedia sectors, and the automation of customer services while integrating new features available through our GPRS and UMTS networks;
- the development of interactive services, focusing on the development of information services and new infrastructure to provide such services, primarily in the Internet Protocol environment;
- the development of management systems designed to strengthen infrastructure and its quality and to develop innovative solutions for the management of our networks and services;
- the development of business support systems intended to provide innovative solutions for business processes; and
- innovation in business services intended to reinforce technological skills in the areas of networks, software and information technologies.

For example, our IP TV service (commercialized under the brand name, Imagenio) is based on IP TV technology and represents a new way to access TV and multimedia content in a customized and interactive way and is supported by research and development carried out by Telefónica I&D.

In 2005, Telefónica I&D has continued developing its network of centers. In Spain, Telefónica I&D has created a new center in Andalusia (Granada). This new center complements the activities conducted at the Telefónica I&D centers in Barcelona, Huesca, Madrid and Valladolid.

In 2005, approximately 49% of Telefónica I&Ds research and development was for the benefit of Telefónica de España, 26% for the benefit of Telefónica Móviles, 9% for Telefónica Latinoamérica, 8% for Telefónica and 8% for our other subsidiaries, such as Atento, Terra and Telefónica Contenidos.

At December 31, 2005, Telefónica I&D had 1,265 employees, who also collaborate with Telefónica R&D qualified professionals from more than 40 companies and 28 universities. In 2005, approximately 1,800 projects were undertaken and incorporated into our strategy for value creation via broadband communications and services and IP networks.

Our total research and development expenses were 461 million and 544 million in 2004 and 2005. These expenses represented 1.5% and 1.4% of our consolidated revenues in each of those years, respectively. These figures have been calculated using the guidelines set out in the OECD Manual. These guidelines include expenses for research and development that, because of timing of projects or accounting classifications, we do not include in their entirety in our consolidated balance sheet.

D. TRENDS AND OUTLOOK

Telefónica is a highly geographically diversified company, offering fixed line telecommunications, broadband and mobility solutions through a variety of platforms with a view to maintaining our leading position in our core markets.

We have changed our business and geographical mix significantly during the past year and a half with the acquisition of the form BellSouth mobile operators, the acquisition of a majority stake in Cesky Telecom and our acquisition of substantially all of the shares of O2. The acquisitions of Cesky Telecom and O2 allows us to enhance our presence in Europe, consolidating our position in two of the principal European mobile markets: the United Kingdom and Germany. The further development of broadband and internet penetration in these markets is expected to allow us to accelerate and try to sell new IP products and services.

Our new global scope resulting from the integration of the BellSouth mobile operators, the acquisition of Cesky Telecom and our acquisition of substantially all the shares of the mobile operator O2, challenges us to realize the potential synergistic benefits and economies of scale from the integration of these companies, in order to offer customers a higher quality of service more efficiently.

In particular, our focus is as follows:

- In our fixed line business in Spain, Telefónica is intensifying its commercial efforts and is specifically focusing on improving its quality of service to increase customer satisfaction. Our business strategy is focused on an integrated offer of telecommunications solutions to satisfy the customer needs of voice, broadband and TV, by providing a unique service package. We are focusing on offering a wide range of products tailored to each customer segment, reinforcing customer loyalty and our quality of service.

- In Latin America, our strategy for our fixed line business is focused on customer segmentation in order to provide and offer more personalized services. We are also focused on increasing the average revenue per customer in the long-term by providing packaged services including voice, broadband and TV along with offering loyalty programs.

- In the mobile business in Spain our primary projects are to strengthen our competitive position and increase our customer loyalty. In an effort to further increase customer loyalty and usage Telefónica Móviles will continue to develop segmented packages and innovative tariff options and deploy new services with a special focus on usage based on UMTS, deploying the UMTS network ahead of our competitors.

- In the mobile business in Latin America, we will seek to maintain the current growth of our customer base in order to retain our leading market position. We are capitalizing on the regional management of operations in the region and the final integration of the former Bellsouth operators. We will also reinforce our position by making investments to improve the quality and coverage of our networks.

- In the rest of Europe, we have two challenges this year: first, the merger of the fixed and mobile business in the Czech Republic, and second, to integrate O2 into the Telefónica Group.

At the same time, we are in the process of transforming ourselves in order to increase our cash flow generation and improve the returns on capital investment. This transformation is centered around our customers and focused on adopting a more efficient business model that optimizes and redirects capital expenditures towards broadband and new services, while at the same time becoming a much less capital intensive business.

E. OFF-BALANCE SHEET ARRANGEMENTS

We have commitments that could require us to make material payments in the future. These commitments are not included in our consolidated balance sheet at December 31, 2005. These commitments are primarily contingent obligations in the form of guarantees for our subsidiaries and put and call rights with respect to some of our joint ventures. These arrangements allow us to provide the necessary credit support for some our subsidiaries to develop their operations and allow us to enter into joint ventures on market terms. As of the date of this Annual Report, we are not aware of any events that would result in the material reduction to us of any of these off-balance sheet arrangements. For a discussion of our off-balance sheet commitments please refer to note 21(b) to the Consolidated Financial Statements.

F. TABULAR DISCLOSURE OF CONTRACTUAL OBLIGATIONS

The following table describes our contractual obligations and commitments with definitive payment terms which may require significant cash outlays in the future. The amounts payable are as of December 31, 2005. For additional information, see note 21(e) to the Consolidated Financial Statements included elsewhere herein. Debt related to our acquisition of O2 is not reflected in this table as it was incurred after December 31, 2005.

	Payments Due by Period				
	Total	**Less than 1 year**	**1-3 years**	**4-5 years**	**More than 5 years**
	(millions of euro)				
Long-term debt obligations(1)(2)	34,403.46	9,235.88	4,735.90	7,936.70	12,494.98
Operating lease obligations(3)	2,107.44	365.87	683.90	363.00	694.67
Purchase obligations(4)	1,005.18	908.01	62.18	7.19	27.80
Other long-term obligations(5)	6,353.24	945.81	1,567.45	1,128.34	2,711.64
Total	43,869.32	11,455.57	7,049.43	9,435.23	15,929.09

(1) Capital (Finance) Lease Obligations are not calculated separately and are instead included as part of our debt obligations.

(2) This item includes the fair value of those derivatives classified as financial liabilities (negative mark to market) under IFRS. It does not include the fair value of derivatives classified as financial assets (positive mark to market) under IFRS. See "Item 11—Quantitative and Qualitative Disclosures About Market Risk".

(3) Our operating lease obligations have in most cases extension options conditioned on the applicable law of each country. Accordingly, we have included only those amounts that represent the initial contract period.

(4) Material purchase obligations include network equipment and audiovisual content obligations and payment obligations under existing licenses.

(5) Other long-term obligations include long-term obligations that require us to make cash payments, excluding financial debt obligations included in the table under "—Anticipated Sources of Liquidity" above.

For details of the composition of, and changes in, our debt, see notes 14, 15 and 16 to our Consolidated Financial Statements.

We financed our entire acquisition cost of O2 with £17.9 billion (approximately €26.4 billion calculated based on a euro-pound exchange rate of €1.00 = 0.6767 on October 31, 2005) of debt incurred under a credit facility. This debt is not included in the above table. As a result, our leverage has increased, and our credit ratings have decreased following recent downgradings by the credit rating agencies. The credit facility has two tranches: one of which has a one-year maturity, which may be extended to two years and to two and a half years (with respect to 50% of the amount of such tranche); and the other which has a three-year maturity. Accordingly, we will be obligated to repay the entire principal amount of such debt within such period, unless we are able to refinance such debt with longer term debt. Although we have refinanced a portion of our outstanding borrowings under the credit facility through the issuance in January 2006 of approximately £4 billion aggregate principal amount of long-term bonds that mature in 2011, 2016, 2018 and 2026, we continue to have substantial refinancing needs. As of April 6, 2006, £14.175 billion (approximately €20.2 calculated based on a euro-pound exchange rate of €1.00 = 0.70060 on April 5, 2006) was outstanding under these credit facilities. See "Item 3.D.—Risk Factors—We are exposed to increased liquidity and solvency risks following our acquisition of O2, thereby increasing our vulnerability to capital markets and business downturns, and reducing our strategic flexibility."

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

A. DIRECTORS AND SENIOR MANAGEMENT

During 2005, the Board of Directors met 12 times. At April 12, 2006, the Board of Directors had met three times during 2006. At April 12, 2006, the directors of Telefónica, S.A., their respective positions on the Board of Directors and the year they were appointed to such positions were as follows:

Name	Age	First Appointed	Current Term Ends
César Alierta Izuel(1)	60	1997	2007
Isidro Fainé Casas(1)(2)	63	1994	2006
Gregorio Villalabeitia Galarraga(1)(3)(4)(6)(8)	55	2002	2007
José Fernando de Almansa Moreno-Barreda(6)(8)	57	2003	2008
David Arculus	59	2006	(11)
Maximino Carpio García(1)(4)(5)	60	1997	2007
Carlos Colomer Casellas(1)(7)	62	2001	2006
Peter Erskine(1)	54	2006	(11)
Alfonso Ferrari Herrero(5)(6)(9)	64	2001	2006
Gonzalo Hinojosa Fernández de Angulo(4)(5)(6)(7)	60	2002	2007
Pablo Isla Álvarez de Tejera(5)(9)	42	2002	2007
Luis Lada Díaz(7)	56	2000	2006
Julio Linares López(1)(8)	60	2005	(11)
Antonio Massanell Lavilla(2)(4)(7)(9)	51	1995	2006
Vitalino Manuel Nafria Aznar(3)	55	2005	(11)
Enrique Used Aznar(6)(8)(9)	64	2002	2007
Mario Eduardo Vázquez	70	2000	2006
Antonio Viana-Baptista(1)	48	2000	2010
	—	—	—
Ramiro Sánchez de Lerín García-Ovies(10)	51	2003	—

(1) Member of the Executive Committee of the Board of Directors.
(2) Nominated by Caja de Ahorros y Pensiones de Barcelona.
(3) Nominated by Banco Bilbao Vizcaya Argentaria, S.A.
(4) Member of the Audit and Control Committee of the Board of Directors.
(5) Member of the Nominating, Compensation and Corporate Governance Committee of the Board of Directors.
(6) Member of the International Affairs Committee.
(7) Member of the Service Quality and Customer Service Committee.
(8) Member of the Regulation Committee.
(9) Member of the Human Resources and Corporate Reputation Committee.
(10) Mr. Sánchez de Lerín was appointed General Secretary and Secretary of the Board of Directors on September 28, 2005 and is not a director.
(11) Appointment must be ratified by the next general shareholders’ meeting.

A significant majority, 12, of our current directors are non-executive directors. In accordance with the regulations of our Board of Directors, a minority of these current directors, four, are appointed by our significant shareholders.

Executive Committee

Our Board of Directors has expressly delegated all of its authority and power to the Executive Committee except as prohibited by Spanish corporate law or under our Articles of Association. This committee is made up of fewer Directors and meets more frequently than our Board of Directors. The members of the Executive Committee are Mr. César Alierta Izuel, Mr. Isidro Fainé Casas, Mr. Maximino Carpio García, Mr. Carlos Colomer Casellas, Mr. Antonio Viana-Baptista, Mr. Gregorio Villalabeitia Galarraga, Mr. Peter Erskine, Mr. Julio Linares López and Mr. Ramiro Sánchez de Lerín García-Ovies, who is the secretary of the Executive Committee.

Audit and Control Committee

The Audit and Control Committee functions are regulated by our bylaws and the Board of Directors regulations. The Audit and Control Committee has the primary objective of providing support to our Board of Directors in its supervisory oversight functions, specifically having the following responsibilities:

- to report, through its Chairman, to our General Meeting of Shareholders on matters raised at the General Meeting by the shareholders relating to the functions and matters of competence of the Committee;
- to propose to our Board of Directors, to submit to our General Meeting of Shareholders, the appointment of our auditors referred to in Article 204 of the Stock Company Act, as well as, when appropriate, the terms of their engagement, scope of professional assignment and revocation or renewal of their appointment;
- to supervise the internal audit services;
- to examine the financial information process and the internal control systems; and
- to maintain the necessary relations with the auditors to receive information on all matters that may put their independence at risk, and any other matters related to the process of auditing our accounts, as well as to receive information and maintain the communication with the auditors as required by law relating to the audit process and with respect to the technical regulations on auditing.

The Audit and Control Committee meets at least once per quarter and as many times as considered necessary. During 2005, the Audit and Control Committee met 12 times and, as of the date of this Annual Report, had met four times in 2006. The members of the Audit and Control Committee are Mr. Antonio Massanell Lavilla (chairman), Mr. Maximino Carpio García, Mr. Gregorio Villalabeitia Galarraga and Mr. Gonzalo Hinojosa Fernández de Angulo.

Nominating, Compensation and Corporate Governance Committee

The Nominating, Compensation and Corporate Governance Committee is responsible for reporting to the Board of Directors with regard to the proposals for the appointment of directors, members of the Executive Committee and the other committees of our Board of Directors and top members of our management and management of our subsidiaries. In addition, the Nominating, Compensation and Corporate Governance Committee is responsible for the compensation packages for our Chairman, determining Directors' compensation and reviewing the adequacy of the compensation packages and informing the Board of Directors and top members of management's compensation. The Nominating, Compensation and Corporate Governance Committee is responsible for preparing our Corporate Governance Annual Report. The members of the Nominating, Compensation and Corporate Governance Committee are Mr. Alfonso Ferrari Herrero (chairman), Mr. Maximino Carpio García, Mr. Pablo Isla Álvarez de Tejera and Mr. Gonzalo Hinojosa Fernández de Angulo. During 2005, the Nominating, Compensation and Corporate Governance Committee met 10 times, and as of the date of this Annual Report, had met three times in 2006.

Human Resources and Corporate Reputation Committee

The Human Resources and Corporate Reputation Committee is responsible for reviewing our personnel policy and making proposals to our Board of Directors regarding our personnel policy, corporate reputation and the promotion of our values within the Group. The Human Resources and Corporate Regulation Committee met five times during 2005, and as of the date of this Annual Report had met once in 2006. The members of the Human Resources and Corporate Reputation Committee are Mr. Pablo Isla Álvarez de Tejera (Chairman), Mr. Alfonso Ferrari Herrero, Mr. Antonio Massanell Lavilla and Mr. Enrique Used Aznar.

Regulation Committee

The Regulation Committees main objective is to monitor the main regulatory matters which affect the Telefónica Group. Another responsibility of the Regulation Committee is to act as a communication and information channel between our management team and our Board of Directors concerning regulatory matters. The members of the Regulation Committee are Mr. Enrique Used Aznar (chairman) , Mr. Gregorio Villalabeitia Galarraga , Mr.

Fernando de Almansa Moreno de Barreda and Mr. Julio Linares López During 2005, the Regulation Committee met nine times, and as of the date of this Annual Report, had met three times in 2006.

Service Quality and Customer Service Committee

The Service Quality and Customer Service Committee is responsible for monitoring and reviewing the standards of quality of the main services provided by the Telefónica Group. The Service Quality and Customer Service Committee acts as an information channel between our senior management team and our Board of Directors. The members of the Service Quality and Customer Service Committee are Mr. Gonzalo Hinojosa Fernández de Angulo (chairman), Mr. Carlos Colomer Casellas, Mr. Antonio Massanell Lavilla and Mr. Luis Lada Díaz. During 2005 the Service Quality and Customer Service Committee met four times, and as of the date of this Annual Report, had met once in 2006.

International Affairs Committee

The International Affairs Committee is responsible for analyzing international events and matters that affect the Telefónica Group and reporting these events and possible consequences to our Board of Directors. The International Affairs Committee pays close attention to events taking place in countries where the Telefónica Group has operations and which may affect our competitive position, corporate image and financial results. The International Affairs Committee also oversees our non-profit foundations in such countries. The members of the International Affairs Committee are Mr. José Fernando de Almansa Moreno-Barreda (chairman), Mr. Alfonso Ferrari Herrero, Mr. Enrique Used Aznar, Mr. Gregorio Villalabeitia Galarraga and Mr. Gonzalo Hinojosa Fernández de Ángulo. During 2005, the International Affairs Committee met six times, and as of the date of this Annual Report had met once in 2006.

Biographies of Directors

Mr. César Alierta Izuel serves as our Executive Chairman and Chairman of our Board of Directors. Mr. Alierta is also currently a member of the O2 Board of Directors. Mr. Alierta began his career in 1970 as general manager of the capital markets division at Banco Urquijo in Madrid, where he worked until 1985. From June 1996 until his appointment as our Chairman, he was the Chairman of Tabacalera, S.A., which after the merger with the French tobacco company, Seita, became Altadis. Previously, he was the Chairman and founder of Beta Capital, which he combined with his post as Chairman of the Spanish Financial Analysts Association as from 1991. He has also been a member of the Board of Directors and Standing Committee of the Madrid Stock Exchange. In January 1997, Mr. Alierta was appointed to our Board of Directors, and has also been appointed as director of Telefónica Internacional (TISA), Plus Ultra and Iberia Lineas Aereas de España, S.A. During his years as Chairman of Tabacalera, Mr. Alierta was also the Chairman of the Board of Directors of Logista, a subsidiary of the Altadis group. Mr. Alierta is currently a member of the Altadis Board of Directors and Standing Committee. On July 26, 2000, Mr. Alierta was appointed as our Chairman and Chief Executive Officer. Mr. Alierta holds a law degree from the University of Zaragoza and an MBA from Columbia University (New York).

Mr. Isidro Fainé Casas serves as our Vice-Chairman of the Board of Directors. Mr. Fainé is currently the General Manager of La Caja de Ahorros y Pensiones de Barcelona (la Caixa). Mr. Fainé has developed his professional career working for several companies in different sectors of the economy, as well as financial institutions, for over 20 years. Mr. Fainé holds a doctorate degree in Economics, a Diploma in *Alta Dirección* (Senior Management) from IESE Business School and an ISMP in Business Administration from Harvard University. He is a financial analyst and an academic at the Real Academia de Ciencias Económicas y Financieras.

Mr. Gregorio Villalabeitia Galarraga serves as a director. Mr. Villalabeitia is currently a member of the Board of Directors of Iberia Líneas Aéreas de España, S.A. and Tefónica Internacional, S.A. He has been General Manager of Caja de Ahorros Vizcaína and Chief Executive of Banco Cooperativo Español. He was appointed Chief Operating Officer of Banco de Crédito Local and was Chief Executive Officer of Caja Postal in January 1995. Following the merger of the various entities of Argentaria, he was named Wholesale Banking General Manager in 1998. In October 1999, following the merger of Argentaria and Banco Bilbao Vizcaya (BBV), he was named General Manager of Global Investment Banking of Banco Bilbao Vizcaya Argentaria, S.A., and after the

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restructuring in December 2001 he was appointed General Manager of the Real Estate and Industrial Group of the bank. Mr. Villalabeitia has a degree in law and economics from the University of Deusto (Bilbao, Spain).

Mr. José Fernando de Almansa Moreno-Barreda serves as a director. He is also a member of the board of directors of Telefónica Móviles, S.A., Telefónica de Argentina S.A., Telefónica del Peru S.A., Telefónica Internacional, S.A., Telecomunicaçoes de São Paulo S.A. and BBVA Bancomer Mexico. He holds a law degree from the University of Deusto (Bilbao, Spain). He was a member of the Spanish Diplomatic Corps and served from 1976 to 1992, as Secretary of the Spanish Embassy in Brussels, Cultural Counselor of the Spanish Delegation to Mexico, Chief Director for Eastern European Affairs and Atlantic Affairs Director in the Spanish Foreign Affairs Ministry, Counselor to the Spanish Permanent Representation to NATO in Brussels, Minister-Counselor of the Spanish Embassy in the Soviet Union, General Director of the National Commission for the 5th Centennial of the Discovery of the Americas, and Deputy General Director for Eastern Europe Affairs in the Spanish Foreign Affairs Ministry. From 1993 to 2002, Mr. Fernando de Almansa was appointed Chief of the Royal Household by His Majesty King Juan Carlos I, and is currently Personal Advisor to His Majesty the King. He has a degree in law from the University of Deusto (Bilbao, Spain).

Sir David Arculus serves as a director. In 2003, he was awarded an Hon. Doctorate (D. UNIV) by the University of Central England. In 1996, he received his masters in Engineering and Science and Economics from Oriel College, Oxford while in 1972 he received his masters in business administration from the London Business School. From 1998 to 2001, he was Chairman of Severn Trent Plc and IPC Group Limited. From 2002 to 2004, he was Earls Court and Olympia Ltd Chairman. From 2004 to January 2006, he served as Chairman of O2 plc. He is currently a director of Telefónica, S.A. and O2. He is also a Non Executive Director of Barclays Plc. Sir David Arculus is Deputy President of CBI and a member of the Oxford University Press Finance Committee.

Mr. Maximino Carpio García serves as a director. Since 1984, he has been Professor of Applied Economics of the Universidad Autónoma de Madrid. From 1983 to 1984, he was Chief of the Studies Services of the Confederación Española de Organizaciones Empresariales. From 1984 to 1992, he worked as head of the Department of Economics and Public Finance of the Universidad Autónoma de Madrid. From 1992 to 1995, he was dean of the Economics and Business Faculty of the Universidad Autónoma de Madrid. From 1995 to 1998, he served as head of the department of Public Economy of the Universidad Autónoma de Madrid. He also serves as a member of the Economic and Social Council, a Spanish government advisory entity, and the Advisory Committee of Abengoa. Mr. Carpio is a member of the Board of Directors of Telefónica Móviles. Mr. Carpio also received his doctorate degree from the Universidad Autónoma de Madrid.

Mr. Carlos Colomer Casellas serves as a director. Mr. Colomer is Chairman of the Colomer Group and a director of Altadis, S.A. Mr. Colomer began his career in 1970 as Marketing Vice-Chairman of Henry Colomer, S.A. In 1980, he was appointed as Chairman and General Manager of Henry Colomer, S.A and Haugron Cientifical, S.A. In 1986, he was also appointed President of Revlon for Europe. In 1989, he became the President of Revlon International and in 1990, he was appointed Executive Vice-President and Chief Operating Officer of Revlon Inc. In 2000, he was appointed Chairman and Chief Executive Officer of the Colomer Group. Currently, Mr. Colomer is also the Chief Operating Officer of INDO, an import-export company, Director of Cataluña for Banco Santander Central Hispano, Director of Hospital General de Cataluña and member of the Advisory Committee of CVC Capital Partners. Mr. Colomer has an economics degree from the University of Barcelona and a degree in business administration from IESE Business School.

Mr. Peter Erskine serves as a director. In 1973, he received a degree in psychology from Liverpool University. From 1993 to 1998, he held a number of senior positions, including Director of BT Mobile and President and Chief Executive Officer of Concert. In 1998 he became Managing Director of BT Cellnet. Subsequently in 2001 he became Chief Executive Officer and a member of the Board of Directors of O2. He currently continues to serve as Chairman of the Board of Director's of O2 along with serving as a director of Telefonica, S.A. Mr. Erskine is also a member of the Advisory Board of the University of Reading Business School.

Mr. Alfonso Ferrari Herrero serves as a director. He also serves as a director of CTC Chile S.A., Telefónica Internacional, S.A. and Telefónica del Peru. From 1995 to 2000, he was Executive Chairman of Beta Capital, S.A. and prior to that he served on several Boards of Directors representing Banco Urquijo where he was a partner from

1985. He has a doctorate in Industrial Engineering from the Industrial Engineers Technical School of the Polytechnic University of Madrid and holds a master's degree in business administration from Harvard University.

Mr. Gonzalo Hinojosa Fernández de Angulo serves as a director. Mr. Hinojosa served as Chairman and Chief Executive Officer of Cortefiel, S.A. He began his professional career with Cortefiel in 1976, and has served in various management positions since then. From 1991 through 2002, he served as a director of Banco Central Hispano Americano and a director of Portland Valderribas. He currently serves as a director of Altadis and Telefónica Internacional, S.A. Mr. Hinojosa has a doctorate in industrial engineering from the Industrial Engineers Technical School of the Polytechnic University of Madrid.

Mr. Pablo Isla Álvarez de Tejera serves as a director. Mr. Isla is currently the Managing Director of Inditex, S.A. Mr. Isla began his career in 1988 as Attorney General with the Spanish Ministry of Transports, Tourism and Communications and in 1991 served as the official delegate in Spain for the United Nations Commission in the Spanish General Direction of Legal Services. From 1992 through 1996, Mr. Isla served as General Manager of the Legal Services Department of Banco Popular. In 1996, he was appointed General Manager of the National Heritage department of the Treasury Ministry. He served as General Secretary of Banco Popular Español from 1998 through 2000. In July 2000, Mr. Isla was appointed Chairman of the Board of Grupo Altadis and Co-Chairman of the company. Mr. Isla has a law degree from the Universidad Complutense of Madrid.

Mr. Luis Lada Díaz serves as a director. He is currently the Chief Executive Officer of Telefónica de España and Vice-Chairman of the Cesky Telecom a.s. Supervisory Board. In 1989, Mr. Lada was Deputy General Manager for Technology, Planning and International Services when he left the Telefónica Group to join Amper Group, a telecommunications systems and equipment manufacturer, as General Manager for Planning and Control. Mr. Lada returned to the Telefónica Group in 1993 as Controller of the Subsidiaries and Participated Companies. In 1994, he was appointed as Chief Executive Officer of Telefónica Móviles de España, S.A., and was promoted to Chairman and President of Telefónica Móviles, S.A. in August 2000. He served as President until July 2002, and between July 2002 and December 2005 served as our General Manager for Development, Planning and Regulatory Affairs. He also serves on the boards of directors of Telefónica Móviles, S.A., Telefónica Internacional, S.A. He holds a degree in telecommunications engineering and joined the Telefónica Group in 1973 in the Research and Development Department, rising through the ranks to hold various managerial and executive positions. Mr. Lada is currently a member of A.P.D. Supervisory Board and a member of the Advisory Board of the UOC University.

Mr. Julio Linares López serves as a director. He is also our General Manager for Coordination, Business Development and Synergies. He joined Telefónica in May 1970 in the research and development center, where he held several positions until he was appointed Head of Telefónica's Technology and Technical Regulations Department. In April 1990, he was appointed General Manager of Telefónica Investigación y Desarrollo (Telefónica I&D). In December 1994, he became Deputy General Manager of Marketing and Development of Telefónica Services in the commercial area and subsequently Assistant Managing Director of Business Marketing. In July 1997, he was appointed Chief Operating Officer of Telefónica Multimedia and Chairman of Telefónica Cable and Producciones Multitemáticas. From May 1998 to January 2000, he served as General Manager of Strategy and Technology at the Telefónica, S.A.'s Corporate Centre, and as a director of Telefónica Sistemas, Telefónica Investigación y Desarrollo and Vía Digital. In January 2000, he was appointed Chairman of Telefónica de España, a position which he held until December 2005 when he was appointed General Manager for Coordination, Business Development and Synergies. Mr. Linares is currently Chairman of Teleinformatica y Comunicaciones, S.A. (TELYCO), Chairman of the Cesky Telecom, a.s. Supervisory Board, director of Telefónica de España, O2 plc. and Sogecable, S.A. Mr. Linares holds a degree in telecommunications engineering from the Polytechnic University of Madrid.

Mr. Antonio Massanell Lavilla serves as a director. Mr. Massanell is Senior Executive Vice President of Caja de Ahorros y Pensiones de Barcelona and a member of the Boards of Directors of Port Aventura, S.A. and Baqueira Beret, S.A. He is also President of Servihabitat, e-laCaixa, S.A. and Internet Global Congress (IGC). As a representative of Caja de Ahorros y Pensiones de Barcelona, he has worked with the Telefónica Group in the deployment of Caja de Ahorros y Pensiones de Barcelona's corporate telecommunications network. Mr. Massanel is currently a director of Telefónica Móviles, S.A. Mr. Massanell received his degree in economics from the University of Barcelona.

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Mr. Vitalino Manuel Nafría Aznar serves as a director. In 1983, Mr. Nafría Aznar was a Director of the Banco de Financiación Industrial (Induban) in Bilbao. In 1988 he worked as the regional Director of Aragón, Navarra y Rioja for Banco Bilbao Vizcaya. In 1990, he was appointed Business management Director of Banco Bilbao Vizcaya (BBV). In 1994, he held a senior position at the Territorial Direction in País Vasco. In April 1998, he was appointed as Chief Executive Officer of BBV in Mexico. In July 2000, he was appointed Director of BBVA Bancomer. In December 2001, he was appointed a Directive Committee member of BBVA at the Global Level and since January 2005 he has been the Retail Banks Director in Spain and Portugal for Banco Bilbao Vizcaya Argentaria.

Mr. Enrique Used Aznar serves as a director. Mr. Used is the Chairman of AMPER, S.A. and AmperProgramas and the Deputy Chairman of Medidata (Brazil). Previously, he held the position of Chairman of Telefónica Latinoamérica, S.A., Telefónica Móviles, S.A., Estratel and Telefónica Investigación y Desarrollo, S.A. He has also served as Deputy Chairman and Chief Executive Officer of Telefónica Publicidad e Información and Compañía Telecomunicaciones de Chile. He has also served as a member of the Board of Directors of Telefónica de Argentina, Telecomunicaciones de Sao Paulo, Telefónica del Perú, Telefónica Internacional, S.A., ATT Network System International and Ericsson (Spain). Mr. Used holds a degree in telecommunications engineering from the Polytechnic University of Madrid.

Mr. Mario Eduardo Vázquez serves as a director. Mr. Vázquez is the President of Telefónica de Argentina, Telefónica Móviles Argentina, S.A., Telinver S.A. and Telefónica Data Argentina S.A. and a director of Telefónica Comunicaciones Personales, S.A., Telefónica Internacional, S.A., Telefónica Holding Argentina S.A., Compañía Internacional de Telecommunicaciones S.A., Terra Networks Argentina S.A. and Radio Services, S.A. He also serves as Chairman of the Board of Directors of Rio Compañía de Seguros, S.A. In addition, he is a director of Banco Río de la Plata, S.A., Ríobank International, Corporación Metropolitana de Finanzas, S.A., Heller Financial Argentina, S.A., Heller-Sud Servicios Financieros, S.A., Motorcare Argentina, S.A., Acsa Loss Control, S.A., Central Puerto, S.A. and Indra SI S.A. Mr. Vázquez holds a degree in economics.

Mr. Antonio Viana-Baptista serves as a director. Mr. Viana-Baptista has served as Chairman and Chief Executive Officer of Telefónica Móviles S.A. since August 2002. He also serves on the Board of Directors of Telefónica Internacional, S.A., Telefónica Móviles España, S.A., Telefónica de España, S.A., O2 plc, Brasilcel, N.V., Portugal Telecom SGPS, S.A. and member of the Supervisory Board of Cesky Telecom, a.s. He was a principal partner of McKinsey & Co. at the McKinsey offices in Madrid and Lisbon from 1985 to 1991 and served as Executive Advisor of the Banco Português de Investimento (BPI) from 1991 to 1996. From 1996 through July 2002, Mr. Viana-Baptista was President of Telefónica Internacional and Executive President of Telefónica Latinoamérica. Mr. Viana-Baptista holds a bachelor's degree from the Catholic University of Lisbon, a graduate degree in European Economics from the Portuguese Catholic University and a master's degree in business administration from INSEAD.

Mr. Ramiro Sánchez de Lerín García-Ovies serves as our General Secretary and Secretary to our Board of Directors. He began his career in Arthur Andersen, first working for its audit department and later for its tax department. In 1982, he became an "Abogado del Estado" and started working for the Treasury Internal Revenue in Madrid (*Delegación de Hacienda de Madrid*). Afterwards he was assigned to the State Secretariat for the European Communities and later to the Foreign Affairs Ministry. He has been General Secretary and Secretary of the Board of Elosúa, S.A., Tabacalera, S.A., Altadis, S.A. and Xfera Móviles, S.A. He has also been teaching in ICADE, Instituto de Empresa and Escuela de Hacienda Pública.

Executive Officers/Management Team

At April 12, 2006, our executive management team was composed of our chief executive officer and eight general managers.

Name	Position	Appointed	Age
César Alierta Izuel	Chairman of the Board of Directors	2000	60

	and Chief Executive Officer		
Julio Linares López	General Manager of Coordination, Business Development and	2000	60

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Name	Position	Appointed	Age
	Synergies		
Ramiro Sánchez de Lerín	General Secretary and Secretary to the Board	2003	51
Santiago Fernández Valbuena	General Manager of Finances and Corporate Development	2002	46
Juan Carlos Ros	General Manager of Legal Services	2005	44
Luis Abril Pérez	General Manager of Corporate Communications	2002	57
Calixto Ríos Pérez	General Manager of Internal Audit	2000	60
Javier Nadal Ariño	General Manager of Institutional Relations and Chief Executive Officer of the Telefónica Foundation	2005	55
Guillermo Fernández Vidal	Corporate General Manager	1998	60

The chief executive officers of our principal business units are as follows:

Name	Position	Appointed	Age
Luis Lada Díaz	Telefónica de España, S.A.	2000	56
José María Alvárez-Pallete López	Telefónica Internacional, S.A. (Latin America)	2002	42
Antonio Viana-Baptista	Telefónica Móviles, S.A.	2002	48
Peter Erskine	O2 plc	2005	54

Biographies of the Executive Officers and Senior Management

Mr. Santiago Fernandez Valbuena has served as General Manager of Finance and Corporate Development since December 2003. He has served as our Chief Financial Officer since July 2002. He joined Telefónica in 1997 as Chief Executive Officer of Fonditel, Telefónicas Pension Assets Manager. Previously, he was Managing Director of Societé Génerale Equities and Head of Equities & Research at Beta Capital in Madrid. He holds an M.S. and a PhD degree in Economics and Finance from Northeastern University. Mr. Fernandez Valbuena served as President of the Research Commission at the Spanish Institute of Financial Analysts. He has held senior teaching positions at Manchester Business School and Instituto de Empresas MBA programs.

Mr. Juan Carlos Ros serves as our General Manager of Legal Services. In May 1998, Mr. Ros was appointed Secretary General of Telefónica Internacional, S.A. He is also a director of Telefónica de Argentina, S.A., Telecomunicaciones de Sao PauloTELESP, S.A., Telefónica Larga Distancia de Puerto Rico Inc. (Puerto Rico), Compañía de Telecomunicaciones de Chile, S.A, and Telefonía del Perú (Perú). He holds a law degree from the Central University of Barcelona.

Mr. Luis Abril Pérez serves as our General Manager of Corporate Communications. Mr. Abril started his professional career as a Microeconomics Professor in the Universidad Comercial de Deusto, where he went on to head the Finance Department. In 1978, he moved to Banco de Vizcaya as Treasury Director and then worked as head of the Presidents Technical Department under Pedro Toledo. During his work with the BBV Group (1988-1991), he acted as General Director for the Asset Management division. During 1994 to 1999, Mr. Abril acted as General Director for Banesto, and he later acted as General Director for Communications for BSCH (1999-2001). Mr. Abril holds a degree in Economics and a degree in Law from the Universidad Comercial de Deusto (1971) and graduate degree in Business Administration from the North European Management Institute, Oslo, Norway (1973).

Mr. Calixto Ríos Pérez serves as our General Manager of Auditing and Management Resources. In 1973, Mr. Ríos joined Banco Exterior de España as the General Manager of Extebank in New York City. Subsequently he was appointed Chief Executive Officer and Chief Operating Officer of Extebandes, in Venezuela. Later, Mr. Rios returned to Madrid as the General Manager of Filiales Bancarias Internacionales of Banco Exterior de España. In 1990, he was appointed Chief Operating Officer responsible for overseeing the construction, management and marketing of the Olympic Village for the Olympic games and a year later was named Chief Financial Officer of Tabacalera, S.A. After the merger of Tabacalera and Seita, he was appointed Advisor to the Chairmen and Head of Strategy and Planning. After joining Telefónica as Corporate General Manager for Institutional Relations, in July 2002 he was appointed General Manager for Internal Auditing and Communications. He holds a degree in Economics from the Complutense University of Madrid.

Mr. Javier Nadal Ariño serves as our General Manager of Institutional Relations and as the Chief Executive Officer of the Telefónica Foundation since December 2004. He joined the Telefónica Group in 1985. From 2003 to 2004, Mr. Nadal served as the Chairman of Telefónica de Peru and from 1995 to 1997, as the Chairman of Telefónica de Argentina. He served for 10 years as General Manager of Communications in the Spanish government while also serving as Telefónica de España’s representative to the Spanish government. From 1989 to 1994, he was the President of Retevisión. He holds an engineering degree from the Universidad Politécnica de Madrid.

Mr. Guillermo Fernández Vidal serves as our Corporate General Manager and Assistant to our Chief Executive Officer. He began his career in 1970 as a systems technician at NCR’s Computer Testing Center. From 1972 to 1987, he worked for ENTEL, S.A. where he rose to General Manager. In 1987, he joined Telefónica as a Deputy General Manager for large customers. Subsequently, he was appointed Assistant Head of Business Communications, Head of Business Communications and General Manager of Businesses and General Public and Chief Operating Officer of Telefónica Data, S.A. Mr. Fernández Vidal holds an engineering and computer science degree.

Biographies of the Chief Executive Officers of our Principal Business Units

Mr. José María Álvarez-Pallete López serves as Chief Executive Officer of Telefónica Latinoamérica. He began his career at Arthur Young Auditors in 1987. In 1988, he joined Benito & Monjardin/Kidder, Peabody & Co., where he held various positions in the research and corporate finance departments. In 1995, he joined Valenciana de Cementos Portland (Cemex) as head of the Investor Relations and Studies department. In 1996, he was promoted to Controller for the company in Spain, and in 1998 to General Manager of Administration and Financial Affairs for Cemex Group’s interests in Indonesia, headquartered in Jakarta. Mr. Álvarez-Pallete holds a graduate degree in Economics from the Complutense University of Madrid. He also studied Economics at the Université Libre de Belgique.

B. COMPENSATION

The total amount of payments made to our directors during 2005 was €12,445,138.2 (€4,578,161.61 as a fixed allowance, including compensation made to our directors for serving as directors of our subsidiaries; €228,394.18 for expenses of attending our Board’s sub-committees’ meetings; €7,422,040.98 for salaries and variable compensation to our directors with executive functions; €169,541.43 for in-kind compensation to our executive directors, including life insurance premiums; and €47,000.00 for our contributions to directors’ pension schemes).

The following table shows the individual breakdown of the fixed payments paid to directors (in their capacity as directors) in 2005:

Position	2005
	(in euro)
Chairman	240,000
Deputy Chairmen	200,000
Directors(1):	
Executive directors	120,000(2)
Nominee directors	120,000
Independent directors	120,000(3)

(1) One of the members of our Board of Directors, who is not resident in Spain, receives an additional annual assignment of €60,101.16, due to the special interest we have in him being part of our Board of Directors due to his experience and dedication in relation to Latin America.

(2) Mr. Antonio Alonso Ureba resigned from his senior management position on September 30, 2005, through which date he had received a fixed payment of 90,000 in 2005.

(3) Includes Mr. Horta, who resigned as a director on March 29, 2006.

The following table shows the individual breakdown of the fixed payments made to our directors (in their capacity as members of our Executive Committee) during 2005:

Position	**2005**
	(in euro)
Chairman	80,000
Deputy Chairman	80,000
Directors	80,000(1)

(1) Mr. Antonio Alonso Ureba resigned from his senior management position on September 30, 2005, through which date he received a fixed payment of 60,000 during 2005.

In 2005, each chairman of our Board's committees received a fixed payment of €20,000.00 and each other member of our Board's committees received a fixed payment of €10,000.00. In addition, each member of our Audit and Control Committee, Nominating, Compensation and Corporate Governance Committee, Human Resources and Corporate Reputation Committee, Regulation Committee, Service Quality and Customer Service Committee and International Affairs Committee received an attendance fee of €1,250.00 per meeting. In addition, the six directors who are members of the Catalonia, Audalusia and Valencia advisory committees received a total of €84,999.77 in 2005.

The compensation of our directors consists of a monthly fixed allowance and of certain per diems for attending Board of Directors' sub-committees' meetings. Our meeting of shareholders held on April 11, 2003 set the annual maximum gross compensation for any director at 6 million for fixed allowances and for expenses of attending our Board's sub-committee meetings. In addition, directors with executive functions receive additional payments for carrying out their executive functions. Directors do not receive any compensation for expenses for attending our Board of Directors' or Executive Committee meetings.

The following table shows the total amount of compensation paid during 2005 to our executive officers, Mr. César Alierta, Mr. Antonio J. Alonso Ureba (who resigned from his senior management position on September 30, 2005), Mr. Luis Lada, Mr. Julio Linares López (nominated as Telefónica, S.A.'s director on December 21, 2005) Mr. Mario Eduardo Vázquez and Mr. Antonio Viana-Baptista, each of whom are also members of our Board of Directors.

Items	**2005(1)**
	(in euro)
Salaries	3,572,766.84
Variable Compensation	3,849,274.14
Compensation in kind	169,541.43
Contribution to pension plans	47,000.00
Total	7,638,582.41

(1) Compensation paid to Mr. Julio Linares López has been included only since the month in which he was nominated as a director.

Additionally, the following table shows the compensation paid to our executive officers (excluding those who are also members of our Board of Directors) in 2005:

Items	2005(1)
	(in euro)
Salaries	4,316,562.75
Variable Compensation	3,114,536.84
Fees and allowances	82,749.40
Compensation in kind	97,550.45
Total	7,611,399.44

(1) Compensation paid to Mr. Julio Linares López has been included only from January 2005 to November 2005.

Employment contracts for executive officers belonging to the Executive Committee have an indemnity clause, which provides for an indemnity in the event we decide to terminate the employment agreement. The indemnification to be paid in such event is equal to three years of salary plus an additional one-years salary, depending on the length of service provided to us. The concept of annual salary includes the last fixed remuneration plus the arithmetic average of the sum of the last two variable annual salaries received in accordance with the employment contract.

We provide pension, retirement or similar benefits to our directors with executive functions and to our executive officers. During 2005, we set aside or accrued approximately 47,000 for our directors with executive functions and 103,844.99 for our executive officers. Non-executive directors do not receive any compensation in the form of pension plans or life insurance policies and do not participate in any stock option plan linked to our market share price.

We did not provide any advances or loans to our directors or members of our management team and do not provide our directors or senior management team with any benefits upon termination of their terms of employment.

Incentive Plans

Our TIES Program, which was tied to the market value of our shares, expired on February 15, 2005. At the commencement of the TIES plan, eligible employees were able to subscribe for shares at the discounted price of 5 per share. The number of shares an eligible employee was able to subscribe for in the initial allocation was based on such employees wage level. As part of the initial allocation, we offered 1,197,880 shares, of which 1,123,072 were subscribed. These shares became freely transferable when the TIES plan expired on February 15, 2005. In June 2005, we canceled 34,760,964 of our ordinary shares held as treasury stock which related to the expired TIES Program.

Our subsidiary, Telefónica Móviles, S.A. has also established its own compensation plan tied to the market price of its shares.

As a result of the merger of Telefónica, S.A. and Terra Networks, S.A., Telefónica, S.A. assumed responsibility for Terra Networks S.A.s outstanding share option plans. Consequently, the options to acquire Terra Networks, S.A. shares were automatically converted into options to acquire Telefónica, S.A. shares in accordance with the exchange ratio for the merger. The plan provides, through the exercise of the share options by their holders, for the ownership of a portion of the capital of Telefónica, S.A. by the employees and executives who previously belonged the Terra Networks Group companies. At December 31, 2005, a total of 117,900 call options on Telefónica, S.A. shares had been assigned to such persons. Following the consummation of the merger, the weighted average strike price for such options was 28.28 per share.

EN-SOP

In order to satisfy certain obligations in connection with our acquisition in 2000 of Endemol Entertainment Holdings, N.V., in April 2001 our Board of Directors approved the establishment of a new stock option plan, which we refer to as the EN-SOP program, that is open to all permanent employees of Endemol Entertainment N.V. and its affiliated companies at January 1, 2001 who do not participate in a similar compensation plan. As part of the EN-SOP program, we delivered to each eligible employee who was employed at Endemol Entertainment N.V. on January 1 of 2001, 2002, 2003 and 2004 a variable number of options to purchase shares of Telefónica, S.A. based on such employees level and salary.

The options expire four years from their respective date of grant and may be exercised in equal amounts beginning in the third and fourth years from such date of grant. We issued options to acquire an aggregate of 8,228,360 shares pursuant to the plan. The total number of options granted each year pursuant to the plan was determined by dividing 27.5 million by the exercise price, which price was equal to the weighted average of the price per ordinary share of Telefónica, S.A. on the automated quotation system of the Spanish stock exchanges during the five trading days prior to the meeting of the Board of Directors which convened the relevant annual shareholders' meeting. The options issued pursuant to this plan have exercise prices ranging from €19.28 to €9.03 per share.

The EN-SOP program is subject to anti-dilution and other provisions customary for stock option plans of this type and to the condition that the participant not terminate his or her employment voluntarily and unilaterally prior to the exercise date.

C. BOARD PRACTICES

Please see "Directors and Senior Management" above.

D. EMPLOYEES

Employees and Labor Relations

The table below sets forth the number of employees at the dates indicated for the parent company of the Telefónica Group, each of the consolidated companies of the groups which comprise our different lines of business and other consolidated subsidiaries. Temporary employees represented 14.0% of our total employees at December 31, 2005, compared to 13.0% at December 31, 2004, due to an increase in the number of temporary employees of Atento. On average during 2005 we had approximately 29,122 temporary employees compared to 20,755 in 2004.

	Year Ended December 31,		
Line of Business	**2003**	**2004**	**2005**
Telefónica, S.A	767	622	650
Telefónica de España (1)	38,464	36,425	35,053
Telefónica Móviles	13,093	19,797	22,739
Telefónica Latinoamérica (1)	25,762	25,905	28,856
Telefónica Contenidos	4,638	5,860	5,734
Terra Networks (1)	2,229	1,584	—
Atento	54,394	74,829	95,907
Telefónica Publicidad e Información	2,787	2,876	2,942
Cesky Group	—	—	10,051
Other (1)	6,154	5,656	5,709
Total Employees	148,288	173,554	207,641

(1) On July 16, 2005 Terra Networks was merged by absorption into Telefónica. As a result the Terra Networks employees in Latin America were counted towards the number of total employees of Telefónica Latinoamérica, employees of Terra España, Azeler Automoción and Maptel Networks were counted towards the number of total employees of Telefónica de España and employees of Educaterra, Terra Asociadas and Terra Business Travel were counted towards the number of total employees in the Other category.

Management believes that labor relations are generally good. On July 23, 2003, Telefónica de España entered into a collective bargaining agreement that provided for increases in wage levels in accordance with anticipated increases in the *Indices de Precios de Consumo* (IPC), the Spanish consumer price index, and an additional productivity bonus per employee. In accordance with this agreement in 2005 wage levels increased 3.7% and employees received an additional productivity bonus of approximately €387.80 per active employee.

In 2005, we incorporated the Cesky Group's employees into the Group.

On July 13, 2004, Telefónica Data España entered into a collective bargaining agreement. Telefónica Móviles España published its collective bargaining agreement on September 30, 2004, which provided for increases in wage levels in accordance with anticipated increases in the Spanish consumer price index and established an additional productivity bonus for each employee.

Our retired employees are provided with certain pension benefits. While Telefónica de España contributes the required amounts to fund these benefits over time, there remains an unfunded past service liability, which is estimated to be approximately 320.3 million. We have agreed to fund this obligation over a period ending in 2007.

In order to adapt to the new competitive environment, we have, among other things, implemented voluntary pre-retirement and early retirement plans in recent years.

On July 29, 2003, Telefónica de España□s labor reduction program (*Plan Social de Expediente de Regulación de Empleo*) was approved by the Spanish Labor Ministry. The program called for voluntary redundancies of up to a maximum 15,000 employees of the company over the subsequent four years. This plan allows Telefónica de España to reduce its workforce while maintaining its competitiveness. The plan is non-discriminatory, voluntary and applies to all of our employees. The aggregate number of employees that have requested to be included in the labor reduction program at December 31, 2005 was 1,877 employees.

In connection with our voluntary retirement programs, we recorded provisions of 706.7 million in 2004 and □577.9 million in 2005, which were charged to results of operations in each respective year. The provision for pre-retirements and early retirements recorded at December 31, 2005 covers all the obligations assumed at that date in connection with our voluntary pre-retirement and early retirement plans.

On June 22, 2004 Terra Networks□ labor reduction program was approved by the Spanish Labor Ministry. This program allows Terra Networks to reduce its workforce up to 130 employees by voluntary redundancies and redeployment. The Labor Ministry has also approved Terra Networks Latin America program to reduce its workforce by 29 employees through similar mechanisms.

E. SHARE OWNERSHIP

At April 12, 2006, the following members of our Board of Directors beneficially owned an aggregate of 1,615,360 shares, representing approximately 0.032% of our capital stock.

Name	No. of Shares Beneficially Owned
César Alierta Izuel	0.021%
Isidro Fainé Casas	0.003%
Julio Linares López	0.000%
Maximino Carpio García	0.000%
Carlos Colomer Casellas	0.000%
Vitalino Manuel Nafria Aznar	0.000%
Alfonso Ferrari Herrero	0.002%
José Fernando de Almansa Moreno-Barreda	0.000%
Gonzalo Hinojosa Fernández de Angulo	0.004%
Pablo Isla Alvarez de Tejera	0.000%
Luis Lada Díaz	0.001%
Antonio Massanell Lavilla	0.000%
Enrique Used Aznar	0.001%
Mario Eduardo Vázquez	0.000%
Antonio Viana-Baptista	0.000%
Gregorio Villalabeitia Galarraga	0.000%
David Arculus	0.000%
Peter Erskine	0.000%

At April 12, 2006, members of our executive management team (excluding members of our Board of Directors listed above) beneficially owned an aggregate of 175,197 shares, representing approximately 0.0035% of our capital stock.

None of our Directors or executive officers beneficially owned shares representing one percent or more of our share capital at April 12, 2006.

None of our Directors and executive officers held options in respect of shares representing one percent or more of our share capital at April 12, 2006.

ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

A. MAJOR SHAREHOLDERS

General

At April 12, 2006, we had 4,921,130,397 shares outstanding, each having a nominal value of €1 per share. All outstanding shares have the same rights.

At April 12, 2006, according to information publicly available to Telefónica, S.A., beneficial owners of 5% or more of our voting stock were as follows:

Name of Beneficial Owner	Number of Shares	Percent
Banco Bilbao Vizcaya Argentaria, S.A.(1)	326,349,743	6.632%
Caja de Ahorros y Pensiones de Barcelona ("la Caixa")(2)	250,466,066	5.090%
Chase Nominees LTD.(3)	487,376,897	9.904%
State Street Bank & Trust Co (4)	377,436,725	7.616%

(1) According to information provided to us by BBVA.

(2) According to information provided to us by la Caixa.